Amendment No. 1
to
Contract No. NA170000165
Crown Castle v. City of Austin
Between
Herrera & Boyle, PLLC.
and the
City of Austin

1.0 The Contract is hereby amended as follows: Change the vendor name as requested and documented by the vendor.

	From	To
Vendor Name	Herrera & Boyle, PLLC dba Herrera & Boyle, PLLC	Alfred R. Herrera dba Herrera Law & Associates, PLLC.
Vendor Code	VS0000022686	VS0000022686
FEIN	[redacted]	[redacted]

2.0 All other terms and conditions of the Contract remain unchanged and in full force and effect.

BY THE SIGNATURE affixed below, this Amendment No. 1 is hereby incorporated into and made a part of the Contract.

Linell Goodin-Brown

Linell Goodin-Brown,
Contract Management Supervisor II
City of Austin, Purchasing Office

3-1-18

Date

CONTRACT BETWEEN THE CITY OF AUSTIN ("City")
AND
HERRERA & BOYLE, PLLC ("Contractor")
for
IMPARTIAL HEARING EXAMINER SERVICES
NA170000165

The City accepts the Contractor's Offer (as referenced in Section 1.1.3 below) for the above requirement and enters into the following Contract.

This Contract is between Herrera & Boyle, PLLC having offices at Austin, TX 78701 and the City, a home-rule municipality incorporated by the State of Texas, and is effective as of the date executed by the City ("Effective Date").

Capitalized terms used but not defined herein have the meanings given them in Solicitation Number MDD0104.

1.1 **This Contract is composed of the following documents:**

1.1.1 This Contract

1.1.2 The City's Solicitation, RFP MDD0104, including all documents incorporated by reference

1.1.3 Herrera & Boyle, PLLC Offer, dated May 2, 2017, including subsequent clarifications

1.2 **Order of Precedence.** Any inconsistency or conflict in the Contract documents shall be resolved by giving precedence in the following order:

1.2.1 This Contract

1.2.2 The City's Solicitation as referenced in Section 1.1.2, including all documents incorporated by reference

1.2.3 The Contractor's Offer as referenced in Section 1.1.3, including subsequent clarifications.

1.3 **Term of Contract.** The Contract will be in effect for a term of 24 months with no extensions. See the Term of Contract provision in Section 0400 for additional Contract requirements.

1.4 **Compensation.** The Contractor shall be paid a total Not-to-Exceed amount of $300,000 for the initial Contract term. Payment shall be made upon successful completion of services or delivery of goods as outlined in each individual Delivery Order.

1.5 **Quantity of Work.** There is no guaranteed quantity of work for the period of the Contract and there are no minimum order quantities. Work will be on an as needed basis as specified by the City for each Delivery Order

1.6 **List of Exhibits**

1.6.1 Exhibit A – Herrera & Boyle, PLLC cost proposal

1.6.2 Exhibit B – 0800 Non Discrimination Certification & 0805 Non-Suspension or Debarment

This Contract (including any Exhibits) constitutes the entire agreement of the parties regarding the subject matter of this Contract and supersedes all prior and contemporaneous agreements and understandings, whether written or oral, relating to such subject matter. This Contract may be altered, amended, or modified only by a written instrument signed by the duly authorized representatives of both parties.

In witness whereof, the parties have caused a duly authorized representative to execute this Contract on the date set forth below.

HERRERA & BOYLS, PLLC	**CITY OF AUSTIN**
Alfred R. Herrera	Matthew Duree
Printed Name of Authorized Person	Printed Name of Authorized Person
Signature	Signature
Principal	Procurement Supervisor
Title:	Title:
June 16, 2017	6-29-17
Date:	Date:

City of Austin, Texas
Section 0800
NON-DISCRIMINATION AND NON-RETALIATION CERTIFICATION

City of Austin, Texas

Equal Employment/Fair Housing Office

To: City of Austin, Texas,

I hereby certify that our firm complies with the Code of the City of Austin, Section 5-4-2 as reiterated below, and agrees:

(1) Not to engage in any discriminatory employment practice defined in this chapter.

(2) To take affirmative action to ensure that applicants are employed, and that employees are treated during employment, without discrimination being practiced against them as defined in this chapter, including affirmative action relative to employment, promotion, demotion or transfer, recruitment or recruitment advertising, layoff or termination, rate of pay or other forms of compensation, and selection for training or any other terms, conditions or privileges of employment.

(3) To post in conspicuous places, available to employees and applicants for employment, notices to be provided by the Equal Employment/Fair Housing Office setting forth the provisions of this chapter.

(4) To state in all solicitations or advertisements for employees placed by or on behalf of the Contractor, that all qualified applicants will receive consideration for employment without regard to race, creed, color, religion, national origin, sexual orientation, gender identity, disability, sex or age.

(5) To obtain a written statement from any labor union or labor organization furnishing labor or service to Contractors in which said union or organization has agreed not to engage in any discriminatory employment practices as defined in this chapter and to take affirmative action to implement policies and provisions of this chapter.

(6) To cooperate fully with City and the Equal Employment/Fair Housing Office in connection with any investigation or conciliation effort of the Equal Employment/Fair Housing Office to ensure that the purpose of the provisions against discriminatory employment practices are being carried out.

(7) To require of all subcontractors having 15 or more employees who hold any subcontract providing for the expenditure of $2,000 or more in connection with any contract with the City subject to the terms of this chapter that they do not engage in any discriminatory employment practice as defined in this chapter

For the purposes of this Offer and any resulting Contract, Contractor adopts the provisions of the City's Minimum Standard Non-Discrimination and Non-Retaliation Policy set forth below.

City of Austin
Minimum Standard Non-Discrimination and Non-Retaliation in Employment Policy

As an Equal Employment Opportunity (EEO) employer, the Contractor will conduct its personnel activities in accordance with established federal, state and local EEO laws and regulations.

The Contractor will not discriminate against any applicant or employee based on race, creed, color, national origin, sex, age, religion, veteran status, gender identity, disability, or sexual orientation. This policy covers all aspects of employment, including hiring, placement, upgrading, transfer, demotion, recruitment, recruitment advertising, selection for training and apprenticeship, rates of pay or other forms of compensation, and layoff or termination.

The Contractor agrees to prohibit retaliation, discharge or otherwise discrimination against any employee or applicant for employment who has inquired about, discussed or disclosed their compensation.

Further, employees who experience discrimination, sexual harassment, or another form of harassment should immediately report it to their supervisor. If this is not a suitable avenue for addressing their compliant, employees are advised to contact another member of management or their human resources representative. No employee shall be discriminated against, harassed, intimidated, nor suffer any reprisal as a result of reporting a violation of

this policy. Furthermore, any employee, supervisor, or manager who becomes aware of any such discrimination or harassment should immediately report it to executive management or the human resources office to ensure that such conduct does not continue.

Contractor agrees that to the extent of any inconsistency, omission, or conflict with its current non-discrimination and non-retaliation employment policy, the Contractor has expressly adopted the provisions of the City's Minimum Non-Discrimination Policy contained in Section 5-4-2 of the City Code and set forth above, as the Contractor's Non-Discrimination Policy or as an amendment to such Policy and such provisions are intended to not only supplement the Contractor's policy, but will also supersede the Contractor's policy to the extent of any conflict.

UPON CONTRACT AWARD, THE CONTRACTOR SHALL PROVIDE THE CITY A COPY OF THE CONTRACTOR'S NON-DISCRIMINATION AND NON-RETALIATION POLICIES ON COMPANY LETTERHEAD, WHICH CONFORMS IN FORM, SCOPE, AND CONTENT TO THE CITY'S MINIMUM NON-DISCRIMINATION AND NON-RETALIATION POLICIES, AS SET FORTH HEREIN, **OR** THIS NON-DISCRIMINATION AND NON-RETALIATION POLICY, WHICH HAS BEEN ADOPTED BY THE CONTRACTOR FOR ALL PURPOSES WILL BE CONSIDERED THE CONTRACTOR'S NON-DISCRIMINATION AND NON-RETALIATION POLICY WITHOUT THE REQUIREMENT OF A SEPARATE SUBMITTAL.

Sanctions:

Our firm understands that non-compliance with Chapter 5-4 and the City's Non-Retaliation Policy may result in sanctions, including termination of the contract and suspension or debarment from participation in future City contracts until deemed compliant with the requirements of Chapter 5-4 and the Non-Retaliation Policy.

Term:

The Contractor agrees that this Section 0800 Non-Discrimination and Non-Retaliation Certificate of the Contractor's separate conforming policy, which the Contractor has executed and filed with the City, will remain in force and effect for one year from the date of filling. The Contractor further agrees that, in consideration of the receipt of continued Contract payment, the Contractor's Non-Discrimination and Non-Retaliation Policy will automatically renew from year-to-year for the term of the underlying Contract.

Dated this 20th day of June, 2017

CONTRACTOR Herrera & Boyle, PLLC

Authorized Signature

Title Principal

Section 0800, 0805, 0810 - Certifications

Non-Discrimination Certification – Section 0800

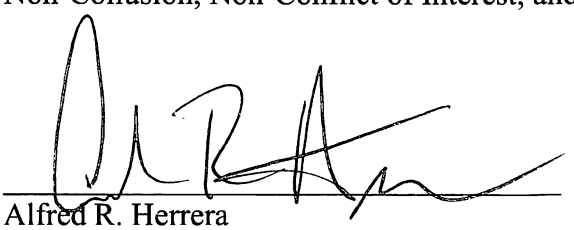
Mr. Herrera hereby certifies that he and Herrera and Boyle, PLLC, conform to the Code of the City of Austin, Section 5-4-2 as set forth in "City of Austin, Texas Section 0800 – Equal Employment/Fair Housing Office Non-Discrimination Certification."

Non-Suspension or Debarment Certification – Section 0805

Mr. Herrera hereby certifies that he, Herrera & Boyle, PLLC and its principals, are not currently suspended or debarred from bidding on any Federal, State, or City of Austin Contracts.

Non-Collusion, Non-Conflict of Interest, and Anti-Lobbying – Section 0810

Mr. Herrera hereby certifies that he and Herrera and Boyle, PLLC, are in conformance with the requirements and prohibitions set forth in "City of Austin, Texas Section 0810 – Non-Collusion, Non-Conflict of Interest, and Anti-Lobbying Certification."



Alfred R. Herrera

CITY OF AUSTIN, TEXAS

Purchasing Office

REQUEST FOR PROPOSAL (RFP)

OFFER SHEET

SOLICITATION NO: RFP 2200 MDD0104

DATE ISSUED: April 10th, 2017

COMMODITY/SERVICE DESCRIPTION: Impartial Hearing Examiner

REQUISITION NO.: RQM 2200 17031600360

COMMODITY CODE: 96105

PRE-PROPOSAL CONFERENCE TIME AND DATE: Thursday, April 20th @ 9:00 am

LOCATION: Municipal Building, 124 W 8th Street
3rd Floor Conference Room
Austin, TX 78701

FOR CONTRACTUAL AND TECHNICAL ISSUES CONTACT THE FOLLOWING AUTHORIZED CONTACT PERSON:

Matthew Duree
Procurement Supervisor

Phone: (512) 974-6346
E-Mail: matt.duree@austintexs.gov

PROPOSAL DUE PRIOR TO: May 2nd, 2017 @ 2:00 PM CST

PROPOSAL CLOSING TIME AND DATE: May 2nd, 2017@ 2:00 PM CST

LOCATION: MUNICIPAL BUILDING, 124 W 8th STREET
RM 308, AUSTIN, TEXAS 78701

LIVE SOLICITATION CLOSING ONLINE: For RFP's, only the names of respondents will be read aloud @ 3:00 pm on the day of closing.
For information on how to attend the Solicitation Closing online, please select this link:

http://www.austintexas.gov/department/bid-opening-webinars

When submitting a sealed Offer and/or Compliance Plan, use the proper address for the type of service desired, as shown below:

Address for US Mail (Only)	**Address for FedEx, UPS, Hand Delivery or Courier Service**
City of Austin	City of Austin, Municipal Building
Purchasing Office-Response Enclosed for Solicitation #MDD0104	Purchasing Office-Response Enclosed for Solicitation # MDD0104
P.O. Box 1088	124 W 8th Street, Rm 308
Austin, Texas 78767-8845	Austin, Texas 78701
	Reception Phone: (512) 974-2500

NOTE: Offers must be received and time stamped in the Purchasing Office prior to the Due Date and Time. It is the responsibility of the Offeror to ensure that their Offer arrives at the receptionist's desk in the Purchasing Office prior to the time and date indicated. Arrival at the City's mailroom, mail terminal, or post office box will not constitute the Offer arriving on time. See Section 0200 for additional solicitation instructions.

All Offers (including Compliance Plans) that are not submitted in a sealed envelope or container will not be considered.

SUBMIT 1 ORIGINAL, __ COPIES, AND 1 ELECTRONIC COPY OF YOUR RESPONSE

*****SIGNATURE FOR SUBMITTAL REQUIRED ON PAGE 4 OF THIS DOCUMENT*****

This solicitation is comprised of the following required sections. Please ensure to carefully read each section including those incorporated by reference. By signing this document, you are agreeing to all the items contained herein and will be bound to all terms.

SECTION NO.	TITLE	PAGES
0100	STANDARD PURCHASE DEFINITIONS	*
0200	STANDARD SOLICITATION INSTRUCTIONS	*
0300	STANDARD PURCHASE TERMS AND CONDITIONS	*
0400	SUPPLEMENTAL PURCHASE PROVISIONS	7
0500	SCOPE OF WORK	ATT
0600	PROPOSAL PREPARATION INSTRUCTIONS & EVALUATION FACTORS	4
0600A	COST PROPOSAL SHEET	ATT
0605	LOCAL BUSINESS PRESENCE IDENTIFICATION FORM – Complete and return	2
0700	REFERENCE SHEET – Complete and return if required	2
0800	NON-DISCRIMINATION AND NON-RETALIATION CERTIFICATION	2
0805	NON-SUSPENSION OR DEBARMENT CERTIFICATION	*
0810	NON-COLLUSION, NON-CONFLICT OF INTEREST, AND ANTI-LOBBYING CERTIFICATION	2
0815	LIVING WAGES CONTRACTOR CERTIFICATION–Complete and return	1
0835	NONRESIDENT BIDDER PROVISIONS – Complete and return	1
0900	SUBCONTRACTING/SUB-CONSULTING UTILIZATION FORM – Complete & return	1
0905	SUCONTRACTING/SUB-CONSULTING UTILIZATION PLAN – Complete and return if applicable	3

*** Documents are hereby incorporated into this Solicitation by reference, with the same force and effect as if they were incorporated in full text. The full text versions of the * Sections are available on the Internet at the following online address:**

http://www.austintexas.gov/financeonline/vendor_connection/index.cfm#STANDARDBIDDOCUMENTS

If you do not have access to the Internet, you may obtain a copy of these Sections from the City of Austin Purchasing Office located in the Municipal Building, 124 West 8th Street, Room #308 Austin, Texas 78701; phone (512) 974-2500. Please have the Solicitation number available so that the staff can select the proper documents. These documents can be mailed, expressed mailed, or faxed to you.

INTERESTED PARTIES DISCLOSURE

In addition, Section 2252.908 of the Texas Government Code requires the successful offeror to complete a Form 1295 "Certificate of Interested Parties" that is signed and notarized for a contract award requiring council authorization. The "Certificate of Interested Parties" form must be completed on the Texas Ethics Commission website, printed, signed and submitted to the City by the authorized agent of the Business Entity with acknowledgment that disclosure is made under oath and under penalty of perjury prior to final contract execution.

https://www.ethics.state.tx.us/whatsnew/elf_info_form1295.htm

The undersigned, by his/her signature, represents that he/she is submitting a binding offer and is authorized to bind the respondent to fully comply with the solicitation document contained herein. The Respondent, by submitting and signing below, acknowledges that he/she has received and read the entire document packet sections defined above including all documents incorporated by reference, and agrees to be bound by the terms therein.

Company Name: HERRERA & BOYLE, PLLC

Company Address: 816 CONGRESS AVE., SUITE 1250

City, State, Zip: AUSTIN, TX 78701

Federal Tax ID No.

Printed Name of Officer or Authorized Representative: ALFRED R. HERRERA

Title: PRINCIPAL

Signature of Officer or Authorized Representative:

Date: MAY 2, 2017

Email Address: aherrera@herreraboylelaw.com

Phone Number: 512-474-1792

*** Proposal response must be submitted with this Offer sheet to be considered for award**

CITY OF AUSTIN
PURCHASING OFFICE
SUPPLEMENTAL PURCHASE PROVISIONS

The following Supplemental Purchasing Provisions apply to this solicitation:

1. **EXPLANATIONS OR CLARIFICATIONS:** (reference paragraph 5 in Section 0200)

   All requests for explanations or clarifications must be submitted in writing to the Purchasing Office five (5) days prior to proposal due date.

2. **INSURANCE:** Insurance is required for this solicitation.

   A. **General Requirements:** See Section 0300, Standard Purchase Terms and Conditions, paragraph 32, entitled Insurance, for general insurance requirements.

      i. The Contractor shall provide a Certificate of Insurance as verification of coverages required below to the City at the below address prior to contract execution and within 14 calendar days after written request from the City. Failure to provide the required Certificate of Insurance may subject the Offer to disqualification from consideration for award
      ii. The Contractor shall not commence work until the required insurance is obtained and until such insurance has been reviewed by the City. Approval of insurance by the City shall not relieve or decrease the liability of the Contractor hereunder and shall not be construed to be a limitation of liability on the part of the Contractor.
      iii. The Contractor must also forward a Certificate of Insurance to the City whenever a previously identified policy period has expired, or an extension option or holdover period is exercised, as verification of continuing coverage.
      iv. The Certificate of Insurance, and updates, shall be mailed to the following address:

      City of Austin Purchasing Office
      P. O. Box 1088
      Austin, Texas 78767

   B. **Specific Coverage Requirements:** The Contractor shall at a minimum carry insurance in the types and amounts indicated below for the duration of the Contract, including extension options and hold over periods, and during any warranty period. These insurance coverages are required minimums and are not intended to limit the responsibility or liability of the Contractor.

      i. **Professional Liability:** The Contractor shall provide coverage, at a a minimum limit of $100,000 per claim, to pay on behalf of the assured all sums which the assured shall become legally obligated to pay as damages by reason of any negligent act, error, or omission arising out of the performance of professional services under this agreement.

   C. **Endorsements:** The specific insurance coverage endorsements specified above, or their equivalents must be provided. In the event that endorsements, which are the equivalent of the required coverage, are proposed to be substituted for the required coverage, copies of the equivalent endorsements must be provided for the City's review and approval.

3. **TERM OF CONTRACT:**

   A. The Contract shall be in effect for an initial term of 24 months and may be extended thereafter for up to 3 additional 12 month periods, subject to the approval of the Contractor and the City Purchasing Officer or his designee.

B. Upon expiration of the initial term or period of extension, the Contractor agrees to hold over under the terms and conditions of this agreement for such a period of time as is reasonably necessary to re-solicit and/or complete the project (not to exceed 120 days unless mutually agreed on in writing).

C. Upon written notice to the Contractor from the City's Purchasing Officer or his designee and acceptance of the Contractor, the term of this contract shall be extended on the same terms and conditions for an additional period as indicated in paragraph A above.

D. Prices are firm and fixed for the first 24 months. Thereafter, price changes are subject to the Economic Price Adjustment provisions of this Contract.

4. **INVOICES and PAYMENT:** (reference paragraphs 12 and 13 in Section 0300)

A. Invoices shall contain a unique invoice number and the information required in Section 0300, paragraph 12, entitled "Invoices." Invoices received without all required information cannot be processed and will be returned to the vendor.

Invoices shall be mailed to the below address:

	City of Austin
Department	Austin Water
Attn:	Accounts Payable
Address	625 East 10th Street
City, State Zip Code	Austin, TX 78701

B. The Contractor agrees to accept payment by either credit card, check or Electronic Funds Transfer (EFT) for all goods and/or services provided under the Contract. The Contractor shall factor the cost of processing credit card payments into the Offer. There shall be no additional charges, surcharges, or penalties to the City for payments made by credit card.

5. **LIVING WAGES:**

A. The minimum wage required for any Contractor employee directly assigned to this City Contract is $13.50 per hour, unless Published Wage Rates are included in this solicitation. In addition, the City may stipulate higher wage rates in certain solicitations in order to assure quality and continuity of service.

B. The City requires Contractors submitting Offers on this Contract to provide a certification **(see the Living Wages Contractor Certification included in the Solicitation**) with their Offer certifying that all employees directly assigned to this City Contract will be paid a minimum living wage equal to or greater than $13.50 per hour. The certification shall include a list of all employees directly assigned to providing services under the resultant contract including their name and job title. The list shall be updated and provided to the City as necessary throughout the term of the Contract.

C. The Contractor shall maintain throughout the term of the resultant contract basic employment and wage information for each employee as required by the Fair Labor Standards Act (FLSA).

D. The Contractor shall provide to the Department's Contract Manager with the first invoice, individual Employee Certifications for all employees directly assigned to the contract. The City reserves the

right to request individual Employee Certifications at any time during the contract term. Employee Certifications shall be signed by each employee directly assigned to the contract. The Employee Certification form is available on-line at https://www.austintexas.gov/financeonline/vendor_connection/index.cfm.

E. Contractor shall submit employee certifications annually on the anniversary date of contract award with the respective invoice to verify that employees are paid the Living Wage throughout the term of the contract. The Employee Certification Forms shall be submitted for employees added to the contract and/or to report any employee changes as they occur.

F. The Department's Contract Manager will periodically review the employee data submitted by the Contractor to verify compliance with this Living Wage provision. The City retains the right to review employee records required in paragraph C above to verify compliance with this provision.

6. **NON-COLLUSION, NON-CONFLICT OF INTEREST, AND ANTI-LOBBYING:**

A. On November 10, 2011, the Austin City Council adopted Ordinance No. 20111110-052 amending Chapter 2.7, Article 6 of the City Code relating to Anti-Lobbying and Procurement. The policy defined in this Code applies to Solicitations for goods and/or services requiring City Council approval under City Charter Article VII, Section 15 (Purchase Procedures). During the No-Contact Period, Offerors or potential Offerors are prohibited from making a representation to anyone other than the Authorized Contact Person in the Solicitation as the contact for questions and comments regarding the Solicitation.

B. If during the No-Contact Period an Offeror makes a representation to anyone other than the Authorized Contact Person for the Solicitation, the Offeror's Offer is disqualified from further consideration except as permitted in the Ordinance.

C. If an Offeror has been disqualified under this article more than two times in a sixty (60) month period, the Purchasing Officer shall debar the Offeror from doing business with the City for a period not to exceed three (3) years, provided the Offeror is given written notice and a hearing in advance of the debarment.

D. The City requires Offerors submitting Offers on this Solicitation to certify that the Offeror has not in any way directly or indirectly made representations to anyone other than the Authorized Contact Person during the No-Contact Period as defined in the Ordinance. The text of the City Ordinance is posted on the Internet at: http://www.ci.austin.tx.us/edims/document.cfm?id=161145

7. **NON-SOLICITATION:**

A. During the term of the Contract, and for a period of six (6) months following termination of the Contract, the Contractor, its affiliate, or its agent shall not hire, employ, or solicit for employment or consulting services, a City employee employed in a technical job classification in a City department that engages or uses the services of a Contractor employee.

B. In the event that a breach of Paragraph A occurs the Contractor shall pay liquidated damages to the City in an amount equal to the greater of: (i) one (1) year of the employee's annual compensation; or (ii) 100 percent of the employee's annual compensation while employed by the City. The Contractor shall reimburse the City for any fees and expenses incurred in the enforcement of this provision.

C. During the term of the Contract, and for a period of six (6) months following termination of the Contract, a department that engages the services of the Contractor or uses the services of a Contractor employee will not hire a Contractor employee while the employee is performing work under a Contract with the City unless the City first obtains the Contractor's approval.

D. In the event that a breach of Paragraph C occurs, the City shall pay liquidated damages to the Contractor in an amount equal to the greater of: (i) one (1) year of the employee's annual compensation or (ii) percent of the employee's annual compensation while employed by the Contractor.

8. **WORKFORCE SECURITY CLEARANCE AND IDENTIFICATION (ID):**

A. Access to the Austin Water Department building by the Contractor, all subcontractors and their employees will be strictly controlled at all times by the City. Security badges will be issued by the Department for this purpose. The Contractor shall submit a complete list of all persons requiring access to the Austin Water building at least thirty (30) days in advance of their need for access. The City reserves the right to deny a security badge to any Contractor personnel for reasonable cause. The City will notify the Contractor of any such denial no more than twenty (20) days after receipt of the Contractor's submittal.

B. Where denial of access by a particular person may cause the Contractor to be unable to perform any portion of the work of the contract, the Contractor shall so notify the City's Contract Manager, in writing, within ten (10) days of the receipt of notification of denial.

C. Contractor personnel will be required to check in at the security desk when entering or leaving the Austin Water building and security badges must be on display at all times when in the building. Failure to do so may be cause for removal of Contractor Personnel from the worksite, without regard to Contractor's schedule. Security badges may not be removed from the premises.

D. The Contractor shall provide the City's Contract Manager with a list of personnel scheduled to enter the building, seven days in advance. The list shall identify the persons by name, date of birth, driver's license number, the times that they will be inside the building and the areas where they will be working. Only persons previously approved by the City for the issuance of security badges will be admitted to the building.

E. The Contractor shall comply with all other security requirements imposed by the City and shall ensure that all employees and subcontractors are kept fully informed as to these requirements.

9. **NURSERY/FLORAL CERTIFICATE FOR LANDSCAPERS AND PLANT VENDORS:**

A. The Contractor shall provide a current Nursery/Floral certificate issued by the Texas Department of Agriculture to sell, lease, or distribute nursery products and/or floral items in accordance with Texas Administrative Code, Title 4, Part 1, Chapter 22, Rule 22.3.

B. A copy of the Contractor's current and valid certificate must be provided to the Buyer prior to award of a contract. Contractor will have 7 calendar days after notification by the City to provide a valid certificate.

10. **ECONOMIC PRICE ADJUSTMENT:**

A. **Price Adjustments:** Prices shown in this Contract shall remain firm for the first 12 months of the Contract. After that, in recognition of the potential for fluctuation of the Contractor's cost, a price adjustment (increase or decrease) may be requested by either the City or the Contractor on the anniversary date of the Contract or as may otherwise be specified herein. The percentage change between the contract price and the requested price shall not exceed the percentage change between the specified index in effect on the date the solicitation closed and the most recent, non-preliminary data at the time the price adjustment is requested. The requested price adjustment shall not exceed five percent (5%) for any single line item and in no event shall the total amount of the contract be

automatically adjusted as a result of the change in one or more line items made pursuant to this provision. Prices for products or services unaffected by verifiable cost trends shall not be subject to adjustment.

B. **Effective Date:** Approved price adjustments will go into effect on the first day of the upcoming renewal period or anniversary date of contract award and remain in effect until contract expiration unless changed by subsequent amendment.

C. **Adjustments:** A request for price adjustment must be made in writing and submitted to the other Party prior to the yearly anniversary date of the Contract; adjustments may only be considered at that time unless otherwise specified herein. Requested adjustments must be solely for the purpose of accommodating changes in the Contractor's direct costs. Contractor shall provide an updated price listing once agreed to adjustment(s) have been approved by the parties.

D. **Indexes:** In most cases an index from the Bureau of Labor Standards (BLS) will be utilized; however, if there is more appropriate, industry recognized standard then that index may be selected.

i. The following definitions apply:
   (1) **Base Period:** Month and year of the original contracted price (the solicitation close date).
   (2) **Base Price:** Initial price quoted, proposed and/or contracted per unit of measure.
   (3) **Adjusted Price:** Base Price after it has been adjusted in accordance with the applicable index change and instructions provided.
   (4) **Change Factor:** The multiplier utilized to adjust the Base Price to the Adjusted Price.
   (5) **Weight %:** The percent of the Base Price subject to adjustment based on an index change.

ii. **Adjustment-Request Review:** Each adjustment-request received will be reviewed and compared to changes in the index(es) identified below. Where applicable:
   (1) Utilize final Compilation data instead of Preliminary data
   (2) If the referenced index is no longer available shift up to the next higher category index.

iii. **Index Identification:** Complete table as they may apply.

Weight % or $ of Base Price: 100	
Database Name: Employment Cost Index	
Series ID: CIU2020000120000I	
☒ Not Seasonally Adjusted	☐ Seasonally Adjusted
Geographical Area: N/A	
Description of Series ID: Wages and salaries for Private industry workers in Professional and related, Inces	
This Index shall apply to the following items of the Bid Sheet / Cost Proposal: All	

E. **Calculation:** Price adjustment will be calculated as follows:

Single Index: Adjust the Base Price by the same factor calculated for the index change.

Index at time of calculation
Divided by index on solicitation close date
Equals Change Factor
Multiplied by the Base Rate

Equals the Adjusted Price

11. **INTERLOCAL PURCHASING AGREEMENTS:** (applicable to competitively procured goods/services contracts).

    A. The City has entered into Interlocal Purchasing Agreements with other governmental entities, pursuant to the Interlocal Cooperation Act, Chapter 791 of the Texas Government Code. The Contractor agrees to offer the same prices and terms and conditions to other eligible governmental agencies that have an interlocal agreement with the City.

    B. The City does not accept any responsibility or liability for the purchases by other governmental agencies through an interlocal cooperative agreement.

36. **OWNERSHIP AND USE OF DELIVERABLES:** The City shall own all rights, titles, and interests throughout the world in and to the Deliverables.

    A. **Patents:** As to any patentable subject matter contained in the Deliverables, the Contractor agrees to disclose such patentable subject matter to the City. Further, if requested by the City, the Contractor agrees to assign and, if necessary, cause each of its employees to assign the entire right, title, and interest to specific inventions under such patentable subject matter to the City and to execute, acknowledge, and deliver and, if necessary, cause each of its employees to execute, acknowledge, and deliver an assignment of letters patent, in a form to be reasonably approved by the City, to the City upon request by the City.

    B. **Copyrights:** As to any Deliverable containing copyrighted subject matter, the Contractor agrees that upon their creation, such Deliverables shall be considered as work made-for-hire by the Contractor for the City and the City shall own all copyrights in and to such Deliverables, provided however, that nothing in this Paragraph 36 shall negate the City's sole or joint ownership of any such Deliverables arising by virtue of the City's sole or joint authorship of such Deliverables. Should by operation of law, such Deliverables not be considered work made-for-hire, the Contractor hereby assigns to the City (and agrees to cause each of its employees providing services to the City hereunder to execute, acknowledge, and deliver an assignment to the City of Austin) all worldwide right, title, and interest in and to such Deliverables. With respect to such work made-for-hire, the Contractor agrees to execute, acknowledge and deliver and cause each of its employees providing services to the City hereunder to execute, acknowledge, and deliver a work-for-hire agreement, in a form to be reasonably approved by the City, to the City upon delivery of such Deliverables to the City or at such other time as the City may request.

    C. **Additional Assignments:** The Contractor further agrees to, and if applicable, cause each of its employees to execute, acknowledge, and deliver all applications, specifications, oaths, assignments, and all other instruments which the City might reasonably deem necessary in order to apply for and obtain copyright protection, mask work registration, trademark registration and/or protection, letters patent, or any similar rights in any and all countries and in order to assign and convey to the City, its successors, assigns, and nominees, the sole and exclusive right, title, and interest in and to the Deliverables, The Contractor's obligations to execute acknowledge, and deliver (or cause to be executed, acknowledged, and delivered) instruments or papers such as those described in this Paragraph 36 A., B., and C. shall continue after the termination of this Contract with respect to such Deliverables. In the event the City should not seek to obtain copyright protection, mask work registration or patent protection for any of the Deliverables, but should arise to keep the same secret, the Contractor agrees to treat the same as Confidential Information under the terms of Paragraph above.

CITY OF AUSTIN
PURCHASING OFFICE
SUPPLEMENTAL PURCHASE PROVISIONS

37

38. **CONTRACT MANAGER:** The following person is designated as Contract Manager, and will act as the contact point between the City and the Contractor during the term of the Contract:

Joseph Gonzalez

Joseph.gonzales@austintexas.gov

512-972-0131

Delete the following for contracts with no anti-lobbying requirements:

*Note: The above listed Contract Manager is not the authorized Contact Person for purposes of the **NON-COLLUSION, NON-CONFLICT OF INTEREST, AND ANTI-LOBBYING Provision** of this Section; and therefore, contact with the Contract Manager is prohibited during the no contact period.

CITY OF AUSTIN SCOPE OF WORK FOR IMPARTIAL HEARING EXAMINER FOR WATER RATE REVIEW PROCESS RFP MDD0104

1. PURPOSE

The City of Austin (COA) is seeking qualified, independent individuals experienced in performing highly advanced, senior-level administrative hearing work. The COA seeks the services of an Impartial Hearing Examiner (IHE) to assist the Austin City Council in establishing fair and balanced water and wastewater rates during Austin Water's ongoing cost of service and rate review.

2. BACKGROUND

Austin Water ("AW") is the municipal water utility, owned and operated by the City of Austin, Texas, and provides water and wastewater services to over 225,000 residential, commercial and industrial customers in Travis and Williamson counties, Texas. AW's governing body is the Austin City Council. The Austin City Council also serves as AW's primary regulator, having the authority to establish retail rates for all customers served by the utility.

In 2016, the Austin City Council set new retail rates for AW customers for the fourteenth consecutive time. The City will hire an IHE whose primary responsibilities will be to preside over certain hearings and proceedings during the rate review and to make recommendations to the Austin City Council.

In April 2013, four wholesale municipal utility districts challenged their AW wholesale rates before the Texas Commission on Environmental Quality (TCEQ) and this challenge was subsequently transferred to the jurisdiction of the Public Utility Commission of Texas (PUC). This action, PUC docket No. 42857, challenged the water rates that were effective February 1, 2013 and the wastewater rates effective November 1, 2012. The challenged rates were the subject of an administrative hearing before the State Office of Administrative Hearings (SOAH) in February 2015. The PUC subsequently issued a final order in this docket which stated the COA did not meet their burden of proof that the rates charged these four wholesale customers were just and reasonable. The COA has appealed this ruling to State District Court where the case is still pending. Additionally, another wholesale customer challenged AW's water and wastewater rates effective November 1, 2016. This action, PUC docket No. 46483, has been referred to SOAH for further proceedings.

AW is currently in the process of conducting a comprehensive cost of service rate study for both retail and wholesale water and wastewater rates. The process includes an extensive public involvement program to review the cost of service methodologies used to allocate costs amongst customer classes and to update the methods of determining fair and defensible rates for utility services. It is expected the cost of service rate study will be completed in the spring of 2017 with proposed water and wastewater rates available for the Impartial Hearings Examiner to review during the summer and fall of 2017.

3. QUALIFICATIONS

The Contractor selected to serve as the IHE ("Contractor") shall possess the experience and qualifications necessary to perform the objectives outlined in this Scope of Work and the requirements and qualifications listed in the 0600 Proposal Preparation Instructions.

3.1 The Contractor shall have the following minimum qualifications:

3.1.1 Graduation from an accredited four year college or university and graduation from an accredited law school with a Juris Doctorate degree.

3.1.2 At least five years of experience as a licensed attorney preparing for, participating in, and reviewing formal hearings or trials involving litigation and/or administrative law at the Federal, State or local level.

3.1.3 Licensed by the State Bar of Texas as a member in good standing.

3.2 An individual shall not serve as the IHE if, at the time the contract is awarded that individual:

3.2.1 Is an employee or paid consultant of a Texas trade association which seeks to promote a business or professional interest related to the water and wastewater utility industry;

3.2.2 Has been registered at some point in the last two years as a lobbyist under Chapter 4-8 of the Austin City Code working on behalf of a business or professional interest related to the water and wastewater utility industry; or

3.2.3 Is currently or has been in the past two years a member of the City of Austin's Water and Wastewater Commission, Resource Management Commission, or City Council.

4. SCOPE OF WORK

The Contractor selected to serve as the Impartial Hearing Examiner ("IHE") shall, at the direction of the Austin City Council, preside over any hearing addressing the cost of service and rate schedule proposed by AW. The IHE shall receive written and oral testimony and evidence. Then, operating within the public policy framework developed by Austin City Council and considering all relevant facts and laws, the IHE shall make independent recommendations to Council regarding AW's cost of service methodologies and rate schedule. The Impartial Hearing Examiner will work under minimal supervision, with extensive latitude for the use of initiative and independent judgment.

4.1 Objectives

The objective of the IHE is to preside over hearings and proceedings to gather testimony and evidence that address AW's recommended rate proposals. At the close of the hearing/proceeding, the IHE shall deliver a written recommendation to the Austin City Council which identifies pertinent issues of related law, findings of fact, and proposals for the Austin City Council to consider. Throughout the review, the IHE shall have the following responsibilities and authority:

4.1.1 Schedule and preside over hearings.

4.1.2 Conduct hearings involving legal, procedural, and technical issues.

4.1.3 Examine witnesses and rule on evidence.

4.1.4 Analyze testimony and evidence.

4.1.5 Rule on discovery disputes, scheduling requests, and motions.

4.1.6 Compile and maintain records of evidence and ensure proper handling for confidentiality.

4.1.7 Prepare opinions, proposals for decision, or orders.

4.1.8 Prepare reports.

4.1.9 Perform related work as assigned.

4.2 Phase 1: Preparation

4.2.1 In preparation for the Rate Review Process, the IHE shall:

a. Review relevant, AW-related Austin City Council ordinances, resolutions, and policies;

b. Develop a comprehensive understanding of the nuances of how Texas municipally owned utilities operate;

c. Review and recommend revisions, as necessary, to proposed hearing procedures; and

d. Help develop a draft procedural schedule.

4.2.2 The IHE shall present an overview of the rate review process at the September 13, 2017 meeting of the City of Austin Water and Wastewater Commission. The presentation shall include discussion of:

a. The role of the IHE;

b. Major milestones of the review process;

c. Opportunities for public participation in the review process; and

d. Any other important issue(s) deemed relevant to the review process by the IHE.

e. The IHE shall present an overview of the rate review process to the Austin City Council, if requested.

4.3 Phase 2: Rate Review Process

4.3.1 AW will present its rate recommendations in a formal process before the Austin City Council. Using a similar procedural schedule to that traditionally used by the Texas State Office of Administrative Hearings, the review process will include the following steps:

a. AW rate recommendation filing;

b. Initial review of rate recommendation by IHE;

c. Issuance of briefs by interested parties advising City Council on Issues to be deliberated in the administrative review process;

d. Order from the City Council assigning the case to the IHE and giving direction on issues to be deliberated in the administrative review process;

e. Establishment of the procedural schedule;

f. Parties' filing of testimony and rebuttal testimony;

g. Parties' filing of and response to Requests for Information submitted by other parties;

h. Oral hearings, at the discretion of the IHE;

i. Parties' filing of final arguments;

j. IHE's development of a Final Recommendation;

k. IHE's delivery of a Final Recommendation to the Austin City Council;

l. Deliberations of the Austin City Council; and

m. Final decision by the Austin City Council

4.3.2 The IHE shall develop a Final Recommendation to be delivered in writing to the Austin City Council. The Final Recommendation shall be based on the IHE's understanding of the policies, laws and rules that regulate AW and be supported by evidence and/or testimony presented in the administrative review process. At a minimum, the Final Recommendation shall include:

a. Discussion of Issues deliberated as directed by the Austin City Council

b. Findings of fact that inform the IHE's recommendations

c. Explanations of law that form the foundation of the IHE's recommendations

d. Description of each recommendation

4.4 General Requirements

4.4.1 The Contractor may not conduct any *ex parte* communications with any interested parties once the review has been assigned to the Contractor by the Austin City Council and until the Council has rendered its final decision.

4.4.2 The Contractor shall not release or cause the release of information protected by the Texas Public Information Act, Chapter 552 of the Texas Government Code, or other confidential information to any non-City party or to any City party who is not entitled to access to certain confidential information.

4.4.3 The Contractor shall attend meetings and make presentations to the Austin City Council or the City Manager's Office as required by the COA's Project Manager. Information provided in these meetings shall be subject to *ex parte* rules.

4.4.4 The Contractor shall conduct status meetings with the COA's Project Manager on the first and third Mondays of each month, unless a different scheduled is approved by the COA's Project Manager. Such meetings need not be in person. Topics to be covered may include a summary of work accomplished, to-date spending and remaining contract balance, concerns which may have an effect on schedule or cost of the project, and recommendations for project improvements.

4.4.5 The following criteria are applicable to all deliverables, except as mutually agreed upon. The Contractor shall:

a. Deliver each deliverable free from error (including, but not limited to: formatting, spelling, grammar, typographical).

b. Submit each written report electronically in a format compatible with Microsoft

Word 2007 or later.

c. Provide all spreadsheets used to conduct analysis and to arrive at any conclusion in "live" Microsoft Excel 2007 or later worksheets.

d. Submit each written presentation electronically in a format compatible with Microsoft Power Point 2007 or later.

5. TIMELINE

The COA anticipates engaging the Contractor by June 2017. Phase I is scheduled to start by June 2017 and conclude by August 2017. Phase II is scheduled to start September 1, 2017 January 31, 2018. The IHE shall submit in writing the Final Recommendation no later than February 15, 2018 to the COA's Project Manager, unless a different due date is approved by the COA's Project Manager.

6. CONFIDENTIALITY AGREEMENT

Upon nomination of contract award and prior to commencement of the work, the COA will require the Contractor to execute a Confidentiality Agreement due to competitive business and technical information that may be provided by AW to the Contractor.

Section 0510: Purchasing Office Exceptions Form

Solicitation Number: MDD0104 Impartial Hearing Examiner

The City will presume that the Offeror is in agreement with all sections of the solicitation unless the Offeror takes specific exception as indicated below. The City, at its sole discretion, may negotiate exceptions to the sections contained in the solicitation documents or the City may deem the Offer non-responsive. The Offeror that is awarded the contract shall sign the contract with the accepted or negotiated sections.

Copies of this form may be utilized if additional pages are needed.

☒ Accepted as written. ☐ Not accepted as written. See below:

Indicate:

- ☐ **0300 Standard Purchase Terms & Conditions**
- ☐ **0400 Supplemental Purchase Provisions**
- ☐ **0500 Scope of Work**

Page Number **Section Number** **Section Description**

Alternative Language:

Justification:

Section 0605: Local Business Presence Identification

A firm (Offeror or Subcontractor) is considered to have a Local Business Presence if the firm is headquartered in the Austin Corporate City Limits, or has a branch office located in the Austin Corporate City Limits in operation for the last five (5) years, currently employs residents of the City of Austin, Texas, and will use employees that reside in the City of Austin, Texas, to support this Contract. The City defines headquarters as the administrative center where most of the important functions and full responsibility for managing and coordinating the business activities of the firm are located. The City defines branch office as a smaller, remotely located office that is separate from a firm's headquarters that offers the services requested and required under this solicitation.

OFFEROR MUST SUBMIT THE FOLLOWING INFORMATION FOR EACH LOCAL BUSINESS (INCLUDING THE OFFEROR, IF APPLICABLE) TO BE CONSIDERED FOR LOCAL PRESENCE.

NOTE: ALL FIRMS MUST BE IDENTIFIED ON THE MBE/WBE COMPLIANCE PLAN OR NO GOALS UTILIZATION PLAN (REFERENCE SECTION 0900).

USE ADDITIONAL PAGES AS NECESSARY

OFFEROR:

Name of Local Firm	Herrera & Boyle, PLLC	
Physical Address	816 Congress Ave., Suite 1250 Austin, Texas 78701	
Is your headquarters located in the Corporate City Limits? (circle one)	Yes	No
or		
Has your branch office been located in the Corporate City Limits for the last 5 years?	Yes	No
Will your business be providing additional economic development opportunities created by the contract award? (e.g., hiring, or employing residents of the City of Austin or increasing tax revenue?)	Yes	No

SUBCONTRACTOR(S):

Name of Local Firm	N/A	
Physical Address		
Is your headquarters located in the Corporate City Limits? (circle one)	Yes	No
or		
Has your branch office been located in the Corporate City Limits for the last 5 years	Yes	No

Will your business be providing additional economic development opportunities created by the contract award? (e.g., hiring, or employing residents of the City of Austin or increasing tax revenue?)	Yes	No

SUBCONTRACTOR(S):

Name of Local Firm	N/A	
Physical Address		
Is your headquarters located in the Corporate City Limits? (circle one)	Yes	No
or		
Has your branch office been located in the Corporate City Limits for the last 5 years	Yes	No
Will your business be providing additional economic development opportunities created by the contract award? (e.g., hiring, or employing residents of the City of Austin or increasing tax revenue?)	Yes	No

Section 0700: Reference Sheet

Responding Company Name Herrera & Boyle, PLLC

The City at its discretion may check references in order to determine the Offeror's experience and ability to provide the products and/or services described in this Solicitation. The Offeror shall furnish at least 3 complete and verifiable references. References shall consist of customers to whom the offeror has provided the same or similar services within the last 5 years. References shall indicate a record of positive past performance.

1. Company's Name: City of Amarillo
   Name and Title of Contact: Michelle Bonner, Asst. City Manager
   Project Name:
   Present Address: 509 E. 7th Ave.
   City, State, Zip Code: Amarillo, Texas 79101
   Telephone Number: (806) 378-4209 Fax Number (806) 378-3018
   Email Address: michelle.bonner@amarillo.gov

2. Company's Name: City of Longview
   Name and Title of Contact: Jim Finley, City Attorney
   Project Name:
   Present Address: 300 Cotton Street
   City, State, Zip Code: Longview, Texas 75601
   Telephone Number: (903) 237-1090 Fax Number (____)
   Email Address: jfinley@longviewtexas.gov

3. Company's Name: Lubbock Power and Light
   Name and Title of Contact: Richard Casner, General Counsel
   Project Name:
   Present Address: 1301 Broadway Street
   City, State, Zip Code: Lubbock, Texas 79401
   Telephone Number: (806) 775-3529 Fax Number (____)
   Email Address: RCasener@mail.ci.lubbock.tx.us

Section 0700: Reference Sheet - Continued

4. Company's Name: Public Citizen
   Name and Title of Contact: Tom "Smitty" Smith - Texas Director
   Project Name:
   Present Address: 815 Brazos St., Suite 300
   City, State, Zip Code: Austin, Texas 78701
   Telephone Number: (512) 477-1155 Fax Number ( )
   Email Address: smitty@citizen.org

5. Company's Name: Law Office of James Brazell
   Name and Title of Contact: James Brazell, Attorney
   Project Name:
   Present Address: 9442 Capital of Texas Hwy., Plaza One, Suite 500
   City, State, Zip Code: Austin, Texas 78759
   Telephone Number: (512) 340-7387 Fax Number (512) 879-3971
   Email Address: jbrazell@brazelllaw.com

City of Austin, Texas
Section 0800
NON-DISCRIMINATION AND NON-RETALIATION CERTIFICATION

City of Austin, Texas

Equal Employment/Fair Housing Office

To: City of Austin, Texas,

I hereby certify that our firm complies with the Code of the City of Austin, Section 5-4-2 as reiterated below, and agrees:

(1) Not to engage in any discriminatory employment practice defined in this chapter.

(2) To take affirmative action to ensure that applicants are employed, and that employees are treated during employment, without discrimination being practiced against them as defined in this chapter, including affirmative action relative to employment, promotion, demotion or transfer, recruitment or recruitment advertising, layoff or termination, rate of pay or other forms of compensation, and selection for training or any other terms, conditions or privileges of employment.

(3) To post in conspicuous places, available to employees and applicants for employment, notices to be provided by the Equal Employment/Fair Housing Office setting forth the provisions of this chapter.

(4) To state in all solicitations or advertisements for employees placed by or on behalf of the Contractor, that all qualified applicants will receive consideration for employment without regard to race, creed, color, religion, national origin, sexual orientation, gender identity, disability, sex or age.

(5) To obtain a written statement from any labor union or labor organization furnishing labor or service to Contractors in which said union or organization has agreed not to engage in any discriminatory employment practices as defined in this chapter and to take affirmative action to implement policies and provisions of this chapter.

(6) To cooperate fully with City and the Equal Employment/Fair Housing Office in connection with any investigation or conciliation effort of the Equal Employment/Fair Housing Office to ensure that the purpose of the provisions against discriminatory employment practices are being carried out.

(7) To require of all subcontractors having 15 or more employees who hold any subcontract providing for the expenditure of $2,000 or more in connection with any contract with the City subject to the terms of this chapter that they do not engage in any discriminatory employment practice as defined in this chapter

For the purposes of this Offer and any resulting Contract, Contractor adopts the provisions of the City's Minimum Standard Non-Discrimination and Non-Retaliation Policy set forth below.

City of Austin
Minimum Standard Non-Discrimination and Non-Retaliation in Employment Policy

As an Equal Employment Opportunity (EEO) employer, the Contractor will conduct its personnel activities in accordance with established federal, state and local EEO laws and regulations.

The Contractor will not discriminate against any applicant or employee based on race, creed, color, national origin, sex, age, religion, veteran status, gender identity, disability, or sexual orientation. This policy covers all aspects of employment, including hiring, placement, upgrading, transfer, demotion, recruitment, recruitment advertising, selection for training and apprenticeship, rates of pay or other forms of compensation, and layoff or termination.

The Contractor agrees to prohibit retaliation, discharge or otherwise discrimination against any employee or applicant for employment who has inquired about, discussed or disclosed their compensation.

Further, employees who experience discrimination, sexual harassment, or another form of harassment should immediately report it to their supervisor. If this is not a suitable avenue for addressing their compliant, employees are advised to contact another member of management or their human resources representative. No employee shall be discriminated against, harassed, intimidated, nor suffer any reprisal as a result of reporting a violation of

this policy. Furthermore, any employee, supervisor, or manager who becomes aware of any such discrimination or harassment should immediately report it to executive management or the human resources office to ensure that such conduct does not continue.

Contractor agrees that to the extent of any inconsistency, omission, or conflict with its current non-discrimination and non-retaliation employment policy, the Contractor has expressly adopted the provisions of the City's Minimum Non-Discrimination Policy contained in Section 5-4-2 of the City Code and set forth above, as the Contractor's Non-Discrimination Policy or as an amendment to such Policy and such provisions are intended to not only supplement the Contractor's policy, but will also supersede the Contractor's policy to the extent of any conflict.

UPON CONTRACT AWARD, THE CONTRACTOR SHALL PROVIDE THE CITY A COPY OF THE CONTRACTOR'S NON-DISCRIMINATION AND NON-RETALIATION POLICIES ON COMPANY LETTERHEAD, WHICH CONFORMS IN FORM, SCOPE, AND CONTENT TO THE CITY'S MINIMUM NON-DISCRIMINATION AND NON-RETALIATION POLICIES, AS SET FORTH HEREIN, **OR** THIS NON-DISCRIMINATION AND NON-RETALIATION POLICY, WHICH HAS BEEN ADOPTED BY THE CONTRACTOR FOR ALL PURPOSES WILL BE CONSIDERED THE CONTRACTOR'S NON-DISCRIMINATION AND NON-RETALIATION POLICY WITHOUT THE REQUIREMENT OF A SEPARATE SUBMITTAL.

Sanctions:

Our firm understands that non-compliance with Chapter 5-4 and the City's Non-Retaliation Policy may result in sanctions, including termination of the contract and suspension or debarment from participation in future City contracts until deemed compliant with the requirements of Chapter 5-4 and the Non-Retaliation Policy.

Term:

The Contractor agrees that this Section 0800 Non-Discrimination and Non-Retaliation Certificate of the Contractor's separate conforming policy, which the Contractor has executed and filed with the City, will remain in force and effect for one year from the date of filling. The Contractor further agrees that, in consideration of the receipt of continued Contract payment, the Contractor's Non-Discrimination and Non-Retaliation Policy will automatically renew from year-to-year for the term of the underlying Contract.

Dated this 20th day of June, 2017

CONTRACTOR Herrera & Boyle, PLLC

Authorized Signature

Title Principal

Section 0800, 0805, 0810 - Certifications

Non-Discrimination Certification – Section 0800

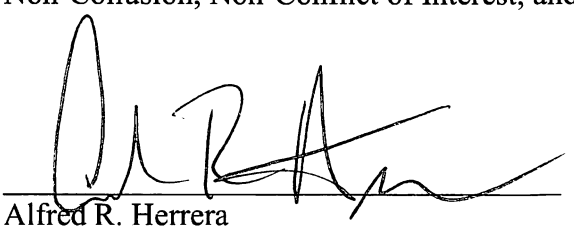
Mr. Herrera hereby certifies that he and Herrera and Boyle, PLLC, conform to the Code of the City of Austin, Section 5-4-2 as set forth in "City of Austin, Texas Section 0800 – Equal Employment/Fair Housing Office Non-Discrimination Certification."

Non-Suspension or Debarment Certification – Section 0805

Mr. Herrera hereby certifies that he, Herrera & Boyle, PLLC and its principals, are not currently suspended or debarred from bidding on any Federal, State, or City of Austin Contracts.

Non-Collusion, Non-Conflict of Interest, and Anti-Lobbying – Section 0810

Mr. Herrera hereby certifies that he and Herrera and Boyle, PLLC, are in conformance with the requirements and prohibitions set forth in "City of Austin, Texas Section 0810 – Non-Collusion, Non-Conflict of Interest, and Anti-Lobbying Certification."



Alfred R. Herrera

Section 0815: Living Wages Contractor Certification

Company Name Herrera & Boyle, PLLC

Pursuant to the Living Wages provision (reference Section 0400, Supplemental Purchase Provisions) the Contractor is required to pay to all employees directly assigned to this City contract a minimum Living Wage equal to or greater than $13.50 per hour.

The below listed employees of the Contractor who are directly assigned to this contract are compensated at wage rates equal to or greater than $13.50 per hour.

Employee Name	Employee Job Title
Brennan Foley	Associate
Leslie Lindsey	Office Manager/Legal Assistant
Mariann Wood	Paralegal
TBD	Law Clerk

USE ADDITIONAL PAGES AS NECESSARY

(1) All future employees assigned to this Contract will be paid a minimum Living Wage equal to or greater than $13.50 per hour.

(2) Our firm will not retaliate against any employee claiming non-compliance with the Living Wage provision.

A Contractor who violates this Living Wage provision shall pay each affected employee the amount of the deficiency for each day the violation continues. Willful or repeated violations of the provision or fraudulent statements made on this certification may result in termination of this Contract for Cause and subject the firm to possible suspension or debarment, or result in legal action.

Section 0835: Non-Resident Bidder Provisions

Company Name Herrera & Boyle, PLLC

A. Bidder must answer the following questions in accordance with Vernon's Texas Statues and Codes Annotated Government Code 2252.002, as amended:

Is the Bidder that is making and submitting this Bid a "Resident Bidder" or a "non-resident Bidder"?

Answer: Resident Bidder

(1) Texas Resident Bidder- A Bidder whose principle place of business is in Texas and includes a Contractor whose ultimate parent company or majority owner has its principal place of business in Texas.
(2) Nonresident Bidder- A Bidder who is not a Texas Resident Bidder.

B. If the Bidder id a "Nonresident Bidder" does the state, in which the Nonresident Bidder's principal place of business is located, have a law requiring a Nonresident Bidder of that state to bid a certain amount or percentage under the Bid of a Resident Bidder of that state in order for the nonresident Bidder of that state to be awarded a Contract on such bid in said state?

Answer: _____ Which State: _____

C. If the answer to Question B is "yes", then what amount or percentage must a Texas Resident Bidder bid under the bid price of a Resident Bidder of that state in order to be awarded a Contract on such bid in said state?

Answer: _____

HERRERA ◆ BOYLE PLLC

May 2, 2017

Mr. Matthew Duree
City of Austin
Purchasing Office-Response Enclosed for Solicitation # RFP 2200 MDD0104
124 8th Street, Rm 308
Austin, Texas 78701

Re: Solicitation # RFP 2200 MDD0104 – Impartial Hearing Examiner

Dear Mr. Duree:

Herrera & Boyle, PLLC (Herrera & Boyle) is pleased to respond to the Request for Proposal (the "RFP") issued by the City of Austin. To that end, please find attached our response to the RFP.

Should you require any additional information or have any questions regarding our response, please do not hesitate contacting me.

Sincerely,

Alfred R. Herrera
Sincerely,

Alfred R. Herrera

816 Congress Ave.
Suite. 1250
Austin, Texas 78701
512-474-1492 (p)
512-474-2507 (f)
www.herreraboylelaw.com
info@herreraboylelaw.com

Herrera & Boyle, PLLC Response to Solicitation No. RFP 2200 MDD0104– May 2, 2017

I. Executive Summary

Alfred R. Herrera, principal in the firm Herrera & Boyle, PLLC presents this response to the City of Austin's request for proposal ("RFP"), RFP 2200 MDD0104. In this RFP Herrera & Boyle will assign Mr. Alfred R. Herrera to undertake the primary tasks identified in the RFP to serve as the Independent Hearings Examiner ("IHE") in Austin Water's ("AW") upcoming review of its cost of service and rate schedules.

Mr. Herrera has approximately 34 years of experience in all aspects of the regulatory arena involving electric utilities, gas utilities, water/wastewater utilities, and telecommunications utilities. Mr. Herrera received his B.A. in American History from the George Washington University in Washington, D.C. in 1978, and he received his Doctor of Jurisprudence from the University of Texas School of Law in 1983. Mr. Herrera is a native Texan and received his licenses to practice law in 1983 and is licensed to practice in all courts of the State of Texas. He is Board Certified in Administrative Law and has been since 1989. Over approximately 80% of Mr. Herrera's practice is before the Public Utility Commission of Texas "PUCT"), the Railroad Commission of Texas ("Railroad Commission"), and the Texas Commission on Environmental Quality ("TCEQ"), with his primary focus on proceedings before the PUCT.

As needed, Herrera & Boyle will also employ the services of the firm's associates, legal assistants, and law clerks as warranted. The firm's personnel have extensive experience in proceedings before the PUCT and the Railroad Commission, and relevant experience in dealings with the TCEQ.

Mr. Herrera will rely on his extensive experience in representing clients in rate-setting proceedings before the PUCT and the Railroad Commission. Additionally, his depth of knowledge regarding the settlement of rate cases before these agencies and his vast understanding of the arbitrations process before the PUCT regarding the arbitration of complex interconnection agreements between telecommunications entities, will serve as a foundation in reviewing – in an objective manner – the disparate positions that parties often take in rate cases. Reaching settlement requires an advocate to undertake an objective review of each party's testimony and evidence, precedent on each issue, and an assessment of the likelihood of success on the merits of a party's position and that skill set enables Mr. Herrera to objectively assess each participant's recommendations.

Mr. Herrera recently served as the Impartial Hearing Examiner in the City's review of Austin Energy's electric rates. Mr. Herrera's experience as the Impartial Hearing Examiner in Austin Energy's rate review process gives him a unique perspective insight in being the Impartial Hearing Examiner for Austin Water.

Crucial to practice before the PUCT (and other state agencies) is a firm grasp of the rule-making process employed by state agencies. Mr. Herrera has participated in numerous rule-making proceedings before the PUCT and the Railroad Commission in the development of procedural and substantive rules adopted by those state agencies. Mr. Herrera's experience in these processes facilitates the task of assisting the City to develop procedures for hearings in the review process.

Mr. Herrera will also rely on his extensive experience in "contested" cases and in rule-making proceedings to objectively review the evidence and testimony presented by interested parties participating in the City of Austin's review process of Austin Energy's ("AW") anticipated cost of

service.

Summation of Proposal

Mr. Herrera envisions the role of the Impartial Hearing Examiner ("IHE") to be one in which the IHE provides the City Council a summary of the evidence and testimony submitted during the review AW's cost of service and rate schedules (collectively, AW's "Rates"). The summary of case the IHE presents would be referred to as a "proposal for decision" ("PFD") and would set out each party's arguments – legal and evidentiary – and the IHE's proposed solution to each disputed issue. The final decision on AW's overall revenue requirement, the allocation of costs among the customer classes, and the ultimate design of rates, rests with the Council.

To perform the scope of work identified in the City's RFP, Mr. Herrera envisions undertaking the following tasks:

PHASE I:

- **Review Applicable Law** – Become more familiar with the City's Code, ordinances, resolutions, and policy directives regarding AW
- **Review Precedent Regarding MOUs** – Review prior PUCT decisions regarding municipally owned utilities ("MOUs")
- **Review Court Precedent Regarding MOUs** – Review the Public Utility Regulatory Act ("PURA"), the Texas Water Code, and court decisions regarding regulation of municipally owned utilities
- **Review PUCT Precedent Regarding Cost Allocation and Rate Design** – Review PUCT's decisions regarding water utilities' rates
- **City's Procedural Rules** – Participate in the City's development of its procedural rules applicable to the review process of AW's Rates and a procedural schedule

PHASE II:

- **Pre-Hearing Events** – Convene "pre-hearing" conferences with affected parties to address the following areas of the review process:

  - Establish a Mechanism for Service of Documents among the participants
  - Identify the Scope of the Hearings
  - Establish a Procedural Schedule
  - Establish a Discovery Process
  - Resolve Disputes Related to Discovery
  - Implement a Confidentiality Agreement
  - Attend As-Needed Meetings with City Council and/or City Manager
  - Make Presentation(s) to the relevant City commissions
  - Convene the Hearings on the Merits of AW's Rates

- **Convene the Hearings on the Merits of AW's Rates**

  - Hold hearings to take parties' arguments and evidence addressing issues within scope of hearings

- Establish time limits for parties' presentation of their respective recommendations
- Establish a sequence for presentation of each party's recommendations
- Rule on evidentiary objections made during the hearings
- Establish deadlines for submittal of "closing" briefs by the parties

❖ **Post Hearing Events** – Prepare reports and recommendations based on evidence and testimony adduced at hearings

- Review and analyze evidence and testimony presented by parties
- Prepare "proposal for decision" ("PFD") for City Council's consideration, including findings of fact and legal conclusions
- Review participants' "exceptions" (that is, disagreements) to PFD
- Present final PFD to City Council
- Be available for follow-up activity, if any, needed regarding PFD

❖ Throughout the process Mr. Herrera anticipates providing progress reports to the Project Manager as may be required by the RFP, or as otherwise directed.

Mr. Herrera is authorized to negotiate terms of the contract to be entered into related to RFP 2200 MDD0104 and render binding decision on contract matters. Mr. Herrera's contact information is:

Mr. Alfred R. Herrera
Herrera & Boyle, PLLC
816 Congress Ave., Suite 1250
Austin, Texas 78701
512-474-1492 (ofc)
512-474-2503 (fax)
aherrera@herreraboylelaw.com

III. Business Organization

A. Business Organization

Herrera & Boyle, PLLC was initially established in the Fall, 2006 as collaboration between by the Law Office of Jim Boyle, PLLC, and the Law Office of Alfred R. Herrera. Herrera & Boyle is organized as a professional limited liability company.

Mr. Boyle has retired and is not a partner in H&B. Mr. Herrera is the principal of the firm and will be the lead attorney for the firm on the project that is the subject of this RFP.

Mr. Herrera has been licensed in the State of Texas since 1983 and over the many years of his practice, has been involved in literally hundreds of ratemaking proceedings before the PUCT and the Railroad Commission combined, including representation of municipal entities and individual customers before the PUCT, the Railroad Commission, the Texas Commission on Environmental Quality ("TCEQ") as well as the courts of our State, including the Supreme Court of Texas.

B. Conflicts of Interest

Mr. Herrera is not aware of any conflicts of interests that disqualify him from serving as the IHE. See attached affidavit by Mr. Herrera regarding the lack of conflicts. See Mr. Herrera's affidavit appended as Attachment D, regarding his statement of no conflicts.

C. Possible Conflicts of Interest

Mr. Herrera's role in utility rate cases has been primarily on the side of the consumer, and in that capacity, has represented the interests of residential, small commercial, and medium-to-large commercial customers, including governmental customers, in rate proceedings before the PUCT and the Railroad Commission.

Mr. Herrera also represents municipally owned utilities in their dealings with entities seeking to use the utility's poles and conduits and a City's rights of way ("ROW").

Mr. Herrera also represents municipalities in negotiating franchise agreements with entities seeking to use the municipality's public rights of way, e.g., investor owned electric and gas utilities, and more recently, entities claiming to be telecommunications providers seeking to use a city's ROW.

Mr. Herrera has also represented municipally owned or cooperatively owned, water utilities in matters regarding service-area boundaries (that is, obtaining or amending "certificates of convenience and necessity" ("CCN")), as well as representing landowners in a variety of transmission-line CCN proceedings with regard to the need for a new transmission line or the routing of a proposed transmission line.

Mr. Herrera also represents numerous municipalities across the State of Texas, typically in rate cases and rulemaking proceedings, before the PUCT and the Railroad Commission. Generally stated, these municipalities join a coalition of cities and Mr. Herrera represents those coalitions. In matters involving Atmos Energy, a gas utility that provides gas-utility services in some areas within the City of Austin's city limits, the City of Austin is a member of a coalition of cities – the Atmos Municipalities of Texas ("ATM") – that Mr. Herrera represents. The City of Austin has in the past also participated in a coalition of cities served by CenterPoint Energy-Entex, also a gas utility, known as the Alliance of CenterPoint Municipalities-South Texas Division ("ACM-S. Tx").

Lastly, Mr. Herrera was recently engaged by the City of Austin's law department to represent the City in a proceeding at the PUCT, Docket No. 47045, *Complaint of Crown Castle NG Central LLC Against the City of Austin for Imposition of a License Agreement and Fees for Use of Public Right of Way*, a complaint filed at PUCT by Crown Castle NG Central LLC against the City contending the City may not require an agreement from the City for Crown Castle to use the City's ROW.

IV. Experience Relevant to the Scope of Work

A. Herrera & Boyle's Relevant Experience

Herrera & Boyle's experience in the rate-setting arena spans over 30 years. Herrera & Boyle represents over 80 cities in the Panhandle and South Plains of Texas in their relationship with Xcel Energy, and over 50 cities in North East Texas in the area served by AEP-Southwestern Electric Power Company (SWEPCO), as well as a smaller coalition of cities served by CenterPoint Energy-Houston Electric. Herrera & Boyle has helped foster a more cooperative regulatory environment between the municipalities and their electric utility, requiring the objective review of the utility's evidence in support of its proposed change in rates, all of which in turn results in a lower cost of regulation and lower rates.

Herrera & Boyle also represents municipalities in rate-setting proceedings involving gas-utility rates and in particular the rates charged by Atmos Energy, CenterPoint Energy-Entex, and West Texas Gas Company.

Herrera & Boyle has also represented small municipalities in appeals to the PUCT brought by ratepayers served outside the city limits of those cities; and represented a small water supply corporation (WSC) against challenges brought by a land developer seeking to have the WSC build infrastructure to serve the proposed land development.

Most recently, Herrera & Boyle – through Mr. Herrera – served as the Impartial Hearing Examiner in the City of Austin's rate-review process of Austin Energy, a process that culminated with issuance of a Proposal for Decision that Mr. Herrera presented to the City Council in the Summer of 2016. That engagement was under RFQ Solicitation No. LAG0501 – Impartial Hearing Examiner.

B. Demonstrated Applicable Experience

1. Legal principles, practices, and proceedings related to the water utility industry

Mr. Herrera began his legal career at the PUCT and has remained in the utility regulatory field since that time. His practice has exposed Mr. Herrera to every aspect of regulation of utilities (water, wastewater, electric, gas, and telecommunications) in the State of Texas, the Federal Energy Regulatory Commission ("FERC), the Federal Communications Commission ("FCC").

Mr. Herrera has been involved in hundreds of contested cases before the PUCT regarding a utility's rates. "Attachment A" shows a selected list of recent proceedings in which Mr. Herrera has served as lead counsel for his clients.

Mr. Herrera's experience regarding water-utility rates extends to the days when the PUCT initially had jurisdiction over water utilities; regulation of water utilities was transferred to the Texas Water Commission, and its successor agency, Texas Commission on Environmental Quality ("TCEQ"). That function was recently transferred from the TCEQ back to the PUCT in 2013. Mr. Herrera was involved in the legislative activity leading to the transfer of water regulation to the PUCT and is

shown in more detail below, has been actively representing clients before the PUCT on matters involving water utility rates.

2. Trial and Administrative Hearing Procedures and Laws

To obtain Board Certification in Administrative Law, Mr. Herrera passed a rigorous examination administered by the State Bar of Texas. The exam probes an applicant's knowledge of the laws of the State of Texas affecting regulation by the State's agencies, including the PUCT, the Railroad Commission, and the TCEQ. The applicant must not only be familiar with statutory law, but also with court cases interpreting statutory law, and the courts' opinions as they affect decisions made by the regulatory agencies.

Additionally, to obtain Board Certification in Administrative Law, an applicant must exhibit a firm understanding of not only "contested cases," but also of the rule making process by which an agency proposes and adopts its rules.

Mr. Herrera has real-world experience in working with such statutes as the Administrative Procedures Act ("APA"), the Public Utility Regulatory Act ("PURA"), the Gas Utility Regulatory Act ("GURA"), the Texas Water Code ("TWC"), the Government Code, and the Local Government Code. While each of these statutes addresses a distinct component of regulation of utilities in the State of Texas, for example, PURA dealing with electric utilities, GURA addressing gas utilities, and the TWC addressing water utilities, the court's decisions often have a "spill-over" effect from one statute to the other. A by-product of Mr. Herrera's practice is knowledge of how one agency's decision or one court's decision regarding, e.g., the GURA or the PURA, may affect the PUCT's decision in interpreting the TWC.

Also of crucial importance to municipalities is the interplay between, for example, the Local Government Code, the TWC, and PURA. Knowing the effect of one may prove crucial in a proceeding before the PUCT, particularly as the PUCT's jurisdiction over municipally owned utilities is concerned.

3. Knowledge of Law, Rules, Regulations Related to Utility Industry

Mr. Herrera has been licensed in the State of Texas for almost thirty-four (34) years. He is Board Certified in Administrative Law and has been since 1989. He has focused his practice in matters affecting the utility industry – electric, gas, water/wastewater, and telecommunications – and in particular in the regulation of utilities, including the rates charged by utilities.

Mr. Herrera's practice concentrates on representing and advising municipalities across the State of Texas with a keen focus in promoting principles that foster local control by municipal officials of utility-related matters. While Mr. Herrera's practice has been in advocating the interest of ratepayers in those cities, his extensive experience in resolving rate cases by way of settlement, necessitates a candid, objective evaluation of the evidence in each case in light of current law, rules, regulations, and the policies of the regulatory agencies. In that endeavor, Mr. Herrera has amassed extensive experience and expertise in representing municipalities acting in their capacity as regulatory authorities in rate cases initiated by investor owned utilities. As a representative of

municipalities in their regulatory capacity, Mr. Herrera is tasked not only with representing the interests of the municipalities and its citizens, but also with ensuring the utility is provided a reasonable opportunity to earn a fair return on its invested capital above the utility's reasonable and necessary expenses.

Through representation of municipalities in rate proceedings, Mr. Herrera has gained invaluable experience in understanding the rate-setting process including all aspects of a utility's cost of service, the allocation of costs among its customer classes, and ultimately the design of rates to recover its cost of service.

4. Laws and Agency Regulations Related to Regulation of Municipally Owned Utilities

With transfer of regulation of water utilities, and under specific circumstances, municipally owned utilities, the PUCT's role is more and more central in a city's operations of its water utility. Mr. Herrera's participation in proceedings before the PUCT in proceedings related to municipally-owned water-utilities provides him with the experience necessary to apply state law to the City's decisions regarding AW's rates, particularly with regard to the PUCT's exercise of its appellate jurisdiction over a MOU's water rates.

Mr. Herrera has also represented the City of Fritch, Texas in two recent appeals brought by outside-the-city ratepayers in Docket No. 43086, *Ratepayer Appeal of the Decision by the City of Fritch to Change Water Rates* and in Docket No. 45248, *Ratepayers' Appeal of the Decision by the City of Fritch to Change Rates*. He also represented the Gum Springs Water Supply Corporation in Docket No. 42921, *Petition of Nathan Draper Appealing the Cost of Obtaining Service from Gum Springs Water Supply Corporation in Harrison County*.

Mr. Herrera currently serves as lead counsel for the City of McKinney in a complaint brought by a group of cities that are members of and are served by the North Texas Municipality Water District ("NTMWD") in PUCT Docket No. 46662, *Petition of the Cities of Garland, Mesquite, Plano and Richardson Appealing the Decision by North Texas Municipal Water District Affecting Wholesale Rates*, a complaint related to a wholesale contract between the NTMWD and its member cities under which NTMWD provides water to several cities.

V. Personnel Qualifications

A. Alfred R. Herrera

1. Qualifications

Mr. Herrera received his B.A. in American History from the George Washington University in Washington, D.C. in 1978, and he received his Doctor of Jurisprudence from the University of Texas School of Law in 1983. Mr. Herrera is a native Texan and received his licenses to practice law in 1983 and is licensed to practice in all courts of the State of Texas.

Since 1983, Mr. Herrera has practiced before the PUCT, and since 2006, before the Railroad Commission of Texas. As noted above, Mr. Herrera is Board Certified in Administrative Law and has been since 1989. Mr. Herrera is a past officer of Council for the Public Utility Law Section of the State Bar, is a past member of the Administrative Law Exam Commission of the Texas Board of Legal Specialization (TBLS), and is a current member of the Administrative Law Advisory Commission. The Administrative Law Advisory Commission's duties include advising the Texas Board of Legal Specialization ("TBLS") regarding any changes necessary to update the Specific Area Requirements for a specialty area of law (in Mr. Herrera's case, with regard to Administrative Law); reviewing applicants for certification and recertification in a specialty area and submitting recommendations of approval or the denial of applicants to TBLS as to whether or not the applicant meets the Standards for Attorney Certification for the specialty area.

Mr. Herrera began his legal career in 1983 at the PUCT as a Staff Attorney in the General Counsel's Office. At the PUCT Mr. Herrera handled all types of cases and rulemakings including water, wastewater rate cases and CCN cases, electric rate cases, CCN cases for generating stations and CCNs for transmission lines.

In 1988 Mr. Herrera was hired by the City of Austin and served as the City's lead regulatory counsel in all aspects of setting rates for what is now known as Austin Energy. Mr. Herrera served at the City of Austin during the tumultuous period in which the City of Austin faced many challenges regarding its municipally owned utility: Bringing a nuclear plant into rates; renegotiating its fuel contracts for coal and deliveries of that coal to the Fayette Power Plant (which it owned jointly with the Lower Colorado Authority); cancelling plans to build a "waste-to-energy" plant, which involved the cancellation of numerous contracts with a multitude of vendors.

Mr. Herrera served as the City of Austin's lead regulatory attorney in the City of Austin's full-blown rate case at the PUCT during a time of extreme controversy in bringing into rates its investment in the South Texas Project (a nuclear project near Bay City, Texas) and the Fayette Power Plant outside Austin.

Mr. Herrera was also charged with negotiating and drafting fuel supply and fuel delivery contracts, resolving contract disputes with vendors that provided services to Austin Energy, and ensuring that contracts for goods and services complied with the State's purchasing laws.

Also, Mr. Herrera was responsible for determining whether information was subject to disclosure under the State's Public Information Act, subject to the City Attorney's final decision on whether to disclose or not the information sought.

In 1991 Mr. Herrera moved to the private sector and served as the lead regulatory attorney and legislative liaison for MCI Telecommunications, Inc. In that capacity, Mr. Herrera successfully represented MCI before the PUCT and the regulatory agencies in the States of Missouri, Oklahoma, Kansas, and Arkansas. Mr. Herrera also represented MCI before the Texas Legislature. Through his efforts, MCI was able to reduce its cost of doing business in the State through the reduction of "access charges" by a factor of over 300% and was able to enter the local markets to offer customers a choice in the provision of local exchange service. Mr. Herrera was also the lead regulatory attorney for MCI in its venture with Banamex in Mexico, MCI's endeavor to open the telecommunications markets to competition in Mexico. In that effort, Mr. Herrera was a key player in drafting and negotiating an interconnection agreement between MCI's Mexican venture "Avantel" and TelMex, Mexico's dominant telecommunications company.

After over 15 years at MCI, in 2006, Mr. Herrera made the transition to private practice and along with Mr. Boyle, formed the firm of Herrera & Boyle. At Herrera & Boyle, Mr. Herrera focused his efforts in representing municipalities and municipally owned utilities. Mr. Herrera has successfully represented municipally owned utilities in Texas, including Greenville Electric Utility System ("GEUS") and New Braunfels Utility ("NBU") with regard to their respective transmission cost of service, and CPS Energy, Denton Municipal Electric ("DME"), and the City of College Station's electric utility, with regard to pole-attachment agreements with telecommunications companies and cable companies needing to attach to these MOUs' distribution poles. Mr. Herrera also represented the City of Fritch (a small city with a population of about 2,500) in an appeal brought to the PUCT, by outside-the-city ratepayers.

Mr. Herrera currently serves as lead counsel for the City of McKinney in a complaint brought by a group of cities that are members of and are served by the North Texas Municipality Water District ("NTMWD") in PUCT Docket No. 46662, a complaint related to wholesale contract for water between the NTMWD and its member cities.

Mr. Herrera has also represented the City of Fritch, Texas in two recent appeals brought by outside-the-city ratepayers in Docket No. 43086, *Ratepayer Appeal of the Decision by the City of Fritch to Change Water Rates* and in Docket No. 45248, *Ratepayers' Appeal of the Decision by the City of Fritch to Change Rates*. He also represented the Gum Springs Water Supply Corporation in Docket No. 42921, *Petition of Nathan Draper Appealing the Cost of Obtaining Service from Gum Springs Water Supply Corporation in Harrison County*.

Mr. Herrera is also experienced in representing and advising municipalities with regard to open-meeting requirements, purchasing of goods and services, public-information disclosure laws, and franchise agreements for access to public rights of way, and with regard to municipally owned utilities.

As noted above, Mr. Herrera served as the Impartial Hearing Examiner in the City of Austin's rate-review process of Austin Energy, a process that culminated with issuance of a Proposal for Decision that Mr. Herrera presented to the City Council in the Summer of 2016.

Overall, Mr. Herrera's primary responsibilities under this RFP would be over the items noted in Section 4.1 (Objectives); Section 4.2 (Preparation); Section 4.3 (Rate Review Process) of the Scope of Work for this RFP:

4.1.1 Schedule and preside over hearings.
4.1.2 Conduct hearings involving legal, procedural, and technical issues.
4.1.3 Examine witnesses and rule on evidence.
4.1.4 Analyze testimony and evidence.
4.1.5 Rule on discovery disputes, scheduling requests, and motions.
4.1.6 Compile and maintain records of evidence and ensure proper handling of confidential data.
4.1.7 Prepare opinions, proposals for decision, or orders.
4.1.8 Prepare reports.
4.1.9 Perform related work as assigned.

5.2.1.1 Preparation for the Rate Review Process
5.2.1.2 Present an overview of the rate review process at the September 13, 2017 meeting of the City of Austin Water and Wastewater Commission

4.3.1 Present the rate recommendations in a formal process before the Austin City Council.

2. Consider objectively the testimony of parties involved in the review process

Although Mr. Herrera's practice has been in the role of an advocate for his clients, Mr. Herrera's practice requires that he be able to assess a party's arguments – legal and evidentiary – in an objective manner so as to avoid the unnecessary expenditure of the client's resources pursuing an issue that would have little to no chance of succeeding before the regulatory agency. In his capacity as an advocate for municipalities and their citizens, Mr. Herrera has resolved numerous cases, or issues within cases, without the need for litigation. In doing so, Mr. Herrera has had to evaluate a party's testimony and other evidence in an objective manner in light of, for example, prior orders the PUCT has issued, or in light of a court's interpretation of a particular provision of the PURA, GURA, and the TWC.

Mr. Herrera also will rely on his extensive experience in representing clients in rate-setting proceedings before the PUCT and the Railroad Commission. His depth of knowledge regarding the settlement of rate cases before these agencies and his vast understanding of the arbitrations process before the PUCT regarding the arbitration of complex interconnection agreements between telecommunications entities, will serve as a foundation in reviewing – in an objective manner – the disparate positions that parties often take in rate cases. Reaching settlement requires an advocate to undertake an objective review of each party's testimony and evidence, precedent on each issue, and an assessment of the likelihood of success on the merits of a party's position and that skill set enables Mr. Herrera to objectively assess each participant's recommendations.

Further, Mr. Herrera recently served as the Impartial Hearing Examiner in the City's review of Austin Energy's electric rates. Mr. Herrera's experience as the Impartial Hearing Examiner in Austin Energy's rate review process gives him a unique perspective and insight in being the Impartial Hearing Examiner for review of Austin Water's rates.

3. Application of Rules and Statutes

Mr. Herrera's participation as lead counsel in hundreds of cases over the span of his almost 34 years

of practice in the regulation of utilities has provided him countless opportunities to apply the law – whether an agency's rule, a State statute, or a court decision – to specific facts raised in contested case, or in a rule-making proceeding.

Relative to the total hours Mr. Herrera estimates to be devoted to this project, Mr. Herrera will perform about 54% of those hours at $375 per hour.

4. Use of Reasoning to Identify Solutions; Judgment to Make Recommendations to City Council; Communicate Effectively

Mr. Herrera's almost 34 years of experience provides him the foundation to use reasoning to identify solutions to disputed issues presented in the AW rate-review process. Similarly, his experience provides him the footing to exercise sound judgment in presenting his recommendations to City Council. Lastly, the countless number of pleadings, briefs, reports to clients, including to city councils across the State, provide Mr. Herrera the experience to communicate effectively orally and in writing.

B. Mr. Brennan Foley

1. Qualifications

Mr. Foley has over 9 years of experience relevant to the utility regulatory arena having been employed by the PUCT from 2007 to 2014. See Attachment E for Mr. Foley's resume.

Mr. Brennan's primary responsibilities would be to assist Mr. Herrera in the following items set forth in Section 4.1 (Objectives) of the Scope of Work for this RFP:

4.1.4 Assisting Mr. Herrera in analyzing testimony and evidence.
4.1.7 Assisting Mr. Herrera in preparing opinions, proposals for decision, or orders.
4.1.8 Assisting Mr. Herrera in preparing reports

Most recently, Mr. Foley assisted Mr. Herrera in his role as the Impartial Hearing Examiner in the City of Austin's rate-review process of Austin Energy. Mr. Foley was responsible for assisting Mr. Herrera in analyzing testimony and evidence adduced at the hearings and in preparing drafts of certain sections of Mr. Herrera's final recommendations to the City Council.

Relative to the total hours Mr. Herrera estimates to be devoted to this project, Mr. Foley will perform about 17% of those hours at $300 per hour.

2. Consider objectively the testimony of parties involved in the review process

As with Mr. Herrera, Mr. Foley's experience positions him well to assist Mr. Herrera in his role as the Impartial Hearing Examiner. Mr. Foley also has had to weigh the evidence in proceedings before the PUCT and the Railroad Commission objectively to better advise Herrera & Boyle's clients. Also, Mr. Foley served in this very role in assisting Mr. Herrera in review of Austin Energy's rates in which Mr. Herrera was the Impartial Hearing Examiner.

3. Application of Rules and Statutes

Mr. Foley's career at the PUCT and more recently in representing clients before the PUCT and the Railroad Commission gives him in-depth knowledge of the relevant statutes applicable to water utilities (and electric and gas utilities, too). More recently, Mr. Foley assisted Mr. Herrera in the appeal of the City of Fritch's water rates, and is assisting Mr. Herrera in PUCT Docket No. 46662 involving the North Texas Municipal Water District and its wholesale water rates.

4. Use of Reasoning to Identify Solutions; Judgment to Make Recommendations to City Council; Communicate Effectively

Mr. Foley's almost 9 years of experience provides him the foundation to use reasoning to identify solutions to disputed issues presented in the AW rate-review process. Similarly, his experience provides him the capacity to exercise sound judgment in assisting Mr. Herrera in presenting his recommendations to City Council. Lastly, Mr. Foley has prepared countless pleadings, briefs, and reports which provide him the experience to communicate effectively orally and in writing.

C. Mariann Wood and Leslie Lindsey

Ms. Wood has over 17 years of experience in participating in proceedings – contested cases and rule-making proceedings – before the PUCT and the Railroad Commission. Ms. Wood holds an Associate of Applied Science in Paralegal Studies from Kaplan University.

Ms. Lindsey has over 6 years of experience in participating in proceedings – contested cases and rule-making proceedings – before the PUCT and the Railroad Commission. Ms. Lindsey holds a Paralegal Studies Certificate from Professional Development Center in Continuing Education, The University of Texas at Austin.

Ms. Wood and Ms. Lindsey each possesses invaluable experience in preparing lengthy briefs, motions, and other pleadings, which experience will serve well in assisting Mr. Herrera in preparing the proposal for decision ("PFD") to be presented to the City Council, and to assist in the prosecution of the review process from the pre-hearing stage (Phase I) to the hearing on the merits (Phase II), and finally, to the post-hearing stage (preparation of the PFD).

Most recently, Ms. Wood and Ms. Lindsey assisted Mr. Herrera in his role as the Impartial Hearing Examiner in the City of Austin's rate-review process of Austin Energy. Ms. Wood and Ms. Lindsey were responsible for preparing the final documents delivered to the City and to participants in the rate-review process.

Relative to the total hours Mr. Herrera estimates to be devoted to this project, Ms. Wood and Ms. Lindsey's combined, will perform about 11% of those hours at $145 per hour.

D. Law Clerk

As do most law firms, Herrera & Boyle employs the services of law clerks largely to assist with such matters as undertaking legal research and analysis, preparing preliminary drafting of routine documents, preparing documents for hearings, and otherwise supporting the attorneys in preparation for hearings and/or oral arguments. Because of the temporary nature of these positions, Herrera & Boyle is not identifying any particular law clerk at this point, but notes that it would be using the services of a law clerk for this RFP. Herrera & Boyle notes, however, that the law clerks it employs will have some degree of exposure to the utility arena, and in particular, to the regulatory arena.

Relative to the total hours Mr. Herrera estimates to be devoted to this project, a Law Clerk will perform about 17% of those hours at $100 per hour.

E. Ethical Standards

Herrera & Boyle and its personnel operate under the strictest ethical standards, are members in good standing with the State Bar, have had no complaints lodged against them with the State Bar and each have sound reputations in the legal community in Texas.

VI. Work Plan and Approach

Mr. Herrera envisions the role of the Independent Hearings Examiner ("IHE") to be one in which the IHE provides the City Council a summary of the evidence and testimony submitted during the review process of AW's Rates. The summary of case the IHE presents would be referred to as a "proposal for decision" ("PFD") and would set out each party's arguments – legal and evidentiary – and the IHE's proposed solution to each disputed issue.

The IHE's PFD would be based on directives from the City Council with regard to its policies, and on the City Charter, the City Code, and Ordinances and Resolutions not yet "codified" in the City Code related to the operations of AW.

The ultimate decision at the city level with regard to AW's Rates would be the City Council's to make, but the IHE's PFD would provide the Council a "roadmap" by which to reach its ultimate decision. In reaching its ultimate decision on AW's Rates, it is highly likely the City Council would make a number of decisions in support of its ultimate decision.

Crucially important to the process is to balance the need for a structured process with the need to facilitate non-attorney participation in the review process.

A. Preparation for Rate Review Process and Review Process

To fulfill the role of the IHE, Mr. Herrera will undertake the following tasks:

- **Review Applicable Law** – Become more familiar with the City's Code, ordinances, resolutions, and policy directives regarding AW
- **Review Precedent Regarding MOUs** – Review prior PUCT decisions regarding municipally owned utilities ("MOUs")
- **Review Court Precedent Regarding MOUs** – Review Public Utility Regulatory Act ("PURA"), the Texas Water Code, and court decisions regarding regulation of municipally owned utilities
- **Review PUCT Precedent Regarding Cost Allocation and Rate Design** – Review PUCT's decisions regarding a water utility's cost of service
- **City's Procedural Rules** – Participate in the City's development of its procedural rules applicable to the review process of AW's Rates
- **Pre-Hearing Events** – Hold "pre-hearing" conferences with affected parties to address the following areas of the review process:

    - **Service of Documents**: Establish a mechanism by which participants in the review process will exchange documents submitted to and among the parties during the review process

    - **Scope of Hearing**:

        - Solicit input from affected parties on scope of issues to be addressed in review process

- Present recommendations to Austin Water and Wastewater Commission ("AWWC") and City Council regarding scope of issues

- **Procedural Schedule**: Establish a procedural schedule that meets the deadlines and milestones noted in the RFP to address, e.g.:

  - Public participation in the review process
  - Hearing dates in the review process
  - Timeline for submittal of requests for information ("RFIs")
  - Deadline for submittal of direct and rebuttal testimony, or other presentations to be made during the review process
  - Deadline for evidentiary objections to testimonies
  - Deadline for preparation and presentation of the IHE's final PFD to the City Council and other City commissions/bodies as directed by the City Council

- **Discovery Process**: Establish a schedule for the discovery process, which will allow affected parties to submit RFIs to AW and to other parties participating in the review process, including deadlines for submitting RFIs and providing responses to RFIs

- **Dispute Resolution Related to Discovery Process**: Establish procedures for resolving disputes that will arise in the Discovery Process, including holding interim hearings or "pre-hearing" conferences, to address disputed issues that arise prior to the hearing on the merits

- **Confidentiality Agreement**: With input from the parties, develop a Confidentiality Agreement to allow for review of AW's confidential data as necessary

- **As-Needed Meetings with City Council and/or City Manager**: Attend City Council meetings and/or meetings with City Manager as directed by Project Manager

- **Austin Water Wastewater Commission** – Make presentation to AWWC to, for example:

  - Provide a "primer" on ratemaking
  - Outline the distinct roles the stakeholders in the case, including the IHE and the City Council, serve
  - Identify the major milestones of the review process
  - Explain avenues available to the public at large to participate in the review process
  - Seek guidance on whether the proceedings on the merits (Phase II) should be transcribed by a court reporter

- **Hearings on the Merits –** Convene hearings on the merits to address the parties' proposed recommendations:

    - Based on direction from City Council regarding scope of hearings, hold hearings to take parties' arguments and evidence addressing issues within scope of hearings
    - Based on the procedural schedule adopted for the review process, convene and preside over hearings to take evidence from the parties addressing AW's Rates
    - Establish time limits for parties' presentation of their respective recommendations
    - Establish a sequence for presentation of each party's recommendations
    - Rule on evidentiary objections made during the hearings
    - Establish deadlines for submittal of "closing" briefs by the parties

- **Post Hearing Events** – Prepare reports and recommendations based on evidence testimony adduced at hearings

    - Review and analyze evidence and testimony presented by parties
    - Prepare final report or "proposal for decision" ("PFD") for City Council's consideration
    - Review parties' "exceptions" to PFD
    - Present final PFD to City Council and other City bodies as directed by City Council
    - Be available for follow-up activity, if any, needed regarding PFD

- Throughout the process Mr. Herrera anticipates providing progress reports to the Project Manager as may be required by the RFP, or as otherwise directed.

B. Presentations to City Bodies

As directed by the City, Mr. Herrera anticipates making presentations to the Austin Water and Wastewater Commission and to the City Council regarding the rate-review process as well as presentations of the final recommendations in the case.

VII. Cost Proposal

See attached Sheet 0600A and Herrera & Boyle's more detailed cost proposal showing the details of Mr. Herrera’s estimate for the time and fees related to this project.

ATTACHMENT A:

Herrera & Boyle, PLLC
Recent Rate Proceedings

Herrera and Boyle, PLLC
Recent Rate Proceedings

Railroad Commission of Texas Gas Utility Dockets

Docket No.	Date	Style
9630		Petition Filed by CenterPoint Energy Entex for Review of the City of Center, et al.'s Municipal Rate Decision and Request for Declaratory Order
9641		Petition Filed by CenterPoint Energy Entex for Review of the City of Longview's Municipal Rate Decision and Request for Declaratory Order
9791	3/6/2008	Statement of Intent of Centerpoint Energy Resources Corp. d/b/a Centerpoint Energy Entex and CenterPoint Energy Texas to Increase Rates in the Unicorporated Areas of Centerpoint's Texas Coast Division
9910	10/13/2009	Appeal of CenterPoint Energy Resources Corp. d/b/a CenterPoint Energy Texas Gas from the Actions of the Cities of Baytown, Clute, Shoreacres, Wharton and Angleton
10000	9/17/2010	Statement of Intent to Chagne the Rate CGS and Rate PT Rates of Atmos Pipeline - Texas
10007	8/11/2010	Appeal of CenterPoint Energy Resources Corp., d/b/a CenterPOint Energy Entex and CenterPoint Energy Texas Gas from the Actions of the TCUC Cities (COSA-3)
10038	12/3/2010	Statement of Intent Filed by CenterPOint Energy Resources Crop., d/b/a CenterPoint Entex and CenterPoint Energy Texas Gas ("CenterPoint") to Increase the Rates on a Division Wide Basis in the South Texas Division
10041	12/17/2010	Statement of Intent Filed by Atmos Energy Corp., West Texas Division to Increase Gas Utility Rates within the Unincorporated areas of the Amarillo Rate Division
10097	4/29/2011	Appeal of Centerpoint Energy Resources Corp., d/b/a Centerpoint Energy Entex and Centerpoint Energy Texas Gas from the Actions of the Cities if Angleton, Baytown, Freeport, L:eague City, Pearland, Shoreacres, West Colombia and Wharton, Texas (COSA-3)
10170	1/31/2012	Statement of Intent Filed by Atmos Energy Corporation to Increase Gas Utility Rates Within the Unincorporated Areas Served by Atmos Energy Corporation - Mid Tex Division (2012)
10174	2/7/2012	Statement of Intent Filed by Atmos Energy Corporation to Increase Gas Utility Rates Within the Unincorporated Areas Served by Atmos Energy Corporation - West Texas Division (2012)
10182	7/2/2012	Statement of Intent of CenterPoint Energy Resources Corp., D/B/A CenterPoint Energy Entex and CenterPoint Energy Texas Gas to Increase Rates on Division-Wide Basis in the Beaumont/East Texas Division (2012)

10235	1/22/2013	Statement of Intent of West Texas Gas, Inc. to Increase Rates in the Unincorporated Areas of Texas and Consolidated Dockets (2013)
10567	11/16/2016	Statement of Intent of CenterPoint Energy Resources Corp., D/B/A CenterPoint Energy Entex and CenterPoint Energy Texas Gas to Increase Rates in the Texas Gulf Division
10580	1/6/2017	Statement of Intent to Change the Rates of City Gate Services (CGS) and Rate Pipeline Transportation (PT) Rates of Atmos Pipeline - Texas (APT)

Public Utility Commision Dockets

Docket No.	Date	Style
32093	12/1/2005	Petition by Commission Staff for a Review of the Rates of CenterPoint Energy Houston Electric, LLC Pursuant to PURA 36.151
32685	5/5/2006	Application of Southwestern Public Service Company for Authority to Surcharge Its Fuel Under-Recoveries
32766	5/31/2006	Application of Southwestern Public Service Company for (1) Authority to Change Rates; (2) Reconciliation of Its Fuel Costs for 2004 and 2005; (3) Authority to Revise the Semi-Annual Formulae Originally Approved in Docket No. 27751 Used to Adjust Its Fuel Facotrs; and (4) Related Relief
32898	6/30/2006	Applcation of Soutwestern Electric Power Company for Authority to Reconcile Fuel Costs
33309	10/4/2006	AEP Texas Cetnral Company Request of a Docket Number for: Application of AEP Texas Central Company For Authority to Change Rates
33310	10/4/2006	AEP Texas Cetnral Company Request of a Docket Number for: Application of AEP Texas North Company For Authority to Change Rates
34470	6/29/2007	Application of Southwestern Public Service Company for: (1) Approval of Line Loss Factors; and (2) Authority to Implement Revised Fuel Factors
35620	5/1/2008	Application of CenterPoint Energy Houston Electric, LLC for Appoval to implement Advanced Meter Information Network Pursuant to PURA 39.107(i)
35639	5/5/2008	Application of CenterPoint Energy Houston Electric, LLC for Approval of Deployment Plan and Request for Surcharge for an Advanced Metering System
35668	5/13/2008	Application of Southwestern Public Service Company for Authority to (1) Revise Its Interruptible Credit Option Tariff; (2) Implement a New Saver's Switch Tariff; and Related Relief

Herrera and Boyle, PLLC
Recent Rate Proceedings

35717	6/27/2008	Application of Oncor Electric Delivery Company LLC for Authority to Change Rates
35763	6/12/2008	Application of Southwestern Public Service Company Authority to Change Rates, to Reconcile Fuel and Purchased Powr Costs for 2006 and 2007 and to Provide a Credit for Fuel Cost Savings
36025	8/18/2008	Application of Texas-New Mexico Power Company for Authority to Change Rates
36025	8/18/2008	Application of Texas-New Mexico Power Company for Authority to Change Rates
36712	2/18/2009	Application of Southwestern Public Service Company for: Authority to Implement Interim Fuel Factors; Revise Its Fuel Factor Formulas; Change Its Fuel Factors; and for Related Relief
36918	4/17/2009	Application of Centerpoint Energy Houston Electric, LLC for Determination of Hurican Restoration Costs
37060	5/29/2009	Application of Southwestern Public Service Company for Approval to Modify It's Fuel Cost Allocation Methodology
37135	6/22/2009	Application of Southwestern Public Service Company for Approval of a Transmission Cost Recovery Factor
37162	6/30/2009	Application of Southwestern Electric Power Company for Authority to Reconcile Fuel Costs
37173	7/1/2009	Petition for Declaratory Order of Southwestern Public Service Company Order Regarding the Generation Demand Charge as a Cap on Compensation for Interruptible Resources
37364	8/17/2009	Application of Southwestern Electric Power Company for Authority to Change Rates
37565	10/13/2009	Application of Southwestern Electric Power Company for Declaratory Ruling Approving a Limited Issue Rate Proceeding
38147	4/12/2010	Application of Southwestern Public Service Company for Authority to Change Rates and to Reconcile Fuel and Purchased Power Costs for 2008 and 2009
38339	6/9/2010	Application of CenterPoint Energy Houston Electric, LLC for Authority to Change Rates
38480	7/22/2010	Application of Texas-New Mexico Power Company for Authority to Change Rates
38929	11/30/2010	Application of Oncor Electric Delivery Company LLC for Authority to Change Rates
39411	5/17/2011	Appplication of Southwestern Public Service Company for Approval to Renew Interruptible Credit Option and Saver's Switch Tariffs

Herrera and Boyle, PLLC
Recent Rate Proceedings

39708	8/29/2011	Application of Southwestern Electric Power Company for Approval of Turk Rate Plan, Associated Rate Increase, and Deferred Accounting Order
40443	5/30/2012	Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs
40627	8/2/2012	Petition by Homeowners United for Rate Fairness to Review Austin Rate Ordinance No. 20120607-055
40824	10/8/2012	Application of Southwestern Public Service Company for Authority to Change Rates and to Reconcile Fuel and Purchased Power Costs for the Period January 1, 2010 through June 30, 2012
42004	11/8/2013	Application of Southwestern Public Service Company for Authority to Change Rates and to Reconcile Fuel and Purchased Power Costs for the Period July 1, 2012 Through June 30, 2013
43695	11/3/2014	Application of Southwestern Public Service Company for Authority to Change Rates
44941	8/10/2015	Application of El Paso Electric Company to Change Rates
45280	10/23/2015	Complaint of ExteNet Network Systems, Inc. Against the City of Houston for Imposition of Fees for Use of Public Right-of-Way
45470	12/23/2017	Complaint Crown Castle NG Central LLC Against the City of Dallas
45524	2/16/2016	Application of Southwestern Public Service Company for Authority to Change Rates
46449	12/16/2016	Application of Southwestern Electric Company for Authority to Change Rates
46662	12/14/2016	Petition of the Cities of Garland, Mesquite, Plano and Richardson Appealing the Decision by North Texas Water District Affecting Wholesale Water Rates
46831	2/3/2017	Application of El Paso Electric Company to Change Rates
46957	3/17/2017	Application of Oncor Electric Delivery Company LLC for Authority to Change Rates
47045	4/7/2017	Complaint of Crown Castle NG Central LLC Against the City of Austin for Imposition of a License Agreement and Fees for Use of Public Right of Way

ATTACHMENT B:

Sample of:
Herrera & Boyle, PLLC Briefs

SOAH DOCKET NO. 473-12-7519
PUC DOCKET NO. 40443

APPLICATION OF SOUTWESTERN ELECTRIC POWER COMPANY FOR AUTHORITY TO CHANGE RATES AND RECONCILE FUEL COSTS	**§ § § §**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

CITIES ADVOCATING REASONABLE DEREGULATION'S

REDACTED

INITIAL BRIEF

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Jason Wakefield
Herrera & Boyle, PLLC
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Austin, Texas 78701

March 6, 2013

SOAH DOCKET NO. 473-12-7519
PUC DOCKET NO. 40443

APPLICATION OF SOUTWESTERN ELECTRIC POWER COMPANY FOR AUTHORITY TO CHANGE RATES AND RECONCILE FUEL COSTS	**§ § § §**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

REDACTED

CITIES ADVOCATING REASONABLE DEREGULATION'S INITIAL BRIEF

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SOAH DOCKET NO. 473-12-7519
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APPLICATION OF SOUTWESTERN ELECTRIC POWER COMPANY FOR AUTHORITY TO CHANGE RATES AND RECONCILE FUEL COSTS	**§ § § §**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

REDACTED

CITIES ADVOCATING REASONABLE DEREGULATION'S

INITIAL BRIEF

I. INTRODUCTION/SUMMARY [PRELIMINARY ORDER (PO) ISSUES 1, 2]

This rate case could be called the "Turk case." About $71 million of SWEPCO's requested $85 million rate increase is due to the Turk plant. Unfortunately for all involved, SWEPCO did not prudently manage certain factors related to the completion of Turk. SWEPCO exceeded the Commission's cost cap by several hundreds of millions of dollars. SWEPCO failed to comply with Arkansas' filing requirements for a certificate of environmental compatibility and public need ("CECPN"), resulting in a denial of its CEPCN by the Arkansas Supreme Court. SWEPCO decided it would build the plant anyway, but chose to no longer serve Arkansas ratepayers even though the plant was built in Arkansas. Furthermore, SWEPCO's decision to build Turk in Arkansas triggered multiple environmental lawsuits. To settle those lawsuits, SWEPCO agreed to close the perfectly functional Welsh 2 plant, resulting in a net *loss* of 88 megawatts ("MW") of capacity. Now, in this case, SWEPCO is asking the ratepayers to pay for all of SWEPCO's expenditures on Turk.

But SWEPCO's rate case is not just about Turk. SWEPCO is taking unsupportable positions on other issues in order to try to remedy the impact of adding Turk to its rate base.

Finally, CARD notes that during this case it coordinated with other intervenors, including the Cities Served by SWEPCO, to avoid duplication of effort.[1] CARD took the same approach with this initial brief. CARD is only briefing the issues that it addressed in testimony or in its statement of position. However, silence by CARD on an issue does not mean CARD supports SWEPCO's position. SWEPCO must meet its burden of proof on all issues, including those issues raised by other intervenors.

II. RATE BASE [PO ISSUES 6, 8, 9]

A. Turk Plant [PO Issue 6]

1. Conditions of CCN [PO Issue 17]

2. Turk Decisional Prudence [PO Issue 9]

3. Turk Litigation and Settlement Costs [PO Issue 9]

However, SWEPCO also proposed post test-year additions for costs and estimated costs of transmission projects associated with the Turk generation plant.[16] In particular, SWEPCO has included a $48,253,216 post test-year adjustment for Turk-related transmission CWIP and an additional $24,253,216 for Estimated Remaining Transmission Costs for the Turk Project.[17] Unlike the post test-year adjustment for Turk Plant CWIP, the Company's proposal to include Turk-related transmission assets and estimated transmission costs fails to comply with Commission rules.[18]

In particular, Commission rules require **each** post test-year adjustment for a rate base addition to **comprise 10%** of the utility's rate base before the adjustment. P.U.C. SUBST. R. § 25.231(c)(2)(F)(II) addresses the requirements for post year adjustments:[19]

> (F) Requirements for post test year adjustments.
> (i) **Post test year adjustments for known and measurable rate base additions** (increases) to historical test year data will be considered only as set out in subclauses (I)-(IV) of this clause.
> (I) Where the addition represents plant which would appropriately be recorded:
>
> (-a-) for investor-owned electric utilities in FERC account 101 or 102;
>
> (-b-) for electric cooperatives, the equivalent of FERC accounts 101 or 102.
>
> (II) **Where each addition comprises at least 10% of the electric utility's requested rate base, exclusive of post test year adjustments and CWIP.**
> (III) Where the plant addition is deemed by this commission to be in-service before the rate year begins.
> (IV) Where attendant impacts on all aspects of a utility's operations (including but not limited to, revenue, expenses and invested capital) can with reasonable certainty be identified, quantified and matched. Attendant impacts are those that reasonably follow as a consequence of the post test year adjustment being proposed.

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16 Direct Testimony of Mark Garrett, CARD Ex. 5 at 4.

17 Direct Testimony of Mark Garrett, CARD Ex. 5 at 4.

18 *See* P.U.C. SUBST. R. § 25.231(c)(2)(F)(II).

19 Emphasis added.

SWEPCO agrees[20] that P.U.C. SUBST. R. § 25.231(c)(2)(F)(II) requires post test-year adjustments to comply with all four requirements; each adjustment must: (1) be recorded in the plant accounts; (2) comprise 10% of rate base; (3) be in service before the rate-effective period; and (4) have all attendant impacts quantified and matched.[21] Neither SWEPCO's proposed transmission additions nor its estimated remaining transmission costs meet the four requirements because neither of them comprised 10% of SWEPCO's rate base before the Turk plant additions.[22]

Despite the rules establishing four requirements for post test-year adjustments, SWEPCO claims the transmission assets and estimated transmission costs are still eligible for a post test-year adjustment. SWEPCO attempts to circumvent the four requirements by characterizing the transmission additions as attendant impacts to the Turk Plant addition.[23] However, contrary to SWEPCO's understanding of attendant impacts, the Commission's rules require that post test-year plant additions include changes in the revenues, expenses, and capital investments of the utility that reasonably follow as a consequence of that plant addition. An example of an attendant impact of a new plant addition might include changes in revenue because of load growth.[24] Changes in expense accounts might include depreciation expense, ad valorem tax expense, and O&M expense directly related to the new plant addition. Finally, changes in capital

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20 Transcript at 2176-2177 (Thur., Feb. 14, 2013).

21 Direct Testimony of Mark Garrett, CARD Ex. 5 at 5.

22 Direct Testimony of Mark Garrett, CARD Ex. 5 at 6. The total post test-year transmission additions including both the transmission CWIP additions and the estimated transmission additions only comprise 3.4% of SWEPCO's rate base before the Turk plant addition. Total transmission addition is $72, total rate base is $3,488 million, and the Turk plant addition is $1,372. [72 / (3,488 – 1,372) = 3.4%].

23 P.U.C. SUBST. R 25.231(c)(2)(F)(i)(IV). Where the attendant impacts on all aspects of a utility's operations (including but not limited to, revenue, expenses and invested capital) can with reasonable certainty be identified, quantified and matched. Attendant impacts are those that reasonably follow as a consequence of the post test-year adjustment being proposed.

24 *Central Power and Light Company/Cities of Alice, et al. v. Pub. Util. Comm'n of Tex.*, 36 S.W.3d 547, 563 (Tex.App.-Austin 2000).

investment accounts could include changes in accumulated depreciation (accrued after the in-service date and before the rate effective period) and changes in accumulated deferred federal income tax associated with the new plant.[25]

SWEPCO's argument focuses on the capital investment portion of the rule. However, SWEPCO's vision of capital investment attendant impacts is too broad. Under SWEPCO's chain-reaction theory it could utilize a post test year adjustment to recover not only transmission line expenses and *estimated* transmission line expenses, but expenses for a vehicle necessary to inspect the line, equipment needed to maintain the line, or employees assigned to service the line. SWEPCO's vision of the rule cannot be correct.

Unlike the above examples, SWEPCO's transmission additions to the Turk Plant are separate asset additions, not attendant impacts. The rules require attendant impacts to follow as a consequence of the adjustment.[26] Simply put, the impacts would not occur ***but for*** the post test-year adjustment of adding the Turk plant. In particular "[w]ithout the adjustment to include the Turk plant in rate base there could be no adjustment for Turk plant depreciation expense, no adjustment for Turk plant ADFIT, and no adjustment for Turk plant O&M expense." However, an adjustment could be made for transmission costs if they meet all four requirements of P.U.C. SUBST. R. § 25.231(c)(2)(F).

SWEPCO's legal interpretation of subparagraph (F)(i) is erroneous because the four requirements for post-test year adjustments that would increase rate base are clearly conjunctive requirements, meaning that each proposed post test year adjustment to increase rate base would have to meet all four requirements. None of SWEPCO's transmission adjustment meets the 10% test, one of the four requirements.

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25 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 6.

26 P.U.C. SUBST. R 25.231(c)(2)(F)(i)(IV).

SWEPCO's interpretation of the rule would be correct if the four requirements were disjunctive requirements.[27] Then, a post test year attendant increase to rate base could stand on its own and not have to meet the other three requirements. However, the authors of the rule clearly knew the difference between conjunctive and disjunctive requirement, because the four requirements for rate base decreases are disjunctive requirements, by contrast to the conjunctive requirements for rate base increases. In subparagraph (F)(iii), which outlines the requirements for rate base decreases, the word "or" appears before the fourth requirement, which again is the attendant impact requirement. This means that for rate base decreases, an attendant impact decrease to rate base would be allowed even if the decrease did not satisfy the other requirements. In order for SWEPCO's interpretation of subparagraph (F)(i) to stand, the subparagraph would have to have been written in the same disjunctive manner in which subparagraph (F)(iii) was written, i.e. it would need to say "or" instead of "and," but it does not.

CARD proposes to remove SWEPCO's requested post test-year increase in rate base for Turk-related Transmission CWIP, which also reverses the Company's proposed attendant impacts associated with the Transmission CWIP additions. This adjustment also includes transmission ADFIT and transmission depreciation expense that Mr. Garrett has quantified in his testimony.[28]

SWEPCO has also included estimated transmission costs of $24,407,697 that were not in CWIP at test-year end. This post test-year adjustment does not comply with the requirements under P.U.C. SUBST. R. 25.231(c)(2)(F) because each post test-year adjustment must comprise 10% of the utility's rate case before the adjustment, and only the amount in CWIP at the end of the year can be included. SWEPCO's estimated transmission costs do not meet either of these

[27] *See* Transcript at 2175-2179 (Thurs., Feb. 14, 2013).

[28] *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 7 and Exhibit MG 3.1.

Sierra Club and Audubon Society.[38] While the evidence clearly shows that SWEPCO was imprudent in retiring a low cost plant in order to complete a smaller, higher-cost plant, the extent of that imprudence will not be known until SWEPCO actually retires Welsh 2.[39] Consequently, CARD recommends deferring any prudence findings on any agreements that SWEPCO made to reduce emissions for the Welsh 2 plant until and unless Welsh 2 is actually retired.[40]

i. SWEPCO's Imprudence

Put simply, it is unreasonable for SWEPCO to retire Welsh 2. Welsh 2 produces cheap and plentiful power. Welsh 2 is one of the SWEPCO's lowest cost plants[41] and produces 528 MW of power, 88 MW more than Turk.[42] Welsh 2 is only 34 years old and, by SWEPCO's own projections, has at least 26 years of remaining useful life.[43] Welsh 2 also provides much needed fuel diversity. As the Commission noted when it approved the CCN for Turk: "the Turk Plant will help SWEPCO to maintain its diversified fuel portfolio for its generation fleet."[44] Retiring Welsh 2 runs directly counter to the Commission's finding – indeed, the net result is 88 MW *less* fuel diversity.[45] SWEPCO therefore acted imprudently when it unilaterally agreed to retire Welsh 2 prior to the end of its useful life.

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38 *Id*.

39 SWEPCO's decision also inappropriately circumvents the Commission's $1.522 billion cost cap from Docket No. 33891. *See* discussion *infra* at Section II.A.8.ii.

40 Direct Testimony of Scott Norwood, CARD Ex. 4 at 14.

41 *Id*. at 13. Even if environmental retrofitting costs are taken into consideration, the costs of the retrofits are approximately half of the $1.522+ billion cost to Texas ratepayers of building Turk. *Id*. In other words, Welsh 2 would still be a tremendous bargain even after the retrofits.

42 *Id*. at 12-14.

43 *Id*. at 13.

44 Docket 33891 Order at 5.

45 The net result of building Turk and retiring Welsh 2 is 88 MW less coal generation than before the Commission approved the Turk plant. *See* Direct Testimony of Scott Norwood, CARD Ex. 4 at 14. This is undoubtedly *not* what the Commission intended.

ii. The Incremental Retirement Costs will be Contrary to Docket No. 33891's Cost Cap

As discussed earlier, the Commission set a $1.522 billion cap on Texas jurisdictional capital costs for Turk[46] and SWEPCO has already exceeded the cap[47]. The costs that SWEPCO will incur to retire Welsh 2 are inextricably linked to the completion of Turk and are thus subject to the cap. As SWEPCO stated to the Southwest Power Pool ("SPP"):

> Southwestern Electric Power Company (SWEPCO) wants to confirm to SPP its plans to retire Welsh Unit 2, a 528-MW coal-fired unit located near Pittsburg, Texas. The retirement is required by the terms of a Consent Order issued on December 22, 2011, by the United States District Court for the Western District of Arkansas, which resolved all pending legal challenges to the completion of construction and commencement of commercial operation of SWEPCO's John W. Turk, Jr. Power Plant …[48]

All of the Welsh 2-related retirement costs, therefore, are per se unreasonable because they will exceed Docket No. 33891's $1.522 billion cap.

iii. Need to Wait for Final Quantification

While the evidence clearly shows that SWEPCO was imprudent and unreasonable in agreeing to retire Welsh 2, the extent of the appropriate disallowance will not be known until SWEPCO actually retires the plant. SWEPCO has not yet quantified, for example, the additional transmission and purchased power costs it will incur to make up for the power lost from the retirement of Welsh 2.[49] CARD recommends, accordingly, that the Commission defer any decisions on the Welsh 2-related agreements until SWEPCO actually retires the plant. This approach is consistent with SWEPCO's position in Docket No. 33891, when it stated:

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46 Docket 33891 Order at 7.

47 Direct Testimony of Scott Norwood, CARD Ex. 4 at 7.

48 Direct Testimony of Scott Norwood, CARD Ex. 4 at 12, Exhibit SN-11.

49 *Id.* at 10.

> SWEPCO is not seeking approval or recognition of the Welsh Unit 2 measures in this Turk CCN proceeding. When SWEPCO seeks to recover the costs of those measures at some future date, it will be required to demonstrate the reasonableness of its decision to make the investment at Welsh based on the relevant circumstances.[50]

The same rationale still applies to the Welsh 2-related agreements in this proceeding.

B. Prepaid Pension Asset and ADIT Impacts [PO Issue 6]

CARD recommends that SWEPCO's calculated prepaid pension asset be excluded from rate base.[51] SWEPCO claims that it has made and recorded as a prepaid pension asset additional pension contributions in excess of pension costs of $113,158,953 in accordance with Financial Accounting Standards ("FAS") 87 and PURA § 36.065. Furthermore, SWEPCO asserts that the prepaid pension asset is supported entirely by actual cash contributions in excess of pension costs. However, SWEPCO's prepaid pension asset is not the type of regulatory asset authorized by PURA § 36.065 and it is not supported exclusively by cash contributions to the pension plan. Finally, and fatal to SWEPCO's request, is that fact that SWEPCO's calculated balance of $113,158,953 is based on the difference between actual cash contributions and FAS 87 pension costs going all of the way back to 1987 when FAS 87 was first promulgated. However, SWEPCO admitted at trial that FAS 87 was not adopted for ratemaking purposes until 2005, which would make 2005 the earliest year the Company could begin tracking the differences between cash contributions and FAS 87 costs.[52]

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50 *Id.*; quoting Application of Southwestern Power Company for a Certificate of Convenience and Necessity Authorization for a Coal Fired Power Plant in Arkansas, Docket No. 33891, Supplemental Rebuttal Testimony on Commissioner's Issues of Venita McCellon-Allen at 14 (May 21, 2008).

51 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 9-14.

52 Before FAS 87 was adopted for ratemaking purposes, rates were set based on the utility's cash contribution levels. This means that before 2005, there were no differences between cash contributions and pension costs for ratemaking purposes. *See* Transcript at 409 (Feb. 5, 2013).

PURA § 36.065 describes a regulatory asset as the difference between the level of pension expense included in rates and the level of pension expense actually experienced in the years after the rates are set. A regulatory asset serves as a pension expense tracker mechanism and is different from the prepaid pension asset that SWEPCO included in rate base. PURA allows SWEPCO to track and recover under-recovered pension expenses, but does not provide for including in rate base pension fund contributions in excess of pension expense as SWEPCO has requested.

Furthermore, SWEPCO's prepaid pension asset is not supported entirely by cash contributions to the pension fund. It was partially the result of negative pension expense.[53] A negative pension expense balance is the result of underestimated pension fund earnings that, relative to their estimates, resulted in higher pension expense and higher contribution requirements. Prior to the adoption of FAS 87 accounting for rate-making purposes in Texas, the pension expense that was included in rates was based on pension fund contributions funded by ratepayers. SWEPCO confirmed that ratemaking treatment for pension did not change until 2005.[54] As SWEPCO stated, "[p]rior to that cash amounts were used for ratemaking purposes,"[55] however SWEPCO did not file a rate case from 1984 until 2009. There was simply no opportunity to change SWEPCO's pension amounts for ratemaking purposes during that entire period because rates were not changed. Therefore, unless clearly demonstrated otherwise, the Commission should assume that the negative pension expense was the result of past over-recoveries of pension cost from ratepayers, and not necessarily the result of post-FAS 87 pension fund contributions by the Company. SWEPCO confirmed this at hearing:

53 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 11 and MG-4.

54 Transcript at 409 (Tues., Feb. 5, 2013).

55 Transcript at 409 (Tues., Feb. 5, 2013).

> We had a period the late 1990s where we had extraordinary good investment market returns and had quite a few years that we didn't have to make any contributions, even had situations where pension costs went negative as a results of those really good revenues.[56]

It is also improper to include SWEPCO's prepaid pension asset in rate base because it conflicts with ratemaking principles. In situations where there is a debit balance in the account, as is the case here, it indicates that the utility has been contributing more to the fund than its SFAS 87 calculated cost levels. If a utility's rates are actually based each year on the FAS 87 calculated cost level, a utility may plausibly assert that it has been contributing more to the pension fund than it has been collecting in rates, and thus should be allowed to earn a return on these "excess" contributions. There are several problems, however, with SWEPCO making such an assertion in this case. First, there is the general problem that SFAS 87 pension expense levels change each year while the amount included in rates changes only when there is a rate case, so the SFAS 87 expense levels each year do not necessarily indicate the amounts that ratepayers have actually paid in rates. When pension expense levels are declining, ratepayers would contribute much more than the SFAS 87 level unless the declining costs are captured each year with a rate case. The opposite situation could also be true during a period of escalating pension costs.

Going forward, if the Company wants to include a pension asset in rate base, the Company should establish a pension tracker at the conclusion of this case so that the FAS 87 levels each year going forward would actually represent the amounts included in rates. Then, in SWEPCO's next rate case, it could submit the difference between actual cash contributions and FAS 87 costs as a pension asset for ratemaking consideration.

However, the larger, more specific problem for SWEPCO is that the Company's prepaid

[56] Transcript at 422 (Tues., Feb. 5, 2013).

pension calculated balance of $113,158,953 is based on the difference between actual cash contributions and FAS 87 pension costs going all the way back to 1987, when FAS 87 was first promulgated for financial reporting purposes. The problem with this calculation is the fact that FAS 87 was not used for ratemaking purposes in Texas until 2005. This means the earliest year SWEPCO could start calculating the differences between cash contributions and FAS 87 pension cost levels would be 2005. The very basis for a pension asset request is an assertion that the utility has contributed more to the fund than it has collected through rates – asserting, in effect, that investors have supplied the excess contributions. SWEPCO, however, cannot assert that the amount collected through rates is the FAS 87 cost level going all the way back to 1987, since FAS 87 was not used to set rates before 2005.[57] At best, SWEPCO's claim would be limited to the accumulated difference between cash contributions and FAS 87 cost levels from 2005 forward.

The maximum amount SWEPCO could claim as investor supplied capital for excess pension contributions – in effect, contributions in excess of amounts collected through rates – would be $31,907,000, not $113,158,953.[58] This amount would then be reduced by associated ADFIT and CWIP costs to comply with previous Commission treatment.

C. Oxbow Investment [PO Issue 6]

D. Mountaineer Carbon Capture & Storage Project [PO Issue 15]

CARD recommends disallowing the $475,922 per year of amortized costs for the Mountaineer Carbon Capture & Storage Project ("Mountaineer CCS Project"). A utility's

[57] Prior to 2005, the cash contribution level was used to set rates in Texas, so, theoretically, there was no difference between cash contribution levels and the amounts included in rates.

[58] *See* CARD Ex. 106, Hugh McCoy Rebuttal Testimony, Exhibit HEM-1R.

investments must be used and useful.[59] SWEPCO stated in discovery that it has no plans to begin construction of a commercial scale carbon capture and storage facility.[60] Consequently, the Mountaineer CCS Project was not used and useful for Texas ratepayers.[61] The Commission, accordingly, should disallow the Mountaineer CCS Project costs.[62]

E. Capitalized Incentive Compensation

III. RATE OF RETURN [PO ISSUES 4, 5]

A. Return on Equity [PO Issue 5]

CARD recommends a "Return on Equity" ("ROE") of 9.55 percent. The record strongly supports an ROE at or below 9.55 percent, and certainly no higher than the 9.8 percent that the Commission recently set for Entergy in Docket No. 39896. As can be seen below, SWEPCO's proposed ROE is far removed from the Commission's recently awarded ROEs and the positions of other parties in this docket[63]:

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59 PURA Sec. 36.051.

60 Direct Testimony of Scott Norwood, CARD Ex. 4 at 21, Exhibit SN-16.

61 Notably, SWEPCO did not seek approval from the Commission to proceed with the project. *Id*. at 20.

62 Direct Testimony of Scott Norwood, CARD Ex. 4 at 22. The Virginia State Corporation Commission reached the same conclusion, stating: "We find that APCO has not shown that it is reasonable to recover FEED study costs from Virginia ratepayers at this time. For example, (i) APCO has not shown how its ratepayers have or will benefit from this study; (ii) there are no existing laws or regulations requiring CCS at this time; (iii) as stated by Consumer Counsel, APCO has acknowledged that AEP is no longer "moving forward with development of the commercial scale carbon capture project;" and (iv) the outcome of potential future carbon legislation, the success of any commercial scale project at Mountaineer, and the value of collecting and sequestering CO2 are all unknown at the present time." *Id*. at 21; quoting Appalachian Power Company - For a 2011 biennial review of the rates, terms and conditions for the provision of generation, distribution and transmission services pursuant to section 56-585.1 A of the Code of Virginia, Docket No. PUE-2011-00037, Final Order at 31 (Nov. 30, 2011).

63 *See also* CARD Exhibit No. 103.

ROEs:

11.25	SWEPCO (Hevert)
…	
9.8	Walmart (Chriss)
9.8	**Entergy (Docket No. 39896)**
9.6	**Lone Star (Docket No. 40020)**
9.55	CARD (Parcell)
9.5	OPUC (Szerszen)
9.3	TIEC (Gorman)
9.2	Staff (Cutter)
9.0	Cities Served by SWEPCO (Hill)

The numbers tell a convincing story – the appropriate ROE for SWEPCO should be at or below 9.8 percent, with a strong case for an ROE of 9.55 percent.

CARD witness Mr. Parcell describes in his testimony why the current financial markets support an ROE of 9.55 percent. Mr. Parcell uses the Discounted Cash Flow ("DCF"), Capital Asset Pricing Model ("CAPM"), and Comparable Earnings ("CE") model to estimate an ROE range of 9.35 to 9.75 percent.[64] The mid-point of this range is 9.55 percent.[65] Short-term interest rates are at an all-time low and corporate bond yields are at a 35-year low, reflecting low capital costs.[66] Furthermore, the financial upheaval of the past five years has made public utility stocks, with their consistent and rising dividend rates, relatively more attractive to investors.[67] Put simply, an ROE of 9.55 percent fits the current economic conditions.

In recent cases, the Commission set ROEs in the range of 9.6 to 9.8 percent. Earlier this month, the Commission set an ROE of 9.6 percent in Docket No. 40020,[68] three months after setting an ROE of 9.8 percent in Docket No. 39896.[69] The record in the current proceeding

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64 Direct Testimony of David Parcell, CARD Ex. 1 at 3, 15-25.

65 *Id*. at 3.

66 *Id*. at 10.

67 *Id*. at 11.

68 *Application of Lone Star Transmission, LLC, for Establish Interim and Final Rates and Tariffs*, Docket No. 40020, Order on Rehearing at 4 (February 12, 2013).

69 *Application of Entergy Texas, Inc., for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing at 6 (November 2, 2012). While

supports the Commission's range. Indeed, if anything, the overwhelming weight of the evidence shows that the ROE should be slightly lower than the Commission's prior 9.6 to 9.8 percent range. All of the parties that conducted traditional ROE analyses,[70] with the exception of SWEPCO, propose ROEs between 9.0 and 9.55 percent. Moreover, with interest rates and bond yields still at historic lows,[71] most investors would be thrilled in today's market to receive a *before-tax* return of 9 percent per year. The record, therefore, strongly supports an ROE at or below the Commission's recent range of 9.6 to 9.8 percent.

For all of these reasons, CARD recommends an ROE of 9.55 percent, and in no event an ROE above the 9.8 percent that the Commission recently set in Docket No. 39896.

B. Cost of Debt [PO Issue 5]

CARD does not contest SWEPCO's proposed cost of debt of 5.96 percent.[72]

C. Capital Structure / Overall Rate of Return [PO Issue 4]

CARD does not contest SWEPCO's proposed capital structure of 50.9 percent long-term debt and 49.1 percent common equity.[73] When combined with CARD's recommended ROE of 9.55 percent and a cost of debt of 5.96 percent, CARD recommends an overall rate of return of 7.72 percent.[74]

Docket No. 40020 involved Lone Star Transmission, LLC, a transmission utility, Entergy Texas, Inc. ("Entergy") is a vertically integrated utility and is directly comparable to SWEPCO.

70 This includes the Commission's Staff, who recommended an ROE of 9.2. *See* Direct Testimony of Slade Cutter, Staff Ex. 2 at 7.

71 Direct Testimony of David Parcell, CARD Ex. 1 at 10.

72 *Id*. at 14.

73 *Id*.

74 *Id*. at 2.

IV. OPERATING & MAINTENANCE EXPENSES [PO ISSUES 18, 19, 21, 23]

A. Turk O&M

B. Gas Fired Generation

C. Planned Outage Expense

CARD recommends normalizing the non-fuel operations and maintenance ("O&M") costs for the Lieberman and Wilkes gas plants to account for the fact that those O&M costs during the test year were much higher than the prior three-year average.[75] The average non-fuel O&M cost for Lieberman from 2008-2010 was $3,834,341, while the corresponding cost for Wilkes was $6,069,761.[76] However, during the test year the cost was $8,394,095 for Lieberman and $10,602,127 for Wilkes; an increase of 118.9 and 74.7 percent, respectively, from the prior three years.[77] The apparent reason for this anomaly is that the plants suffered combined outages of 12,200 hours during the test year, compared to an average of 4,500 hours per year during the 2008-2010 time period.[78] SWEPCO manages the two plants, so ratepayers should not be penalized for the abnormally high outage rates resulting from SWEPCO's mismanagement. Therefore, CARD recommends using the four-year average of non-fuel O&M costs for Lieberman and Wilkes, which reduces SWEPCO's revenue requirement by $6.98 million.[79]

D. Welsh Unit Two

CARD discusses the Welsh 2-related issues in Section II.A.8, *supra*.

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75 Direct Testimony of Scott Norwood, CARD Ex. 4 at 19-20.

76 *Id*. at 19.

77 *Id*.

78 *Id*. at 18.

79 *Id*. at 20.

E. 2010 Severance Costs [PO Issue 15]

CARD recommends disallowing SWEPCO's request to amortize $30.6 million of 2010 severance costs over five years. SWEPCO should not be permitted to recover in prospective rates amounts that it has already collected in the interim since its last case. According to SWEPCO's own calculations it saved $14.7 million per year from its 2010 severance program.[80] However, SWEPCO's own calculations show that by July 2012 the savings (from avoided O&M and fringe benefit costs) were $31,787,262, savings in excess of the total amount the Company expended in implementing the severance program. Furthermore, SWEPCO believes the savings will continue into the future even beyond its proposed five-year amortization period.[81]

Based on the Company's calculations, the cumulative benefit for cost savings attributable to the severance program retained by the Company during the interim period between rate cases is $37,900,197 as of December 31, 2012.[82] For every month that the rate-effective period is delayed beyond January 2013, the net benefit to SWEPCO grows by $1,222,587.[83] The Company's financial benefit from these ongoing savings far exceeds the costs incurred to implement the program and therefore it is not appropriate for SWEPCO to recover additional amounts in its prospective rates.[84]

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80 The actual amount of costs avoided (and accrued to the benefit of the company) during the interim period since the last rate case is *greater* than $14.7 million per year. However, for purposes of CARD's analysis it utilized the Company's stated annual cost savings of $14.7 million per year. *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 17.

81 Direct Testimony of Mark Garrett, CARD Ex. 5 at 17.

82 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 17 ("Company's net benefit from the 2010 Severance Program **exceeds** the total cost of the program by more than $7,273,319 (through December 2012), resulting in a 23.75% return on the cost incurred to implement the program.") (Emphasis added).

83 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 18 ("The Company's return on investment grows by another 4% per month.").

84 Direct Testimony of Mark Garrett, CARD Ex. 5 at Exhibit MG 3.2.

SWEPCO's request also violates the Commission's prohibition on retroactive ratemaking.[85] The costs SWEPCO seeks to recover occurred before the test year began. Since these costs are outside the test year, SWEPCO cannot now retroactively seek to recover the costs in future rates. As a general ratemaking rule, it is inappropriate for a utility to seek to recover in future rates perceived deficiencies in prior rates. Pursuant to PURA § 36.051, utilities are only allowed a reasonable opportunity to earn a reasonable return; they are not guaranteed a return and cannot adjust rates to retroactively compensate for unrecovered losses.

Further SWEPCO's witness only offered the decision in the Entergy rate case to justify its request for an *ex post facto* deferral of the 2010 severance costs.[86] However, the Commission ultimately disallowed the requested deferral (even though the expense was incurred from the test year going forward) and stated it could allow the deferral of cost when it is **necessary to carry out a provision of PURA**.[87] SWEPCO did not cite any particular provision of PURA that would not be carried out if the Commission rejected SWEPCO's request to defer the 2010 severance expense.[88] Moreover, SWEPCO experienced no financial harm from its expenses related to the 2010 Severance Program, and instead derived a significant net financial benefit from the program. Accordingly, from either a legal or fairness perspective, the Company should not be permitted to recover these past expenses in the prospective rates that will be set in this case.

85 Public Utility Comm'n of Texas v. GTE-Southwest, Inc., 901 S.W.2d 401 (Tex. 1995).

86 Transcript at 350-357 (Tues., Feb. 5, 2013).

87 Transcript at 350-357 (Tues., Feb. 5, 2013) and *Application of Entergy Texas., Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing (Nov. 2, 2012).

88 Transcript at 356-357 (Tues., Feb. 5, 2013).

F. Vegetation Management

G. Credit Line Fees

H. Obsolete Inventory

I. Depreciation Expense [PO Issue 21]

1. Production Plant

a. Steam Production Life Span

i. Turk

CARD advocates a minimum 55-year life for the Turk Plant,[89] by contrast to the 40-year life proposed by the Company.[90] As Mr. Pous explains in his Direct Testimony, the Company's proposed life for Turk is inconsistent with the lives of the Company's other coal-powered generation assets, such as the Flint Creek and Pirkey plants, each of which currently presume a 60-year life.[91]

SWEPCO assumes a shorter life for the Turk Plant compared to its other coal plants allegedly due to "a lack of a long-term operational history" and "due to the great amount of uncertainty in future years from both an economic and regulatory perspective."[92] However, neither of these issues justifies arbitrarily and significantly truncating the Turk Plant's useful life compared to other coal-powered generation plants.

Mr. Franklin complains that SWEPCO's other coal generation facilities were only recently attributed longer lives, and suggests that "[a]s Turk goes into operation and SWEPCO gains experience, it is possible that the useful life might be extended beyond 40 years."[93]

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89 Direct Testimony of Jacob Pous, CARD Ex. 2 at 12.

90 Direct Testimony of Paul Franklin, SWEPCO Ex. 32 at 18.

91 Direct Testimony of Jacob Pous, CARD Ex. 2 at 10, citing SWEPCO Schedule D-6.

92 Direct Testimony of Paul Franklin, SWEPCO Ex. 32 at 19.

93 Direct Testimony of Paul Franklin, SWEPCO Ex. 32 at 18.

However, SWEPCO's "wait and see" approach ignores what experience has already shown, namely that coal generation plants tend to experience useful lives much longer than 40 years, despite changing regulatory and economic conditions. As Mr. Pous explained, it is improper to artificially shorten a life span and increase it in increments as one gains experience, as this process would only ensure the creation of intergenerational inequity and would fail to comply with the regulatory matching principle.[94] Even if SWEPCO later expanded the Turk Plant's estimated life span, it would not compensate the preceding customer generation that paid for the plant at an accelerated rate due to its initial unreasonably short presumed life.

SWEPCO's concern about the "uncertainty in future years" in terms of economics and regulations is nothing more than non-specific speculation that some economic or regulatory condition in the future would force the Turk Plant to close 20 years sooner than other SWEPCO's other coal plants. SWEPCO has no legitimate ability to predict economic or regulatory conditions as many as forty years in the future, and should not be allowed to use its vague negative premonitions as a basis for receiving more rapid depreciation to enhance its cash flow. Indeed, SWEPCO's actual experience with other generation plants demonstrates that it continuously understates the initial expected life for its new generation. History has consistently proven SWEPCO initially underestimates the useful life of its plants. SWEPCO should not be allowed to again overcharge current customers based on speculative future concerns that are without reliable basis and have consistently proven wrong.

Furthermore, if SWEPCO sincerely anticipates negative economic and regulatory developments that would curtail the Turk Plant's useful life, it should have declined to build the Turk Plant in favor of a less-expensive, more short-term solution such as upgrading Welsh 2, as

[94] Direct Testimony of Jacob Pous, CARD Ex. 2 at 10.

Mr. Pous explained.[95] Despite its claim that anticipated regulatory demands dictate an abbreviated life, SWEPCO also asserts that, "When completed, Turk will be one of the cleanest, most efficient coal-fueled plants in the United States. … The plant will use state-of-the-art emissions control equipment known collectively as the Air-Quality Control System (AQCS) for reliable compliance with stringent emission regulatory requirements."[96] SWEPCO on the one hand wants to laud its decision to build the plant by portraying it as efficient, advanced, and able to comply with stringent emission requirements, but then on the other hand requests accelerated recovery for that investment based on speculative concerns that the plant will become economically inefficient and non-compliant in fewer years than its other coal plants have historically supported due to its inability to comply with undefined emission requirements.

CARD's recommendation is reasonable and conservative. It presumes a minimum useful life of 55 years, which could later be extended if the "advanced" and "efficient" Turk Plant instead lasts the 60-70 years demonstrated by its other steam-fired generation plants.[97] This approach is consistent with SWEPCO's historical experience and reduces the likelihood of intergenerational inequity that would result from adopting SWEPCO's initial life span proposal that is once again materially and artificially short.

The impact of increasing the life span for the Turk plant from 40 years to (at least) 55 years results in a $9.1 million decrease in annual depreciation expense on a total Company basis for plant as of December 31, 2011, and a corresponding $3.0 million decrease in depreciation expense on a Texas jurisdictional basis.[98]

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95 Direct Testimony of Jacob Pous, CARD Ex. 2 at 11.

96 Direct Testimony of Venita McCellon-Allen, SWEPCO Ex. 25A at 16.

97 SWEPCO Schedule D-6, SWEPCO Ex. 2.

98 Direct Testimony of Jacob Pous, CARD Ex. 2 at 13.

ii. Dolet Hills

CARD recommends that the life span for the Dolet Hills plant be maintained at 60 years.[99] SWEPCO, by contrast, proposes a dramatic 20-year reduction to Dolet Hills' useful life.[100]

SWEPCO witness Mr. Franklin attributes SWEPCO's proposed 33% reduction in Dolet Hill's anticipated useful life to an evaluation conducted by the Central Louisiana Electric Cooperative (CLECO), which operates and maintains the plant.[101] The Company did not provide CLECO's life analysis. In response to a discovery request for "all documentation supporting the proposed 40-year life for the Dolet Hills plant," SWEPCO merely references the record for a proceeding before the Louisiana Public Service Commission ("LPSC") without specificity, and attaches the resulting LPSC order that approved a proposed Uncontested Stipulated Settlement.[102] The attached order in part provides "The new reserves acquired through the Oxbow Mine purchase will extend life of the Dolet Hills Lignite Unit from 2016-2019 to at least 2026."[103] The Company does not and cannot make any showing that the settlement's presumption that Dolet Hills' life would extend "at least 2026" indicates that Dolet Hills would have no remaining reserves after 2026, nor does the Company provide any analysis of whether alternative fuel sources are available that could economically supplement those reserves.

Given that SWEPCO has failed to provide clear and compelling evidence that would support a conclusion that the Dolet Hills plant will no longer be able to operate beyond 2026, and

99 Direct Testimony of Jacob Pous, CARD Ex. 2 at 14.
100 Direct Testimony of Paul Franklin, SWEPCO Ex. 32 at 18.
101 Direct Testimony of Paul Franklin, SWEPCO Ex. 32 at 18.
102 SWEPCO's Response to TIEC's RFI 2-7, SWEPCO Ex. 104.
103 SWEPCO's Response to TIEC's RFI 2-7, SWEPCO Ex. 104.

SWEPCO's previous representations that the Dolet Hills Plant had a life of 60 years,[104] the 60-year presumption should be maintained unless and until SWEPCO makes an adequate showing that the lignite reserves will be exhausted in 2016 (rather than the more ambiguous claim they will last "at least until" 2016), and providing compelling research and testimony that supports the conclusion that no economically suitable alternatives are available. SWEPCO's direct testimony does not even acknowledge that the 40-year life is a reduction of 20 years and provides no justification for its newly proposed short life other than deference to another entity, without evidence or testimony from that entity or any independent investigation or analysis.[105]

Continuing to rely on a 60-year life span for the Dolet Hills plant would result in a $3.5 million reduction in depreciation expense on a total Company basis for plant as of December 31, 2011, with a corresponding Texas jurisdictional depreciation expense reduction of $1.1 million.[106]

iii. Stall Plant

CARD advocates a presumed useful life for the new Stall Plant of no less than 40 years,[107] rather than the SWEPCO's initial offering of a 35-year life.[108]

The Company bases its 35-year useful life on the expected repair cycle of the unit's heat recovery steam generator ("HRSG"), which drives the steam turbine.[109] SWEPCO witness Mr. Franklin testifies "[t]he expectation is that the HRSG, which is used to create steam, will require

104 Rebuttal Testimony of Paul Franklin, SWEPCO Ex. 71 at 19.
105 Direct Testimony of Paul Franklin, SWEPCO Ex. 32 at 18.
106 Direct Testimony of Jacob Pous, CARD Ex. 2 at 15.
107 Direct Testimony of Jacob Pous, CARD Ex. 2 at 17.
108 SWEPCO Schedule D-6, SWEPCO Ex. 2.
109 Direct Testimony of Paul Franklin, SWEPCO Ex. 32 at 9, 17.

major work approximately every 18 to 20 years, and that at the second repair cycle it would be more economical to replace the generation rather than to replace the HRSG at the Stall Plant."[110]

However, even if one assumes Mr. Franklin's presumed repair cycle is reliable, the earliest the second repair cycle might occur is at year 36 – a year later than the end of the artificially short useful life offered by SWEPCO. Mr. Franklin's testimony suggests a useful life in the 36-40 year range and does not support a 35-year life, consistent with SWEPCO's continuous practice of offering unreasonably short initial life spans for new generation. As Mr. Pous explained, Stall's efficiency incentivizes SWEPCO to make capital investments that would allow Stall to continue to operate,[111] so there is no reason to presume that it would be economical to retire Stall a year before the low end of the range of years in which a major repair may be required. Mr. Franklin testified that Stall is "the most efficient plant in the SWEPCO gas fleet, meaning that it requires less heat input than any other plant to produce the same electrical output."[112] SWEPCO has provided no reason to believe that this new, highly efficient plant will have a useful life shorter than comparable modern combined-cycle gas plants. For example, SWEPCO affiliate Public Service Company of Oklahoma presumed a 38-year life for its combined-cycle unit at Comanche generating station.[113] Rocky Mountain Power presumes a 40-year life,[114] as does the Michigan Public Service Commission.[115]

Accordingly, CARD's proposed life of no less than 40 years is reasonable, and within the range of the years wherein HRSG's repair cycle would allegedly necessitate an economic

110 Direct Testimony of Paul Franklin, SWEPCO Ex. 32 at 17.

111 Direct Testimony of Jacob Pous, CARD Ex. 2 at 16.

112 Direct Testimony of Paul Franklin, SWEPCO Ex. 32 at 14.

113 Direct Testimony of Jacob Pous, CARD Ex. 2 at 16, citing OCC Cause No. PUD201000050 Exhibit DAD-1 page 29 of 29, provided in the Workpapers of Jacob Pous, CARD Ex. 2A at Bates 46-47.

114 Direct Testimony of Jacob Pous, CARD Ex. 2 at 16.

115 Direct Testimony of Jacob Pous, CARD Ex. 2 at 16.

retirement, and is consistent with the useful life presumed by other utilities for modern combined-cycle units. By contrast, SWEPCO has provided insufficient evidence to support its assertion that a 35-year useful life is reasonable.

Increasing the Stall generating facility's life span from 35 to 40 years would result in a $1.7 million reduction in annual depreciation expense on a total Company basis for plant in service as of December 31, 2011, and a corresponding reduction in Texas retail depreciation expense of $550,000.[116]

iv. Welsh 2

The Welsh 2 facility is addressed by CARD in section II(A)(8), *supra*. Pursuant to CARD's position in that section, CARD recommends that Welsh 2's useful life not be reduced to accommodate the Company's unilateral decision to retire the plant early as part of a settlement agreement, given that the Company acknowledges that Welsh 2 has 26 more years of useful life.[117] Accordingly, CARD advocates that Welsh 2's original useful life of 60 years be maintained, and that the Company not receive any further depreciation for any years subsequent to its early retirement, whenever that occurs, given that SWEPCO's early retirement imprudently and unfairly denies ratepayers the benefit of those subsequent years of operation.

v. Interim Retirements

Interim retirements are retirements of plant components that may occur prior to the end of the anticipated life of the plant itself.[118] Applying interim retirements to the life span method of depreciation analysis artificially reduces the anticipated service life of the overall plant to reflect

116 Direct Testimony of Jacob Pous, CARD Ex. 2 at 17.

117 Direct Testimony of Scott Norwood, CARD Ex. 4 at 13.

118 Direct Testimony of Jacob Pous, CARD Ex. 2 at 39.

the shorter life of certain plant subcomponents.[119] As discussed in the following "Steam Production Net Salvage" section, the Company inappropriately incorporated interim retirements into its depreciation calculation for this case, even though the Commission recently rejected the interim method in favor of the retirement (actuarial) rate method.[120] SWEPCO employed a life span method for production plant (which recognizes interim retirements), rather than the pure actuarial rate method (which is preferred by the Commission and does not recognize interim retirements). As the Commission explained in a prior case, "[t]he rate at which interim retirements will be made is not known and measurable. Incorporation of interim retirements… would best be done when those retirements are actually made."[121] By incorporating interim retirements in its analysis, the Company has inappropriately reduced the anticipated service life of its production plant, thereby inappropriately increasing the depreciation rate and the depreciation expense.

CARD recommends excluding interim retirements for ratemaking purposes in this proceeding and eliminating the impact of interim retirements from the Company's proposed depreciation calculation.[122] Eliminating interim retirements would result in a total Company reduction to depreciation expense of $3.2 million based on plant as of December 31, 2011, and a corresponding $1 million reduction on a Texas retail basis.

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119 Direct Testimony of Jacob Pous, CARD Ex. 2 at 39.

120 Direct Testimony of Jacob Pous, CARD Ex. 2 at 4, citing Docket 39896, *Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Order on Rehearing at Finding of Fact No. 100 at 21 (Nov. 2, 2012). *See also* Direct Testimony of Jacob Pous, CARD Ex. 2 at 36-38.

121 PUC Docket Nos. 8425 and 8431, *Application of Houston Lighting and Power Company for Authority to Change Rates; Application of Houston Lighting and Power Company for a Final Reconciliation of Fuel Costs Through September 30, 1988*, Final Order, Finding of Fact No. 212 (16 Tex. P.U.C. Bull. 2684, 1990 WL 711948 (Tex. P.U.C.)) (Jun. 20, 1990).

122 Direct Testimony of Jacob Pous, CARD Ex. 2 at 40.

b. Steam Production Net Salvage

CARD recommends a negative 1.4% net salvage for production plant[123] versus SWEPCO's proposed negative 3.4%.[124]

CARD recommends this adjustment because SWEPCO failed to meet its burden of proof to justify the related inclusion of an additional annual depreciation expense of $4.9 million on a Company basis for plant as of December 31, 2011 (with a corresponding Texas retail impact of $2.0 million).[125] In response, Mr. Pous has adjusted some of the unsupported assumptions that are unreasonable, and accordingly conservatively recommends reducing the depreciation expense by $3.7 million (with a corresponding Texas retail reduction of approximately $1.2 million).[126]

Alternatively, Mr. Pous recommends a positive net salvage of 15%, as a "first step" in recognizing that SWEPCO is subject to deregulation and once that occurs, the divestiture of its generation facilities would result in substantial positive net gains.[127] Mr. Pous' alternative recommendation would result in a $24.6 million reduction in total Company depreciation expense and a corresponding $8.0 million reduction in expense on a Texas retail basis.[128]

S&L's Demolition Conceptual Cost Estimates

To support its demolition cost estimates, SWEPCO relies upon "conceptual cost estimates"[129] that its witness, Mr. Bertheau, describes as "being in the mid-range between a high level conceptual cost estimate and a more detailed cost estimate based on project specific bids

123 Direct Testimony of Jacob Pous, CARD Ex. 2 at 20.

124 Direct Testimony of David Davis, SWEPCO Ex. 43 at DAD-1, page 17 (Total Production Plant Column (V) divided by Column (111)-1).

125 Direct Testimony of Jacob Pous, CARD Ex. 2 at 18.

126 Direct Testimony of Jacob Pous, CARD Ex. 2 at 4, 39.

127 Direct Testimony of Jacob Pous, CARD Ex. 2 at 20, 38.

128 Direct Testimony of Jacob Pous, CARD Ex. 2 at 39.

129 Direct Testimony of Steven Bertheau, SWEPCO Ex. 44, Exhibit SRB-1, "Conceptual Cost Estimates for Electrical Generating Station Demolition."

from equipment vendors and contractors."[130] CARD's witness, Mr. Pous, concluded that S&L's studies "produce excessively high and unreliable demolition cost estimates," and complained that S&L did not provide much of the requested underlying critical support for its estimates.[131]

Mr. Bertheau attempts to rebut Mr. Pous' criticisms of Sargent & Lundy, LLC's ("S&L's") conceptual demolition estimates, complaining that:

> My initial overall observation, which should be particularly noted, is that Mr. Pous has not prepared any independent studies of what costs would be expected to be incurred to dismantle and remove SWEPCO's generating facilities upon their retirement.

Mr. Bertheau's criticism is misdirection; nothing more. It is not CARD's burden to produce a competing estimate to disprove SWEPCO's assertions. It is SWEPCO's duty to produce sufficient evidence to meet its burden of proof that its requested rate change is just and reasonable.[132] Concerning its conceptual cost estimates for demolition, SWEPCO has failed to meet this burden, and so CARD appropriately reduces a substantial portion of SWEPCO's related requested depreciation expense increase. Mr. Bertheau implies that CARD should estimate the demolition costs for SWEPCO's own facilities – a task that is both practically impossible, given the limited time to conduct discovery, and unreasonable, given the impact such competing studies would have on rate-case expenses. But more importantly, it is not CARD's burden to provide a more accurate study than SWEPCO's. SWEPCO has requested an increase to its depreciation expense, and if the Commission finds that SWEPCO's study and methodology are unreliable or fail to show that the requested increase is just and reasonable, the proposed increase should be denied.

130 Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 6.

131 Direct Testimony of Jacob Pous, CARD Ex. 2 at 20.

132 PURA § 36.006(1).

S&L derives its "conceptual" estimate from general and vague sources that SWEPCO did not disclose, thereby preventing the other parties from confirming that S&L's hard-number estimates were accurately derived from reliable information. For example, CARD asked SWEPCO for the crew mix for each activity in the decommissioning process, along with all support and justification. SWEPCO chose to withhold the requested information, claiming that the crew mixes were "confidential and proprietary."[133] As Mr. Pous explained, "[w]ithout the benefit of knowing the labor crew mix for any activity, one cannot test whether the assumptions reflected in the S&L study rely on a top-heavy loading of crew members (i.e. supervisors rather than common laborers)."[134] Similarly, when CARD requested that the Company specifically provide the source of each presumed productivity factor and an explanation of how it was developed to allow verification of the calculation, the Company chose to reference a data response that set forth the final man hours and quantity removed rather than the requested information.[135] Because S&L and SWEPCO chose to withhold data necessary to show the validity of their "conceptual estimated" labor costs and productivity factors, they failed to meet the burden of proof required to increase their depreciation expense based on those inputs. SWEPCO's decision to knowingly withhold an important component of the underlying basis for its proposal is a simple failure to meet its burden of proof, and any finding to the contrary would require an unreasonable leap of faith in favor of the utility.

While SWEPCO has claimed that its estimates of the quantity of material required for each demolition were obtained from plant-specific drawings and documents,[136] it is important to

133 Direct Testimony of Jacob Pous, CARD Ex. 2 at 21, and see Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 62.

134 Direct Testimony of Jacob Pous, CARD Ex. 2 at 21.

135 Direct Testimony of Jacob Pous, CARD Ex. 2 at 23, and *see* Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 82-101.

136 Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A, Bates 79.

note that they do not commit to exactly which plant's drawings they relied upon. SWEPCO made the same "plant-specific" claim in Docket No. 37364, but also admitted that it relied on information not for SWEPCO units, but rather from "comparisons to previous estimates of similar power plant design configurations performed by Sargent & Lundy in the 1990s. The amount was scaled from the amount contained in a 127-MW unit owned by another utility."[137] In other words, S&L based its conceptual demolition estimate for a SWEPCO generation unit on its conceptual demolition estimate performed in a different decade for a different generation unit owned by a different utility. Perhaps that estimate was in turn based on yet another estimate. Again, although S&L advocates utility-specific estimates, the sources supporting those estimates are unclear and at times were withheld from other parties during discovery.

Simply put, there is insufficient data transparency to know whether any of S&L's estimates are based on SWEPCO plant drawings for SWEPCO units close in time to when the estimated demolition cost is being appraised. If the estimates were based on prior estimates for other facilities, it is unreasonable to presume that one estimate meets the burden of proof simply because it is consistent with an earlier estimate for a different facility. SWEPCO has not provided the information necessary for CARD or the Commission to identify the actual sources of S&L's estimates, let alone when those sources provided actual known amounts specific to SWEPCO's facilities rather than on another layer of estimation and/or data for a non-SWEPCO plant.

Furthermore, Mr. Pous has support for his conclusion that S&L's conceptual estimate was excessive compared to an actual demolition. Mr. Pous noted that in 2005, S&L's conceptual estimate for AEP subsidiary Indiana Michigan Power Company's ("IMPC's") Breed generating

[137] Direct Testimony of Jacob Pous, CARD Ex. 2 at 22; *and see* Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 81.

station estimated the demolition cost for that plant at $28.7 million, whereas the actual net salvage experience was only $10.8 million after accounting for inter-company salvage value.[138]

Although Mr. Bertheau has alleged that some demolition tasks have yet to occur, it strains credulity given that a related 2008 discovery response states that "The actual demolition occurred between 1994 and 2006" and "The net total cost for the demolition of the Breed plant was $12,090,704 [minus $1.2 million due to transfer of assets to other AEP facilities]."[139] Mr. Bertheau's assertion that certain demolition tasks had yet to be performed is inconsistent with AEP/IMPC's discovery response that addresses the "net total cost for the demolition."[140] Furthermore, Mr. Bertheau indicates that the difference between the conceptual estimate and the actual costs can be attributed to AEP's alleged failure to remove foundations and structures to a level two feet below grade and cover the site with two feet of soil,[141] implying that these unperformed acts account for the approximately 62% difference between S&L's conceptual estimate and the actual net total demolition cost. It is particularly hard to believe that the coal-fired Breed Plant required an additional $17.9 million to account for unfinished 2-feet below grade excavation and placement of two feet of topsoil when Mr. Bertheau's exhibit for the Dolet Hills lignite plant attributes relatively minor amounts to these activities; certainly nothing approaching 62% of the total "conceptual estimated" cost of demolition.[142]

S&L's over-estimation for the Breed demolition costs versus the actual demolition costs is not an anomaly among S&L's estimates and subsequent demolitions. In fact, it is the only

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138 Direct Testimony of Jacob Pous, CARD Ex. 2 at 20, citing Response to AG 7-45 in OCC Cause No. 200800144, provided in Errata to Jacob Pous Workpapers, CARD Ex. 2C, Attachment 2 and Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 63-68.

139 Direct Testimony of Jacob Pous, CARD Ex. 2 at 20, citing Response to AG 7-45 in OCC Cause No. 200800144, provided in Errata to Jacob Pous Workpapers, CARD Ex. 2C, Attachment 2 and Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 63-68.

140 *Id*. (Emphasis added.)

141 Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 9-10.

142 Direct Testimony of Steven Bertheau, SWEPCO Ex. 44 at SRB-1.

S&L conceptual demolition estimate that has resulted in an actual demolition to CARD's knowledge. Although Mr. Bertheau touts S&L's experience with demolition studies by declaring that "S&L has performed over 205 previous demolition cost studies on 43 power plants," the aforementioned 2008 discovery response confesses that "[t]he AEP Breed Plant is the only power generation facility that Sargent and Lundy is aware of for which it performed a conceptual demolition cost estimate, and the facility was subsequently demolished."[143]

S&L's studies are also unreliable in that they selectively exclude inputs that would otherwise reduce the net demolition cost. For example, while Mr. Bertheau recognizes that certain plant facilities such as black start units can be reused, he withdrew their tonnage from the plant's scrap value,[144] but also did not offset the net demolition cost for the reuse (or resale) value of these facilities. In other words, his "recognition" of the black start unit's reuse value was to pretend the units were not part of the plant by excluding them from his analysis, rather than recognizing the unit's positive offset to total net salvage as an item that could be reused or resold. Even for a "conceptual" demolition cost estimate, S&L's decision to simply disregard the black start units reveals a prominent bias for negative net salvage results. Similarly, S&L's analysis disregarded the dollar value for pumps, motors, cranes, and other equipment that would have produced a more accurate net salvage cost.[145] S&L also disregarded the resale value of the land on which the plant resided,[146] as well as the water rights that were obtained to serve the facility.[147] While SWEPCO claims that these valuable assets are non-depreciable, S&L chose to include demolition costs dealing with the restoration of the land at the site. If the salvage value

143 Direct Testimony of Jacob Pous, CARD Ex. 2 at 20, citing Response to AG 7-45 in OCC Cause No. 200800144, provided in Errata to Jacob Pous Workpapers, CARD Ex. 2C, Attachment 2 and Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 63-68.

144 Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 26.

145 Direct Testimony of Jacob Pous, CARD Ex. 2 at 29-30.

146 Direct Testimony of Jacob Pous, CARD Ex. 2 at 33-34.

147 Direct Testimony of Jacob Pous, CARD Ex. 2 at 27.

of land cannot be included in the S&L study, then consistency demands that the cost to grade, seed, and landscape the land must be given comparable treatment.

Mr. Bertheau's approach is to attribute each item either a scrap value or no value,[148] even if the item can be reused or sold for a salvage value higher than scrap. In other words, the S&L cost estimate is an inaccurate estimate due in part to the fact that it is based on a methodology designed to derive a more negative net salvage value than an actual demolition with reasonable reuse/resale efforts would experience. Moreover, S&L's conceptual cost estimate presumes the plant will be completely demolished – it never even considers the possibility that the plant itself could be at least in part reused or resold, nor does it apply a negative contingency to its demolition estimate to account for such possibilities that would produce a significantly more positive net salvage.[149] As noted by Mr. Pous, the S&L study is a worst-case scenario, and as such provides an inappropriate basis for setting rates in this case.[150]

S&L's study is further biased because, while it does not acknowledge contingencies that could produce a more positive net salvage value, it assigns contingency percentages that create a more negative net salvage amount, but does so without meaningful support for the specific contingency applied. For example, even where Mr. Bertheau recognizes that portions of demolished plant would have a positive scrap value, he applies arbitrary contingency factors that discount the scrap value without any reliable evidence that would support his specific factors. Specifically, the conceptual estimate assumes that 10% of the actual scrap market values "would be expended during demolition and preparation of the scrap for market sales," but provides no

148 Direct Testimony of Jacob Pous, CARD Ex. 2 at 28, *and see* Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 120.

149 Direct Testimony of Jacob Pous, CARD Ex. 2 at 24.

150 Direct Testimony of Jacob Pous, CARD Ex. 2 at 27.

data or other information that would support this specific percentage discount, or any other.[151] Furthermore, Mr. Bertheau fails to show that his high-side cost estimate does not already include the cost of preparing scrap for market sale, which would render the separate 10% preparation cost redundant. Acceptance of the S&L cost estimates may very well allow SWEPCO to double recover future demolition costs.

Furthermore, S&L discounts the value of scrap by an additional 15% for negative contingency that "assumes a potential drop in the salvage value" without any basis for that assumed "potential" drop in value.[152] One could reasonably assume that the price of copper, for example, will change over time, but SWEPCO has provided no evidence to support its presumption that the change will result in copper scrap becoming less expensive. Moreover, this arbitrary 15% "contingency" for scrap value is not only in addition to the arbitrary 10% discount mentioned previously, it is also compounded by S&L's additional 15% (cost-inflating) contingency for the entire cost estimate.[153] When CARD asked SWEPCO to provide all support and justification for the level and need for the 15% contingency, SWEPCO made general comments claiming that contingencies are generally due to "future unknowns," but ultimately provided no support for its judgment that the contingency should inflate the estimate, let alone by 15%.[154]

Based on the available information and the related lack of evidentiary support, Mr. Pous relied on his extensive experience relating to demolition cost estimates and reasonably concluded that S&L's conceptual estimates "can only be characterized as a worst case scenario that results

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151 Direct Testimony of Jacob Pous, CARD Ex. 2 at 30, *and see* Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 139.

152 Direct Testimony of Jacob Pous, CARD Ex. 2 at 30, *and see* Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 105.

153 Direct Testimony of Jacob Pous, CARD Ex. 2 at 31-32.

154 Direct Testimony of Jacob Pous, CARD Ex. 2 at 32, *and see* Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 145.

in an excessively high-side demolition cost estimate associated with the retirement of the Company's generating facilities."[155]

Inappropriate Calculations Performed on the Demolition Estimates

Mr. Pous also explained that Mr. Davis performed two inappropriate calculations upon S&L's "worst case" conceptual cost estimates.

First, Mr. Davis escalated the estimates for as many as 40 years into the future at an annual inflation rate of 2.5%, and did not discount this future amount to present dollars to account for the time-value of money.[156] In other words, SWEPCO assumed future demolition expenses in a certain amount that accounted for inflation, but then sought recovery for that amount starting in the present – without acknowledging that payments made today have different buying power than payments made in the future. Mr. Davis' approach creates unreasonable levels of intergenerational inequity because if the payment made by a current customer for a cost level is inflated up to 40 years in the future, future customers will pay a lesser nominal (not inflated) amount for the same service. In short, Mr. Davis selectively ignored the time-value of money where it would benefit current customers (i.e., by recognizing the potential for interest) while simultaneously recognizing the time-value of money where it might negatively impact SWEPCO (i.e., by ensuring that the payments accounted for estimated inflation). As Mr. Pous explained, it is inappropriate to inflate current payments for future demolition costs to account for inflation without discounting those future costs to present dollar values to reflect the time value of money.[157]

155 Direct Testimony of Jacob Pous, CARD Ex. 2 at 3, and Appendix A.

156 Direct Testimony of Jacob Pous, CARD Ex. 2 at 34.

157 Direct Testimony of Jacob Pous, CARD Ex. 2 at 35-36.

Second, Mr. Davis inappropriately incorporated $19.2 million of negative net salvage associated with interim retirements in his final net salvage calculation,[158] even though the Commission recently rejected the interim method in favor of the retirement (actuarial) rate method.[159] SWEPCO employed a life span method for production plant, not a pure actuarial rate method. As the Commission explained in a prior case, "[t]he rate at which interim retirements will be made is not known and measurable. Incorporation of interim retirements… would best be done when those retirements are actually made."[160] Moreover, the Company relies on only 9 years of retirement activity, which is a short and inappropriate time span for calculating reasonable levels of interim net salvage.[161] Furthermore, one plant out of 18 different plants that the Company analyzed for interim retirement activity accounted for approximately 67% of the entire interim net salvage proposal; the impact of this single account is significantly out of proportion to investment and so distorts the Company's proposal.[162] It is important to note that Mr. Davis removes outliers elsewhere in his depreciation study,[163] but retained this outlier. Finally, the Company's approach deviates from industry norms in that it does not establish an overall net salvage percentage to apply to all retirements, and analyzes total plant transactions

158 Direct Testimony of Jacob Pous, CARD Ex. 2 at 36-37, *and see* Direct Testimony of David Davis, SWEPCO Ex. 43, depreciation workpapers in response to Staff 3-l Attachment "Net Salvage Ratio for Prod. 2011" at tab "Net Salvage Ratio."

159 Direct Testimony of Jacob Pous, CARD Ex. 2 at 4, citing Docket 39896, *Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Order on Rehearing at Finding of Fact No. 100 at 21 (Nov. 2, 2012). *See also* Direct Testimony of Jacob Pous, CARD Ex. 2 at 36-38.

160 PUC Docket Nos. 8425 and 8431, *Application of Houston Lighting and Power Company for Authority to Change Rates; Application of Houston Lighting and Power Company for a Final Reconciliation of Fuel Costs Through September 30, 1988*, Final Order, Finding of Fact No. 212 (16 Tex. P.U.C. Bull. 2684, 1990 WL 711948 (Tex. P.U.C.)) (Jun. 20, 1990).

161 Direct Testimony of Jacob Pous, CARD Ex. 2 at 36-37.

162 Direct Testimony of Jacob Pous, CARD Ex. 2 at 37.

163 *See, e.g.* Rebuttal Testimony of David Davis, SWEPCO Ex. 81 at 59-60.

rather than transactions by account.[164] In summary, SWEPCO's presentation of interim retirement net salvage is fatally flawed and unreliable for ratemaking purposes.

Accordingly, CARD recommends elimination of all interim retirements in compliance with the Commission's long-standing precedence.[165] If instead the Commission decides to begin allowing inclusion of interim retirements, CARD recommends relying on the ultimate net salvage adopted by the Commission for terminal production plant retirements as the appropriate value for interim net salvage purposes.

2. Transmission Plant

a. Account 353 – Transmission Station Equipment

CARD recommends a net salvage value of 0% for this account, by contrast to the Company's proposed negative 13% net salvage.[166] As Mr. Pous explained, the Company's proposal is excessively negative and fails to adequately recognize certain key factors, some of which it selectively recognizes in other accounts.[167] In particular, the Company's proposal fails to recognize a trend in the data towards a less negative value, and fails to analyze what retired and why the annual negative net salvages within its 10-year average range from negative 3% to negative 74%.[168] Furthermore, the Company does not provide any narrative evidencing the basis for its proposed percentage, which can only be inferred from its workpapers.[169]

Mr. Pous' recommendation accounts for the Company's failure to acknowledge that a sizable portion of its investment in this account is associated with transformers that contain

164 Direct Testimony of Jacob Pous, CARD Ex. 2 at 37.
165 Direct Testimony of Jacob Pous, CARD Ex. 2 at 37.
166 Direct Testimony of Jacob Pous, CARD Ex. 2 at 48-49.
167 Direct Testimony of Jacob Pous, CARD Ex. 2 at 49.
168 Direct Testimony of Jacob Pous, CARD Ex. 2 at 49.
169 Direct Testimony of Jacob Pous, CARD Ex. 2 at 49.

sizeable quantities of copper, which has an increasingly high scrap value.[170] Mr. Davis specifically excluded SWEPCO's sale of a transformer in this account that produced a positive 76% net salvage value, without discussing this removal in his depreciation study.[171] However, Mr. Davis thereby failed to acknowledge that while there are relatively few transformer retirements in the account compared to more common items such as lighting arrestors and switches, the transformers represent a disproportionately high level of account investment and thus have more influence on actual net salvage for the account.[172] Mr. Davis also failed to consider that the periods with the lowest dollar retirements (thus reflecting retirement of items other than transformers) averaged a negative 22.1% net salvage, whereas the three years with the highest dollar levels of retirement activity were associated with transformer retirements and averaged only a negative 5.7% net salvage. Similarly, Mr. Davis' analysis failed to appropriately weigh the negative 5% net salvage realized in the most recent year, given that the highest dollar level was realized in that year's retirement experience.[173] Higher dollar levels also reflect greater opportunities to realize economies of scale that would result in a more positive net salvage value.[174] In short, Mr. Davis failed to acknowledge that his simple mechanical average of annual net salvage values varies dramatically according to the dollar level and types of assets retired in each year. Because a few higher-dollar items (i.e., transformers) represent a majority of the utility's investment in this account, the infrequent retirement of those items should not be dismissed as non-recurring or unlikely to occur in the future, they should instead be considered more representative of the account's overall net salvage value.

170 Direct Testimony of Jacob Pous, CARD Ex. 2 at 49-50.
171 Direct Testimony of Jacob Pous, CARD Ex. 2 at 50.
172 Direct Testimony of Jacob Pous, CARD Ex. 2 at 49-50.
173 Direct Testimony of Jacob Pous, CARD Ex. 2 at 49.
174 Direct Testimony of Jacob Pous, CARD Ex. 2 at 50-51.

CARD's recommended net salvage rate of 0% for this account is conservative, especially in light of rising scrap copper prices.[175] CARD's recommendation would decrease overall total Company depreciation expense by $1,055,218 based on plant as of December 31, 2011, which would reduce depreciation expense on a Texas jurisdictional basis by $419,871.

b. Account 355 – Transmission Poles and Fixtures

i. Net Salvage

CARD recommends a net salvage value of negative 45%, as compared to the Company's proposed net salvage value of negative 67%.[176] The Company's depreciation study does not provide a narrative explanation to support its result, rather it must be inferred from Mr. Davis' workpapers that the proposal is based on a 10-year average.[177] CARD disputes the Company's net salvage for this account because SWEPCO failed to meet its burden of proof, and it is excessively negative.[178] Mr. Davis performed a mechanical average of the data, without adequately addressing the very large, unexplained change in the annual levels of net salvage beginning in 2001 and continuing through 2007 (negative 105% net salvage), relative to the prior six year period (negative 30% net salvage) and the subsequent four year period (negative 48% net salvage).[179] The Company's approach fails to justify itself and fails to explain why a simplistic average appropriately predicts net salvage when the annual results range from positive 1% to negative 157%.[180] Given that the Company could not explain the variances, it should have

175 Direct Testimony of Jacob Pous, CARD Ex. 2 at 51.
176 Direct Testimony of Jacob Pous, CARD Ex. 2 at 51-52.
177 Direct Testimony of Jacob Pous, CARD Ex. 2 at 51.
178 Direct Testimony of Jacob Pous, CARD Ex. 2 at 51.
179 Direct Testimony of Jacob Pous, CARD Ex. 2 at 52.
180 Direct Testimony of Jacob Pous, CARD Ex. 2 at 52.

sought guidance from industry information, which indicates that average values typically fall in the negative 25% range.[181]

In its last depreciation study, the Company again proposed a negative 67% net salvage, but in the four years after that study, the net salvage ranged from negative 30% to negative 89%, for an average of negative 48%.[182] The trend in the last three years reveals a decreasingly negative net salvage value for this account, ranging from negative 89% to negative 58% to more currently negative 30%.

Furthermore, the Company cannot identify the retirement activity associated with emergency situations, replacement activity, contractor-driven costs, or other relevant factors.[183] It also fails to consider economies of scale, where years with greater levels of retirement activity tend to experience less negative net salvage values in this account.[184] Given dispersion patterns proposed by the Company and the aging of plant, a greater annual level of retirement activity is expected in future years, which suggests that a less negative net salvage value is appropriate going forward.[185]

CARD's recommendation would result in a decrease in annual depreciation expense of $1,505,118 on a total Company basis as of December 31, 2011, thereby resulting in a $598,886 reduction to depreciation expense for the Texas retail jurisdiction.[186]

181 Direct Testimony of Jacob Pous, CARD Ex. 2 at 52.
182 Direct Testimony of Jacob Pous, CARD Ex. 2 at 52-53.
183 Direct Testimony of Jacob Pous, CARD Ex. 2 at 52.
184 Direct Testimony of Jacob Pous, CARD Ex. 2 at 53.
185 Direct Testimony of Jacob Pous, CARD Ex. 2 at 53.
186 Direct Testimony of Jacob Pous, CARD Ex. 2 at 53.

ii. Useful Life

While the Company relies on actuarial analysis for estimating the useful life for this account, its analyses and interpretation of results are inappropriate and result in an artificially short life expectation.[187] The Company proposes a 50S0 life-curve combination without any specific support in its depreciation study, but workpapers indicate that the Company performed two actuarial analyses before concluding that the 50S0 was a better fit.[188] By contrast, CARD recommends a 54L1 life-curve combination because it reflects a superior fit to the actuarial results, by appropriately placing more emphasis on a better fit near the top and middle portion of the Observed Life Table (OLT) rather than the less relevant tail portion.[189] CARD's recommendation results in a $737,264 reduction in annual depreciation expense on a total Company basis for plant as of December 31, 2011, and a corresponding $293,357 reduction on a Texas jurisdictional retail basis.[190]

c. Account 356 – Transmission Overhead Conductors & Devices

CARD recommends a negative 25% net salvage for this account.[191] By contrast, the Company recommends negative 40% net salvage, but its basis is unexplained in its depreciation study and it must be inferred from its workpapers that it relied on the most recent 10-year average.[192]

The Company has failed to meet its burden of proof to support to support its preferred net salvage rate for this account, as demonstrated by the fact that it cannot identify the number of

187 Direct Testimony of Jacob Pous, CARD Ex. 2 at 61-64.
188 Direct Testimony of Jacob Pous, CARD Ex. 2 at 65.
189 Direct Testimony of Jacob Pous, CARD Ex. 2 at 65-67.
190 Direct Testimony of Jacob Pous, CARD Ex. 2 at 67.
191 Direct Testimony of Jacob Pous, CARD Ex. 2 at 54.
192 Direct Testimony of Jacob Pous, CARD Ex. 2 at 54.

linear feet of overhead conductors in place; the linear feet of conductors retired by year; the amount of copper conductor retired or still on the system; the level of contractor expenditures, emergency situations, and other relevant elements associated with the net salvage for this account.[193] The absence of this data is particularly important because the historical net salvage for this account changed significantly from 2002-2005 (negative 74%), relative to the four prior years (negative 5%), and the period after 2005 (negative 26%). The Company offered no analysis to explain what underlies these changes, and instead relied upon a simple average without examination and consideration of trends and their causes. Moreover, from 1999-2006, the Company reported a total of only $2,422 of gross salvage, which is less than any single year's gross salvage before that period, and significantly less than the approximately $12,000 annual average following that period.[194] Given the Company could not explain these variations, it should have sought guidance from industry data, which indicates that a negative 20% to negative 25% range is reasonable.[195] The Company again fails to consider that years with higher dollar levels of retirement activity benefit from economies of scale in that they are more likely to realize a less negative net salvage rate, as reflected by the correlation between retirement activity and net salvage rate.[196] The dispersion pattern and the Company's proposed average service life suggest that future activity will experience higher levels of retirement activity, so a less negative salvage rate should be anticipated.[197]

193 Direct Testimony of Jacob Pous, CARD Ex. 2 at 54.
194 Direct Testimony of Jacob Pous, CARD Ex. 2 at 54-55.
195 Direct Testimony of Jacob Pous, CARD Ex. 2 at 55.
196 Direct Testimony of Jacob Pous, CARD Ex. 2 at 55.
197 Direct Testimony of Jacob Pous, CARD Ex. 2 at 55.

CARD's recommendation results in a decrease of depreciation expense of $756,475 as of December 31, 2011 on a Company-wide basis, and a corresponding $301,001 reduction in depreciation expense in the Texas retail jurisdiction.[198]

3. Distribution Plant

a. Net Salvage

i. Account 362 – Distribution Station Equipment

CARD recommends a negative 5% net salvage for this account.[199] By contrast, the Company proposes a negative 16% net salvage, but once again provided no basis for its proposal in its depreciation study, and it is necessary to infer from its workpapers that it relied on the overall 28-year average.[200] The Company's proposed net salvage for this account is excessively negative, again because, similar to Transmission Account 353 – Station Equipment, a substantial level of the accounts investments are in transformers, which retire infrequently but have a much less negative (and often positive) salvage value due in part to their high quantity of copper.[201] An example of potential positive net salvage is demonstrated by the Company's $1,540,156 positive net salvage associated with the sale of the Eastman substation.[202]

The Company's depreciation study again engages in a simple mathematical average of the covered period, without due consideration to trends and causes of trends within those years. For example, the most recent seven-year period within the Company's 28-year historical average provided a net salvage average of negative 22%, but if the sale of the Eastman substation had

198 Direct Testimony of Jacob Pous, CARD Ex. 2 at 56.
199 Direct Testimony of Jacob Pous, CARD Ex. 2 at 56.
200 Direct Testimony of Jacob Pous, CARD Ex. 2 at 56.
201 Direct Testimony of Jacob Pous, CARD Ex. 2 at 56.
202 Direct Testimony of Jacob Pous, CARD Ex. 2 at 56-57.

properly been included, the net salvage average would have been less than negative 9%.[203] In addition, the three years with the highest level of retirement activity during the last 7 years yields a positive 2% net salvage compared to the three years with the lowest retirement activity during those same 7 years, which yielded a negative 26% net salvage; again, this reflects the benefits of economies of scale associated with higher retirement levels.[204] It is also indicative of the fact that transformers represent higher dollar-value retirements in this account, and they obtain a more favorable net salvage due to their copper content and copper scrap's significantly increasing value within recent years.[205]

Given that the Company failed to engage in a meaningful analysis of its simple average, its conclusions should be checked against industry data, which instead suggests that a negative 3% to negative 7% net salvage level is typical, and some utilities even experience positive levels of salvage for this account.[206]

CARD conservatively recommends a negative 5% net salvage for this account, which is equal to the Company's prior level before the settlement in Docket No. 37364, and represents the midpoint of the various industry databases.[207] The result of CARD's recommendation would be a decrease in depreciation expense on a total Company basis of $498,720 as of December 31, 2011, and a corresponding depreciation expense decrease of $177,395 in the Texas retail jurisdiction.[208]

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203 Direct Testimony of Jacob Pous, CARD Ex. 2 at 57.
204 Direct Testimony of Jacob Pous, CARD Ex. 2 at 57.
205 Direct Testimony of Jacob Pous, CARD Ex. 2 at 57.
206 Direct Testimony of Jacob Pous, CARD Ex. 2 at 57.
207 Direct Testimony of Jacob Pous, CARD Ex. 2 at 57.
208 Direct Testimony of Jacob Pous, CARD Ex. 2 at 58.

b. Useful Lives

i. Account 364 – Distribution Poles

CARD recommends a 54L0 combination to reflect the reasonable expected Average Service Life (ASL) for this account.[209] Although the Company originally proposed a 50L0 life-curve combination, Mr. Davis' rebuttal testimony indicates that the Company accepts Mr. Pous' recommendation regarding the service life for Account 364 – Distribution Poles.[210] SWEPCO's adoption of CARD's recommended ASL for this account results in a $716,339 reduction in annual depreciation expense on a Company basis based on plant as of December 31, 2011, and a corresponding $254,802 reduction on a Texas retail basis.[211]

ii. Account 367 – Distribution UG Conductor

CARD recommends a 50R1.5 life-curve combination for Account 367.[212] By contrast, the Company proposes a 45R2.5 life-curve combination.[213] Although the Company's depreciation study does not explain the basis for its recommendation, its workpapers indicate that the Company performed two separate actuarial analyses that it claims indicate that a 45R2.5 combination is appropriate.[214]

CARD's recommendation is based on Mr. Pous' review of both the actuarial results and his knowledge of the change in the life characteristics and technological underpinning of investment in this account.[215] Although the Company's proposal appears to be a better fit beginning at age 50, and is a much superior fit as it nears the tail end of the curve (i.e. 65-75

209 Direct Testimony of Jacob Pous, CARD Ex. 2 at 68.
210 Rebuttal Testimony of David Davis, SWEPCO Ex. 81 at 5, 43-44.
211 Direct Testimony of Jacob Pous, CARD Ex. 2 at 70.
212 Direct Testimony of Jacob Pous, CARD Ex. 2 at 70.
213 Direct Testimony of Jacob Pous, CARD Ex. 2 at 70.
214 Direct Testimony of Jacob Pous, CARD Ex. 2 at 70.
215 Direct Testimony of Jacob Pous, CARD Ex. 2 at 71.

years), the Company's preference for matching the tail end of the curve is inappropriate, given that better fits near the top and middle portions of the curve are more important.[216] Authoritative sources support the practice of giving less credence to the tail end of a curve.[217] For example, in this account, the dollar level of investment around 50 years of age (past the middle of the curve, which is located at approximately age 38) only amounts to $300,000, whereas the initial exposure level (the top of the curve) represents $185 million.[218] Thus, although the Company's life-curve is a better fit at the tail end, CARD's is a better fit at the more relevant top and middle portions of the curve, where the vast majority of investment exposed to retirement is affected. Furthermore, CARD's recommendation takes into account various advances in underground cable technology over the last several decades that support a longer life for this kind of investment even though it would not yet be adequately reflected in the Company's historical actuarial results.[219] The technological improvements over the last several decades are significant, given that approximately 50% of the investment has been added since 2000.[220]

CARD's proposed ASL for this account results in a $493,969 decrease in annual depreciation expense on a total Company basis for plant as of December 31, 2011, and a corresponding reduction of $175,705 on a Texas retail jurisdictional basis.[221]

216 Direct Testimony of Jacob Pous, CARD Ex. 2 at 71-72.
217 Direct Testimony of Jacob Pous, CARD Ex. 2 at 63.
218 Direct Testimony of Jacob Pous, CARD Ex. 2 at 72-73.
219 Direct Testimony of Jacob Pous, CARD Ex. 2 at 73-74.
220 Direct Testimony of Jacob Pous, CARD Ex. 2 at 74.
221 Direct Testimony of Jacob Pous, CARD Ex. 2 at 75.

4. General Plant

a. Account 390 – General Structures and Improvements

CARD recommends a positive 25% net salvage as a first step to establishing a more appropriate level of net salvage for the Company's investment in this account.[222] Although the Company initially proposed a negative 7% net salvage,[223] it reduced its proposal to negative 3% in light of Mr. Pous' testimony.[224]

Although the Company partially accepts Mr. Pous' recommendation, its proposed revision to its net salvage for this account from negative 7% to negative 3% is inadequate and remains inappropriately negative. This account normally reflects a large percentage of investment in physical buildings (e.g. office buildings and warehouses).[225] Although the building themselves may not retire from service for 50 to 100 years, subcomponents such as lighting systems, air conditioning systems, and carpeting may retire during the life of the building.[226] If the historical experience is judged during a period where a disproportionate level of retirements are associated with subcomponents rather than the larger investment in buildings, it would significantly skew results.[227] Carpeting, for example, has no salvage value, whereas the buildings have a strong potential for a positive resale value.[228] If the Company had examined the results of the most recent 10-year period (as it did for several other accounts), it would have resulted in a positive 22% net salvage value.[229] Instead, the Company simply averaged the annual net salvage rates, without giving due consideration or weight to years in which higher dollar-levels of

222 Direct Testimony of Jacob Pous, CARD Ex. 2 at 60.
223 Direct Testimony of Jacob Pous, CARD Ex. 2 at 58.
224 Rebuttal Testimony of David Davis, SWEPCO Ex. 81 at 5, 64-65.
225 Direct Testimony of Jacob Pous, CARD Ex. 2 at 58.
226 Direct Testimony of Jacob Pous, CARD Ex. 2 at 58.
227 Direct Testimony of Jacob Pous, CARD Ex. 2 at 58.
228 Direct Testimony of Jacob Pous, CARD Ex. 2 at 58-59.
229 Direct Testimony of Jacob Pous, CARD Ex. 2 at 59.

retirement occurred due to the sale of buildings given that the Company's ten largest buildings represent the majority of the Company's investment in this account (two of which account for 43% of the total investment).[230] The Company's simple average methodology was also skewed because it failed to acknowledge that most of the cost of removal resulted from one year, 1996, in which a major and unusual asbestos removal project was required.[231] In rebuttal, Mr. Davis resolved this shortcoming by removing both years 1996 and 2004 from the average.[232] However, while it was appropriate to remove 1996 as an anomalous cost of removal that is not expected to recur or be representative of future experience, by contrast the positive net salvage in 2004 (positive 34%) was the result of the sale of the Company's Fayetteville office building at a substantial profit,[233] and there is no evidence to suggest that similar building sales will not occur in the future and would not be positive. If only 1996 had been removed, the net salvage would be positive 11% rather than negative 3%.[234]

CARD's recommended rate of positive 25% is conservative, as it is not as great as the positive 34% percent experienced by the Company during the year in which it sold an office building (and again, buildings represent the majority of the account's investments in terms of dollar value).[235] Furthermore, the positive 25% net salvage is close to the Company's experience on an accumulated basis for the six most recent 10-year roll averages.[236] CARD also recommends that the Commission order the Company to perform a more detailed analysis for this account for its next rate case that would identify the type of investment within the account

230 Direct Testimony of Jacob Pous, CARD Ex. 2 at 59.
231 Direct Testimony of Jacob Pous, CARD Ex. 2 at 59.
232 Rebuttal Testimony of David Davis, SWEPCO Ex. 81 at 64.
233 Direct Testimony of Jacob Pous, CARD Ex. 2 at 60.
234 Direct Testimony of Jacob Pous, CARD Ex. 2 at 59-60.
235 Direct Testimony of Jacob Pous, CARD Ex. 2 at 60.
236 Direct Testimony of Jacob Pous, CARD Ex. 2 at 60.

and the type of retirement activity and costs of such activity, so that a better relationship between investment and retirement activity and potential positive salvage can be determined.[237] Finally, CARD recommends that the Commission order the Company to have appraisals conducted for its largest buildings and structures to identify market expectation for the value of such facilities in the event of sale.[238]

CARD's recommendation (versus the original proposed rate) results in a $780,746 reduction in depreciation expense on a total Company-wide basis as of December 31, 2011, with a corresponding $277,711 reduction on a Texas retail basis.[239]

4. General Plant

5. Depreciation Reserve

J. Mountaineer Carbon Capture & Storage Project Amortization

CARD addresses the issue of the amortization of the Mountaineer Carbon Capture & Storage Project in Section II.D.

K. Labor Costs [PO Issue 30]

1. Payroll – AEPSC and SWEPCO

2. Incentive Compensation

a. Annual Incentive Compensation

The Commission should not permit SWEPCO to recover the Company's annual incentive plan costs that include amounts tied to financial performance. Instead, the Commission should apply its precedent that for ratemaking purposes excludes incentive payments related to the financial performance of the utility. Contrary to the Commission's precedent on this issue,

237 Direct Testimony of Jacob Pous, CARD Ex. 2 at 60.

238 Direct Testimony of Jacob Pous, CARD Ex. 2 at 60.

239 Direct Testimony of Jacob Pous, CARD Ex. 2 at 60.

SWEPCO has included financially-based incentives for recovery in rates. It should be noted that the disallowance of this expense does not prohibit SWEPCO shareholders from paying for the programs that are designed for their benefit.

Historically the Commission has excluded financially based incentive compensation because:[240]

1) Payment amounts are uncertain from year to year and are only based on a tentative expense that may not be paid at all.
2) Many of the factors that significantly impact earnings are outside the control of most company employees and have limited value to customers.
3) Earnings-based plans can discourage conservation and thus be contrary to energy efficiency goals.
4) The utility and its stockholders assume none of the financial risks associated with incentive programs while ratepayers pay for the programs even if the Company does not reach its targets.
5) Incentive payments based on financial performance measures should be made out of increased earnings that signify earnings objectives have been met.
6) Incentive payments embedded in rates shelter the utility against the risk of earnings erosion through attrition by supplementing its earnings in years that it does not perform well.

The Commission has consistently disallowed efforts to include financially based incentives in rate base.[241] Texas' treatment of incentive compensation is consistent with virtually all the Western States. As shown in Mr. Garrett's Incentive Survey of the 23 Western States taken in 2007 and updated in 2009 and 2011, most of those states follow guidelines similar to Texas and none of the states allow full recovery of incentive compensation through rates as a general rule.[242] SWEPCO acknowledged it had reviewed CARD's testimony on the subject, including other states in which AEP operates, and did not dispute these facts or offer contrary

240 Direct Testimony of Mark Garrett, CARD Ex. 5 at 20-22.

241 *See* PUC Docket No. 39896 and PUC Docket No. 28840.

242 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 23-29

testimony on the subject.[243] Therefore, SWEPCO's request is not only unrecoverable in Texas, but would not be recoverable in most of the 23 surveyed states.

SWEPCO's Incentive Compensation Program is Based on Financial Performance

States disallow recovery of financially based incentive compensation programs because those programs are designed to benefit shareholders and employees, not ratepayers.[244] If the incentive program instead focused on operational measures that benefited ratepayers with increased reliability and quality of service, then it might be equitable for ratepayers to pay a portion of the incentive program cost. However, because SWEPCO's programs are designed to increase earnings, it is appropriate for those increased earnings to fund the programs.

SWEPCO's and AEPSC's annual incentive plan targets indicate that a variety of factors are financially based.[245] SWEPCO only identifies the goal specifically labeled as "Financial" as the financially based portion of its incentive plan. However, that characterization ignores other goals that are financially based in the plan including "Margin Generating," "Regulatory," and "Strategic."

> **Margin Sharing goals** are based on employees increasing the margins on items where the margins are shared between the customers and the shareholders. On any such item, the customers have already provided the Company with an incentive to increase these margins by sharing a portion of the margin that would otherwise belong to the customers. Any further incentive to increase margins for the Company should be paid by the Company.
>
> **Regulatory goals** are based on employees' successful efforts in achieving higher rates of return on the regulated operations of the Company. Clearly, ratepayers should not be asked to pay for these efforts.
>
> **Strategic goals** are based on objectives related to bringing the Turk plant and transmission projects on-line and into rates. Again, these goals clearly provide financial benefits to the Company more than they do its customers.

243 Transcript at 495-498 (Tues., Feb. 5, 2013).

244 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 23-29.

245 Direct Testimony of Mark Garrett, CARD Ex. 5 at 30.

Another indication that the incentive plans benefit the Company rather than ratepayers is demonstrated by the overall compensation payment calculation, which is subjected to the Company's Earnings per Share Modifier thereby ensuring employees will be compensated only to the extent additional earnings are available after the Earnings Per Share ("EPS") targets are achieved. The EPS Modifier permits AEP to withhold all incentive payments if goals are not met, and instead amounts collected in rates for incentive programs are retained by the shareholders.

SWEPCO's plan is overwhelmingly weighted in the company's favor rather than the customers and could be entirely excluded. If the Commission wants to encourage the non-financial goals that focus on customer concerns, it could include the portion for the plan costs that appears to be based on non-financial goals.[246] Limiting the Company's recovery to plan costs that are tied to non-financial goals would be consistent with previous Commission decisions regarding other AEP incentive plans,[247] and would be consistent with the states SWEPCO competes with for employees.[248] Further exclusion of these financially based incentive compensations payments would not harm SWEPCO because the EPS modifier guarantees that the Company's earnings goals are met before any incentive payments are made.

Finally, it would also be reasonable for the Commission to consider a larger adjustment to incentive pay. Based upon an independent third-party report, the J.D. Power report, SWEPCO's performance in customer satisfaction is below average, so the Commission could accordingly determine that a larger disallowance of incentive compensation is appropriate.[249] At

246 That treatment would result in 24.20% of the SWEPCO incentives being excluded and 41.38% of the AEPSC incentives being excluded. *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 30-32.

247 *Application of AEP Texas Central Company for Authority to Change Rates*, Docket No. 28840; SOAH Docket No. 473-04-1033, Final Order (August 15, 2005).

248 Direct Testimony of Mark Garrett, CARD Ex. 5 at 33-34.

249 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 35-36 and MG-5.

whatever amount the Commission disallows of incentive costs, it should remove those expenses from both operating expense and also rate base. Removing expenses from both operating expense and rate base is necessary because a significant portion of the Company's incentive payments are capitalized each year into the plant accounts that are included in pro forma rate base, where they earn a return and would be recovered through depreciation rates if not adjusted in this case. Therefore, it is necessary to reduce the amount of incentives capitalized in rate base by the same percentage disallowed in operating expense.

b. Long-Term Incentive Compensation

CARD recommends disallowing all the cost of SWEPCO's long-term incentive plans. SWEPCO's long–term incentive plans award performance stock units and restricted stock units that are generally similar to AEP common stock and are tied exclusively to financial performance. These awards to officers, executives, and key employees are generally excluded in Texas for ratemaking purposes. In particular, in the recent Entergy Texas Inc. rate case the Commission disallowed similar financially based incentives that were tied to earnings per share and stock price because they benefit shareholders, not ratepayers.[250] The Commission's precedent is consistent with other states' treatment of long-term incentive compensation.[251]

It is appropriate to disallow these expenses because the top-level employees for SWEPCO have a duty of loyalty to the corporation itself and not to the customers. The top employees' loyalty to the company before ratepayers creates conflicts that lead to regulators excluding executive bonuses, incentive compensation, and supplemental benefits from utility rates because those expenses are more appropriately paid by shareholders. Even though SWEPCO claims these expenses should be recovered in rates because they are necessary to

[250] *See* Proposal for Decision in PUC Docket No. 39896 at 171.

[251] Direct Testimony of Mark Garrett, CARD Ex. 5 at 38-40.

attract and retain key personnel, the facts in the record contradict SWEPCO's claim. First, any properly designed incentive compensation program should provide ample additional funds to make any incentive payments.[252] There is no competitive disadvantage because the additional earnings should be more than adequate to support the programs. Finally, SWEPCO is not placed at a disadvantage because most states exclude executive incentive compensation. Other utilities in other states that SWEPCO competes with for personnel are also not recovering those expenses in rates.[253] Therefore it is unnecessary for SWEPCO to recover these expenses in rates and nothing prevents SWEPCO from appropriately having shareholders pay for these programs, if SWEPCO believes they are necessary.

CARD's adjustment removes 100% of the cost of the long-term plans included in pro forma operating expense in the amount of $4,694,652.[254]

3. Executive Perquisites

4. Relocation

L. Pension and Related Benefits [PO Issue 28]

1. Pensions

2. OPEBs

3. Post-employment Benefits

4. Supplemental Executive Retirement Plan (SERP)

CARD recommends disallowing the costs of the non-qualified retirement plans from the cost of service in the amount of $561,719.[255] SWEPCO provides supplemental retirement plans

252 Direct Testimony of Mark Garrett, CARD Ex. 5 at 40.

253 Direct Testimony of Mark Garrett, CARD Ex. 5 at 41.

254 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at Exhibit MG 3.4.

255 Direct Testimony of Mark Garrett, CARD Ex. 5 at 44 and Exhibit MG 3.5.

to highly compensated employees because the Internal Revenue Code places limits on the general retirement plans and benefits beyond an annual cap ($245,000 for 2011).[256] The supplemental plans are designed to provide benefits in addition to the general plans that do not exceed the cap.

Shareholders should pay for SWEPCO's plan expenses that exceed the cap. Ratepayers already pay for all the Company's regular pension plans. While regular pension expenses may be necessary for the provision of utility service, shareholders should pay for discretionary expenses designed to compensate only the top executives at AEP that are loyal to the corporation and not customers. The Commission recently disallowed the same type of expense in the 2012 Entergy rate case.[257] Although SWEPCO claims it should be treated differently than Entergy, its witness on the subject admitted that he had not "reviewed the plans themselves."[258] But a review of the findings in the Proposal for Decision and adopted by the Order on Rehearing indicate the precise expenses SWEPCO is attempting to recover in this proceeding are what the Commission disallowed only four months ago:

> They are non-qualifying retirement plans available only to employees and executives earning more than $245,000 a year, and they constitute benefits over and above the company's standard retirement benefits package.[259]

SWEPCO wants to recover retirement plan expenses above its standard retirement plan, but the Commission does not permit this recovery. Further the Commission's treatment of these expenses is also entirely consistent with other states.[260] The Commission should treat these

256 Direct Testimony of Mark Garrett, CARD Ex. 5 at 42.

257 Proposal for Decision in Docket No. 39896 at page 178.

258 Transcript at 400 (Tues., Feb. 5, 2013).

259 Docket No. 39896, Proposal for Decision at 179-180.

260 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 43-44.

supplemental retirement expenses just as it did in the Entergy case last year and disallow them in their entirety for SWEPCO and AEPSC.

M. Federal Income Tax [PO Issue 23]

N. Storm Amortization [PO Issue 15]

CARD recommends removing from the cost of service the remaining storm cost because the costs will be fully amortized by the time SWEPCO's new rates go into effect. In SWEPCO's last full rate proceeding, Docket No. 37364, it was permitted to recover $3.6 million of storm costs over three years at a rate of $1.2 million per year. SWEPCO states that $400,000 would remain unamortized as of January 1, 2013. SWEPCO includes that $400,000 unamortized balance to set rates going forward each year until SWEPCO files another rate case. However the $400,000 balance will be fully amortized when rates go into effect this summer. The Commission should reduce the Texas retail revenue requirement by $400,000 annually to reflect the fact that the balance will be fully collected by the time rates go into effect.[261]

O. Fuel and Logistics Expense Allocation [PO Issues 29, 30]

P. Director & Office Liability Insurance

Q. Convenience Payments

R. Injuries and Damages Expense

The Commission should adjust the injuries and damages expense to reflect a more realistic expense level based on a five-year average of injuries and damages account balances. The test year amount is significantly higher than the previous 4 years and is the type of expense that can fluctuate significantly because of the uncertain nature of the expense. CARD

[261] *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 45 and Exhibit MG 3.6.

recommends taking an average and reducing the Company's request of $4,543,773 by $1,981,212 to a level of $2,561,861 as reflected on the table below:[262]

Injuries and Damages Account 5-Year Average		
Year	Annual Cost	5-Year Average
2007	$(250,509)	
2008	$2,593,596	
2009	$2,623,014	
2010	$3,299,431	
2011	$4,543,773	
5 Year Average		$2,561,861
Test Year		$4,543,773
Adjustment		**$(1,981,912)**

S. Office Supplies Expense

T. Temporary Labor

U. Turk Independent Monitor Costs

V. Separation Costs

W. VEMCO Legal Fees

X. Customer Choice Costs

Y. Intangible Asset Amortization Expense

Z. Weather Normalization [PO Issue 34]

CARD supports the recommendation by Cities' witness Mr. Johnson to reverse SWEPCO's proposed weather adjustment or, in the alternative, to use a 10-year weather period

[262] *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 46 and Exhibit MG 3.7.

for the adjustment.[263] Staff's witness Mr. Abbott also persuasively rebuts SWEPCO's proposed use of a 30-year weather period.[264] As Mr. Johnson and Mr. Abbott show, the Commission's distribution cost recovery factor ("DCRF") rule relies on a 10-year weather period.[265] Furthermore, as Mr. Johnson shows, the statistical evidence shows that the last 10 years has been clearly warmer than the last 30 years, at a 93 percent statistical confidence level.[266] This means SWEPCO's reliance on a 30-year weather period significantly overstates the impact of the weather normalization – Mr. Johnson estimates that overstatement at $3.3 million.[267] Finally, Mr. Johnson explains how SWEPCO failed to meet its burden of proof on its proposed weather adjustment in its entirety, which reduces SWEPCO's revenue requirement by $7.13 million.[268] CARD, therefore, recommends a reduction of SWEPCO's revenue requirement by $7.13 million or, in the alternative, $3.3 million.

VI. RESIDENTIAL KWH GROWTH IN THE POST-TEST YEAR ADJUSTMENT [PO ISSUES 3, 34]

VII. CLASS COST ALLOCATION AND RATE DESIGN [PO ISSUES 32, 33]

A. Class Cost Allocation

1. Lighting Allocation

CARD supports calculating the average demand for the lighting classes by dividing the lighting classes' kWh usage by 8,760 hours, as sponsored by Staff's witness Mr. Abbott and

263 Direct Testimony of Clarence Johnson, Cities Ex. 5 at 15-16.

264 Direct Testimony of William B. Abbott, Staff Ex. 1 at 10-14.

265 Direct Testimony of Clarence Johnson, Cities Ex. 5 at 14; Direct Testimony of William B. Abbott, Staff Ex. 1 at 12, quoting P.U.C. Subst. R. 25.243(b)(5).

266 Direct Testimony of Clarence Johnson, Cities Ex. 5 at 10.

267 *Id*. at 16.

268 *Id*. at 15-16.

Cities' witness Mr. Johnson, instead of the 4,000 hours initially proposed by SWEPCO.[269] SWEPCO accepted the Cities' and Staff's correction in its rebuttal testimony.[270] CARD recommends adoption of the corrected (i.e., 8,760) figure.

2. Residential Customer Unit Costs

Cities' witness Mr. Johnson estimates that residential customers cause SWEPCO to incur customer-related charges of $4.46 per month, once overhead charges are excluded.[271] This uncontroverted finding[272] supports CARD's, Cities', and OPUC's recommendation to set the residential customer charge no higher than the existing $7.25 level.[273]

3. Transmission Cost Allocation

CARD supports the twelve coincident peak ("12CP") allocation method for transmission costs, as proposed by SWEPCO's witness Mr. Aaron.[274] The 12CP method is appropriate because, as Mr. Aaron explains, the SPP bills SWEPCO for transmission on a 12CP basis.[275] To the extent SWEPCO's transmission costs are prudently incurred, SWEPCO should allocate those costs in the manner that it incurs them – i.e., through the 12CP method.

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269 Direct Testimony of William B. Abbott, Staff Ex. 1 at 17-20; Direct Testimony of Clarence Johnson, Cities Ex. 5 at 20-24.

270 Rebuttal Testimony of John O. Aaron, SWEPCO Ex. 87 at 5.

271 Direct Testimony of Clarence Johnson, Cities Ex. 5 at 31-32.

272 SWEPCO challenges the appropriateness of excluding the overhead costs, but does not challenge the calculation itself. *See* Rebuttal Testimony of John O. Aaron, SWEPCO Ex. 87 at 6.

273 Direct Testimony of Clarence Johnson, Cities Ex. 5 at 31-32; Direct Testimony of Lacy L. Seybold, OPUC Ex. 3 at 11-13. Mr. Johnson also outlines why the record supports a customer charge of $6.00-$6.50, if the Commission elects to lower the customer charge from the existing level. Direct Testimony of Clarence Johnson, Cities Ex. 5 at 31-32.

274 Rebuttal Testimony of John O. Aaron, SWEPCO Ex. 87 at 10.

275 *Id*. at 8.

4. Municipal Franchise Fees

CARD supports the collection of municipal franchise fee costs ("MFF") from all customers, as sponsored by Staff's witness Mr. Abbott, Cities' witness Mr. Johnson, and OPUC's witness Ms. Seybold.[276] This method, called the "spread" method[277], is consistent with a long line of Commission precedent.[278] The "spread" method is also appropriate as a matter of policy, since many of the facilities – including generation plants and transmission lines – that a utility places within municipal limits benefit all ratepayers.[279]

5. Miscellaneous Gross Receipts Taxes

CARD supports allocating miscellaneous gross receipts taxes in proportion to class revenues, as sponsored by Cities witness Mr. Johnson and OPUC witness Ms. Seybold.[280] As the Commission found in Docket No. 39896:

> The same reasons for allocating and collecting MFF as set out in Finding of Fact Nos. 178-181 also apply to the allocation and collection of Miscellaneous Gross Receipts Taxes. The company's proposed allocation of these costs to all retail

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276 Direct Testimony of William B. Abbott, Staff Ex. 1 at 22-23; Cross Rebuttal Testimony of Clarence Johnson, Cities Ex. 10 at 5-9; Cross Rebuttal Testimony of Lacy L. Seybold, OPUC Ex. 4 at 17-21.

277 Direct Testimony of William B. Abbott, Staff Ex. 1 at 23.

278 *Application of TXU Electric Company for Approval of Unbundled Cost of Service Rate Pursuant to PURA § 39.201 and Public Utility Commission Substantive Rule § 25.344*, Docket No. 22350, Order at 162, FOF 157 (October 4, 2001); *Application of Reliant Energy HL&P for Approval of Unbundled Cost of Service Rate Pursuant to PURA § 39.201 and Public Utility Commission Substantive Rule § 25.344*, Docket No. 22355, Order at 147, FOF 222B (October 4, 2001); *Application of CenterPoint Electric Delivery Company, LLC, for Authority to Change Rates*, Docket No. 38339, Order on Rehearing at 33, FOF 179 (June 23, 2011); *Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing at 30, FOF 178-180 (November 2, 2012).

279 *See, e.g., Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing at 30, FOF 179 (November 2, 2012) ("ETI's facilities located within municipal limits benefit all customers, whether the customers are located inside or outside of the municipal limits").

280 Cross Rebuttal Testimony of Clarence Johnson, Cities Ex. 10 at 9-12; Cross Rebuttal Testimony of Lacy L. Seybold, OPUC Ex. 4 at 22.

customer classes based on customer class revenues relative to total revenues is appropriate.[281]

The same reasoning and result are appropriate for this proceeding.

6. Primary Distribution Substation and Line Services

CARD recommends allocating primary distribution line costs to primary substation customers, as sponsored by Cities' witness Mr. Johnson.[282] Utilities typically incur distribution costs to serve substation customers, since most utilities do not allow substation customers to locate their facilities directly at the substation.[283] It is inappropriate, accordingly, to exempt substation customers from the allocation of distribution costs.

7. Appropriate Load Factor for Use in Average Component of A&E/4CP

CARD supports using a 65 percent 4CP load factor, as sponsored by Cities' witness Mr. Johnson.[284] TIEC's witness Mr. Pollock proposes a 58 percent load factor.[285] Mr. Pollock's proposal, however, is based on maximum diversified demands ("MDD"), instead of coincident peak demands.[286] 4CP load factors should be set based on coincident peaks, not MDDs, since generation plants must be built to serve the load at the coincident peak.[287] CARD, therefore, recommends the rejection of Mr. Pollock's proposal.

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281 *Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing at 30, FOF 182 (November 2, 2012).

282 Cross Rebuttal Testimony of Clarence Johnson, Cities Ex. 10 at 20-25.

283 *Id.* at 22.

284 Supplemental Cross Rebuttal Testimony of Clarence Johnson, Cities Ex. 11 at 3-6.

285 Rebuttal Testimony of Jeffry Pollock, TIEC Ex. 2 at 20.

286 Supplemental Cross Rebuttal Testimony of Clarence Johnson, Cities Ex. 11 at 4-5.

287 *See* Direct Testimony of John O. Aaron, SWEPCO Ex. 50 at 33 ("The excess component of the 4CP A&E, calculated as the 4CP peak demand less the average demand, recognizes the additional cost responsibility that should be assigned to those customers who place a peak demand on the system that is in excess of their average demand.")

B. Revenue Distribution [PO Issues 35, 36]

CARD supports an allocation of no more than 100 percent of the residential class' cost to residential customers, as sponsored by SWEPCO's witness Ms. Jackson and OPUC's witness Ms. Seybold.[288] Put another way, the relative rate of return for the residential class should not exceed 1.0. A relative rate of return above 1.0 would result in residential customers subsidizing other customers, which would be unfair and send improper pricing signals to those residential customers.

C. Rate Design [PO Issue 32, 34]

1. Residential

a. Customer Charge

CARD recommends retaining, at a maximum, the existing $7.25 residential customer charge, as sponsored by Cities' witness Mr. Johnson and OPUC's witness Ms. Seybold.[289] Mr. Johnson estimates that residential customers cause SWEPCO to incur customer-related charges of $4.46 per month, once overhead charges are excluded.[290] Furthermore, other vertically integrated utilities in Texas have customer charges between $5.00 and $6.00.[291] Consequently, a customer charge somewhere between $6.00 and $7.25 is appropriate for SWEPCO.

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288 Direct Testimony of Jennifer L. Jackson, SWEPCO Ex. 51 at 16; Cross Rebuttal Testimony of Lacy L. Seybold, OPUC Ex. 4 at 8.

289 Direct Testimony of Clarence Johnson, Cities Ex. 5 at 29-33; Direct Testimony of Lacy L. Seybold, OPUC Ex. 3 at 11-13. Mr. Johnson also outlines why the record supports a customer charge of $6.00-$6.50, if the Commission elects to lower the customer charge from the existing level. Direct Testimony of Clarence Johnson, Cities Ex. 5 at 31-32.

290 Direct Testimony of Clarence Johnson, Cities Ex. 5 at 31-32.

291 Direct Testimony of Lacy L. Seybold, OPUC Ex. 3 at 11.

b. Energy Charge

c. Winter Declining Block Rate

d. Summer Inclining Block Rate

2. Commercial

3. Industrial

a. Primary Substation

b. Large Lighting and Power Service

c. Proposed Metal Melting Secondary Service

d. Non-Firm Rates

4. Other

VIII. FUEL RECONCILIATION [PO ISSUES 40-51]

A. Dolet Hills Lignite Company Benchmark Price [PO Issue 41]

B. CenterPoint Energy Gas Transmission Contract

IX. OTHER ISSUES

A. Request to Recover Purchased Capacity Through Fuel

CARD recommends that the Commission reject SWEPCO's request to recover purchased power capacity costs through SWEPCO's fuel factor.[292] PUC Subst. R. 25.236(a)(4) states in relevant part: "the electric utility may not recover demand or capacity costs" in its fuel expenses. PUC Subst. R. 25.236(a)(6) allows for a good cause exception to this rule, if the utility establishes special circumstances. To establish special circumstances, the utility must show:

> [W]hether the fuel expense or transaction giving rise to the ineligible fuel expense resulted in, or is reasonably expected to result in, increased reliability of supply or lower fuel expenses than would otherwise be the case, and that such benefits

[292] *Id*. at 23.

> received or expected to be received by ratepayers exceed the costs that ratepayers otherwise would have paid or otherwise would reasonably expect to pay.[293]

SWEPCO fails to make the required showing, instead relying on more general policy arguments about the variability of purchased power costs.[294] SWEPCO's request fails to meet the requirements of PUC Subst. R. 25.236, is improper piecemeal ratemaking,[295] and is contrary to recent Commission precedent[296]. CARD, therefore, recommends that the Commission reject SWEPCO's request.

B. Request to Recover Consumables and Allowances as Fuel [PO Issue 41]

CARD recommends that the Commission reject SWEPCO's request to recover environmental consumable and allowance costs through SWEPCO's fuel factor.[297] The legal analysis is nearly identical to the analysis for the purchased power capacity costs, discussed above in Section IX.A. SWEPCO did not attempt to establish special circumstances, as required by PUC Subst. R. 25.236(a)(6). Instead, SWEPCO relied on general arguments that upcoming environmental regulations will require SWEPCO to incur consumable and allowance costs.[298] SWEPCO's request, accordingly, is insufficient as a matter of law and should be rejected.

SWEPCO's request is also improper as a matter of policy. SWEPCO cites to the Environmental Protection Agency's ("EPA's") Cross State Air Pollution Rule ("CSAPR") and

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293 PUC Subst. R. 25.236(a)(6).

294 Direct Testimony of Scott Norwood, CARD Ex. 4 at 22.

295 *Id*. at 23.

296 *See Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket 39896, Order on Rehearing at 12, FOF 12 ("[T]he company's proposed purchased-power capacity rider should not be addressed in this case and that such costs should be recovered through base rates.") Furthermore, the Commission is looking at the general issue of purchased power capacity costs in Project No. 39246. Consequently, there is no need to address this issue in this docket.

297 Direct Testimony of Scott Norwood, CARD Ex. 4 at 24.

298 *Id*. at 24. SWEPCO also argued that other utilities recover allowance costs through their fuel rates. *Id*. at 25. This argument fails to support SWEPCO's request, since all of those utilities received that rate treatment through non-precedential settlements and none of the other utilities recover consumables through their fuel rates. *Id.*; Transcript at 1032-1034 (Thurs., Feb. 7, 2013).

Mercury and Air Toxics Standard ("MATS") rules as support for its request.[299] The D.C. Circuit, however, vacated the CSAPR rule last August.[300] Moreover, the MATS rule is not effective until April 2015 at the earliest.[301] This means the alleged cost increases that SWEPCO is relying on may not arise for several years, if at all.[302] Finally, many other expenses fluctuate with fuel expenses, but are not recovered in the fuel factor.[303] SWEPCO's request, accordingly, is premature at best, improper as a matter of policy, and should be rejected.

C. TCRF Baseline [PO Issue 39]

D. DCRF Baseline [PO Issue 39]

E. IBEW Staffing Issues

CONCLUSION

CARD respectfully urges the ALJs and Commission to incorporate each of CARD's recommendations in determining SWEPCO's revenue requirements and related issues and that in the end, the Commission significantly reduce SWEPCO's revenue requirement and grant a rate increase of **no more** than $24.2 million. CARD also requests it be granted all other relief upon which it is entitled.

299 Direct Testimony of Scott Norwood, CARD Ex. 4 at 24.

300 *EME Homer City Generation LP v. EPA*, D.C. Cir. No. 11-1302 (Aug. 21, 2012).

301 Direct Testimony of Scott Norwood, CARD Ex. 4 at 24.

302 *Id*; *see also* SWEPCO's Response to CARD RFI 25-8, CARD Ex. 12 at 1 ("Accordingly, the exact impact of the 2010 SO2 standard on the Welsh Plant has not yet been determined").

303 Transcript at 1685-1691 (Tues., Feb. 12, 2013).

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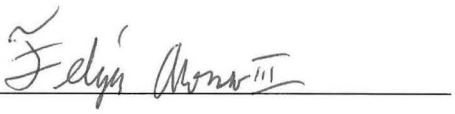
By: 

Felipe Alonso III

ATTORNEYS FOR CITIES ADVOCATING REASONABLE DEREGULATION

CERTIFICATE OF SERVICE

I hereby certify that on this the 6th day of March, 2013, a true and correct copy of CARD's Initial Brief was served upon all parties of record by facsimile and/or First-class United States mail, postage paid.

By: Felipe Alonso III

Felipe Alonso III

SOAH DOCKET NO. 473-12-7519
PUC DOCKET NO. 40443

APPLICATION OF SOUTHWESTERN ELECTRIC POWER COMPANY FOR AUTHORITY TO CHANGE RATES AND RECONCILE FUEL COSTS	**§ § § §**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

REDACTED

CITIES ADVOCATING REASONABLE DEREGULATION'S

REPLY BRIEF

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March 20, 2013

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CITIES ADVOCATING REASONABLE DEREGULATION'S REPLY BRIEF

I. INTRODUCTION/SUMMARY [PRELIMINARY ORDER (PO) ISSUES 1, 2]

Cities Advocating Reasonable Deregulation ("CARD") files this Reply Brief. SWEPCO's Initial Brief does not mask the fundamental flaws of its overall case. SWEPCO imprudently managed key decisions it made while attempting to complete the Turk plant, including decisions that led to expensive litigation and its agreement to prematurely retire the solidly performing Welsh 2 plant. SWEPCO is now proposing that Texas customers pay for its mistakes. SWEPCO's arguments to the contrary lack merit. SWEPCO also fails to meet its burden of proof regarding non-Turk issues. SWEPCO's positions on Return on Equity ("ROE"), depreciation, compensation, prepaid pension assets, severance costs, and damages expenses, among others, are inconsistent with Commission precedent and are not supported by record evidence. Therefore, CARD respectfully urges the Administrative Law Judges ("ALJs") and the Commission to grant SWEPCO a rate increase of no more than $24.2 million, as further reduced by meritorious adjustments proposed by the other intervening parties and Commission Staff.

4. Post-Test Year Adjustment [PO Issues 16, 31]

a. Turk In-Service Date – Not Briefed

b. Transmission Investment and CWIP

SWEPCO claims that it "properly included" a post-test year adjustment for actual and even estimated Construction Work in Progress ("CWIP") for certain transmission projects. However, its proposal does not comply with Commission rules.[4] Although post-test year adjustments are extraordinary relief beyond the standard test year standard,[5] SWEPCO's Initial Brief provides only two paragraphs of argument with scant support for its request that exceeds $72 million dollars.[6] SWEPCO fails to cite a single case to support its claim that under Commission rules, transmission lines are "attendant impacts" of a construction plant thus entitling SWEPCO to an extraordinary, post-test year adjustment. SWEPCO can identify no instance in which the Commission has approved such relief. Instead, SWEPCO dismissively declares that its interpretation "cannot be reasonably debated."[7] SWEPCO is incorrect; it can and should be debated, because SWEPCO's interpretation of the requirements for post-test year adjustments would award extraordinary relief via an unsupported interpretation of the Commission's rule contrary to the Commission's historical practice.

Although SWEPCO agrees that its transmission lines do not independently qualify for a post-test year adjustment,[8] it then claims its transmission lines are nonetheless eligible for a post-test year adjustment because the transmission lines are an "attendant impact" of Turk plant expenses[9] that it asserts are fully eligible for a post-test year adjustment.[10] SWEPCO provides no

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4 *See* P.U.C. SUBST. R. § 25.231(c)(2)(F)(i).

5 *See* PURA § 11.003(2) and P.U.C. SUBST. R. § 25.231(a).

6 SWEPCO's Initial Brief at 30-31 and *see* Direct Testimony of Mark Garrett, CARD Ex. 5 at 4 and Schedule B-1.4. $48,253,216 post test year adjustment of Turk-related transmission CWIP and an additional $24,407,698 for estimated remaining transmission costs for the Turk project.

7 SWEPCO's Initial Brief at 30.

8 *See* Tr. at 2176-2177 (Feb. 14, 2013)

9 SWEPCO's Initial Brief at 30-31.

10 *Id.* at 29.

support in its brief for this theory that an otherwise invalid post-test year adjustment can "piggy back" on an adjustment that may comply with the rule.[11]

Post-test year adjustments must meet the four requirements established by P.U.C. SUBST. R. § 25.231, the rule governing Cost of Service.[12] SWEPCO brushes these requirements aside by claiming that its transmission assets and estimated transmission costs are nonetheless eligible for a post-test year adjustment as an attendant impact.[13] P.U.C. SUBST. R. § 25.231 does reference "invested capital" where it requires that post-test year adjustments must identify, quantify, and match attendant impacts.[14] However, it allows a proposed post-test year adjustment only if all attendant impacts can "with reasonable certainly be identified, quantified, and matched."[15] It does not declare that attendant impacts qualify for a post-test year adjustment; only that attendant impacts of a proposed post-test year adjustment must be identified, quantified, and matched. Whether an attendant impact is sufficiently identified, quantified, and matched to qualify for a post-test year adjustment is a question of fact; attendant impacts do not automatically qualify for post-test year adjustments. The courts have upheld the Commission's ability to deny post-test year adjustments.[16]

The transmission additions to the Turk Plant that SWEPCO describes as "attendant impacts" are simply separate asset additions, not attendant impacts. SWEPCO defines attendant impacts so broadly that it would swallow the rule by allowing any project to qualify as an "attendant impact" of an expense that may qualify for a post-test year adjustment based merely on the claim that it is somehow tangentially connected to that project. Under SWEPCO's

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11 *Id.* at 30-31.

12 P.U.C. SUBST. R. § 25.231(c)(2)(F)(i).

13 *See* Tr. at 2175-2179 (Feb. 14, 2013) and P.U.C. SUBST. R § 25.231(c)(2)(F)(i)(IV). Where the attendant impacts on all aspects of a utility's operations (including but not limited to, revenue, expenses and invested capital) can with reasonable certainty be identified, quantified and matched. Attendant impacts are those that reasonably follow as a consequence of the post test year adjustment being proposed.

14 P.U.C. SUBST. R. § 25.231(c)(2)(F)(i)(IV).

15 *Id.*

16 *Central Power and Light Company/Cities of Alice, et al. v. Pub. Util. Comm'n of Tex.*, 36 S.W.3d 547, 563 (Tex.App.-Austin 2000) (*CP&L v. PUC*).

interpretation of the rule, transmission lines are eligible for post-test year adjustments because they "reasonably follow as a consequence" of the Turk plant. This logic creates the potential for a "daisy-chain" of attendant impacts – e.g. any assets that "reasonably follow" from its transmission lines would by association also "reasonably follow" from Turk. In an interconnected electrical grid system, everything is to some extent connected. SWEPCO fails to sufficiently identify how the transmission lines are attendant impacts. Instead SWEPCO merely states it built the transmission lines because it built Turk.[17]

SWEPCO's claim that transmission lines are an "attendant impact" of generation plant is overly broad and improperly characterizes a separate capital addition as an "impact." SWEPCO has not shown that transmission CWIP qualifies independently as a post-test year adjustment, nor has it established that the transmission lines are an attendant impact of the Turk plant rather than simply a separate asset.

SWEPCO's presumption that attendant impacts qualify for inclusion in its rate base as post-test year adjustments would effectively negate the rule's other three requirements for post-test year adjustments.[18] The rule requires that a valid proposal for a post-test year adjustment must meet each of the four requirements in subsection (c)(2)(F)(i). But under SWEPCO's approach, if one project qualifies for a post-test year adjustment, other related projects can qualify as "attendant impacts" without satisfying all four requirements of the Commission's post-test year adjustment rule. Although the rule requires that a proposed post-test year adjustment must identify, quantify, and match all attendant impacts, SWEPCO's approach interprets that requirement as instead providing that attendant impacts merit additional extraordinary relief without meeting any of the other three requirements. SWEPCO is converting the intent of the rule from one that requires that the *attendant impacts be identified before relief is rewarded*, into a presumption that *relief can be awarded for attendant impacts*.

17 SWEPCO's Initial Brief at 30-31.

18 P.U.C. SUBST. R. § 25.231(c)(2)(F)(i)(II).

Properly understood, P.U.C. SUBST. R. § 25.231(c)(2)(F)(i) provides that a post-test year adjustment will be considered only if the attendant impacts of a proposed adjustment on the utility's operations can be identified, quantified, and matched. It does not provide that attendant impacts qualify for extraordinary relief in the form of a post-test year adjustment. Traditionally, this provision has been understood as saying "we cannot allow this extraordinary relief unless we know all of its impacts" – e.g., potentially offsetting revenues, tax and other expense implications, etc. For example, in *CP&L v. PUC*, the Court discussed Central Power and Light Company's failure to identify attendant impacts as follows: "CPL's *reason* for constructing the asset does not necessarily speak to the *impact* its construction may have on revenues."[19] The – "attendant impact" requirement is not a mechanism for providing additional relief. Instead, the attendant impact requirement prevents that award of a proposed post-test year adjustment unless the utility can identify, quantify, and match the impacts that the proposed adjustment would have on the utility's operations. SWEPCO is trying to stretch the scope of the "attendant impact" requirement while ignoring that its interpretation is contrary to the intent of the rule and how the Commission has previously interpreted the rule.

SWEPCO's argument is even more strained when it seeks to include estimated transmission costs that were not in CWIP at test-year end. Not only is SWEPCO seeking extraordinary relief for expenses beyond the test year when those expenses do not meet all four requirements, but it stretches credulity when it seeks to recover expenditures that it has *not yet incurred*. It is improper to award SWEPCO a post-test year adjustment for these expenses simply because they are connected to the Turk plant, when these transmission lines would never qualify for a post-test year adjustment on their own merits. SWEPCO's proposed post-test year adjustment does not comply with Commission rules because it does not comprise 10% of SWEPCO's rate base before the adjustment.[20] It is also ineligible because only the amount of

[19] *Central Power and Light Company*, 36 S.W.3d at 563.

[20] P.U.C. SUBST. R. § 25.231(c)(2)(F)(i)(II).

CWIP at the end of the test year can be included in rates and the amount SWEPCO seeks to include as a post-test-year adjustment is only estimated.[21]

Further, as explained above, estimated transmission additions are not attendant impacts of the post-test-year adjustment related to the Turk plant nor is inclusion of those additions consistent with the intent of the rule, which requires assets to be more than generally related to establish an attendant impact. More importantly, the "attendant-impact" provision is meant as an analysis that must be conducted before regarding a proposed adjustment; it is not a vehicle for additional relief. Assets can be included in rates as a post-test year adjustment only if they meet all four post-test year adjustment requirements, which even the Company admits it cannot meet.[22]

SWEPCO's request is an aggressive, expansive view of attendant impacts that could have far-reaching impacts in this case and beyond. CARD respectfully asks the ALJs and the Commission to reject SWEPCO's view that if an asset qualifies for a post-test year adjustment, any other assets somehow partially related to the qualifying asset automatically becomes recoverable in CWIP as an attendant impact. CARD instead urges the Commission to continue its historical view of attendant impacts that is based on the matching principal[23] and related accounting conventions.[24] SWEPCO's post-test year increase in rate base for estimated transmission costs and related ADFIT, depreciation expense, and ad valorem tax expense should be denied.[25]

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21 P.U.C. SUBST. R. § 25.231(c)(2)(F)(ii).

22 *See* Tr. at 2176-2177 (Feb. 14, 2013)

23 *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 37364 Supplemental Preliminary Order at 7-8 (Oct. 12, 2009). The matching principal dictates that whenever you take into account additional costs, one must also factor in additional revenue over the same period of time to establish reasonable and necessary rates.

24 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 6-9.

25 *Id.* at 9.

5. Turk Land Costs [PO Issue 6] – Not briefed.

6. Turk Auxiliary Boiler [PO Issue 6]

SWEPCO's description of its decision-making process in buying the ultimately unused auxiliary boiler confirms the conclusion that SWEPCO should pay for the cost of that boiler. SWEPCO states it "believed not only that the air permit could be revised to reflect this engineering and design refinement, but also that this revision would be relatively quick and of little risk to the project schedule."[26] SWEPCO in essence is saying that it believed it could ignore the requirements of the air permit and get forgiveness for that deviation later. The ALJs should not validate SWEPCO's approach. SWEPCO imprudently handled the purchase of the unused auxiliary boiler and therefore its shareholders should bear the cost of that boiler.

7. Application of Cost Cap [PO Issues 6, 17]

CARD discusses the application of the cost cap in Section II.A.3 (litigation and settlement costs) and Section II.A.8 (Welsh Unit Two). As CARD discusses in those sections, the cost cap bars SWEPCO's recoveries of the Turk litigation and settlement costs, as well as any future Welsh 2 retirement costs.

8. Welsh Unit Two

As a threshold matter, CARD agrees with SWEPCO "[that] any impacts of the Welsh Unit 2 retirement should be considered when that retirement becomes fact."[27] Accordingly, CARD respectfully urges the Commission to defer any finding on the prudence of any retirement of Welsh 2 until the plant is actually retired.

However, if SWEPCO implements its plan to retire Welsh 2, the current record shows that such a decision would be imprudent. On pages 12-13 of its Initial Brief, SWEPCO provides a detailed analysis of the benefits of fuel diversity. CARD fully agrees that fuel diversity is

[26] SWEPCO's Initial Brief at 33.

[27] SWEPCO's Initial Brief at 10.

beneficial. Unfortunately, SWEPCO is making its system less fuel diverse - with a net loss of 88MW of coal - by deciding to close Welsh 2 in order to justify approval to deploy Turk.[28]

SWEPCO's other arguments in favor of retiring Welsh 2 also lack merit. SWEPCO first argues that it had already agreed to retire Welsh 2 when it settled the Sierra Club litigation.[29] SWEPCO's argument is inconsistent with its letter to SPP, where it told SPP:

> Southwestern Electric Power Company (SWEPCO) wants to confirm to SPP its plans to retire Welsh Unit 2, a 528-MW coal-fired unit located near Pittsburg, Texas. The retirement is required by the terms of a Consent Order issued on December 22, 2011, by the United States District Court for the Western District of Arkansas, which resolved all pending legal challenges to the completion of construction and commencement of commercial operation of SWEPCO's John W. Turk, Jr. Power Plant …[30]

In this letter, SWEPCO told SPP that it was retiring Turk due to the Turk litigation, which includes the Sierra Club litigation. Changing that story now is simply not credible.

SWEPCO next argues that it would have to take remedial environmental actions for Welsh 2 regardless of Turk.[31] This, however, does not justify retiring Welsh 2 in order to complete Turk. SWEPCO estimates that retrofitting Welsh 2 would cost $529 million.[32] Turk, on the other hand, will cost Texas ratepayers at least $1.522 billion. Texas ratepayers, therefore, are paying an additional nearly $1B in order to receive 88M less capacity. This is a bad deal. SWEPCO is acting imprudently by choosing to retire instead of retrofitting Welsh 2.

SWEPCO also argues that settling the Turk-related lawsuits saved ratepayers costs associated with Allowance for Funds Used During Construction ("AFUDC").[33] SWEPCO's

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28 Direct Testimony of Scott Norwood, CARD Ex. 4 at 13.

29 SWEPCO's Initial Brief at 25.

30 Direct Testimony of Scott Norwood, CARD Ex. 4 at 12, Exhibit SN-11.

31 SWEPCO's Initial Brief at 27.

32 *Id*.

33 *Id*. at 26.

argument is factually incorrect. Nothing in the Commission's order in Docket No. 33891 excludes AFUDC from the cost cap. The Commission's order states in relevant part:

> The cap on the capital costs that Texas retail consumers may be responsible for is the Texas jurisdictional allocation of $1.522 billion. This limits the financial risk to Texas ratepayers arising out of uncertainties identified in the testimony including, but not limited to, the following: increased material and labor costs due to delays; costs as a result of changes in certification or approval of the Turk Plant by other jurisdictions; changes in the currently proposed ownership participation; and additional costs of plant construction, including those associated with the use of ultra-supercritical technology.[34]

There is no exclusion of AFUDC. Indeed, the Commission addresses AFUDC in P.U.C. SUBST. R. § 26.72(g) under the heading "Rules related to capitalization of construction costs," which makes it clear that the Commission views AFUDC as a capital cost. Because AFUDC is a capital cost, it is subject to the Commission's cost cap from Docket No. 33891. Therefore, SWEPCO's argument that it saved ratepayers AFUDC costs by agreeing to retire Welsh 2 is simply factually wrong.

Finally, SWEPCO argues that its customers benefit from the completion of Turk.[35] SWEPCO's argument is at best questionable, particularly given the imprudent steps – such as agreeing to retire Welsh 2 – that SWEPCO took to complete the Turk. SWEPCO is asking customers to pay 33 percent higher rates for 88MW less capacity (once Welsh 2 is retired). SWEPCO should bear the costs of its imprudent decisions, including the future retirement of Welsh 2.

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[34] *Application of Southwestern Power Company for a Certificate of Convenience and Necessity Authorization for a Coal Fired Power Plan in Arkansas*, Docket No. 33891, Order at 20 (Aug. 12, 2008).

[35] SWEPCO's Initial Brief at 28.

B. Prepaid Pension Asset and ADIT Impacts [PO Issue 6]

SWEPCO claims that compliance with PURA § 36.065(b) and (c) is optional, and seeks a prepaid pension asset without these "optional" mechanisms.[36] SWEPCO does not want to establish a pension expense tracker as outlined in PURA § 36.065(b) and (c) because although it would allow SWEPCO "to track and recover under-recovered pension expense," it would "not provide for the inclusion in rate base of pension fund contributions in excess of pension expense, which is what the Company is requesting."[37]

However, it is important to require a pension tracker because the Company's pension asset is not exclusively composed of cash contributions, but rather consists of a negative pension expense or a combination of cash contributions and negative pension expense.[38] Prior to the adoption of FAS 87 in 1987,[39] "the pension expense included in rates was based on pension fund contributions **funded by ratepayers**."[40] There is simply no evidence since implementation of FAS 87 in 1987 that the Company's pension asset consists of pension fund contributions by the Company.[41] The tracker would establish exactly what the Company contributed in cash and should be adopted.

Even though SWEPCO acknowledged that FAS 87 was not adopted for ratemaking purposes in Texas until 2005, which would make 2005 the earliest year the Company could begin tracking the differences between cash contributions and FAS 87 costs, the Company's proposal includes amounts going back to 1987.[42] SWEPCO did not file a rate case between

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36 *Id.* at 38-40.

37 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 11.

38 A negative pension expense balance is the result of underestimated pension fund earnings that, relative to their estimates, resulted in higher pension expense and higher contribution requirements.

39 Tr. at 408 (Feb. 5, 2013).

40 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 12.

41 *Id.*

42 Before FAS 87 was adopted for ratemaking purposes, rates were set based on the utility's cash contribution levels. This means that before 2005, there were no differences between cash contributions and pension costs for ratemaking purposes. *See* Tr. at 409 (Feb. 5, 2013).

1984 and 2009,[43] so its pension expenses could not be based upon FAS 87 for ratemaking purposes because there was no change in the ratemaking treatment by SWEPCO's since FAS 87 was implemented.[44] The fact that FAS 87 did not exist until 2005 undermines SWEPCO's central claim that it has contributed more to the fund than it has collected through rates since 1987, because it could not have used FAS 87 to set rates before 2005 when FAS 87 was implemented in Texas, or 2009 when it had its last rate case.[45] At best, SWEPCO's claim would be limited to the accumulated difference between cash contributions and FAS 87 cost levels from 2005 forward.

Once again, the best way to resolve how much SWEPCO has contributed to its pension asset in this case and going forward is to establish a pension-expense tracker. Doing so would mitigate the concern that actual FAS 87 pension-expense levels change each year while the amount included in rates can only change pursuant to a rate case. In other words, yearly FAS 87 expense levels are not necessarily consistent with the amount customers actually pay in rates. The Commission should only permit recovery of pension assets in rate base if a pension tracker is established in this case. Afterwards, in a future rate case, SWEPCO could submit the difference between actual cash contributions and FAS 87 costs as a pension asset for ratemaking consideration.

Once the tracker is established, the prepaid pension balance could be submitted for ratemaking consideration in the next rate case. The analysis could then focus on 1) the reasonableness of the contributions; and 2) the benefit that customers derived from these contributions.[46] Also the benefit to customers should be consistent with the actuarially expected

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43 "We had a period the late 1990s where we had extraordinary good investment market returns and had quite a few years that we didn't have to make any contributions, even had situations where pension costs went negative as a results of those really good revenues." Tr. at 422 (Feb. 5, 2013).

44 Tr. at 409 (Feb. 5, 2013).

45 Prior to 2005, the cash contribution level was used to set rates in Texas, so, theoretically, there was no difference between cash contribution levels and the amounts included in rates.

46 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 14.

return of pension assets that is used to determine the annual FAS 87 pension calculation. The Company expects a return of 7.5%, so the return allowed on the excess pension contributions should not exceed 7.5%, and should not be based on the full rate base return grossed up for tax as SWEPCO proposes. Such a calculation artificially drives up the return allowed on the excess pension contributions. The Commission should not assign a higher rate of return on the excess pension assets that is beyond what the Company realistically expects to achieve because it is inequitable and not supported by the Company's own calculations. It would be fair to cap customer contributions such that they do not exceed the benefit that customers receive from the contributions, i.e. the expected return.

SWEPCO's prepaid pension asset should not be included in rate base, but at the very least, no portion of the pension asset should be recognized prior to the adoption of PURA § 36.065 and FAS 87 in 2005. This means the amount that would be included in rate base would be $31,907,000 on a total company basis, which would then be reduced by ADFIT (35%) and CWIP (28.70%),[47] to comply with prior commission orders.[48]

C. Oxbow Investment [PO Issue 6] – Not Briefed

D. Mountaineer Carbon Capture & Storage Project [PO Issue 15]

SWEPCO attempts to rely on a 25-year old decision to justify its request to recover the Mountaineering CCS costs.[49] SWEPCO's reliance is misplaced. West Texas Utility ("WTU") wanted to recover $17,500, while SWEPCO is seeking over 25 times that amount – $475,922 – for the Mountaineering CCS Project. For a project of this magnitude and type, SWEPCO should have sought advanced approval from the Commission. SWEPCO did not. SWEPCO, therefore,

47 *See* Exhibit MG3.1

48 Rebuttal Testimony of Hugh E. McCoy at Exhibit HEM-1R, SWEPCO Ex. 79. The $31,907,000 is the difference between Cash Contributions and FAS 87 Pension Costs from 2005 forward.

49 SWEPCO's Initial Brief at 44.

should bear the cost of this unused project. And more importantly, the Mountaineering CCS Project is not nor has it ever been used and useful in providing service to ratepayers.

E. Capitalized Incentive Compensation – Not Briefed

III. RATE OF RETURN [PO ISSUES 4, 5]

A. Return on Equity [PO Issue 5]

SWEPCO spends many pages of its Initial Brief addressing the details of its proposed Return on Equity ("ROE").[50] CARD responds below to the specific issues that CARD addressed in its Initial Brief. The back and forth between SWEPCO's argument and the parties' positions, however, can mask the real issue. The bottom line is that there is ample evidence in the record to support an ROE at or below the 9.6 to 9.8 percent range that the Commission recently set for Entergy Texas, Inc. ("Entergy") and Lone Star Transmission, LLC ("Lone Star").[51] Nothing in SWEPCO's Initial Brief rebuts this clear conclusion.

i. Reasonable Range of ROEs

SWEPCO first argues that the Staff's and Intervenors' recommended ROEs are "outliers."[52] However, when the parties' recommendations are compared to the Commission's recently approved ROEs, it is clear that SWEPCO's recommendation is the outlier.[53]

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50 *Id.* at 46-72.

51 *Application of Entergy Texas, Inc., for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing at 6 (November 2, 2012) ("Entergy"); *Application of Lone Star Transmission, LLC, for Establish Interim and Final Rates and Tariffs*, Docket No. 40020, Order on Rehearing at 4 (February 12, 2013) ("Lone Star").

52 SWEPCO's Initial Brief at 47.

53 *See also* CARD Ex. 130 (outlining the Commission's precedent and the parties' positions on ROE).

ROEs:

11.25	SWEPCO (Hevert)
…	
11.0	
…	
10.0	
…	
9.8	Walmart (Chriss)
9.8	**Entergy (Docket No. 39896)**
9.6	**Lone Star (Docket No. 40020)**
9.55	CARD (Parcell)
9.5	OPUC (Szerszen)
9.3	TIEC (Gorman)
9.2	Staff (Cutter)
9.0	Cities Served by SWEPCO (Hill)

SWEPCO's recommended ROE of 11.25 percent is 145 to 165 basis points higher than the Commission's recently approved ROEs for Entergy and Lone Star. CARD's recommendation, on the other hand, is within 5 and 25 basis points of the Commission's recent decisions. By any rational use of the word "outlier," SWEPCO is the outlier.

SWEPCO's analysis of recently authorized ROEs is also factually incorrect. SWEPCO argues that the "central tendency for authorized returns" is between 10 and 10.5 percent.[54] The Commission's recent awards of 9.6 and 9.8 percent directly refute SWEPCO's argument. Indeed, SWEPCO remarkably makes *no* mention of the Commission's recent ROE decisions.

Furthermore, SWEPCO's own data shows that the central tendency for authorized returns is at or below 9.8 percent when evaluating states that are comparable to Texas. Texas is ranked as a "2" in Standard & Poor's ("S&P's") rankings.[55] The mean authorized ROE for other states ranked as a "2" in 2012 was 9.78 percent and the comparable median ROE was 9.8 percent.[56] States that are geographically close to Texas, such as Missouri and Kansas, authorized ROEs of

[54] SWEPCO's Initial Brief at 47.

[55] Rebuttal Testimony of Robert B. Hevert, SWEPCO Ex. 74 at Exhibit RBH-27R.

[56] *Id*.

9.8 and 9.5 percent, respectively, in the last quarter of 2012.[57] And, the last authorized ROE in 2012 is 9.8 percent.[58] Texas' recent range of 9.6 to 9.8 percent, therefore, is very competitive with its peers.

ii. Economic Conditions

SWEPCO paints a picture of market risk that is flatly inconsistent with actual economic conditions.[59] Interest rates are at historical lows – the Federal Funds Rate is at 0.25 percent, an all-time low, and bond yields are at their lowest levels in 35 years.[60] Inflation is also at its lowest level in three decades.[61] SWEPCO does not contest these inescapable facts.

Instead, SWEPCO argues that historically low interest rates and inflation somehow equate to increasing costs of equity.[62] This argument is contrary to common sense. If an investor is earning nearly zero in his or her savings account and barely more than that from government bonds, even a low return on equities looks appealing. Indeed, most investors these days would be thrilled with the before-tax annual return of 9.55 percent that CARD is recommending in this case.

SWEPCO's argument is also contrary to the economic models that SWEPCO itself relied upon to calculate its ROE.[63] Interest rates and inflation impact the growth rate of the DCF model, the risk-free return of the CAPM, and the bond yield in the "Bond Yield Plus Risk

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57 *Id*. SWEPCO also attempts to restate CARD witness Mr. Parcell's data to argue that authorized returns often occur between 10 and 11.25 percent. SWEPCO's Initial Brief at 68-69. SWEPCO's argument fails for the same reasons discussed above. When the parties' ROE positions are compared to the recent Texas decisions and the decisions of Texas' peers, the ROEs in the 9.5 to 9.8 percent range are the comparable decisions. Indeed, Mr. Parcell's data supports this conclusion, since in 2011, for example, 19 of 43 decisions fell under 10 percent. Direct Testimony of David Parcell, CARD Ex. 1 at 32.

58 Rebuttal Testimony of Robert B. Hevert, SWEPCO Ex. 74 at Exhibit RBH-27R.

59 SWEPCO's Initial Brief at 48-50.

60 Direct Testimony of David Parcell, CARD Ex. 1 at 10.

61 *Id*.

62 SWEPCO's Initial Brief at 48-49.

63 *See* Direct Testimony of Robert B. Hevert, SWEPCO Ex. 35 at 18-33 (applying the Discounted Cash Flow ("DCF"), Capital Asset Pricing Model ("CAPM"), and Bond Yield Plus Risk Premium models).

Premium" model. As interest rates and inflation drop, the growth rate, risk-free return, and bond yield drop as well, causing each respective model to lower the required ROE.

Finally, SWEPCO argues that utility stocks have recently underperformed relative to the S&P 500,[64] but omits the fact that utility stocks outperformed the S&P 500 in six of the last nine years.[65] This is not surprising, given the market turbulence caused by the "Great Recession" and the popular perception of utility stocks as safe havens. The Edison Electric Institute ("EEI"), SWEPCO's own utility trade group, succinctly captures this pattern:

> As the market recovery continued in 2010, with 14% to 17% gains, the staid utility sector's 7% return could not keep pace. Yet when 2011 produced worries of economic slowdown, the worsening of the European debt crisis and the summer's woefully memorable deficit gridlock and S&P downgrade of U.S. Treasury debt in August — along with sharply falling interest rates — the EEI Index powered forward with a 20% return against single-digit gains across the broader markets.[66]

Thus, even SWEPCO's own trade group recognizes that utility stocks remain an attractive investment.

In summary, utility companies, with their consistent and rising dividends[67], can easily attract equity in an economy offering next to nothing for savers seeking low risk investments. The authorized ROE should be set accordingly.

iii. SWEPCO's Risk Factors

SWEPCO argues that it should receive a higher ROE because of environmental compliance costs.[68] The record reflects otherwise. In its Initial Brief SWEPCO references "a

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64 SWEPCO's Initial Brief at 49-50.

65 Direct Testimony of Michael P. Gorman, TIEC Ex. 3 at 9, Figure 1. Figure 1 shows the S&P outperforming utility stocks for the first three quarters of 2012.

66 *Id*. at 9, quoting EEI Q3 2012 Financial Update "Stock Performance" at 6.

67 Direct Testimony of David Parcell, CARD Ex. 1 at 11.

68 SWEPCO's Initial Brief at 50-51.

series of regulations finalized by the EPA."[69] SWEPCO does not mention that arguably the most costly regulation, the Cross-State Air Pollution Rule ("CSAPR"), was vacated by the D.C Circuit last August.[70] The other most controversial regulation, the Mercury and Air Toxics Standard ("MATS"), does not become effective until April 2015, at the earliest.[71] It is unsound public policy to set rates in anticipation of events that will not occur for at least two years, if at all.

Furthermore, even if the Environmental Protection Agency ("EPA") does ultimately implement some of those regulations, there is nothing about the regulations that would fundamentally change the risk profile of utilities such as SWEPCO. As Moody's stated in its June 29, 2011 credit opinion for AEP, SWEPCO's parent company, "in our opinion, the costs of environmental compliance will largely be recoverable in rates in regulated jurisdictions."[72] Moody's also opined that it "incorporates a view that the timing of compliance requirements with any new laws or proposals will be incurred over many years and the costs associated with any new legislation regarding emissions will generally be recoverable through rates" and concludes "[a]s a result, recent EPA rules and proposals are not viewed as a material credit negative over the near-term horizon."[73] In other words, nothing fundamental has changed.

Finally, SWEPCO argues that it should receive a higher ROE due to its "relatively weak financial profile."[74] SWEPCO's argument lacks merit, since it created its own capital risks. SWEPCO mismanaged the completion of the Turk plant, resulting in cost overruns, litigation, and costly settlements.[75] PURA Section 36.052 outlines the factors the Commission should consider in setting an ROE, including the efficiency of the utility's operations and the quality of

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69 *Id*. at 50.

70 *EME Homer City Generation LP v. EPA*, 696 F.3d 7 (D.C. Cir. 2012).

71 40 CFR § 63.9984.

72 Direct Testimony of David Parcell, CARD Ex. 1 at 33-34; quoting SWEPCO's Response to CARD's 8th RFI, Question No. 8.2, Attachment Page 2 of 46.

73 Direct Testimony of David Parcell, CARD Ex. 1 at 34; quoting SWEPCO's Response to CARD's 8th RFI, Question No. 8.2, Attachment Pages 2 and 3 of 46.

74 SWEPCO's Initial Brief at 51.

75 CARD's Initial Brief at 1, 3-5, 11-13.

the utility's management.[76] Turk increased SWEPCO's net plant by nearly a third[77] – unfortunately for its ratepayers, SWEPCO poorly managed the completion of this hugely rate-impacting project. Applying PURA Section 36.052, SWEPCO should receive a lower ROE, not a higher one.

iv. Application of the ROE Models

SWEPCO spends over 14 pages of its Initial Brief arguing for its flavors of the various ROE models.[78] Below CARD will briefly address SWEPCO's arguments on the ROE-modeling issues that CARD addressed in this case. However, CARD notes as a threshold matter the sage observation by the Administrative Law Judges in Docket No. 39896: "[A]s acknowledged by virtually all experts on the subject, estimating the cost of equity is not an exact science, but rather a result of informed judgment."[79] The Intervenors and Staff introduced extensive testimony in the record that supports ROEs of between 9 and 9.55 percent and that meets the legal requirements of *Hope* and *Bluefield*.[80] The parties' collective testimony certainly provides evidentiary support for a 9.6 to 9.8 percent range, comparable to the ROEs that the Commission recently set in the *Lone Star* and *Entergy* cases. Nothing in the record of this case suggests that SWEPCO's ROE should be higher than Entergy's 9.8 percent – indeed, the record supports, if anything, a moderately lower ROE.[81]

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76 PURA Sec. 36.052(3) and (4).

77 SWEPCO's Petition and Statement of Intent at 5 ("SWEPCO's investment in the Turk plant … represents an increase of approximately 35% to SWEPCO's net plant at December 31, 2011.").

78 SWEPCO's Initial Brief at 54-68.

79 Docket No. 39896, Proposal for Decision at 91.

80 *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 at 601 (1942) ("Hope"); *Bluefield Water Works and Improvements Co. v. Public Serv. Comm'n of West Virginia*, 262 U.S. 679 at 691 (1923) ("Bluefield").

81 CARD's Initial Brief at 21.

a. DCF Model

SWEPCO argues that it is acceptable to rely solely on analysts' forecasted earnings per share for the DCF model's growth rate.[82] However, SWEPCO's approach is unreasonably limited because it assumes that investors only consider analyst's reports when evaluating stocks.[83] This view of the investing process is unrealistic, as investors consider many sources of information, including historical earnings information that is widely available through sources such as Value Line.[84] Furthermore, academic studies and past investor experience have shown that analysts typically overestimate earnings.[85] CARD, therefore, recommends using both projected and historical data when evaluating the DCF models.[86]

b. CAPM Model

SWEPCO attempts to justify its inflated risk premiums, which are a key component of the CAPM calculation.[87] SWEPCO's arguments lack merit. The risk premium is the differential in returns between common stocks and government bonds.[88] From 1929 to the present, that differential has averaged between 4.1 percent (geometric average) and 5.7 percent (arithmetic average).[89] SWEPCO's proposed risk premiums of 9.99 to 10.62 percent[90] are simply designed to increase the ROE, and are far above the historical experience. CARD recommends rejecting SWEPCO's proposed risk premiums.

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82 SWEPCO's Initial Brief at 57-58.

83 Direct Testimony of David Parcell, CARD Ex. 1 at 29-30.

84 *Id*.

85 *Id*. at 30-31, Exhibit DCP-15.

86 *Id*. at 17.

87 SWEPCO's Initial Brief at 61-62.

88 Direct Testimony of David Parcell, CARD Ex. 1 at 20.

89 *Id*. at 21.

90 SWEPCO's Initial Brief at 63.

B. Cost of Debt [PO Issue 5] – Not Briefed

C. Capital Structure/Overall Rate of Return [PO Issue 4]

For the reasons that CARD discusses above, CARD recommends an overall rate of return of 7.72 percent.[91]

IV. OPERATING & MAINTENANCE EXPENSES [PO ISSUES 18, 19, 21, 23]

A. Turk O&M – Not Briefed

B. Gas Fired Generation – Not Briefed

C. Planned Outage Expense

SWEPCO's rebuttal to CARD's $6.98 million disallowance of non-fuel O&M related to SWEPCO's outages at certain of its generating plants[92] lacks merit. SWEPCO first argues that O&M costs should be looked at the entire fleet level of its plants.[93] CARD agrees. However, in discovery, SWEPCO stated that the increase in gas plant O&M was caused by the addition of the Stall plant and major planned outages at the Lieberman and Wilkes plants.[94] CARD witness Mr. Norwood, therefore, focused on the Lieberman and Wilkes plants and noted that the test year costs for those two plants were far higher than the costs in prior years.[95] It is a standard ratemaking procedure to normalize costs if the test year costs are dramatically different than the costs in prior years. Mr. Norwood did precisely that.

SWEPCO then argues that CARD did not normalize solid fuel O&M costs.[96] SWEPCO, not CARD, bears the burden of supporting its solid fuel O&M costs. If SWEPCO believed its

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91 Direct Testimony of David Parcell, CARD Ex. 1 at 2.

92 SWEPCO's Initial Brief at 76-77.

93 *Id*.

94 Direct Testimony of Scott Norwood, CARD Ex. 4 at 17.

95 *Id*. at 18.

96 SWEPCO's Initial Brief at 77.

solid fuel O&M costs warranted normalization, it could have proposed as much. If the facts show that the test year costs are materially different from prior year costs, CARD supports an adjustment to normalize those costs. CARD, however, did not address solid fuel O&M costs in this case so it cannot provide an opinion at this stage of the proceeding on SWEPCO's claim. SWEPCO's raising of the issue during the briefing stage is simply too late. Nor does SWEPCO's argument that the failure to normalize an expense in one element of its costs warrants a rejection normalizing an expense in a separate area of its costs.

D. Welsh Unit Two

CARD discusses the Welsh 2-related issues in Section II.A.8, *supra*.

E. 2010 Severance Costs [PO Issue 15]

SWEPCO claims that it did not actually receive any cost savings from its 2010 severance program because it used those savings to partially offset the Texas portion of the operating cost and return at SWEPCO's Stall plant.[97] SWEPCO claims that it should be allowed to retain its severance-program profits because it made a bargain with itself that it would get to keep those windfall profits in exchange for a delay in seeking recovery of its expenditures in the Stall plant. While SWEPCO's "because I said so (to myself)" approach may be simpler, it has no basis in PURA or Commission precedent. And importantly, the record does not support SWEPCO's argument; there simply is no connection between the operating costs at the Stall plant and SWEPCO's severance program. What the record shows is that:

- ***10 days after the Commission approved a settlement*** in SWEPCO's previous rate case, Docket No. 37364, SWEPCO informed the parties, for the first time, of the 2010 severance program.[98]

[97] *Id.* at 79-83.

[98] SWEPCO's Initial Brief at 80.

- The severance program, according to SWEPCO's own calculations, ***saves it $14.7 million per year*** and started the same month as the rates approved in the settlement in Docket No. 37364, a settlement that is now nearly three years old.[99]

- SWEPCO ***unilaterally declared*** that its windfall profits from its severance program would permit it to delay its request for Stall recovery.[100]

- SWEPCO then withdrew its limited-issue rate proceeding in Docket No. 37565 which sought extraordinary relief not contemplated by PURA or the Commission's rules**.**

But none of this verifies SWEPCO's claim that is unilateral decision to delay the addition of Stall plant into rates is somehow linked to its savings from the severance program. There is no settlement agreement or Commission order corroborating this nexus. SWEPCO ignores that PURA and the Commission's rules govern how its rates are set and which of its investments are to be included in rates. Instead the above facts show that SWEPCO reached settlement in its previous rate case and immediately changed the foundation of settlement. This change only benefited SWEPCO. The parties and the Commission never had an opportunity to assess the value of the severance expenses in relation to Stall because they were never given that opportunity and such scrutiny demonstrates that are not related. After the Docket No. 37364 deal was approved SWEPCO withdrew its limited-issue rate proceeding, Docket No. 37565. However, neither the Commission nor the parties ever agreed that Stall and the severance cost savings were offsetting expenses and savings. The severance expenses are outside the test year, fully recovered, unnecessary for SWEPCO's financial integrity and were never established as deferred assets. SWEPCO's request to now recover severance costs should be rejected.

In support of its theory SWEPCO attempts to demonstrate that when the 2010 severance-cost savings and the partial recovery of Stall in Docket No. 37364 are totaled, it somehow results

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99 The actual amount of costs avoided (and accrued to the benefit of the company) during the interim period since the last rate case is *greater* than $14.7 million per year. However, for purposes of CARD's analysis it utilized the Company's stated annual cost savings of $14.7 million per year. *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 16.

100 SWEPCO's Initial Brief at 80-81.

in a significant under recovery. The ALJs and the Commission should reject SWEPCO's theory as nothing more than that: A theory lacking support in fact or in the record.

In Docket No. 37364 the Commission approved a settlement setting SWEPCO's rates.[101] The Commission's order approving the settlement concluded that the settlement rates were "just and reasonable."[102] But well after the fact, SWEPCO now argues that when the Commission approved the settlement rates, the Commission was tacitly agreeing that SWEPCO could retain the savings produced by the Severance Program in exchange for the purported "shortfall" in revenue for the delay in seeking recovery of the Stall plant in rates. But what SWEPCO excludes from its theory is that it never disclosed to the parties or the Commission that the level of expenses upon which the settlement rates were based, was about to be reduced by about least $14.7 million annually.

The more open way for SWEPCO to remedy its purported shortfall would have been either to have disclosed the impending layoffs and to have sought recovery of its Stall plant in the settlement agreement it supported, or refuse settlement and seek the relief in a litigated hearing. Instead, SWEPCO is now pointing to a one-party bargain it made with itself and requesting a rate increase to lock in those anticipated profits; doing so is not only inequitable to ratepayers, but also constitutes retroactive ratemaking.[103] SWEPCO also misconstrues CARD's argument that the Commission should not create a regulatory asset for subsequent recovery, that is, approve deferred-accounting treatment with regard to SWEPCO's 2010 Severance Program, as an argument that the Commission can never utilize deferred accounting.[104] That is not CARD's position. The Commission can use deferred accounting if it is necessary to carry out a provision of PURA and where the utility establishes that such treatment is necessary for its

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101 *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 37364 Final Order (April 16, 2010).

102 *Id.* at CoL 5.

103 *State v. Public Utility Comm'n of Texas*, 883 S.W.2d190, 198-199 (Tex. 1994).

104 SWEPCO's Initial Brief at 81.

financial integrity.[105] Even the case SWEPCO relies upon[106] ultimately resulted in the Commission disallowing the requested deferral (even though the expense was incurred from the test year going forward unlike here where SWEPCO is requesting recovery for a three-year old expense that it has already recovered).[107] In the *Entergy Case*, Entergy failed to secure deferred accounting, it followed the general process of 1) seeking approval to record the charges; and then 2) the charges were reviewed in a subsequent rate proceeding.[108]

Rather than following the required process, SWEPCO followed the process the Commission rejected in Oncor Electric Delivery Company's rate case, Docket No. 35717.[109] Just like SWEPCO, Oncor undertook a variety of restructuring measures that saved it considerable expense outside of the test year and which it had fully recouped by the time of its test year.[110] The Commission in an identical situation determined, "Oncor's restructuring expenses were not incurred in the test year, were not authorized by PURA or a Commission rule or preapproved by the Commission, and the recovery of which were not shown to be essential to its financial integrity."[111] SWEPCO has offered no justification that would overcome the precedent of the Commission's decision in Docket No. 35717.

SWEPCO also cites to the Commission's Preliminary Order in Docket 39741. In that order the Commission noted that it granted deferred accounting "to protect the financial integrity

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105 Tr. at 350-357 (Feb. 5, 2013) and *Application of Entergy Texas., Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing (Nov. 2, 2012) ("Entergy Case").

106 SWEPCO's Initial Brief at 82 and *see Application of Entergy Texas., Inc. for Authority to Defer Expenses Related to its Proposed Transition to Membership in the Midwest Independent Transmission System Operator*, Docket No. 39741, Preliminary Order (Nov. 22, 2011).

107 Tr. at 350-357 (Feb. 5, 2013) and *Application of Entergy Texas., Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing (Nov. 2, 2012). Docket No. 39741 was consolidated into Docket No. 39896.

108 *West Texas Utilities Co. v. Office of Public Utility Counsel*, 896 S.W.2d 261, 265 (Tex. App.-Austin, 1995, no writ history).

109 *Application of Oncor Electric Delivery Company LLC for Authority to Change Rates*, Docket No. 35717, Order on Rehearing at 20, FoFs 75-78 (Nov. 30, 2011).

110 Docket No. 35717, Order on Rehearing at 20, FoF 75.

111 *Id.* at FoF 77.

of those utilities, which the Commission found was at risk due to the effect of extraordinary regulatory lag."[112] By contrast, SWEPCO does not make a financial integrity claim in its filing.

Additionally, SWEPCO cites to two provisions of PURA to show deferred accounting is necessary to carry out a provision of PURA. SWEPCO cites PURA § 36.051, which is the basic overall revenues statue, and PURA § 36.033(a), which requires just and reasonable rates. SWEPCO claims these two broad statues permit it deferred accounting "to carry out the major statutory policy objectives" in PURA.[113] While these two provisions of PURA may authorize the Commission grant the extraordinary relief of deferred accounting, SWEPCO has not made the requisite showing that it warrants such relief.

Further, SWEPCO's sweeping claim would stretch beyond what Entergy proposed and the Commission rejected in Docket No. 39741. In the *Entergy Case*, Entergy posited two possible standards for deferred accounting: 1) "to preserve for future recovery a cost that is appropriately recovered by the utility but cannot be captured in the context of test[-]year ratemaking principles;" and 2) "a utility should be allowed to defer for future recovery costs that are incurred in good faith in pursuit of a regulatory objective reflected in PURA, if the alternative would be to write off the expenses."[114] The Commission rejected Entergy's proposed standards stating, "[t]hat standard would allow deferral of costs if there was the slightest movement towards a statutory objective, a term that is vague and therefore not useful to decide the present question. The Commission concludes that to carry out a provision of PURA means more than simply make some undefined progress towards some objective."[115]

Yet here SWEPCO presents to the Commission a deferred accounting request that is not necessary for its financial integrity, is based upon undefined and broad statutory objectives, and for expenses that it has already collected in the interim since its last case. SWEPCO's request to

112 Docket No. 39741, Preliminary Order at 4.

113 SWEPCO's Initial Brief at 82.

114 Docket No. 39741, Preliminary Order at 10.

115 *Id.* at 11.

recover the 2010 severance cost expenses is ineligible for deferred accounting and SWEPCO's request to recover these expenses in prospective rates should be rejected.

F. Vegetation Management – Not Briefed

G. Credit Line Fees – Not Briefed

H. Obsolete Inventory – Not Briefed

I. Depreciation Expense [PO Issue 21][116]

1. Production Plant

a. Production Plant Lives

i. Turk

As explained in CARD's Initial Brief, CARD advocates a minimum 55-year life for the Turk Plant, by contrast to the 40-year life proposed by the Company.[117] Mr. Davis incorrectly assumed that Mr. Pous had recommended a 60-year life, and SWEPCO's Initial Brief continues this error.[118] In its Initial Brief, the Company rejects CARD's point that Turk should have an estimated life that is consistent with SWEPCO's other coal generating units, asserting that it only recently changed the projected lives of its coal units to beyond 40 years, and Turk lacks the same track record.[119] SWEPCO's claim that Turk lacks the same, or any, track record is meaningless because all new units lack a track record, and that situation does not justify presuming a default 40-year life. Indeed, as CARD explained in its Initial Brief, SWEPCO's "wait and see" for Turk is inappropriate because SWEPCO's experience (i.e. track record) with other units demonstrates

116 CARD notes that it has changed the organization of this section so that it is consistent with the structure of SWEPCO's Initial Brief to facilitate convenient cross-reference.

117 CARD's Initial Brief at 25-27.

118 SWEPCO's Initial Brief at 91.

119 *Id.* at 91.

that coal generating plants are much more likely to experience useful lives much longer than 40 years, despite changing regulatory and economic conditions.[120]

Mr. Pous' point that SWEPCO has routinely advocated life estimates that underestimated the life of its coal generating plants is not a "smear tactic" as SWEPCO complains;[121] instead it correctly acknowledges the fact that SWEPCO has consistently underestimated useful life for coal generation, and it shows that a 40-year life expectancy is inconsistent with actual experience.[122] Similarly, historical experience shows that SWEPCO also initially underestimates its useful life for its gas generating plants,[123] even though Mr. Franklin acknowledges that the majority are expected to have a 65-year life span,[124] and some are projected to last beyond 65 years.[125] As SWEPCO itself states in a later section of its Initial Brief, "… in the absence of a known reason to conclude otherwise, the past is a reasonable indicator of what will occur in the future."[126]

SWEPCO's proposal to wait for a "track record" before assuming a useful life consistent with its other units would reject historical experience in favor of speculative concerns, would create intergenerational inequity, and would fail to comply with the regulatory matching principle.[127] If SWEPCO later expanded the Turk Plant's estimated life span, it would not compensate the preceding generations of customers that paid accelerated depreciation due to the plant's initial unreasonably short presumed life. At the hearing, Mr. Davis acknowledged that if a plant's useful life is initially underestimated and there are no additional plants or other

120 CARD's Initial Brief at 26.

121 SWEPCO's Initial Brief at 91.

122 Direct Testimony of Jacob Pous, CARD Ex. 2 at 10-12.

123 Tr. at 236-240 (Feb. 4, 2013) and *see* DN 3716 Rebuttal Testimony of J.S. Ferguson for SWEPCO, CARD Ex. 90, which shows the initial life estimates for a number of SWEPCO's generation plants of approximate 30-40 years. *See also* by contrast SWEPCO's Response to Staff RFI No. 3-12, OPUC Ex. No. 17 at 25.

124 Tr. at 232 (Feb. 4, 2013).

125 Tr. at 233-234 (Feb. 4, 2013).

126 SWEPCO's Initial Brief at 98.

127 Direct Testimony of Jacob Pous, CARD Ex. 2 at 10.

exceptional costs added to the plant, generational inequity could result.[128] In this case, any suggestion that it is permissible to underestimate the Turk Plant's useful life now because later plant additions might offset generational inequity requires speculation about future additions. Moreover, speculating that the Turk Plant could later be expanded contradicts an express term of SWEPCO's settlement with the Hempstead County Hunting Club that agrees, "no additional generation units would be constructed at the Turk plant site."[129]

SWEPCO complains that "an increasingly stringent environmental compliance regime places in doubt the ability of plants built today to have the same service life as those built three decades ago,"[130] but SWEPCO cannot offer any evidence that the current environmental regulations will become increasingly stringent – it can only speculate that they might.

Furthermore, SWEPCO fails to explain how these presumed changes to environmental regulations specifically dictate a 15 to 20-year reduction to Turk's useful life. Changes in environmental laws are not a new phenomenon; SWEPCO's other coal plants managed to achieve 60-year useful lives despite radical changes in environmental laws. For example, the EPA did not even exist until 43 years ago.[131] SWEPCO has offered no evidence to suggest that Turk would become incompatible or unable to adapt to environmental regulation changes, even though historically other units have remained viable and SWEPCO admits that in some cases units should be retrofitted instead of retired.[132] To the contrary, SWEPCO claims that Turk uses "state-of-the-art emissions control equipment … for reliable compliance with stringent emission regulatory requirements."[133] If SWEPCO sincerely anticipates negative economic and regulatory developments that would curtail the Turk Plant's useful life, it should have declined to build the Turk Plant in favor of a less-expensive, more short-term solution such as upgrading Welsh 2, as

128 Tr. at 2272 (Feb. 14, 2013).

129 Direct Testimony of Venita McCellon-Allen, SWEPCO Ex. 25 at 32.

130 SWEPCO's Initial Brief at 91.

131 Reorganization Plan No. 3 of 1970, 35 F.R. 15623, 84 Stat. 2086); and *see*, http://www.epa.gov/history/.

132 Tr. at 1304 (Feb. 11, 2013).

133 Direct Testimony of Venita McCellon-Allen, SWEPCO Ex. 25A at 16.

Mr. Pous explained.[134] For example, SWEPCO estimates that retrofitting Welsh 2 would cost $529 million,[135] whereas the new Turk plant will cost Texas ratepayers at least $1.522 billion.

As to SWEPCO's contention that a 40-year life is appropriate because Turk was presented on the basis of a 30-year life span in its CCN,[136] that fact is fairly meaningless, except that SWEPCO admits it underestimated Turk's useful life to the Commission. The scope of a CCN proceeding does not include contests over useful life; it only addresses the need for the plant at issue. SWEPCO complains that "Procurement of equipment specified that major pieces of equipment should have 40-years design lives," but it has made no showing that its plants have tended to retire consistent with their minimum-life equipment specifications. Equipment within a plant may retire and be replaced prior to the end of the overall plant's useful life, as SWEPCO itself recognizes in its arguments regarding interim retirements and additions. In other words, the overall useful life of a generation plant is not limited to or defined by the useful life of its subcomponents or equipment.

CARD's recommendation is reasonable and conservative. It presumes a minimum useful life of 55 years, which is consistent with SWEPCO's historical experience and reduces the likelihood of intergenerational inequity that would result from adopting SWEPCO's artificially short life span proposal. SWEPCO should not be allowed to again overcharge current customers (1) based on speculative future concerns that are without reliable basis and contrary to historical experience; and (2) based on an approach that has consistently proven to underestimate useful life. Nothing that SWEPCO has presented rises to the level of meeting its burden of proof that a 40-year life for Turk is the appropriate value. CARD's recommended life for Turk is supported by SWEPCO's and AEP's actual operating experience for coal-fired units.

134 Direct Testimony of Jacob Pous, CARD Ex. 2 at 11.

135 *Id*.

136 SWEPCO's Initial Brief at 92.

The impact of increasing the life span for the Turk plant from 40 years to (at least) 55 years results in a $9.1 million decrease in annual depreciation expense on a total Company basis for plant as of December 31, 2011, and a corresponding $3.0 million decrease in depreciation expense on a Texas jurisdictional basis.[137]

ii. Stall Plant

As explained in CARD's Initial Brief, CARD advocates a useful life for the new Stall Plant of no less than 40 years, as opposed to SWEPCO's initial offering of a 35-year life.[138]

The Company bases its 35-year useful life on the "expected" repair cycle of the unit's heat recovery steam generator ("HRSG") of "approximately every 18 to 20 years."[139] However, as CARD's Initial Brief explained, the earliest the second repair cycle might occur is at year 36 – a year later than the end of the artificially short useful life offered by SWEPCO.[140] Mr. Franklin's testimony suggests a useful life in the 36-40 year range and does not support a 35-year life. SWEPCO contends that it has operated the Stall Plant more than it anticipated,[141] but it has offered no data to confirm that the current level of use would accelerate the approximate expected repair cycles a full year below the bottom end of the expected range, nor is there any evidence to suggest that it will continue to be dispatched above its anticipated norm. As other new, more efficient units with more advanced technology are placed in service, the annual operating hours for Stall will predictably decline. Furthermore, SWEPCO offered no economic analysis of what it would cost at the 35- to 40-year mark to undertake the repairs of the heat recovery system generator versus retiring and replacing the entire generation unit.[142] Based on

137 Direct Testimony of Jacob Pous, CARD Ex. 2 at 13.

138 CARD's Initial Brief at 29-31.

139 Direct Testimony of Paul Franklin, SWEPCO Ex. 32 at 17.

140 CARD's Initial Brief at 30.

141 SWEPCO's Initial Brief at 92.

142 Tr. at 242 (Feb. 4, 2013).

the available evidence, the 18 to 20 "expected" repair cycle should be considered a minimum rather than a maximum life expectation.

As CARD's Initial Brief explained, the Stall Plant generates energy more efficiently than any other unit in SWEPCO's gas fleet,[143] which incentivizes SWEPCO to make capital investments that would allow Stall to continue to operate.[144] Thus, there is no reason to presume that it would be economical to retire Stall a year before the low end of the approximate range of years in which a major repair may be required. SWEPCO has provided no reason to believe that this new, highly efficient plant will have a useful life shorter than comparable modern combined-cycle gas plants.[145]

Accordingly, CARD's proposed life of no less than 40 years for the Stall Plant is reasonable, and within the range of the years wherein HRSG's repair cycle would allegedly necessitate an economic retirement, and is consistent with the useful life presumed by other utilities for modern combined-cycle units. By contrast, SWEPCO has provided insufficient evidence to support its assertion that a 35-year useful life is reasonable, especially when SWEPCO's historical evidence shows that 35 years underestimates the useful life of a gas generation plant.[146]

Increasing the Stall generating facility's life span from 35 to 40 years would result in a $1.7 million reduction in annual depreciation expense on a total Company basis for plant in service as of December 31, 2011, and a corresponding reduction in Texas retail depreciation expense of $550,000.[147]

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143 Direct Testimony of Paul Franklin, SWEPCO Ex. 32 at 14.

144 Direct Testimony of Jacob Pous, CARD Ex. 2 at 16.

145 *Id*.

146 Tr. at 236-240 (Feb. 4, 2013).

147 Direct Testimony of Jacob Pous, CARD Ex. 2 at 17.

iii. Dolet Hills

CARD recommends that the life span for the Dolet Hills plant be maintained at 60 years, whereas SWEPCO proposes a dramatic 20-year reduction to Dolet Hills' useful life.[148]

SWEPCO asserts that its 40-year proposal "matches the expected useful life recently approved for CLECO and Dolet Hills by the LPSC [Louisiana Public Service Commission]."[149] However, as explained in CARD's Initial Brief, the referenced LPSC order only approved a proposed Uncontested Stipulated Settlement.[150] The attached order in part provides "The new reserves acquired through the Oxbow Mine purchase will extend life of the Dolet Hills Lignite Unit from 2016-2019 to at least 2026."[151] Furthermore, SWEPCO did not provide CLECO's life analysis to support its reliance on the settlement's presumed useful life.[152] The Company does not and cannot make any showing that the settlement's presumption that Dolet Hills' life would extend until "at least 2026" indicates that Dolet Hills would have no remaining reserves after 2026, nor does the Company provide any analysis of whether alternative fuel sources are available that could economically supplement those reserves.

SWEPCO does not contest that it previously asserted that the Dolet Hills Plant had a life of 60 years.[153] SWEPCO has failed to provide clear and compelling evidence that the Dolet Hills plant will no longer be able to operate beyond 2026. The Company's proposal to truncate Dolet Hills' useful life essentially proposes shutting down a plant that has twenty more years of useful life due to a presumed lack of remaining assets in a nearby mine. Before wasting or squandering those remaining years of service, it is incumbent upon SWEPCO to make a meaningful and reasonable effort to independently investigate other nearby mines and the

148 CARD's Initial Brief at 28-29.

149 SWEPCO's Initial Brief at 93-94.

150 SWEPCO's Response to TIEC's RFI 2-7, SWEPCO Ex. 104.

151 *Id*.

152 *Id.*

153 Rebuttal Testimony of Paul Franklin, SWEPCO Ex. 71 at 19.

potential for economically altering the plant to accommodate another type of fuel over the next 15 years, but it has not done so.[154]

Accordingly, the 60-year presumption should be maintained unless and until SWEPCO makes an adequate showing that the lignite reserves will be exhausted in 2016 (rather than the more ambiguous claim they will last "at least until" 2016, which could mean 2020, 2025 or even 2036), and provides compelling research and testimony that support the conclusion that no economically suitable alternatives are available for such a valuable asset.

SWEPCO has the burden of proof to support its proposed dramatic change to Dolet Hills' useful life, and the only justification it has provided is deference to a settlement approved by the LPSC that indicates the reserves will last "at least" until 2016. Settlement terms do not establish facts. SWEPCO did not provide any evidence to support or clarify the settlement's findings, and it has failed to provide investigation or analysis of reasonable alternatives. In fact, SWEPCO did not provide such supporting information despite discovery by the parties to elicit the documentation that SWEPCO relied upon.[155] SWEPCO's failure to operate prudently and investigate economic options before wasting twenty years of useful life cannot be rewarded.

SWEPCO complains that "Mr. Pous claims that SWEPCO did not prove the negative" by failing to demonstrate that another lignite mine could not be found or that Dolet Hills could not be converted to another fuel source.[156] However, SWEPCO's complaint obscures the point that SWEPCO did not offer *any analysis* of alternative fuel sources. SWEPCO has the burden of proof to support its proposal to waste 20 years of Dolet Hills' useful life, given that it has no perceivable fatal flaws that would prevent its continued operation.[157] It failed to meet that burden because it relies only on a vague estimation found in a settlement approved by another

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154 Direct Testimony of Jacob Pous, CARD Ex. 2 at 14.

155 *See, e.g.* SWEPCO's Response to TIEC 2-7, SWEPCO Ex. 104; and *see* Direct Testimony of Lane Kollen, Cities Ex. 3 at 50.

156 SWEPCO's Initial Brief at 94.

157 Tr. at 240 (Feb. 4, 2013).

state; it did not offer any evidence or testimony from that proceeding that would support a shorter life, and it did not explore or investigate whether any reasonable alternatives were available. SWEPCO has failed to meet its burden of proof to curtail Dolet Hills' presumed useful life by 20 years, and unless and until it offers evidence sufficient to meet that burden, the remaining life should remain at 60 years consistent with SWEPCO's testimony in Docket 37364, which was given four months *after* SWEPCO filed testimony with the LPSC.[158]

Continuing to rely on a 60-year life span for the Dolet Hills plant would result in a $3.5 million reduction in depreciation expense on a total Company basis for plant as of December 31, 2011, with a corresponding Texas jurisdictional depreciation expense reduction of $1.1 million.[159]

iv. Welsh 2

The Welsh 2 facility is addressed by CARD in section II(A)(8), *supra*. Pursuant to CARD's position in that section, CARD recommends that Welsh 2's useful life not be reduced to accommodate the Company's unilateral decision to retire the plant early as part of a settlement agreement, given that the Company acknowledges that Welsh 2 has 26 more years of useful life.[160] Accordingly, CARD advocates that Welsh 2's original useful life of 60 years be maintained unless and until the retirement is addressed in a subsequent proceeding.

v. Interim Retirements

CARD's Initial Brief explains that interim retirements are retirements of plant components that may occur prior to the end of the anticipated life of the plant itself.[161]

In an order recently issued in PUCT Docket No. 39896, the Commission indicated a preference for the actuarial method over the interim method.[162] In its Initial Brief, SWEPCO

158 Direct Testimony of Lane Kollen, Cities Ex. 3 at 51.

159 Direct Testimony of Jacob Pous, CARD Ex. 2 at 15.

160 Direct Testimony of Scott Norwood, CARD Ex. 4 at 13.

161 CARD's Initial Brief at 31-32.

asserts that the Commission's preference is inapplicable here because SWEPCO used the life-span method, which it claims is "consistent with the 'retirement (actuarial) rate method' that the Commission endorsed."[163] However, even if one assumed that the Commission had not explicitly rejected Mr. Davis' alternative approach, SWEPCO has not shown that the Commission has approved interim retirements for any production plant account under any method. To the contrary; it has consistently rejected recognition of interim retirements.

SWEPCO also attempts to distinguish the Commission's holding in Docket No. 39896 by explaining that "[o]ne of the prior precedents cited in PUCT Docket No. 39896 as support for rejecting the inclusion of interim retirements in the calculation of production plant average remaining lives is PUCT Docket No. 14965," and pointing out that in that docket interim retirements were rejected in conjunction with the issue of interim additions.[164] SWEPCO argues that it has not included interim additions, thus implying that the Commission's precedent does not apply. However, the Order on Rehearing for PUCT Docket No. 39896 does not cite to PUCT Docket No. 14965 regarding interim retirements; it cites to that docket regarding the direct assignment of affiliate expenses.[165] While the Proposal for Decision referenced PUCT Docket No. 14965 concerning interim retirements, it was summarizing a witness's argument, not citing it to support its conclusion that Commission precedent clearly disfavors the use of interim retirement.[166] The Order on Rehearing did not rely upon any specific prior docket for its finding that rejected the interim retirement method.

SWEPCO attempts to evade application of Commission precedent by claiming the precedent addressed interim retirements and interim additions, whereas SWEPCO only considers

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162 Direct Testimony of Jacob Pous, CARD Ex. 2 at 4, citing Docket 39896, *Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Order on Rehearing at Finding of Fact No. 100 at 21 (Nov. 2, 2012) (the "ETI Rate Case"). *See also* Direct Testimony of Jacob Pous, CARD Ex. 2 at 36-38.

163 SWEPCO's Initial Brief at 97.

164 *Id.* at 97-98.

165 *ETI Rate Case*, Order on Rehearing at 8 (Nov. 2, 2012).

166 *ETI Rate Case*, Proposal for Decision at 125.

interim retirements. However, the logic supporting Commission precedent applies equally to either interim retirements or interim additions, because they are two aspects of the same uncertain future event. The Commission has previously explained that interim retirements should not be predicted, because "[t]he rate at which interim retirements will be made is not known and measurable. Incorporation of interim retirements … would best be done when those retirements are actually made."[167] The Commission's concern that the future retirements are not known and measurable logically applies both to plant sub-components that wear out (interim retirements) and to the sub-components that replace them (interim additions). SWEPCO's proposal to only recognize interim retirements but not interim additions does not avoid the Commission's concern that the timing of the retirement/replacement event is uncertain. Furthermore, SWEPCO does not cite to a single case where interim retirements were authorized while interim additions were not. Indeed, SWEPCO does not, and cannot, cite to a single case where the PUCT ever authorized any type of interim retirements for production-plant depreciation, as none exists.

By incorporating anticipated interim retirements in its analysis, the Company inappropriately reduced the anticipated remaining life of its production plant, thereby inappropriately increasing the depreciation rates and the depreciation expense. CARD recommends complying with long-standing PUCT precedence and thereby excluding interim retirements for ratemaking purposes in this proceeding and eliminating the impact of interim retirements from the Company's proposed depreciation calculation.[168] Eliminating interim retirements would result in a total Company reduction to depreciation expense of $3.2 million based on plant as of December 31, 2011, and a corresponding $1 million reduction on a Texas retail basis.

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[167] PUCT Docket Nos. 8425 and 8431, *Application of Houston Lighting and Power Company for Authority to Change Rates; Application of Houston Lighting and Power Company for a Final Reconciliation of Fuel Costs Through September 30, 1988*, Final Order, Finding of Fact No. 212 (16 Tex. P.U.C. Bull. 2684, 1990 WL 711948 (Tex. P.U.C.)) (Jun. 20, 1990).

[168] Direct Testimony of Jacob Pous, CARD Ex. 2 at 40.

b. Production Plant Net Salvage

CARD conservatively recommends a negative 1.4% net salvage for production plant[169] versus SWEPCO's proposed negative 3.4% as its primary recommendation.[170] As CARD explained in its Initial Brief, CARD recommends this adjustment because SWEPCO failed to meet its burden of proof to justify the added annual depreciation expense.[171] Mr. Pous has adjusted SWEPCO's request to remove values attributable to some of SWEPCO's unsupported assumptions that are clearly unreasonable, and accordingly conservatively recommends reducing the depreciation expense by $3.7 million (with a corresponding Texas retail reduction of approximately $1.2 million).[172]

Alternatively, CARD recommends a positive net salvage of 15% as a "first step" in recognizing that SWEPCO is subject to deregulation and once that occurs, the divestiture of its generation facilities would result in substantial positive net salvage.[173] CARD's alternative recommendation would result in a $24.6 million reduction in total Company depreciation expense and a corresponding $8.0 million reduction in expense on a Texas retail basis.[174]

Sargent & Lundy's Demolition Conceptual Cost Estimates

SWEPCO asserts that it calculated its production plant net salvage using "engineering studies" to determine the cost to demolish and remove each of its power plants.[175] However, it is important to keep in mind that these studies are "engineering studies" by name only and in fact are only "conceptual cost estimates."[176] The testimonies of Mr. Davis and Mr. Bertheau attempt

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169 *Id.* at 20.

170 Direct Testimony of David Davis, SWEPCO Ex. 43 at DAD-1, page 17 (Total Production Plant Column (V) divided by Column (111)-1).

171 CARD's Initial Brief at 33.

172 Direct Testimony of Jacob Pous, CARD Ex. 2 at 4, 39.

173 *Id.* at 20, 38.

174 Direct Testimony of Jacob Pous, CARD Ex. 2 at 39.

175 SWEPCO's Initial Brief at 99-100.

176 Direct Testimony of Steven Bertheau, SWEPCO Ex. 44, Exhibit SRB-1, "Conceptual Cost Estimates for Electrical Generating Station Demolition."

to lend these "conceptual cost estimates" an air of reliability and objectivity that the record shows they do not deserve since they are anything but reliable and objective. Moreover, it is important to realize that Mr. Bertheau's studies are intentionally and inappropriately limited in scope as neither he nor any other SWEPCO witness analyzed any retirement options other than full and complete demolition and site restoration of generating stations.[177] SWEPCO's failure to consider other real retirement options is more than questionable, given that: (1) SWEPCO's Texas affiliates sold all of their generating units for positive net salvage amounts and did not demolish a single unit, and (2) one of SWEPCO's non-Texas affiliates removed various items of plant prior to demolition.[178]

Although SWEPCO asserts that its calculations "took into account the specific attributes of each plant,"[179] the record reflects that Sargent & Lundy (S&L) to some extent actually relied on estimates performed for non-SWEPCO facilities,[180] and SWEPCO has declined to provide the underlying critical support for its estimates that parties requested in discovery.[181] Furthermore, the conceptual cost estimates that SWEPCO paid S&L to perform were designed with a bias that unreasonably ensured more negative net salvage results. For example, even though Mr. Bertheau acknowledges that even though other generating units were sold or partially dismantled upon retirement, the scope of S&L's work required that they presume facilities would be demolished and did not consider the potential salvage value from selling any portion of the generating facilities.[182] Furthermore, S&L's conceptual cost estimates did not award any equipment a salvage value other than as scrap, except for black start units.[183] For black start units, Mr. Bertheau admitted that they could be reused, but instead of recognizing their positive salvage

177 Tr. at 589, 592 (Feb. 4, 2013).

178 Direct Testimony of Jacob Pous, CARD Ex. 2 at 20-30.

179 SWEPCO's Initial Brief at 99-100.

180 Direct Testimony of Jacob Pous, CARD Ex. 2 at 22; and *see* Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 81.

181 Direct Testimony of Jacob Pous, CARD Ex. 2 at 20.

182 Tr. at 588-589 (Feb. 6, 2013).

183 Tr. at 589-590 (Feb. 6, 2013).

value in his estimate, he instead "ignored" them.[184] Mr. Bertheau's unjustified actions for black start units is conceptually even more skewed than his other assumptions since it deprives customers of even scrap value for such units, let alone the reuse or resale value that he acknowledges.

SWEPCO's Initial Brief complains that Mr. Pous' criticisms lack merit because he did not provide "alternative engineering studies."[185] SWEPCO's criticism that Mr. Pous did not develop an alternative demolition estimate suggests that SWEPCO's estimate must be believed unless another party produces a more compelling study. Such is not the case.

As CARD explained in its Initial Brief, SWEPCO misrepresents its burden of proof.[186] SWEPCO has proposed an increase to its depreciation expense. Before the Commission can approve that increase, SWEPCO must affirmatively show the increase is just and reasonable.[187] A portion of SWEPCO's proposed increase is based on its conceptual cost estimates for net salvage. If the Commission determines that those conceptual cost estimates are unreliable or insufficient evidence to meet SWEPCO's burden of proof, then the depreciation increase they support should be denied. SWEPCO's conceptual cost estimates must stand on their own merits and demonstrate that the proposed increase based on those estimates is just and reasonable.

SWEPCO's unrealistic attempt to shoulder Mr. Pous with the burden of producing a more reliable engineering study is a red herring. SWEPCO knows that time, access, and prohibitive impacts on rate case expenses prevent other parties from developing a competing study, and competing engineering studies would only introduce additional inefficient disputes over variations in the underlying data. Furthermore, it is not necessary to produce a competing study to show that SWEPCO's study lacks merit. As Mr. Davis acknowledged at hearing, experts can

184 Tr. at 591-592 (Feb. 6, 2013).

185 SWEPCO's Initial Brief at 102.

186 CARD's Initial Brief at 34.

187 PURA § 36.006(1).

refer to the same data yet come to different conclusions using different methodologies.[188] Mr. Pous can and did legitimately criticize SWEPCO's demolition cost estimates without producing a separate "engineering" or "conceptual cost estimate" study using separate data. More importantly, however, SWEPCO's criticism that Mr. Pous did not produce a demolition study distorts the burden of proof. SWEPCO is seeking a rate increase, and so it is the only party obligated to demonstrate that its recommended rate is just and reasonable. Other parties are within their rights to criticize and adjust the utility's proposal without producing their own proposed rate-filing package, and it is standard practice in Commission rate case proceedings to do so.

SWEPCO's dismissal of Mr. Pous' criticisms as "scatter shot" is a poor effort to re-characterize the numerous flaws that Mr. Pous identified in the "conceptual cost estimates" as some failure on Mr. Pous' part. Mr. Pous' various and valid criticisms reveal that SWEPCO's "conceptual cost estimates" are unreliable, inaccurate, and biased. Given these numerous flaws, SWEPCO's conceptual cost estimates do not support SWEPCO's request for an increase to depreciation expense, and so SWEPCO fails its burden to prove that its request is just and reasonable. Accordingly, to the extent SWEPCO's proposed increase relies on the flawed conceptual cost estimates, it should be denied or reduced as advocated by Mr. Pous.

The "Conceptual Cost Estimates" are Unreliable

Even though SWEPCO asserts, "for unique assets such as power plants, the cost of removal and net salvage should be determined by taking the specific characteristics of the depreciable plant into account,"[189] S&L's studies in part rely on the specific characteristics of non-SWEPCO plants. Mr. Bertheau's rebuttal testimony walks back the Company's blanket claim to relying on "plant-specific" data to admit that S&L's demolition quantities were based

188 Tr. at 2273 (Feb. 14, 2013).

189 SWEPCO's Initial Brief at 100.

"principally" from SWEPCO-specific information, but "[w]here appropriate, reference to other information was also made, such as … in connection with Arsenal Hill Unit 5."[190]

Mr. Bertheau's discussion of Arsenal Hill Unit 5 addressed SWEPCO's response to an RFI in Docket No. 37364 where SWEPCO acknowledged that S&L's estimate for Arsenal Hill Unit 5 was based on another power-plant design configuration that S&L performed for another utility during the 1990's.[191] Thus, by admitting that S&L's estimates in this proceeding rely on "other information" such as it did with Arsenal Hill Unit 5 in Docket No. 37364, Mr. Bertheau admits that S&L's estimates in this proceeding are not consistently based on SWEPCO-specific data. As CARD explained in its Initial Brief, S&L's study is unreliable because it is unclear when it relies on actual SWEPCO-specific data as it claims, and when it relies on another layer of estimates conducted for other utilities' plants (and those estimates, in turn, may rely on yet another layer of estimates).[192] SWEPCO could have cured this problem by specifying its sources of data when and where they were relied upon, but it did not, even after it had to admit that not all of its information originated from analyses of SWEPCO plants.

SWEPCO's Initial Brief acknowledges that S&L's "conceptual cost estimates" were in the mid-range between a high-level conceptual cost estimate and a more detailed cost estimate.[193] SWEPCO distinguishes its studies from a more detailed cost estimate explaining that its studies are "without the more detailed cost information that would be required for a more detailed cost estimate based on specific bids from equipment vendors."[194] However, S&L's studies are more "conceptual" than SWEPCO's description admits. Although SWEPCO submits that its studies should be judged "on the information considered, of the assumptions used, of the data underlying

190 Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 17.

191 *See* Direct Testimony of Jacob Pous, CARD Ex. 2 at 22; and *see* Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 81; and *see* Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 16.

192 CARD's Initial Brief at 35-36.

193 SWEPCO's Initial Brief at 102.

194 *Id.*

these assumptions, and of the judgments made in performing the studies,"[195] it is entirely unclear where its studies are based on judgment or actual verifiable data specific to SWEPCO plants. As explained previously, Mr. Bertheau acknowledges that the studies relied in part on "reference to other information" such as it did with Arsenal Hill Unit 5 in Docket No. 37364, but neither he nor SWEPCO identifies what other information S&L referenced and relied upon, let alone identifies when and to what extent those references to non-SWEPCO specific data influenced its assumptions and analysis. Indeed, SWEPCO declined to provide support for numerous requested areas of concern contained within its elected "conceptual" study. SWEPCO's unilateral decision to develop a "conceptual" study does not relieve it from meeting its burden of proof relating to the assumptions and analyses contained therein.

Although SWEPCO claims that its conceptual cost estimates identified S&L's sources for labor rates, productivity factors, scrap metal values, and material costs,[196] it actually withheld information necessary to meaningfully review and verify the sources that SWEPCO relied upon. As explained in CARD's Initial Brief, CARD requested the crew mix assumptions S&L used in its conceptual estimates, but SWEPCO withheld the information, claiming that they were "confidential and proprietary."[197] Similarly, when CARD requested the source of each presumed productivity factor and an explanation of how it was developed to allow verification of the calculation, the Company chose to reference a data response that set forth the final man hours and quantity removed rather than the requested information.[198]

Although Mr. Bertheau broadly claims that S&L's crew mix and productivity factors "were developed by S&L utilizing standard industry data and input from U.S. Dismantlement," he does not identify the actual source of the "standard industry data" nor does he explain how

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195 *Id*. at 106-107.

196 SWEPCO's Initial Brief at 102-103.

197 Direct Testimony of Jacob Pous, CARD Ex. 2 at 21, and *see* Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 62.

198 Direct Testimony of Jacob Pous, CARD Ex. 2 at 23, and *see* Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 82-101.

and why it deviates from U.S. Dismantlement's input, which is likewise not provided.[199] In fact, he refused to provide the crew mix data when it was specifically requested.[200] Likewise, when SWEPCO states in its Initial Brief that "the crew mixes used in the S&L studies were reasonable and not top-heavy,"[201] it is supported only by Mr. Bertheau's rebuttal, which consists of general examples without specificity or citation.[202] These few cursory examples are not supported by any documentation that objectively confirms his general statements regarding certain activities, let alone any support to show that the crew mixes for activities he does not mention were appropriate.

SWEPCO's efforts to withhold and obfuscate the underlying data that forms its estimates prevent other parties, the ALJs, and the Commission from verifying those calculations and evaluating the reasonableness of the inputs. By refusing to "show its work," S&L's estimates require an unreasonable leap of faith, and so fail to meet the utility's burden of proof.

In his rebuttal testimony, Mr. Davis claims that the negative 3.4% net salvage sought by SWEPCO "is based on empirical data for SWEPCO's power plants"[203] However, SWEPCO's response to discovery revealed that "[t]he term 'empirical data' as used in Mr. Davis' rebuttal testimony refers to data 'originating or based on observation or experience.'"[204] In other words, there are no objective numerical data that can be reviewed by the ALJs or the Commissioners; the overall net salvage Mr. Davis proposes is based on "empirical data" defined as Mr. Davis' observations or experience. SWEPCO admits that the negative 3.4% net salvage is based on Mr. Davis' "observations or experience" but fails to explain how this "empirical data" based on judgment and observation allowed him to define the specific inputs necessary to calculate a

199 Rebuttal Testimony of Steven Bertheau, SWEPCO Exhibit 82 at 10.

200 Direct Testimony of Jacob Pous, CARD Ex. 2 at 21, and *see* Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 62.

201 SWEPCO's Initial Brief at 103.

202 Rebuttal Testimony of Steven Bertheau, SWEPCO Exhibit 82 at 12.

203 Rebuttal Testimony of David Davis, SWEPCO Ex. 81 at 21.

204 SWEPCO's Response to CARD RFI No. 28-3, CARD Ex. 32.

negative 3.4% overall net salvage. Behind the curtain of SWEPCO's claims of "empirical data" and "plant-specific engineering studies," there are only personal observations and judgment and conceptual estimates with very little transparency as to what information was relied upon and how SWEPCO developed its very specific net salvage percentages. SWEPCO cannot meet its burden of proof by relying on "data" that consists only of personal observations that cannot be reviewed or verified by any other party to determine whether its specific revenue requests based on such "empirical data" are reasonable.

As for Mr. Bertheau's "observations or experiences," they appear to be limited and/or unreliable. Although he claims to have personally toured every plant in the S&L study, he could not recall a single city in which a plant was located.[205] While SWEPCO claims that the estimated quantities of materials at the SWEPCO plants were based on existing plant drawings,[206] Mr. Bertheau by contrast testifies that S&L did not review detailed plant shop drawings to establish the plant commodities, because this type of information was not available.[207] And in response to discovery, Mr. Bertheau asserted that both union and nonunion labor was relied upon, but in his rebuttal testimony, he instead indicated that only nonunion labor was relied upon.[208]

In discovery, SWEPCO was asked to identify the data supporting the contingencies it applied in its cost studies and to fully document the information that would demonstrate that the values were not generic values or ratios of historically used values.[209] SWEPCO had four levels of contingency that each result in a more negative net salvage value: a 15% direct cost multiplier; a 10% indirect cost multiplier; a negative 10% reduction in scrap metal based on preparation costs; and a negative 15% reduction in scrap prices to account for "price volatility."

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205 Tr. at 646-647 (Feb. 6, 2013).

206 SWEPCO's Initial Brief at 103.

207 Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 7.

208 Tr. at 610-611 (Feb. 6, 2013).

209 SWEPCO's Response to CARD RFI No. 28-3, CARD Ex. 32.

SWEPCO's discovery response supported the 15% direct cost multiplier by referencing Mr. Bertheau's "professional experience and observations guided by S&L's 120-plus years of practical experience," without any additional information or objective data, or any explanation of how those observations and experience led Mr. Bertheau to derive the very specific 15% cost multiplier.[210] Mr. Bertheau's support for this contingency amounts to nothing more tangible than "trust me," which is insufficient to support the very specific hard numbers that the 15% multiplier inflicts on the negative net salvage value.

On the stand, Mr. Bertheau acknowledged that he applied an additional 10% "contingency" multiplier for indirect costs.[211] However, although the discovery request asked SWEPCO to support the contingencies reflected in the Company's demolition cost studies, SWEPCO's response did not mention its contingency for indirect costs, nor did it provide any rationale or any of the requested data that would support this contingency.[212] At the hearing, he claimed the specific 10% multiplier was based on "judgment and discussions with the utility;"[213] in other words, he once again increased the demolition cost estimate by a specific numerical multiplier without any objective, independently verifiable or reproducible data or calculation in support.

For S&L's 10% reduction in scrap metal value based on preparation costs, Mr. Bertheau relies exclusively on unspecified "empirical data" that consists only of his "judgment and experience and observation" and attaches two webpage printouts to the discovery response.[214] Each of the printouts provide some definitions related to scrap materials, but in no way discuss the cost of preparing scrap, let alone provide any evidence that shows a 10% cost for preparing scrap is appropriate. Nonetheless, Mr. Bertheau testified at the hearing that the two attachments

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210 *Id.*

211 Tr. at 647-648 (Feb. 6, 2013).

212 SWEPCO's Response to CARD RFI No. 28-3, CARD Ex. 32.

213 Tr. at 613 (Feb. 6, 2013).

214 Tr. at 620-623 (Feb. 6, 2013). *See also* SWEPCO's Response to CARD RFI No. 29-24, CARD Ex. 63 and *see* SWEPCO's Response to CARD RFI No. 28-3, CARD Ex. 32.

provided "adequate information for an experienced power plant engineer to arrive at the same conclusion."[215] His conclusion is completely unsupported by the evidence.

CARD urges the ALJs and the Commission to review the two printouts in question[216] and determine whether they provide any information that would support the specific 10% contingency as Mr. Bertheau claims, or for that matter any other value. Given that CARD requested all data and information supporting SWEPCO's contingencies and the limited information SWEPCO provided in response, one can only conclude that Mr. Bertheau's decision to reduce scrap metal value by 10% was arbitrary, and his persistent claims to the contrary only diminish his credibility.

Furthermore, it is unclear whether S&L's high-side estimate already accounts for the cost of sizing and processing scrap, which would render the separate 10% preparation cost contingency redundant and would allow SWEPCO to double-recover those costs.[217] SWEPCO must not be rewarded for its failure to provide requested support for its revenue requests, or for its practice of advocating specific revenue increases based on arbitrary "judgment" calls that lack any quantitative or verifiable foundation.

Regarding S&L's 15% reduction to scrap value that allegedly accounts for volatility in current scrap metal prices, the only support provided is Mr. Bertheau's Exhibit SRB-2R and Workpaper WP/EXHIBITSRB-2R.[218] This Exhibit and Workpaper merely chart scrap prices over time; there is no indication or explanation of how Mr. Bertheau's specific 15% reduction is appropriate in light of the data offered. In response to a discovery request for the actual calculations (e.g. regression analyses, etc.) associated with the straight-line analysis Mr. Bertheau claims justify the 15% reduction, Mr. Bertheau did not offer any calculations, but instead referenced the straight-line analysis in Exhibit SRB-2R and Workpaper

215 Tr. at 657-662 (Feb. 6, 2013).

216 SWEPCO's Response to CARD RFI No. 28-3, CARD Ex. 32.

217 CARD's Initial Brief at 40.

218 SWEPCO's Response to CARD RFI No. 28-3, CARD Ex. 32.

WP/EXHIBITSRB-2R as "performed by S&L using a heuristic approach that provided practical results based on experience."[219] At hearing Mr. Bertheau agreed that "heuristic" is defined as involving experimental methods.[220] In other words, Mr. Bertheau's 15% reduction is based on an experimental or trial-and-error method[221] based on his experience, and lacks any credible or reliable foundation in accepted techniques or even a reproducible methodology. At the hearing, Mr. Bertheau claimed that his "heuristic" analysis was also a statistical analysis, but he indicated he was not aware of a minimum population size that is required to conduct a valid statistical analysis.[222] Furthermore, he admitted that his analysis did not exclude data from 2008 and 2009 during the world-wide economic meltdown, even though he agreed those years were unusually volatile.[223] Finally, he acknowledged that the only analytical support he offered for the 15 percent net contingency versus any other value was "[j]ust the years of volatility with a straight-line through it."[224] Again, the referenced "straight-line" is Mr. Bertheau's "heuristic," i.e. experimental, analysis.

As CARD explained in its Initial Brief,[225] SWEPCO has provided no evidence to support its presumption that future price changes will result in copper scrap becoming less expensive, let alone justified its presumption that scrap value should specifically be discounted by 15%. When asked for copies of each prior demolition study that included a contingency cost and the actual demolition costs, Mr. Bertheau could only point to the estimated and actual costs for the Breed Plant.[226] However, the Breed Plant does not support S&L's use of a contingency, because S&L's estimated costs of $28.7 million exceeded the actual demolition costs of $10.8 million by 62%.[227]

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219 SWEPCO's Response to CARD RFI No. 29-25, CARD Ex. 64.

220 Tr. at 628-629 (Feb. 6, 2013).

221 *See* www.merriam-webster.com/dictionary/heuristic.

222 Tr. at 627-628 (Feb. 6, 2013).

223 Tr. at 629-630 (Feb. 6, 2013).

224 Tr. at 631 (Feb. 6, 2013).

225 CARD's Initial Brief at 40.

226 SWEPCO's Response to CARD RFI No. 29-31, CARD Ex. 70.

227 CARD's Initial Brief at 36-28.

Mr. Bertheau claims that some grading and below-ground excavation remain to be completed at the Breed demolition site,[228] but as explained in CARD's Initial Brief[229] and later herein, his claims are unreliable and in no way establish that another $17.9 million in demolition costs remain.

In short, S&L created a more negative net salvage value by applying multiple negative contingency percentages, but none of those contingencies are supported by objective data and S&L applied specific percentage contingencies without a just and reasonable basis. Although Mr. Bertheau claims that he has reviewed demolition and site grading cost estimates prepared by other firms in the industry and could confirm that including a positive contingency to capture unknown and future changes is a common industry standard practice, when asked to provide a copy of these other demolition cost estimates, he could not produce a single one.[230] S&L's consistent and unfounded presumptions that inputs should be adjusted by arbitrarily selected percentages that presume more negative values reveal its persistent and unsupported bias in favor of calculating a more negative net salvage result.

Mr. Davis relies upon Mr. Bertheau's "conceptual cost estimates" to determine net salvage values for calculating production plant depreciation rates.[231] Mr. Davis attempts to make his proposed net salvage of negative 3.4% appear more reliable by arguing that the Company's production net salvage percentage is reasonable on its face, based on the Commission's recent order in Entergy Texas ("ETI") Docket No. 39896 where it approved a rate of negative five percent.[232] However, this argument has no merit, because as Mr. Davis admits in the same RFI response, the reasonableness of a net salvage factor depends on specific facts and circumstances

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228 Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 9-10, and *see* SWEPCO's Response to CARD RFI No. 29-33, CARD Ex. 72.

229 CARD's Initial Brief at 36-28.

230 Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 29, and *see* SWEPCO's response to CARD RFI No. 29-30, CARD Ex. 69.

231 Direct Testimony of Steven Bertheau, SWEPCO Ex. 44 at 11.

232 SWEPCO's Response to CARD RFI No. 28-2, CARD Ex. 31.

related to each generating station.[233] The facts and circumstances that supported ETI's overall net salvage factor have no bearing on the facts and circumstances applicable to SWEPCO's plants, and so the Commission's finding that ETI's net salvage was reasonable does not establish that SWEPCO's proposed net salvage, based on different facts and circumstances, is reasonable. At the hearing, Mr. Davis conceded that ETI's facts were different from SWEPCO's:[234]

> Q. Okay. And Mr. Farrell asked you questions about the facts of the ETI case being different from the facts for SWEPCO, and I believe your answer was, yes, you agreed?
>
> A. Yes, they were.
>
> Q. And you would agree that the facts are different with respect to any other utility case that does not involve SWEPCO?
>
> A. Right. I would agree with that, yes.

Similarly, Mr. Davis attempts to make S&L's "conceptual cost estimates" appear more reliable by arguing that in other states, other utility commissions have adopted AEP's depreciation calculations based on similar demolition studies and have accepted the practice of inflating demolition costs to the date of retirement.[235] However, in response to a discovery request asking SWEPCO to identify litigated cases that support Mr. Davis' inclusion of inflation, Mr. Davis admitted that "[m]ost of AEP's recent rate orders are based on settlements..."[236] and only identified two relevant fully litigated cases – an Indiana case where a decision was still pending, and an Oklahoma case where the Commission did not mention inflation in its final order. Mr. Pous testified that in the Oklahoma case the Oklahoma Commission adopted Mr. Pous' position rather than Mr. Davis' position, and this testimony has not been rebutted.[237] In other words, although Mr. Davis represented that utility commissions have accepted the practice of inflating demolition expense, he could not identify a single litigated case where a commission

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233 *Id.*

234 Tr. at 2290-2291 (Feb. 14, 2013).

235 Rebuttal Testimony of David Davis, SWEPCO Ex. 43 at 26; and *see* SWEPCO's Response to CARD RFI No. 28-6, CARD Ex. 35.

236 SWEPCO's Response to CARD RFI No. 28-6, CARD Ex. 35.

237 Direct Testimony of Jacob Pous, CARD Ex. 2 at 35.

approved the use of inflation. What is known is that the Oklahoma Commission did not approve Mr. Davis' proposal. As CARD explained in its Initial Brief, Mr. Davis' application of inflation is inappropriate because he fails to discount the future demolition costs to present dollar values to consistently acknowledge the time value of money and to avoid intergenerational inequity.[238]

The "Conceptual Cost Estimates" are Biased

SWEPCO claims that Mr. Bertheau refuted Mr. Pous' contention that S&L failed to make adequate consideration for potential resale of equipment by explaining that an active market does not always exist for used power plant equipment, and inter-company transfer of equipment is limited.[239] However, as explained in CARD's Initial Brief, S&L's conceptual cost estimates are biased because they selectively exclude inputs that would otherwise reduce the net demolition cost.[240] At the hearing, Mr. Bertheau acknowledged that S&L's conceptual cost estimate specifically assumed that there would be no resale of equipment or material, but when the Breed Plant was retired, there were several valuable parts that were transferred and reused by the Company.[241] Mr. Bertheau recognizes that certain plant facilities such as black start units can be reused,[242] but instead of attributing those units a value higher than scrap, he simply excluded them from the net salvage analysis and by doing so gave them no value, not even scrap value.[243] Similarly, he excluded the dollar value for pumps, motors, cranes, and other equipment that would have produced a more accurate net salvage cost.[244] Whereas S&L's conceptual cost estimates apply numerous contingency multipliers to create a substantially more negative overall net salvage based on speculative variances in scrap metal prices and direct and indirect costs, S&L's estimates address an allegedly volatile market for resale of equipment by ignoring it

238 CARD's Initial Brief at 41.

239 SWEPCO's Initial Brief at 103-104.

240 CARD's Initial Brief at 38-39.

241 Tr. at 613-614 (Feb. 6, 2013).

242 Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 26.

243 CARD's Initial Brief at 38; *see also* SWEPCO's Response to CARD RFI No. 29-29, CARD Ex. 68.

244 CARD's Initial Brief at 38.

completely, rather than attributing a contingency multiplier that would acknowledge a more positive net salvage given the potential for resale or reuse. Such bias is not the hallmark of a reliable and credible analysis.

S&L's conceptual cost estimates are also biased because the study's parameters unreasonably include certain presumptions that drive a more negative net salvage result. For example, S&L assumed that the SWEPCO plants would be demolished at the end of their expected useful lives, rather than weighing the estimated cost to account for the possibility that a given plant could be partially reused or resold.[245] SWEPCO's presumption that no resale or reuse is possible is contrary to the evidence and its own experience with the Breed plant.[246]

Furthermore, S&L presumed that plant equipment would be maintained and operated such that the O&M cost of operating it exceeds any remaining value in the plant components other than scrap value.[247] While SWEPCO advocates reducing useful life for its plants to account for plant components retiring before the overall plant's useful life expires (i.e. interim retirements), S&L by contrast presumes that the useful life of all plant equipment will exhaust exactly when the plant's useful life ends. S&L's presumption that plant components will be operated such that they will only have scrap value when demolition occurs contradicts SWEPCO's argument that some plant components have useful lives that are shorter than the overall plant's useful life. Although these approaches are logically inconsistent, they share one common trait: they would each increase SWEPCO's depreciation expense.

S&L's conceptual cost estimates are also biased because they applied scrap market values exclusively from Zone 3 of the Scrap Metals Marketwatch publication, without considering

245 SWEPCO's Initial Brief at 104.

246 Direct Testimony of Jacob Pous, CARD Ex. 2 at 29-30.

247 SWEPCO's Initial Brief at 104.

whether other adjacent Zones offer better prices[248] or would have lower shipping costs due to their proximity to a given plant.[249]

Mr. Pous pointed out that S&L and SWEPCO propose tens of millions of dollars for land-related backfilling, grading, landscaping and ash removal, but there is no offsetting benefit to customers for the increase in value of the site due to these proposed site improvements that customers would pay for in advance.[250] Mr. Bertheau and SWEPCO contend that these are not costs to "improve" the land, but are required to restore the sites to their original condition.[251] Although Mr. Davis admits that he is not aware of any requirement to grade, seed, or landscape generating station land when the related generating station is removed,[252] Mr. Bertheau argues that such efforts to "restore" the demolition sites "reflects prudent management and demonstrates the Company's public obligation to safety and proper stewardship."[253] However, as mentioned previously, AEP does not seem to agree with Mr. Bertheau's belief that such efforts are necessary for safety and proper stewardship if he is correct that the Breed demolition site is not fully graded and restored[254] even though demolition efforts ceased in 2006.[255] In any case, whether the site is restored to improve its value or for proper stewardship, it does not change the fact that these types of expenditures are not associated with the retirement of depreciable assets. Consistency demands that if the land value is not considered because land is not depreciable, then the cost to improve land or address proper stewardship of the must also not be included because they are likewise not depreciable.

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248 Mr. Bertheau acknowledged that Zone 4 has better prices than Zone 3 for mixed steel and copper. *See* Tr. at 596-597 (Feb. 6, 2013).

249 Tr. at 594-595 (Feb. 6, 2013).

250 Direct Testimony of Jacob Pous, CARD Ex. 2 at 26.

251 Rebuttal Testimony of Steven Bertheau, SWEPCO Exhibit 82 at 32; SWEPCO's Initial Brief at 105.

252 SWEPCO's Response to CARD RFI No. 28-7, CARD Ex. 36.

253 Rebuttal Testimony of Steven Bertheau, SWEPCO Exhibit 82 at 32.

254 *Id.* at 9-10.

255 Direct Testimony of Jacob Pous, CARD Ex. 2 at 20.

Mr. Pous explains consistency requires that the demolition cost estimate include the sale value of the land, given that the Company proposes to charge customers in advance for improving the condition of the land as part of the demolition.[256] SWEPCO responds that land rights and water rights are not depreciated, and so customers do not pay for these assets through the depreciation calculation.[257] When asked to identify each accounting principle and support for its claim that water rights are not depreciable, SWEPCO failed to identify any principles and offered no meaningful support.[258] Furthermore, SWEPCO's position is inconsistent: it rejects the value of the land and water rights from the depreciation calculation because it claims they are not depreciable; yet it includes the cost of grading, seeding, and landscaping, even though they are not depreciable assets.

SWEPCO further asserts that depreciation studies should not account for the value of land because customers are not charged for these assets:

> Customers are charged a rate of return on land and water rights through inclusion of investment in rate base, but no mechanism in the rate making process requires the customers to pay for the cost of land or water rights. Since land and water rights are not depreciated and customers are not charged for these assets, the cost or sale value of these assets should not be considered when preparing a depreciation study.[259]

SWEPCO's position is again inconsistent. It acknowledges that customers are charged a rate of return for investments in land and water rights, but then it claims "customers are not charged for these assets."

As the Texas Supreme Court has observed, "benefits should follow burdens" and "gain should follow risk of loss."[260] It would be illogical and unfair to charge ratepayers a return on the

256 *Id.* at 26.

257 SWEPCO's Initial Brief at 105-106.

258 SWEPCO's Response to CARD RFI No. 28-9, CARD Ex. 38.

259 SWEPCO's Initial Brief at 106.

260 *Public Utility Comm'n of Texas v. Gulf States Utilities Co.*, 809 S.W.2d 201, 211 (Tex. 1991).

Company's investment in land akin to mortgage payments to a bank, but then assert that the customers have not been charged for their use of that land and deny them the return on the investment made on their behalf in exchange for a guaranteed return. If the Company obtains that guaranteed return on its investment and then retains all profits from the sale of the land, it obtains a second windfall return on its investment, even though customers were burdened with all risk of loss by guaranteeing shareholders a consistent return on the investment in rate base regardless of the investment's market value.

In the Order on Rehearing in PUC Docket No. 38339, in a finding that SWEPCO cites for other purposes, the Commission explains that "Land is not a depreciable asset, and customers have not paid any depreciation expense associated with the land. This does not mean ratepayers have no claim on any gain or loss resulting from the sale of land."[261]

As to whether or not land or water rights should be excluded from the depreciation calculation, the answer must be consistent: if the non-depreciable costs necessary to prepare the land for marketability (i.e. "restoring" the land) are included in the net salvage calculation, then the offsetting profits from selling that non-depreciable land should also be included.

SWEPCO argues that restoring the land is a cost to remove the depreciable production plant so it should be included in the net salvage value,[262] but by the same logic the initial land purchase is a cost necessary to install the depreciable production plant, and so the net gains from the land's sale are inherently linked to depreciable production plant's net salvage value and should also be applied. As Mr. Pous testified, the treatment must be consistent:

> It is inappropriate and inconsistent to recognize demolition costs associated with land restoration and enhancements of the value of the land, if land values are excluded in the cost estimating process. The cost for enhancing the value of the

[261] *Application of CenterPoint Electric Delivery Company, LLC, for Authority to Change Rates*, PUC Docket No. 38339, Order on Rehearing at 29, FoF No. 137 (Jun. 23, 2011).

[262] SWEPCO's Initial Brief at 105.

> land should be removed from the demolition cost estimate and treated as a component of the offset to the sale value or reuse of the property, or vice versa.[263]

Likewise, if SWEPCO is going to include land improvement costs because they are linked to removal of depreciable plant, the offsetting value of water rights obtained to accommodate the installation of the depreciable plant should be recognized as a positive asset that creates a more positive net salvage value for that plant when it is retired.[264] By including land improvement costs while ignoring land and water-related salvage gains, S&L's study exhibits a heavy bias in favor of a high net cost estimate that will result in windfall profits for the Company when it actually retires the plant and sells and reuses the various valuable assets that its estimate ignored.[265]

Finally, SWEPCO states, "SWEPCO has no current plans, Mr. Davis stated, to sell or reuse land or water rights."[266] It is irrelevant whether SWEPCO has such plans or whether Mr. Davis is simply unaware of them. SWEPCO's customers should not pay a higher depreciation expense because SWEPCO lacks a plan to salvage a valuable asset. If SWEPCO declines to recover the salvage value of a marketable asset upon retirement, that decision should cost SWEPCO for its poor stewardship, it should not cost SWEPCO's customers who cannot control the disposition of the asset. The net salvage analysis should not speculate as to the utility's whimsy and discount salvage values if its plans to salvage assets are unclear; the purpose of the analysis is to identify the just and reasonable costs and offsetting salvage values associated with a plant's retirement and set the depreciation expense according to that reasonable net value.

The "Conceptual Cost Estimates" are Inaccurate When Compared to Actual Costs

As CARD explained in its Initial Brief, S&L performed a "conceptual estimate" for AEP subsidiary Indiana Michigan Power Company's ("IMPC's") Breed generating station in 2005

263 Direct Testimony of Jacob Pous, CARD Ex. 2 at 26.

264 *Id.* at 27.

265 *Id.* at 27-28.

266 SWEPCO's Initial Brief at 106.

that estimated a demolition cost of $28.7 million, but when the Breed Plant was actually demolished, the actual net salvage experience was only $10.8 million after accounting for inter-company salvage value.[267] As recently as at least 2008, the AEP Breed Plant is the only power generation facility for which S&L had performed a conceptual demolition cost estimate that had actually been demolished.[268]

SWEPCO's Initial Brief protests that although the cost estimate was substantially higher than the actual demolition cost incurred to date at this plant, Mr. Bertheau stated that the scope of work completed to date at this plant did not include all of the tasks included in the S&L study.[269] When Mr. Bertheau was confronted at the hearing with webpages from a demolition company that claimed it had performed a complete demolition with grading,[270] he dismissed it casually as a "marketing paper."[271] Mr. Bertheau claims that the site has only been partially graded and has only been demolished to ground level, leaving two feet below grade that still needed to be demolished,[272] even though he did not identify a single requirement demonstrating that such efforts are mandatory.[273] But as explained in CARD's Initial Brief,[274] it is extremely difficult to believe Mr. Bertheau's claim that the approximately 62% difference between his estimate for the Breed Plant demolition and the actual demolition costs can be attributed to unfinished demolition requirements, given that he acknowledges above-ground demolition has already occurred and only alleges that below-ground demolition and grading have not occurred.[275] Furthermore, Mr. Bertheau's exhibit for the Dolet Hills plant attributes much smaller amounts to below-grade

267 CARD's Initial Brief at 36-38.

268 CARD's Initial Brief at 37-38, *citing* Direct Testimony of Jacob Pous, CARD Ex. 2 at 20, *citing* Response to AG 7-45 in OCC Cause No. 200800144, provided in Errata to Jacob Pous Workpapers, CARD Ex. 2C, Attachment 2 and Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 63-68.

269 SWEPCO's Initial Brief at 102.

270 Printout of the Featured Projects page from Brandenberg Company's website, CARD Ex. 98, and Printout of the Brandenberg Company's description of Breed Plant demolition project, CARD Ex. 99.

271 Tr. at 607 (Feb. 6, 2013).

272 Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 9.

273 Tr. at 616-617 (Feb. 6, 2013).

274 CARD's Initial Brief at 37.

275 Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 9.

demolition and grading.[276] Finally, AEP/IMPC's response to discovery in 2008 suggests that the demolition ended in 2006: "The actual demolition occurred between 1994 and 2006."[277] This is consistent with SWEPCO's response to discovery in this case: "The demolition of the Breed Plant began in 1994 and was completed in 2006."[278] [Emphasis added.]

Mr. Bertheau's assertion that certain demolition tasks had yet to be performed is inconsistent with AEP/IMPC's discovery response that addresses the "net total cost for the demolition."[279] Furthermore, Mr. Bertheau's claim that demolition and grading for the Breed Plant remains unfinished presumes that the Breed Plant has been left in what he claims is an unsafe condition for over six years.[280] Mr. Bertheau's testimony that the Breed Plant demolition is not complete and has been left in an ungraded state contradicts his testimony that the Company would not permit unsafe demolition practices during the actual demolition process.[281]

SWEPCO claims that because the actual net salvage rate for the Breed Plant demolition work to date was negative 7.04%, it does not undercut SWEPCO's overall net salvage rate of negative 3.4%.[282] However, SWEPCO's argument that the Breed net salvage should be compared to SWEPCO's estimated net salvage runs contrary to SWEPCO's emphasis that net salvage should be based on plant-specific information.[283] Because the Breed Plant is not directly at issue in this case, CARD has not investigated and reviewed all of its demolition costs to determine whether any were unreasonable or inefficient, or to identify unique characteristics of that plant, such as its original cost, that would tend to produce a more negative net salvage rate

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276 CARD's Initial Brief at 37.

277 Direct Testimony of Jacob Pous, CARD Ex. 2 at 20, citing Response to AG 7-45 in OCC Cause No. 200800144, provided in Errata to Jacob Pous Workpapers, CARD Ex. 2C, Attachment 2 and Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at Bates 63-68.

278 SWEPCO's Response to CARD RFI No. 29-15, CARD Ex 54.

279 *Id*. (Emphasis added.)

280 Tr. at 592-593 (Feb. 6, 2013).

281 Tr. at 597-598 (Feb. 6, 2013).

282 SWEPCO's Initial Brief at 102.

283 *See, e.g.* SWEPCO's Initial Brief at 110-111.

compared to other the plants at issue in this proceeding. Moreover, the demolition of the Breed Plant occurred in prior years, and the different market rates for scrap material in those years could result in a more negative net salvage rate.

Mr. Bertheau agrees that plant-specific facts and circumstances are important. At the hearing, Mr. Bertheau was asked to review S&L's estimate for demolishing a 526-foot tall chimney at the Pirkey Plant and compare it to S&L's estimate for demolishing a 550-foot tall chimney at the Breed Plant.[284] For the Pirkey Plant, S&L estimated that demolishing the shorter 526-foot chimney would cost $1,622,400, or approximately 13% of the entire demolition estimate before add-ons.[285] By contrast, S&L's estimate for demolishing the taller 550-foot tall chimney at the Breed Plant was only $482,000.[286] It is important to recall that, as explained above, the Breed Plant greatly overestimated the cost of demolition. Nonetheless, Mr. Bertheau testified that the approximately 340% difference between the two chimney demolition estimates can be attributed to unspecified differences between the two chimneys.[287] Without commenting on the credibility of Mr. Bertheau's assertion given the huge disparity in estimated cost despite the comparable sizes of the chimneys, his complaint is at least consistent with the principle that salvage for one facility cannot be reliably compared to another facility without first establishing that the facts and circumstances are similar.

Because the Breed Plant had different facts and circumstances relative to SWEPCO's various plants, the Breed Plant's percentage net salvage has no bearing on what percentage net salvage is reasonable for SWEPCO's plants, and so SWEPCO's comparison of those percentage rates is inappropriate and irrelevant. SWEPCO compares the percentage net salvage for Breed and SWEPCO's proposed percentage net salvage without any deeper analysis than comparing Breed's net salvage relative to SWEPCO's proposed net salvage. SWEPCO's crude comparison

284 Tr. at 598-603 (Feb. 6, 2013).
285 Tr. at 599 (Feb. 6, 2013).
286 Tr. at 601-602 (Feb. 6, 2013).
287 Tr. at 602 (Feb. 6, 2013).

is only an attempt to distract from the key point: S&L's dollar estimate for the Breed Plant was wildly inaccurate in favor of an excessive depreciation expense. S&L conducted the Breed Plant conceptual estimate, and that estimate was dramatically inflated compared to the actual demolition costs. Mr. Bertheau's attempt to attribute the 62% difference between the Breed Plant's estimated and actual expenses to insufficient grading and below-grade demolition only undermines his own credibility, and further erodes the reliability of S&L's conceptual cost estimates.

SWEPCO's discovery responses and Mr. Bertheau's testimony reveal that S&L's studies "produce excessively high and unreliable demolition cost estimates" as Mr. Pous explains.[288] S&L either chose not to provide the requested underlying critical support for its estimates, or it could not because no such support exists.[289] SWEPCO has the burden of proof in this proceeding, and to the extent its request for increased depreciation relies on the "conceptual cost estimates," SWEPCO failed to meet that burden.

As explained above and in CARD's Initial Brief,[290] S&L's conceptual demolition estimates are unreliable, biased, and inaccurate. To the extent SWEPCO's requested depreciation expense increase relies on these conceptual cost estimates, that request should be denied. SWEPCO complains that Mr. Pous' criticisms were not quantifiably connected with his overall net salvage recommendation.[291] However, CARD provided electronic files that show his adjustments to Mr. Davis' proposals in response to SWEPCO RFI No. 1-1(f) on December 21, 2012. If Mr. Pous' methodology was not clear to Mr. Davis despite Mr. Pous' testimony, workpapers, and electronic workpapers that support his recommendations, SWEPCO could have sought clarification in discovery, or through cross-examination of Mr. Pous, but it did not.

288 Direct Testimony of Jacob Pous, CARD Ex. 2 at 20.

289 *Id*.

290 CARD's Initial Brief at 33-43.

291 SWEPCO's Initial Brief at 106.

Accordingly, SWEPCO's proposed net salvage should be adjusted to a negative 1.4% net salvage for production plant as recommended by Mr. Pous.[292]

Alternatively, CARD recommends a positive net salvage of 15% as a "first step" in recognizing that SWEPCO is subject to deregulation and once that occurs, the divestiture of its generation facilities would result in substantial positive net gains.[293]

Mr. Davis Performed Inappropriate Calculations on the Demolition Estimates

At trial Mr. Davis agreed subject to check that if his cost-of-removal calculation were applied to a generating unit to be retired 35 years from now, the inflation he includes in the calculation would increase each $1 of estimated cost of removal paid by current customers by an *additional* $1.37.[294] As explained previously and in CARD's Initial Brief, [295] Mr. Davis' decision to inflate S&L's demolition conceptual cost estimates to the date of retirement was inappropriate because he failed to discount those future demolition costs to present dollar values to consistently acknowledge the time value of money and to avoid intergenerational inequity. Mr. Davis' approach would cause intergenerational inequity because it requires current customers to pay an added amount to account for future costs, but future customers near the time of actual retirement would pay only in current dollars without an extra charge for inflation.

Mr. Davis' inflation adjustment requires customers to pay the future inflated cost of retirement today. Mr. Davis suggests that it is appropriate to inflate costs without accounting for the time-value of money because depreciation expense "adds to accumulated depreciation which reduces rate base. … So because that rate base amount is being reduced by depreciation, then ratepayers are already being compensated a rate of return."[296] This line of thought completely

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292 Direct Testimony of David Davis, SWEPCO Ex. 43 at DAD-1, page 17 (Total Production Plant Column (V) divided by Column (111)-1).

293 Direct Testimony of Jacob Pous, CARD Ex. 2 at 20, 38.

294 Tr. at 688 (Feb. 6, 2013).

295 CARD's Initial Brief at 41.

296 Tr. at 690 (Feb. 6, 2013).

fails to recognize the intergenerational inequity problem that would be created. Intergenerational inequity occurs between generations of customers. If current customers are forced to pay a premium in current dollars to account for future inflation, it unfairly increases the burden to this generation of customers and reduces the burden of future customers who not only do not pay the same premium, they also have their burden reduced due to the premium's impact over time.

As to SWEPCO's complaint that discounting the future obligation to current dollars would not result in straight-line depreciation amounts,[297] it is incorrect. Depreciation is always reflected in base rates over the then-expected remaining life of the plant in a straight-line rate, and subsequent rate cases determine whether any adjustments are appropriate. This has always been the Commissions practice when dealing with depreciation. Although SWEPCO attempts to support its "pay extra now" approach by citing an almost 20 year-old case addressing nuclear decommissioning costs, the comparison is inappropriate, because the Commission specifically relied on the fact that nuclear construction costs and decommissioning costs "have a tendency to escalate," and no analogous evidence has been offered in this proceeding related to conventional generation plant construction or retirement.[298]

Mr. Davis is suggesting that it is proper for SWEPCO to force the current generation of customers to pay more than they owe if future customers earn a "return" of sorts. However, there is no credible basis in law for obligating current customers to "invest" in accumulated depreciation and thereby denying them other investment opportunities in return for subsidizing future customers' rate base obligations. Mr. Davis claims that it would be improper to discount the future costs to reflect the time-value of money because customers receive a "return" on the "investment," which essentially asserts that it is improper to correct calculation errors that

297 SWEPCO's Initial Brief at 108.

298 *Id.* at 109, citing *Application of Texas Utilities Electric Company for Authority to Change Rates and Investigation of the General Counsel into the Accounting Practices of Texas Utilities Electric Company*, Docket No. 11735, 20 P.U.C. Bull. 1029, 1215-1217, 1454 (FoF No. 126) (May 27, 1994).

overburden current customers if future customers get a compensatory benefit.[299] Mr. Davis' logic is flawed – the fact that his improper calculation results in an overpayment that earns a marginal return for future customers does not resolve the error; it only attempts to justify the error's preservation. There is nothing "improper" about correcting Mr. Davis' calculation error that would foreseeably result in excess accumulated depreciation, regardless of whether or not that error produces some serendipitous benefit for future customers that is not equivalent to the immediate cost to current customers.

Yet another problem with SWEPCO's position is that it implies acceptance and widespread use of Mr. Davis' approach that calculates production plant depreciation rates with inflation but without discounting to present rates.[300] SWEPCO was unable to cite a comparable situation for steam production-plant depreciation in Texas, as none exists. Furthermore, SWEPCO did not and could not rebut Mr. Pous' statement that Mr. Davis proposed the same inflation approach in a contested case in Oklahoma for an affiliate of SWEPCO, and was rejected.[301]

Finally, it should be noted that although Mr. Davis accuses Mr. Pous of speculation, he admits that the inflation rate that he adopted is based on assumptions, and that different entities that predict future inflation rates do not all agree on what that rate should be.[302] In short, by his own definition, the inflation rate he applies is speculative.[303]

Mr. Davis also inappropriately incorporated $19.2 million of negative net salvage associated with interim retirements in his final net salvage calculation,[304] even though the

299 Tr. at 690-691 (Feb. 6, 2013).

300 SWEPCO's Initial Brief at 109.

301 Direct Testimony of Jacob Pous, CARD Ex. 2 at 35.

302 Tr. at 2273-2275 (Feb. 14, 2013).

303 Tr. at 2272 (Feb. 14, 2013).

304 Direct Testimony of Jacob Pous, CARD Ex. 2 at 36-37, and *see* Direct Testimony of David Davis, SWEPCO Ex. 43, depreciation workpapers in response to Staff 3-l Attachment "Net Salvage Ratio for Prod. 2011" at tab "Net Salvage Ratio."

Commission has historically, and again recently, rejected interim retirements when calculating production-plant depreciation.[305] As CARD explained in its Initial Brief,[306] the Commission has found that "[t]he rate at which interim retirements will be made is not known and measurable. Incorporation of interim retirements … would best be done when those retirements are actually made."[307] Moreover, the Company relies on only 9 years of retirement activity, which is a short and inappropriate time span for calculating reasonable levels of interim net salvage.[308] Furthermore, one plant out of 18 different plants that the Company analyzed for interim retirement activity accounted for approximately 67% of the entire interim net salvage proposal; the impact of this single account is significantly out of proportion to investment and so distorts the Company's proposal.[309] It is important to note that Mr. Davis removes outliers elsewhere in his depreciation study,[310] but retained this outlier.

For these reasons and for the other reasons discussed previously, SWEPCO's proposal to abandon Commission precedent and include in its net salvage calculation interim retirements and inflation without discounting to present value should be denied.

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305 Direct Testimony of Jacob Pous, CARD Ex. 2 at 4, *citing Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing at Finding of Fact No. 100 at 21 (Nov. 2, 2012). *See also* Direct Testimony of Jacob Pous, CARD Ex. 2 at 36-38.

306 CARD's Initial Brief at 42.

307 PUC Docket Nos. 8425 and 8431, *Application of Houston Lighting and Power Company for Authority to Change Rates; Application of Houston Lighting and Power Company for a Final Reconciliation of Fuel Costs Through September 30, 1988*, Final Order, Finding of Fact No. 212 (16 Tex. P.U.C. Bull. 2684, 1990 WL 711948 (Tex. P.U.C.)) (Jun. 20, 1990).

308 Direct Testimony of Jacob Pous, CARD Ex. 2 at 36-37.

309 *Id.* at 37.

310 *See, e.g.* Rebuttal Testimony of David Davis, SWEPCO Ex. 81 at 59-60.

2. Transmission Plant

a. Life parameter for FERC Account 355-Poles and Fixtures

As explained in CARD's Initial Brief,[311] SWEPCO's proposal to adopt a 50S0 life-curve combination is inappropriate because the 54L1 life-curve combination that CARD advocates reflects a superior fit to the actuarial results. The 54L1 fit is superior because it appropriately places more emphasis on a better fit of the more meaningful and significant portion of the Observed Life Table (OLT) rather than the less relevant or meaningless tail portion.[312] SWEPCO's Initial Brief acknowledges Mr. Pous' emphasis of the importance of a better fit near the top and middle of the OLT, and in rebuttal it refers to testimony that claims SWEPCO put appropriate emphasis on the top and middle portions based on a visual inspection.[313] However, SWEPCO's claim that it placed appropriate emphasis on the top and middle portions is clearly incorrect, given that Mr. Davis admitted that his mathematical curve fitting process assigns an equal weight to the top, middle, and bottom portions of the curve.[314] CARD maintains that a visual inspection instead shows that the 54L1 combination provides a superior fit in the top and middle portions relative to SWEPCO's proposed 50S0 combination and should be adopted on that basis. Review of the curve plots on page 66 of Mr. Pous' testimony shows that Mr. Davis' proposal is only a better fit at the tail of the curve (ages 55 to 85) where the dollar level of exposures to retirements often fall below $10,000 compared to $307 million of exposures at the top of the OLT.[315]

311 CARD's Initial Brief at 47.

312 Direct Testimony of Jacob Pous, CARD Ex. 2 at 65-67.

313 SWEPCO's Initial Brief at 112.

314 Tr. at 698 (Feb. 6, 2013).

315 Direct Testimony of Jacob Pous, CARD Ex. 2 at 66.

CARD's recommendation results in a $737,264 reduction in annual depreciation expense on a total Company basis for plant as of December 31, 2011, and a corresponding $293,357 reduction on a Texas jurisdictional retail basis.[316]

b. Net salvage for FERC Account 353 –Station Equipment

As explained in CARD's Initial Brief,[317] CARD recommends a net salvage value of 0% for this account, by contrast to the Company's proposed negative 13% net salvage.[318] As Mr. Pous explained, the Company's proposal is excessively negative and fails to adequately recognize certain key factors, some of which it selectively recognizes in other accounts.[319] In particular, the Company's proposal fails to recognize a trend in the data towards a less negative value, and fails to analyze what specifically retired and why the annual negative net salvages within its 10-year average range from negative 3% to negative 74%.[320] Furthermore, the Company does not provide any narrative evidencing the basis for its proposed percentage, which can only be inferred from its workpapers.[321]

SWEPCO's Initial Brief responds to CARD's arguments by relying upon Mr. Davis, who has five or six years of experience developing depreciation studies and has prepared about 13 depreciation studies,[322] to assert that Mr. Pous, who has prepared utility depreciation studies for the past 37 years, who has been involved in over 400 utility rate cases in the United States and Canada,[323] and has testified on behalf of the staff of five different state regulatory agencies[324] is in error. For example, SWEPCO complains that "Mr. Davis pointed out that Mr. Pous' use of just

316 *Id.* at 67.
317 CARD's Initial Brief at 43-45.
318 Direct Testimony of Jacob Pous, CARD Ex. 2 at 48-49.
319 *Id.* at 49.
320 *Id.*
321 *Id.*
322 Tr. at 684-685 (Feb. 6, 2013).
323 Direct Testimony of Jacob Pous, CARD Ex. 2 at Appendix A, Bates 79.
324 *Id.* at 2.

one year's data as indicative of a trend is not a valid analytical approach."[325] However, Mr. Davis either misunderstands or misrepresents Mr. Pous' criticism. Mr. Pous did not testify or suggest that the one year of data was "indicative of a trend;" he instead suggested that given the magnitude of the retirements and corresponding negative 5% net salvage in that year, Mr. Davis should have given it more significance in his analysis.[326] He then goes on to explain that this particular account has a few high-cost items (transformers) that retire less frequently, but represent a disproportionate amount of the investment in the account relative to the many lower-cost items that it contains.[327] Therefore, years in which the high-cost items retire, better represent the overall net salvage for the account, relative to the more frequent retirements that represent less of the account's actual investment (e.g. lightning arrestors and switches).[328]

By contrast, Mr. Davis employed a crude mechanical average for all years, rather than giving appropriate weight to years in which a more representative mix of investment was retired. If Mr. Davis had given a more thoughtful analysis and weighed years with greater dollar levels of retirement, he would have produced a net salvage rate that is more representative of the recovery of investment in this account, since investment in the account is weighted toward higher-priced items that retire less frequently.

Mr. Pous then explains that the higher-price retirements (transformers) correlate with less negative net salvage rates, as demonstrated by observing a historical trend, specifically that the three years with the largest retirements during the last seven years yield a negative 5.7% net salvage, whereas the years with the lowest level of retirement activity have a negative 22.1% net salvage.[329] The less negative salvage rates in years with the largest retirements reflect the higher salvage value associated with large-investment transformers, and higher dollar levels also reflect

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325 SWEPCO's Initial Brief at 113, *citing* Rebuttal Testimony of David Davis, SWEPCO Ex. 81 at 50.

326 Direct Testimony of Jacob Pous, CARD Ex. 2 at 49.

327 *Id*.

328 *Id*. at 49-50.

329 Direct Testimony of Jacob Pous, CARD Ex. 2 at 50.

greater opportunities to realize economies of scale that would result in a more positive net salvage value.[330]

Mr. Pous explains that Mr. Davis further erred in his analysis by removing the $3,680,378 of gross salvage from a transformer sale without any explanation, when transformer retirements, although infrequent, are not anomalous. Mr. Davis on the one hand criticizes Mr. Pous for emphasizing the significance of a single year that would suggest a less negative net salvage, while he simultaneously singles out and removes a single transaction to result in a more negative net salvage. Although SWEPCO defends Mr. Davis' decision to remove the salvage from the Pirkey transformer by claiming it was not representative of future experience,[331] Mr. Davis admitted that his conclusion involved some speculation,[332] and was removed not because transformers would not retire in the future, but instead because the Company does not normally sell transformers even though they have that option.[333]

In response to discovery, Mr. Davis gave a different explanation, claiming that the transformer sales in this account and account 362 were removed because their salvage prices were abnormally large in comparison to other salvage transactions posted to these accounts.[334] As explained previously, transformers represent a significantly larger investment than other items in this account, such as lightning arrestors and switches. The fact that transformers have a higher salvage value than the less expensive items does not make their salvage unrepresentative of the future as Mr. Davis claims.[335] To the contrary, both sales evidence future salvage expectations the next time a transformer is retired and salvaged.

330 *Id.* at 50-51.

331 SWEPCO's Initial Brief at 113.

332 Tr. at 2276-2277 (Feb. 14, 2013).

333 Tr. at 2277-2280 (Feb. 14, 2013).

334 SWEPCO's Response to CARD RFI No. 29-7, CARD Ex. 46.

335 *Id.*

In short, Mr. Davis did not establish that the salvage obtained for that transformer was inappropriately high and only rejected the salvage value because he speculated that the utility might not try to recover such salvage values in the future. The sale of the transformer evidences that transformers have a salvage value; that value should not be removed from the analysis because SWEPCO might elect to waste that value by failing to make commercially reasonable efforts to conduct salvage when that type of item retires in the future. Nor should it be removed because transformers have a higher salvage value than other types of items within this account.

SWEPCO again engages in a comparison to other utilities' net salvage rates,[336] but as explained previously herein and as discussed at the hearing, net salvage should be based on each utility's facts and circumstances.[337] SWEPCO's attempt to lend its proposed net salvage credibility by referencing the net salvage rates of other utilities is inappropriate when utility specific data is available, and should be ignored.

Finally, SWEPCO asserts that Mr. Pous "relies on unquantifiable and speculative generalizations such as potential economies of scale and increases in scrap copper values because of a resurgence in the economies of China and India."[338] However, as Mr. Davis admitted at hearing, any estimate of net salvage concerns the future, and "anything from the future would involve some speculation," even if it is based on historical evidence (e.g., rising copper prices and the growth of industrial economies in China and India).[339] As SWEPCO itself states in a later section of its Initial Brief, "…in the absence of a known reason to conclude otherwise, the past is a reasonable indicator of what will occur in the future."[340]

336 SWEPCO's Initial Brief at 113.

337 Tr. at 2282-2284 (Feb. 14, 2013).

338 SWEPCO's Initial Brief at 113.

339 Tr. at 2276-2277 (Feb. 14, 2013).

340 SWEPCO's Initial Brief at 98.

CARD's recommended net salvage rate of 0% for this account is conservative.[341] CARD's recommendation would decrease overall total Company depreciation expense by $1,055,218 based on plant as of December 31, 2011, which would reduce depreciation expense on a Texas jurisdictional basis by $419,871.

c. Net salvage for FERC Account 355-Poles and Fixtures

As explained in CARD's Initial Brief,[342] CARD recommends a net salvage value of negative 45%, as compared to the Company's proposed net salvage value of negative 67%.[343] Consistent with his other net salvage calculations, Mr. Davis relied on a simple mechanical average for this account, in this case covering the 10-year period from 2002-2011.[344]

SWEPCO criticizes Mr. Pous' contention that because the 10-year period exhibited large fluctuations, guidance should be sought from industry information.[345] SWEPCO asserts that Mr. Davis demonstrated the lack of merit in Mr. Pous' analysis by claiming that Mr. Pous' approach "is extremely selective, choosing outdated industry data when it serves his purpose, but arbitrarily choosing SWEPCO data such as the most recent four-year data for 2008-2011 when it serves his purpose."[346] SWEPCO does not mention that it provided the data to Mr. Pous in response to discovery.[347]

Ironically, SWEPCO attempts to claim Mr. Pous is selectively referencing the 2008-2011 year period, when its focus on those four years is itself selective given that Mr. Pous' analysis examined every year from 1996-2011, during which many years had rates even less negative than the negative 48% rate from 2007-2011, as explained below. Rather than rely on an overly

341 Direct Testimony of Jacob Pous, CARD Ex. 2 at 51.

342 CARD's Initial Brief at 45-46.

343 Direct Testimony of Jacob Pous, CARD Ex. 2 at 51-52.

344 SWEPCO's Initial Brief at 113.

345 *Id.* at 113-114.

346 *Id.*

347 Workpapers to Direct Testimony of Jacob Pous, CARD Ex. 2A at 172 (Confidential).

simplistic mechanical average as Mr. Davis did, Mr. Pous "drilled down" to identify trends and deviations within the entire study period, and weighed his recommendation in light of those deviations and trends and their causes.

SWEPCO's focus on Mr. Pous' reference to the negative 48% net salvage from 2007-2011 attempts to paint Mr. Pous' reference to certain years as arbitrary, when it was instead only part of a deeper analysis than the mechanical average advocated by Mr. Davis. Mr. Davis' simple average of the 10-year period fails to recognize that the years from 2001-2007 were unusually negative and failed to investigate or explain the changes in net salvage over the years he averaged. Surely, a reliable and thorough depreciation analysis involves more than taking the overall salvage rate for each year and averaging them, without considering the level of investment in each year or considering whether there are years where rates change dramatically and attempting to find the cause of such changes. SWEPCO did not rebut Mr. Pous' position that adequate levels of materiality, frequency and pattern are necessary for reliable net salvage analyses.[348] Mr. Davis' simplistic mathematical averaging process fails to test the adequacy of materiality, frequency, and patterns in the data.

In the course of Mr. Pous' appropriately more rigorous analysis, he pointed to the divergent net salvage rates in various years to show that the period from 2001 – 2007 was extremely negative compared to its surrounding years. Specifically, he noted that the 2001-2007 period yields a negative 105% net salvage, but by contrast the period from 1996-2001 yields a negative 30% net salvage, the period from 2008-2011 yields a negative 48% net salvage, and the annual results range from positive 1% to negative 157%.[349] These divergences and trends show that Mr. Davis' crude average does not reliably reflect historical experience, and so it likewise does not reliably predict future experience. Instead, it shows that a crude average is biased by

348 Direct Testimony of Jacob Pous, CARD Ex. 2 at 48.

349 *Id.* at 52.

the inclusion of a limited period of years within the study that are excessively negative relative both to past and to more recent experience.

Simply put, Mr. Davis' "just average it" analysis was too limited to be useful or reliable. Mr. Davis failed to adequately consider trends and anomalies in the data he was averaging. If he identified the trends and anomalies but could not ascertain their cause, he should have given more consideration to industry data as Mr. Pous suggested.[350] If SWEPCO honestly believed that the particular industry data that Mr. Pous referenced is inaccurate, it could have offered another sample of industry data, but it chose not to. Indeed, the data is what SWEPCO provided to Mr. Pous.[351] SWEPCO has the burden of proof to justify its net salvage for this account, and it has failed to meet that burden.

Mr. Pous' proposal to apply a negative 45% net salvage for this account is reasonable and conservative. Mr. Pous' recommendation discounts the atypical experience from 2001-2007, and instead of advocating the even less negative experience shown in years from 1996-2001, it reasonably proposes a more negative value that is more typical of recent experience from 2007-2011.

d. Net salvage for FERC Account 356-Overhead Conductor

As explained in CARD's Initial Brief,[352] CARD recommends a negative 25% net salvage for this account,[353] whereas the Company recommends negative 40% net salvage.[354]

SWEPCO characterizes Mr. Pous' argument that the records maintained by SWEPCO were inadequate as "a diversionary attempt to create the misleading impression that the

350 *Id.*

351 Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at 172 (Confidential).

352 CARD's Initial Brief at 47.

353 Direct Testimony of Jacob Pous, CARD Ex. 2 at 54.

354 *Id*.

availability of this type of data would provide a more conclusive result."[355] However, as Mr. Pous explained, the absent data[356] is important for a more conclusive result, given that the historical net salvage for this account changed significantly from 2002-2005 (negative 74%), relative to the four prior years (negative 5%), and the period after 2005 (negative 26%). As with other accounts, Mr. Davis performed another simplistic mechanical average and failed to recognize the dramatic changes year-to-year, let alone conduct any investigation as to their cause.

SWEPCO's complaint that it is not required to retain the records Mr. Pous sought misses the point: SWEPCO has the burden of proof. It failed to recognize or explain the significant net salvage variations that are apparent in the years that Mr. Davis simply averaged without due analysis. If SWEPCO cannot explain those variations, there is no reason to believe that an average of the years will be representative of future experience. Mr. Pous' point was that the fluctuations merited investigation, and his own attempts at investigation were prevented by a dearth of relevant data despite his efforts to retrieve it through discovery.

Even if the Commission does not specifically require that SWEPCO keep certain records, that does not mean that destroying or refusing to gather the data excuses SWEPCO from its responsibility to show that its proposed rate request is just and reasonable. If SWEPCO believes that the data Mr. Pous questioned is irrelevant or unreasonably difficult to obtain, it should have attempted to investigate and explain the variations using other available information. Similarly, if SWEPCO believes that the industry data Mr. Pous referenced were inaccurate, it could have offered an alternative set of industry data. Instead, it continued to rely on its mechanical average, and failed to conduct any meaningful analysis or explanation of the underlying variations that its mechanical average obscures.

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355 SWEPCO's Initial Brief at 115.

356 Direct Testimony of Jacob Pous, CARD Ex. 2 at 54. The missing data includes the number of linear feet of overhead conductors, the linear feet of conductors retired by year, the amount of copper conductor retired or still on the system, the level of contractor expenditures, and other relevant elements associated with net salvage.

SWEPCO has failed to meet its burden of proof, and so its proposal to adopt a net salvage rate of negative 40% is without adequate support and should be rejected, or adjusted to negative 25% for the reasons set forth by Mr. Pous.[357]

3. Distribution Plant

a. Life parameter for FERC Account 367 – Underground Conductor

As explained in CARD's Initial Brief,[358] CARD recommends a 50R1.5 life-curve combination for Account 367,[359] whereas the Company proposes a 45R2.5 life-curve combination.[360] SWEPCO claims that its proposed life parameter "is based on the goodness of fit criterion (least squared deviations)," but Mr. Pous explained that although the Company's proposal appears to be a better fit beginning at age 50, and is a much superior fit as it nears the tail end of the curve (i.e. 65-75 years), the Company's preference for matching the tail end of the curve is inappropriate given that better fits near the top and middle portions of the curve are more important.[361]

Mr. Pous' recommendation, by contrast, appropriately advocates the life-curve combination with a superior fit near the top and middle (i.e. the significant and meaningful) portions of the curve.[362] SWEPCO's Initial Brief does not address let alone deny Mr. Pous' contention that the top and middle portions of the curve are more important. As Mr. Pous explained, the relative importance of the top and middle of the curve are demonstrated by SWEPCO's account, where the dollar level of exposures around 50 years of age are $300,000

357 Direct Testimony of Jacob Pous, CARD Ex. 2 at 53-56.

358 CARD's Initial Brief at 51-52.

359 Direct Testimony of Jacob Pous, CARD Ex. 2 at 70.

360 *Id*.

361 *Id*. at 71-72.

362 Direct Testimony of Jacob Pous, CARD Ex. 2 at 71-72.

and less compared to an initial exposure level of $185 million.[363] In other words, the statistical reliability of the curve is based on a significantly greater amount of dollars at its beginning and middle, while its statistical stability becomes relatively insignificant beyond 50 years. Thus, Mr. Davis' selection of the best mathematical fit over the entire period is inappropriate and misleading. Again, Mr. Davis' approach favors an overly simplistic and incorrect analysis that fails to weigh relevant factors such as the relative level of investment exposed to retirement. Accordingly, Mr. Davis' proposed life-curve combination should be rejected, and Mr. Pous' proposed life-curve combination of 50 R1.5 that better fits the beginning and middle of the curve should be adopted in its stead.

b. Net salvage for FERC Account 362 – Substation Equipment

CARD recommends a negative 5% net salvage for this account,[364] whereas the Company proposes a negative 16% net salvage.[365]

As explained in CARD's Initial Brief,[366] the Company's proposed net salvage for this account is excessively negative, again because, similar to Transmission Account 353 – Station Equipment, a substantial level of the account's investments are in transformers, which retire infrequently but have a much less negative (and often positive) salvage value due in part to their high quantity of copper.[367]

SWEPCO claims that Mr. Pous failed to provide quantifiable support or calculations that the amounts of copper in a transformer would offset the costs of retiring or removing a distribution substation.[368] However, an example of potential positive net salvage is demonstrated by the Company's $1,540,156 positive net salvage associated with the sale of the Eastman

363 *Id.* at 72.
364 *Id.* at 56.
365 *Id.* at 56.
366 CARD's Initial Brief at 49-50.
367 Direct Testimony of Jacob Pous, CARD Ex. 2 at 56.
368 SWEPCO's Initial Brief at 117.

substation.[369] SWEPCO attempts to dismiss this example, which it excluded from its analysis, by implying that it is not representative of what would be expected in the future. However, neither SWEPCO nor Mr. Davis explains *why* this event is atypical from future expectations.[370] Consistent with the discussion regarding Account 353, Mr. Davis's presumption regarding future expectations involves some speculation.[371] Specifically, Mr. Davis is either presuming that substations will not retire in the future (a patently unreasonable presumption) or he is again assuming that the Company will chose not to attempt to sell substations in the future to obtain their full salvage value.

SWEPCO has not shown that there is no market for salvage from substations and that it will not sell other transformers in the future; to the contrary, the Eastman sale shows that such a market exists and historically SWEPCO has engaged in it. Although such retirements may be infrequent, they represent a substantial portion of the investment value of the account, and so should not be disregarded.

In response to discovery, Mr. Davis claimed that the transformer sales in this account and account 353 were removed because their salvage prices were abnormally large in comparison to other salvage transactions posted to these accounts.[372] As explained previously, transformers represent a substantial level of the account's investments. The fact that transformers have a higher salvage value than the less expensive items in the account does not make their salvage unrepresentative of the future as Mr. Davis claims.[373] To the contrary, it evidences future salvage expectations the next time a transformer is retired and salvaged, e.g. when a substation is retired.

The Company's depreciation study once again relies upon a simple mathematical average of the covered period, without due consideration to trends and causes of trends within those

369 Direct Testimony of Jacob Pous, CARD Ex. 2 at 56-57.

370 SWEPCO's Initial Brief at 117. *See also* Direct Testimony of David Davis, SWEPCO Ex. 43 at 59-60.

371 Tr. at 2276-2277 (Feb. 14, 2013).

372 SWEPCO's Response to CARD RFI No. 29-7, CARD Ex. 46.

373 *Id.*

years. As CARD's Initial Brief explains, the most recent seven-year period within the Company's 28-year historical average provided a net salvage average of negative 22%, but if the sale of the Eastman substation had properly been included, the net salvage average would have been less than negative 9%.[374] In addition, the three years with the highest level of retirement activity during the last 7 years yields a positive 2% net salvage compared to the three years with the lowest retirement activity during those same 7 years, which yielded a negative 26% net salvage; this reflects the benefits of economies of scale associated with higher retirement levels.[375]

Again, SWEPCO has the burden of proof. It selectively removed the Eastman substation revenue without due cause, and once again failed to engage in a meaningful analysis of trends and causes of trends in the year-to-year data, instead favoring a crude average. Given that the Company failed to engage in a meaningful analysis of its study period, its conclusions should be checked against industry data. Mr. Pous' analysis of industry data suggests that a negative 3% to negative 7% net salvage level is typical, and that some utilities even experience positive levels of salvage for this account.[376] SWEPCO once again complains that Mr. Pous' industry data is inappropriate, but it could have supported its proposed rate by presenting alternative industry data, and it chose not to. Mr. Pous reasonably employed data that the Company had provided him in response to discovery.[377] Given that Mr. Davis' approach was overly simplistic and was also biased by excluding the sale of the Eastman substation, it should be rejected. Mr. Pous' industry data is more reliable in this instance, and his recommended net salvage rate that represents the midpoint of that data should be adopted.[378]

374 Direct Testimony of Jacob Pous, CARD Ex. 2 at 57.

375 *Id.*

376 *Id.*

377 Workpapers to the Direct Testimony of Jacob Pous, CARD Ex. 2A at 172 (Confidential).

378 Direct Testimony of Jacob Pous, CARD Ex. 2 at 57.

c. Life parameter for FERC Account 364 – Distribution Poles

CARD recommends a 54L0 combination to reflect the reasonable expected Average Service Life (ASL) for this account.[379] Although the Company originally proposed a 50L0 life-curve combination, Mr. Davis' rebuttal testimony indicates that the Company accepts Mr. Pous' recommendation regarding the service life for Account 364 – Distribution Poles.[380] SWEPCO's adoption of CARD's recommended ASL for this account results in a $716,339 reduction in annual depreciation expense on a Company basis based on plant as of December 31, 2011, and a corresponding $254,802 reduction on a Texas retail basis.[381]

4. General Plant

a. Account 390 – General Structures and Improvements

As explained in CARD's Initial Brief,[382] CARD recommends a positive 25% net salvage as a first step to establishing a more appropriate level of net salvage for the Company's investment in this account.[383] Although the Company initially proposed a negative 7% net salvage,[384] it reduced its proposal to negative 3% in light of Mr. Pous' testimony.[385] However, SWEPCO's proposed revision to negative 3% remains inadequate and remains inappropriately negative.

As CARD explained in its Initial Brief, if the Company had examined the results of the most recent 10-year period (as it did for several other accounts), it would have resulted in a positive 22% net salvage value.[386] Instead, the Company again simply averaged the annual net salvage rates, without giving due consideration or weight to years in which higher dollar-levels

379 *Id.* at 68.

380 Rebuttal Testimony of David Davis, SWEPCO Ex. 81 at 5, 43-44.

381 Direct Testimony of Jacob Pous, CARD Ex. 2 at 70.

382 CARD's Initial Brief at 53-55.

383 Direct Testimony of Jacob Pous, CARD Ex. 2 at 60.

384 *Id.* at 58.

385 Rebuttal Testimony of David Davis, SWEPCO Ex. 81 at 5, 64-65.

386 Direct Testimony of Jacob Pous, CARD Ex. 2 at 59.

of retirement occurred due to the sale of buildings. SWEPCO's failure to rely on more relevant data is significant given that the Company's ten largest buildings represent the majority of the Company's investment in this account (two of which account for 43% of the total investment).[387]

The Company's simple average methodology was also skewed because it failed to acknowledge that most of the cost of removal resulted from one year, 1996, in which a major and unusual asbestos removal project was required.[388] In rebuttal, Mr. Davis resolved this shortcoming by removing both years 1996 and 2004 from the average.[389] However, while it was appropriate to remove 1996 as an anomalous cost of removal that is not expected to recur or be representative of future experience, by contrast the positive net salvage in 2004 (positive 34%) was the result of the sale of the Company's Fayetteville office building at a substantial profit,[390] and there is no evidence to suggest that similar building sales will not occur in the future and would not be positive. If only 1996 had been removed, the net salvage would be positive 11% rather than negative 3%.[391]

Although SWEPCO complains that removing building subcomponents such as lighting and air conditioning can be costly,[392] it provides no data to suggest that these expenses entirely or even materially offset the type of net gain on sale experienced by the Company's sale of its Fayetteville building. Similarly, although SWEPCO notes that a building's age, location, or the condition of its structure can affect its sale value,[393] it offered no data or evidence to suggest that its remaining investments in buildings were in any way diminished in value due to these factors, or somehow distinguished from the Fayetteville property. Instead, SWEPCO suggests that "the

387 *Id.*

388 *Id.*

389 Rebuttal Testimony of David Davis, SWEPCO Ex. 81 at 64.

390 Direct Testimony of Jacob Pous, CARD Ex. 2 at 60.

391 *Id.* at 59-60.

392 SWEPCO's Initial Brief at 118.

393 *Id.*

best course of action is to consider SWEPCO's history," even though the relevant history of SWEPCO's building sales is only evidenced by the Fayetteville sale.[394]

CARD's recommended rate of positive 25% is conservative, as it is not as great as the positive 34% percent experienced by the Company during the year in which it sold an office building (and again, buildings represent the majority of the account's investments in terms of dollar value).[395] Furthermore, the positive 25% net salvage is close to the Company's experience on an accumulated basis for the six most recent 10-year roll averages.[396]

CARD also recommends that the Commission order the Company to perform a more detailed analysis for this account for its next rate case that would identify the type of investment within the account and the type of retirement activity and costs of such activity, so that a better relationship between investment and retirement activity and potential positive salvage can be determined.[397] Finally, CARD recommends that the Commission order the Company to have appraisals conducted for its largest buildings and structures to identify market expectation for the value of such facilities in the event of sale.[398]

5. Depreciation Reserve

CARD supports TIEC's assertion that SWEPCO's depreciation expense should be reduced by $13.2 million (Texas Retail) and the depreciation surplus should be amortized over a 10-year period to promote generational equity.[399]

394 *Id.*

395 Direct Testimony of Jacob Pous, CARD Ex. 2 at 60.

396 *Id.*

397 *Id.*

398 Direct Testimony of Jacob Pous, CARD Ex. 2 at 60.

399 TIEC's Initial Brief at 60-63.

J. Mountaineer Carbon Capture & Storage Project Amortization

CARD addresses the issue of the amortization of the Mountaineer Carbon Capture & Storage Project in Section II.D, *supra*.

K. Labor Costs [PO Issue 30]

1. Payroll – AEPSC and SWEPCO – Not Briefed

2. Incentive Compensation

a. Annual Incentive Compensation

SWEPCO admits that its proposal to include financial measures that primarily benefit shareholders violates Commission precedent.[400] SWEPCO wants the Commission to change its "policy around financially based performance measures and incentive compensation."[401] SWEPCO has not offered evidence that compels a change to long-established, well-regarded precedent.

SWEPCO posits two theories on why it should be permitted recovery of its incentive pay: 1) without incentive pay SWEPCO's pay would be below the market rate; and 2) SWEPCO's incentive pay benefits customers.[402] First it should be noted that any disallowance of incentive pay would not necessarily result in SWEPCO discontinuing incentive pay, but rather would result in shareholders paying for the benefits they receive from the program.

The undisputed evidence shows that contrary to SWEPCO's assertions, Texas' treatment of incentive compensation is consistent with much of the country.[403] SWEPCO first in rebuttal

400 SWEPCO's Initial Brief at 125.

401 Tr. at 486 (Feb. 5, 2013).

402 SWEPCO's Initial Brief at 126.

403 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 23-29

testimony,[404] and then at the hearing, did not contest CARD's extensive showing that nationwide, incentive compensation is not generally permitted in rates.[405]

SWEPCO is not disadvantaged when incentive compensation is denied ratemaking recovery because "most states exclude equity incentive pay as a matter-of-course, and many other exclude equity incentives as a practical matter."[406] In fact, incentive pay is so widely disallowed that if the Commission granted SWEPCO's request it would actually give SWEPCO an unfair advantage in the marketplace that does allow recovery in rates.[407] The Texas Commission, as well as numerous other commissions, consistently exclude financially based incentive compensation for concrete reasons that are explained in detail in CARD's Initial Brief[408] and CARD's testimony[409] and will not be repeated in detail here. When evaluating the "market" in which SWEPCO operates it is apparent that incentive compensation is almost always offered, but shareholders pay the expense because it is shareholders who benefit from the employees reaching their incentive goals.[410] SWEPCO's marketplace argument is not supported by the record and the Commission should reject SWEPCO's request to require ratepayers to pay for SWEPCO's incentive-compensation plan.

Furthermore, incentive compensation programs should generate funding when employees hit their targets.[411] A financially based incentive program ***should*** result in financial benefit; otherwise it is a dysfunctional incentive. It is appropriate and reasonable that the additional funds generated by the incentive programs should provide funding to the programs that generated the funds. If SWEPCO is not recouping the cost of the programs, plus additional

404 Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80.

405 Tr. at 495-498 (Feb. 5, 2013).

406 Direct Testimony of Mark Garrett, CARD Ex. 5 at 33.

407 *Id.*

408 CARD's Initial Brief at 55-60.

409 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 19-41

410 *Id.*

411 Direct Testimony of Mark Garrett, CARD Ex. 5 at 33.

funds beyond the pay-out level, the incentive program is poorly designed.[412] It does not disadvantage SWEPCO in the marketplace to establish programs that make more money for the Company than they cost to fund. If the programs do not consistently generate additional funds they should be discontinued; they do not need to be subsidized by ratepayers.

SWEPCO offers little to support its claim that financially based incentive programs benefit ratepayers more than shareholders, other than providing the pay structure of employees' salaries.[413] Once again, this pay structure benefits shareholders, not ratepayers who are interested in operational measures that increase reliability and quality of service, not increased earnings.[414] Finally, even if SWEPCO employees meet operational goals, they would only be compensated to the extent additional earnings are available after the Earnings Per Share ("EPS") targets are achieved.[415] So, no matter what the benefit to customers, failure to hit the EPS target could result in the withholding of all incentive, and the entire amount collected in rates for incentive programs to be retained exclusively by the shareholders.

SWEPCO also disputes the scope of its financially based performance measures.[416] SWEPCO's view of financial metrics is too narrow and was addressed fully in CARD's Initial Brief.[417] Far from being mere cost control measures,[418] SWEPCO requested recovery of several financially based goals including margin sharing goals,[419] regulatory goals,[420] and strategic

412 Direct Testimony of Mark Garrett, CARD Ex. 5 at 33.

413 *Id.* at 23-29.

414 *Id.* at 19-41.

415 *Id.* at 32-33.

416 SWEPCO's Initial Brief at 128-130.

417 Direct Testimony of Mark Garrett, CARD Ex. 5 at 30-36 and CARD's Initial Brief at 55-60.

418 SWEPCO's Initial Brief at 128-130 and Docket No. 39896, Proposal for Decision at 174-176.

419 **Margin Sharing goals** are based on employees increasing the margins on items where the margins are shared between the customers and the shareholders. On any such item, the customers have already provided the Company with an incentive to increase these margins by sharing a portion of the margin that would otherwise belong to the customers. Any further incentive to increase margins for the Company should be paid by the Company.

420 **Regulatory goals** are based on employees' successful efforts in achieving higher rates of return on the regulated operations of the Company. Clearly, ratepayers should not be asked to pay for these efforts.

goals.[421] Each one of these goals is financial in nature and promotes shareholder benefits, does not advantage ratepayers, and should be disallowed. SWEPCO has failed to present a valid reason to discontinue long-standing Commission policy[422] that disallows financially based incentive programs.

b. Long-Term Incentive Compensation

SWEPCO raises many of the same arguments in its brief regarding long-term incentive compensation as it did in its annual incentive compensation section. CARD incorporates by reference its above discussion regarding incentive compensation, as well as its discussion in its Initial Brief to support its rejection of inclusion in rates of SWEPCO's incentive compensation programs, either short-term or long-term programs.[423] SWEPCO raises one additional point regarding long-term incentive compensation. SWEPCO claims that unlike financial performance units, which are awarded based on financial performance, Restricted Stock Units ("RSUs") are only awarded due to the passage of time.[424] It is true that RSU vesting is tied to the passage of time; however they are also "tied exclusively to financial measures, since the value of the restricted units is tied to the appreciation of AEP's stock price over the vesting period."[425]

SWEPCO also ignores the fact that in the recent Entergy case, the Commission excluded this type of benefit to officers, executives, and key employees for ratemaking purposes because it benefited shareholders, not ratepayers.[426] The Commission determined that a similar, financially based incentive program was not recoverable in rates because it was tied to stock price.[427] It is

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421 **Strategic goals** are based on objectives related to bringing the Turk plant and transmission projects on-line and into rates. Again, these goals clearly provide financial benefits to the Company more than they do its customers.

422 *Application of AEP Texas Central Company for Authority to Change Rates*, Docket No. 28840; SOAH Docket No. 473-04-1033, Final Order (August 15, 2005).

423 CARD's Initial Brief at 55-60.

424 SWEPCO's Initial Brief at 130-131.

425 Direct Testimony of Mark Garrett, CARD Ex. 5 at 37.

426 *See* Proposal for Decision in PUCT Docket No. 39896 at 171.

427 *Id.*

therefore appropriate in this proceeding to disallow Restricted Stock Units and induce shareholders, not ratepayers, to pay for the program.[428] The Commission should remove all of the cost of SWEPCO's long-term incentive plans.[429]

3. Executive Perquisites – Not Briefed

4. Relocation – Not Briefed

L. Pension and Related Benefits [PO Issue 28]

1. Pensions – Not Briefed

2. OPEBs – Not Briefed

3. Post-employment Benefits – Not Briefed

4. Supplemental Executive Retirement Plan ("SERP")

SWEPCO's attempt to distinguish the Commission's decision in Docket No. 39896, the Entergy rate case, is entirely unpersuasive.[430] The Entergy rate case is directly on point with the issue presented in this case. Only four months ago the Commission was presented the same issue in the Entergy case and found that:[431]

> 140. ETI provides non-qualified supplemental executive retirement plans for highly compensated individuals such as key managerial employees and executives that, because of limitations imposed under the Internal Revenue Code, would other wise not receive retirement benefits on their annual compensation over $245,000.
>
> 141. ETI's non-qualified supplemental executive retirement plans are discretionary cots designed to attract, retain and reward highly compensated employees whose interests are more closely aligned with those of the shareholders than the customers.

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428 Direct Testimony of Mark Garrett, CARD Ex. 5 at 37-41.

429 *Id.* at Exhibit MG 3.4.

430 *Application of Entergy Texas., Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing (Nov. 2, 2012) and SWEPCO's Initial Brief at 138-140.

431 Docket No. 39896, Final Order at 26, FoFs 140-142.

142. ETI's non-qualified executive retirement benefits in the amount of $2,114,931 are not reasonable or necessary to provide utility service to the public, not in the public interest, and should not be included in ETI's cost of service.

The Commission's findings describe Entergy's supplemental pension plan, but the description applies equally well to SWEPCO's supplemental pension plan. SWEPCO attempts to distinguish its supplemental pension-plan expense from Entergy's by stating that the same formula applies regardless of the level of pay in its plan.[432] It implies that its policy of applying the same formula regardless of pay level differs from all three types of supplemental executive retirement plans offered by Entergy (the Pension Equalization Plan, the Supplemental Retirement Plan, and the System Executive Retirement Plan) [433] that the Commission ultimately disallowed.[434] SWEPCO merely implies there is the possibility of a distinction because its witness admitted that he had not "reviewed the plans themselves,"[435] so in actuality SWEPCO cannot definitively state that the plans are different.

Further, the record indicates SWEPCO's plan is just like Entergy's Pension Equalization Plan, which "provides supplemental retirement benefits to account for the fact that Internal Revenue Code regulations limit the level of retirement benefits that qualify for tax treatment favorable to ETI and Entergy."[436]

As with Entergy's plan, SWEPCO's supplemental pension plan "replaces the portion of pension benefits under the pension benefit formula that the employees otherwise would not receive under the ERISA qualified plan limits." [437] SWEPCO's test-year, plan limit is

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432 Tr. at 399 (Feb. 5, 2013) ("Q: So in other words, if you don't make over $245,000, there would be no benefit for the other plan? A: You would be a member of that plan who would have zero benefit accrued.") and *see* SWEPCO's Initial Brief at 138.

433 Docket No. 39896, Proposal for Decision at 178-180.

434 Docket No. 39896, Final Order at 26, FOFs 140-142.

435 Tr. at 400 (Feb. 5, 2013).

436 Docket No. 39896, Proposal for Decision at 178-180.

437 Rebuttal Testimony of Hugh E. McCoy at 35, SWEPCO Ex. 79.

$245,000,[438] the same limit as when the Commission disallowed Entergy's supplemental pension expenses of highly compensated individuals.[439] The Commission addressed the same pension plan in the Entergy decision as SWEPCO presents in this case.

The Commission also addressed the primary justification offered for these plans by Entergy in its rate case that SWEPCO now offers, i.e. the utilities' claim that the plans are necessary to attract, retain and motivate highly competent and qualified leaders.[440] The Commission in the Entergy rate case determined that the supplemental pension "plans are discretionary costs designed to attract, retain, and reward highly compensated employees whose interests are more closely aligned with those of the shareholders than the customers."[441] What was true for Entergy is also true for SWEPCO: SWEPCO's plan is only beneficial to highly compensated employees and is designed to provide additional benefits beyond the general pension plan.[442] Shareholders should bear this cost, as it is unnecessary for the provision of utility service.[443] The Commission should find, as it did four months ago, that these supplemental pension benefits "are not reasonable or necessary to provide utility service to the public, not in the public interest, and not should not be included in" SWEPCO's cost of service.[444]

M. Federal Income Tax [PO Issue 23] – Not Briefed

N. Storm Amortization [PO Issue 15]

In SWEPCO's last full rate proceeding, Docket No. 37364, it was permitted to recover $3.6 million of storm costs over three years at a rate of $1.2 million per year. Beginning in May

438 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 42.
439 Docket No. 39896, Final Order at 26, FOF 140.
440 Docket No. 39896, Proposal for Decision at 179.
441 Docket No. 39896, Final Order at 26, FoF 141.
442 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 41-44.
443 *Id.*
444 Docket No. 39896, Final Order at 26, FoF 142.

2010, SWEPCO began amortizing $100,000 per month for storm costs. As of January 2013, SWEPCO had a remaining unamortized amount of $400,000, which is included in its rate request. By including the $400,000 in its rate request SWEPCO will continue to collect $400,000 annually for as long as these rates are in effect. This is a problem because by May 2013, before the Final Order is issued in this case, SWEPCO will have collected the remaining $400,000 balance and therefore any storm cost collection after that point will be unnecessary.[445] SWEPCO's agreement to reduce its annual storm amortization asset to $300,000 does not solve the problem.[446] SWEPCO will over collect this deferred asset for years to come if the $400,000 or $300,000 balance is included in rates. The solution is to remove the remaining storm costs from the cost of service because the costs will be fully amortized by the time the Final Order in this case is issued. This adjustment will not deny SWPECO a single dollar of the $3.6 million storm costs rewarded in Docket No. 37364.

Alternatively, CARD agrees with SWEPCO that this issue can be addressed in the true-up following this case. In the true-up SWEPCO's temporary rates will be reconciled with the final rates approved in this case. At that time, the storm expense asset will be fully amortized, and storm expenses can be removed from rates. SWEPCO appears to agree to this approach, and if properly implemented CARD would also support this approach.

445 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 45 and Exhibit MG 3.6.

446 SWEPCO's Initial Brief at 142.

O. Fuel and Logistics Expense Allocation [PO Issues 29, 30] – Not Briefed

P. Director & Office Liability Insurance – Not Briefed

Q. Convenience Payments – Not Briefed

R. Injuries and Damages Expense

In establishing an electric utility's rates the Commission must determine a "utility's reasonable and necessary operating expenses."[447] A review of the expenses for injuries and damages for the previous five years indicates that the test tear amount far exceeds the typical, reasonable cost.[448] The 2011 figure of $4,543,773 was over $1.2 million more than the 2010 figure and nearly $4.8 million above the 2007 number.[449] SWEPCO did not justify this dramatic increase or give any indication that this unusual level of expense would continue going forward. History has shown that the test year level is not normal or supportable by the record.[450] It is inadequate for SWEPCO to argue that any expense is inherently reasonable and necessary merely because it exists. SWEPCO must provide credible evidence to show why the amounts it is requesting in rates are just and reasonable and an explanation for the wide fluctuations in amounts year to year. SWEPCO has not done so in this case. Absent an assessment of the reasonableness of the test-year figure, there is nothing inherently reasonable or necessary about including this type of account in rates.[451]

The 2011 figure should be averaged with the previous four years to arrive at a five-year average of $2,561,861. Mr. Garrett's proposed adjustment of $1,981,912 is supported by the record and comports with an approach the Commission has utilized previously to normalize expense items that are expected to fluctuate over time.[452] This adjustment addresses an

447 PURA § 36.051.

448 *See* Direct Testimony of Mark Garrett, CARD Ex. 5 at 46 and Exhibit MG 3.7.

449 *Id.*

450 *Id.*

451 *Id.*

452 *Id.*

anomalous 2011 injuries-and-damages expense, that but for Mr. Garrett's adjustment would result in an unreasonable expense being collected in rates going forward. Also, with Mr. Garrett's adjustment, setting the expense level at $2,561,861 still provides SWEPCO a level of expense that is more reflective of the actual expenses SWEPCO incurred over the previous five years.

S. Office Supplies Expense – Not Briefed

T. Temporary Labor – Not Briefed

U. Turk Independent Monitor Costs – Not Briefed

V. Separation Costs – Not Briefed

W. VEMCO Legal Fees – Not Briefed

X. Customer Choice Costs – Not Briefed

Y. Intangible Asset Amortization Expense – Not Briefed

Z. Weather Normalization [PO Issue 34]

CARD continues to support the recommendation by Cities witness Mr. Johnson to reverse SWEPCO's proposed weather adjustment or, in the alternative, to use a 10-year weather period for the adjustment.[453]

[453] Direct Testimony of Clarence Johnson, Cities Ex. 5 at 15-16.

V. RESIDENTIAL KWH GROWTH IN THE POST-TEST YEAR ADJUSTMENT [PO ISSUES 3, 34] – NOT BRIEFED

VI. CLASS COST ALLOCATION AND RATE DESIGN [PO ISSUES 32, 33]

A. Class Cost Allocation

1. Lighting Allocation

SWEPCO agrees that it should calculate the average demand for the lighting classes by dividing the lighting classes' kWh usage by 8,760 hours, instead of 4,000 hours.[454]

2. Residential Customer Unit Costs

CARD continues to support the Cities and OPUC's recommendation to set the residential customer charge no higher than the existing $7.25 level.[455]

3. Transmission Cost Allocation

CARD continues to support SWEPCO witness Mr. Aaron's recommendation to use the twelve coincident peak ("12CP") allocation method for transmission costs.[456]

4. Municipal Franchise Fees

CARD continues to support the collection of municipal franchise fee costs ("MFF") from all customers, as sponsored by Staff witness Mr. Abbott, Cities witness Mr. Johnson, and OPUC witness Ms. Seybold.[457]

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454 SWEPCO's Initial Brief at 155.

455 Direct Testimony of Clarence Johnson, Cities Ex. 5 at 31-32; Direct Testimony of Lacy L. Seybold, OPUC Ex. 3 at 11-13. Mr. Johnson also outlines why the record supports a customer charge of $6.00-$6.50, if the Commission elects to lower the customer charge from the existing level. Direct Testimony of Clarence Johnson, Cities Ex. 5 at 31-32.

456 Rebuttal Testimony of John O. Aaron, SWEPCO Ex. 87 at 10.

457 Direct Testimony of William B. Abbott, Staff Ex. 1 at 22-23; Cross Rebuttal Testimony of Clarence Johnson, Cities Ex. 10 at 5-9; Cross Rebuttal Testimony of Lacy L. Seybold, OPUC Ex. 4 at 17-21.

5. Miscellaneous Gross Receipts Taxes

CARD continues to support the allocation of miscellaneous gross receipts taxes in proportion to class revenues, as sponsored by Cities witness Mr. Johnson and OPUC witness Ms. Seybold.[458]

6. Primary Distribution Substation and Line Services

CARD continues to support the allocation of primary distribution line costs to primary substation customers, as sponsored by Cities witness Mr. Johnson.[459]

7. Appropriate Load Factor for Use in Average Component of A&E/4CP

CARD continues to support using a 65 percent 4CP load factor, as sponsored by Cities witness Mr. Johnson.[460]

B. Revenue Distribution [PO Issues 35, 36]

CARD continues to support an allocation of no more than 100 percent of the residential class' cost to residential customers, as sponsored by SWEPCO witness Ms. Jackson and OPUC witness Ms. Seybold.[461]

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458 Cross Rebuttal Testimony of Clarence Johnson, Cities Ex. 10 at 9-12; Cross Rebuttal Testimony of Lacy L. Seybold, OPUC Ex. 4 at 22.

459 Cross Rebuttal Testimony of Clarence Johnson, Cities Ex. 10 at 20-25.

460 Supplemental Cross Rebuttal Testimony of Clarence Johnson, Cities Ex. 11 at 3-6.

461 Direct Testimony of Jennifer L. Jackson, SWEPCO Ex. 51 at 16; Cross Rebuttal Testimony of Lacy L. Seybold, OPUC Ex. 4 at 8.

C. Rate Design [PO Issue 32, 34]

1. Residential

a. Customer Charge

CARD continues to support retaining, at a maximum, the existing $7.25 residential customer charge, as sponsored by Cities witness Mr. Johnson and OPUC witness Ms. Seybold.[462]

b. Energy Charge – Not Briefed

c. Winter Declining Block Rate – Not Briefed

d. Summer Inclining Block Rate – Not Briefed

2. Commercial – Not Briefed

3. Industrial – Not Briefed

a. Primary Substation – Not Briefed

b. Large Lighting and Power Service – Not briefed

c. Proposed Metal Melting Secondary Service – Not Briefed

d. Non-Firm Rates – Not Briefed

4. Other – Not Briefed

VII. FUEL RECONCILIATION [PO ISSUES 40-51]

A. Dolet Hills Lignite Company Benchmark Price [PO Issue 41] – Not Briefed

B. CenterPoint Energy Gas Transmission Contract – Not Briefed

[462] Direct Testimony of Clarence Johnson, Cities Ex. 5 at 29-33; Direct Testimony of Lacy L. Seybold, OPUC Ex. 3 at 11-13. Mr. Johnson also outlines why the record supports a customer charge of $6.00-$6.50, if the Commission elects to lower the customer charge from the existing level. Direct Testimony of Clarence Johnson, Cities Ex. 5 at 31-32.

VIII. OTHER ISSUES

A. Request to Recover Purchased Capacity Through Fuel

SWEPCO argues that it should be allowed to recover purchased capacity through fuel because it may need to purchase power when plants are curtailed for environmental reasons.[463] As a preliminary matter, this adds insult to injury since SWEPCO's requested relief would allow SWEPCO to pass through purchased power costs based on SWEPCO's imprudent decision to retire Welsh 2.[464] Furthermore, SWEPCO does not provide any quantification of the potential costs that it would incur due to environmental issues. It is poor public policy to deviate from the long-standing requirements of the Fuel Rule based on speculative and unsupported contentions of future events. Finally, the Commission is addressing this issue in Project No. 39246. That is the proper forum to decide the issue.

B. Request to Recover Consumables and Allowances as Fuel [PO Issue 41]

The primary argument SWEPCO offered for recovery of environmental consumables through the fuel factor is that the expenses for such items fluctuate.[465] As cross-examination of Staff's witness Ms. Glenda Spence showed, there are a wide variety of expenses that fluctuate but that are nonetheless recovered in base rates.[466] Neither SWEPCO nor the Commission Staff has provided a sound basis for recovery of environmental consumables through the fuel factor. And like purchased-capacity costs, costs of consumables are not included within the types of expenses that the Commission's Fuel Rule allows to be recovered in the fuel factor. CARD requests that the ALJs and the Commission reject SWEPCO's request to recover environmental consumables through the fuel factor.

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463 SWEPCO's Initial Brief at 176.

464 *See* discussion, infra, Section II.A.8.

465 SWEPCO's Initial Brief at 178.

466 Tr. at 1686-1691 (Feb. 12, 2013).

SWEPCO also argues "now-existing federal regulations will increase SWEPCO's cost of generating electricity." SWEPCO's argument is internally inconsistent. If the regulations are "now-existing," the costs should already be in SWEPCO's base rates. There is no need to include them in fuel. Indeed, the "now-existing" regulation that SWEPCO cites supports this conclusion. The Phase I cap for the Clean Air Interstate Rule ("CAIR") has been in place since 2009 and 2010.[467] SWEPCO's compliance costs for this cap are already known and will be included in base rates in this proceeding. Two future regulations, on the other hand, CAIR's Phase II cap and the Mercury and Air Toxics Standards ("MATS") rule, will not be effective until 2015.[468] There is no policy reason to change the long-standing Fuel Rule to address potential costs that will not materialize for two years, if at all.

C. TCRF Baseline [PO Issue 39] – Not Briefed

D. DCRF Baseline [PO Issue 39] – Not Briefed

E. IBEW Staffing Issues – Not Briefed

IX. CONCLUSION

CARD respectfully urges the ALJs and Commission to incorporate each of CARD's recommendations in determining SWEPCO's revenue requirements and related issues and that the Commission significantly reduce SWEPCO's requested revenue requirement and grant a rate increase of **no more** than $24.2 million, and as may be further reduced by meritorious adjustments proposed by other parties. CARD also requests it be granted all other relief to which it is entitled.

[467] SWEPCO's Initial Brief at 177.

[468] *Id*. at 177-178.

Respectfully submitted,

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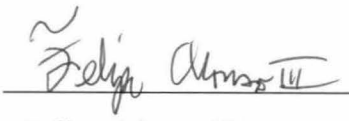
By: 

Felipe Alonso III

ATTORNEYS FOR CITIES ADVOCATING REASONABLE DEREGULATION

CERTIFICATE OF SERVICE

I hereby certify that on this the 20th day of March, 2013, a true and correct copy of **CARD's Reply Brief** was served upon all parties of record by facsimile and/or First-class United States mail, postage paid.

By: _____

Felipe Alonso III

SOAH DOCKET NO. 473-15-1556
PUC DOCKET NO. 43695

APPLICATION OF SOUTHWESTERN PUBLIC SERVICE COMPANY FOR AUTHORITY TO CHANGE RATES	**§ § § §**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

ALLIANCE OF XCEL MUNICIPALITIES'

INITIAL BRIEF

COST ALLOCATION/RATE DESIGN

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JULY 28, 2015

SOAH DOCKET NO. 473-15-1556
PUC DOCKET NO. 43695

APPLICATION OF SOUTHWESTERN PUBLIC SERVICE COMPANY FOR AUTHORITY TO CHANGE RATES	**§**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

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ALLIANCE OF XCEL MUNICIPALITIES' INITIAL BRIEF – COST ALLOCATION/RATE DESIGN

I. Summary of Cost Allocation / Rate Design [PO Issues 1, 2, 3]

The Alliance of XCEL Municipalities ("AXM") respectfully makes the following recommendations on cost allocation and rate design issues.

II. Present Revenue [PO Issues 31, 38]

A. Weather Normalization [including Revenue Requirement effect]

AXM recommends applying the same weather normalization adjustments to both the revenue requirement and class cost of service ("CCOS") models.[1] Specifically, the CCOS model demand allocation factors should include a weather adjustment that matches the weather normalization utilized in determining the required change in retail revenues and the billing units employed in designing rates. If the Commission rejects a weather normalization adjustment for SPS' CCOS model, as requested by TIEC and Occidental Permian Ltd. ("OPL"), the Commission should also reject a weather normalization adjustment for SPS' revenue requirement model.[2] Applying a weather normalization adjustment to one model, but not the other, distorts SPS' rates and produces unreasonable rates since weather sensitive rate classes will be penalized twice for abnormal weather and industrial classes will receive a windfall.[3] AXM provides an illustration of these distortions in Attachment CJ-R-1 of Mr. Johnson's cross-rebuttal testimony.

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1 AXM Exh. 6A, Cross-Rebuttal Testimony of Clarence Johnson at 3.

2 *Id*.

3 *Id*.

AXM also recommends using AXM's more recent ten-year period for weather normalizing SPS' test year sales.[4] SPS used the ten-year period of January 1, 2003 through December 31, 2012.[5] AXM's witness Mr. Brosch supports instead use of weather data for the most recent ten-year period ending with the test year.[6] Use of the most recent ten years of weather data ending with the test year includes more relevant weather data and adheres to the Commission's policy of capturing current weather trends.[7] SPS' use of weather data from 2003 to 2013 unreasonably excludes 18 months of more current data. AXM recommends using the more recent ten-year period that ends with the test year so as to not arbitrarily omit relevant and more current weather data.

SPS' rationale for excluding test year weather data in calculating its proposed weather-normalization adjustment lacks merit. According to the Company, using actual weather data from the test year period in the calculation of the 'normal' weather values "may create a bias toward the actual test year weather, which would potentially misstate the variance of the test-year weather from normal weather conditions."[8] SPS, however, provided no information or analysis to demonstrate that inclusion of more recent actual weather data within the ten-year averages used to define normal weather would introduce any "bias" or otherwise yield improper results.

Indeed, SPS' use of weather recorded during test years in its other rate cases belies its argument that use of test year data somehow "bias" the normalization adjustment. Specifically, SPS included weather data from the relevant test years in Docket Nos. 32766, 35763, 38147, 40824, and 42004.[9] (*AXM Exh. 1, Direct Testimony of Michael Brosch at 8.)* There simply is no credible reason to exclude weather data applicable to the test-year in the pending Docket No. 43695, when in the very next rate case the same data would presumably be included by SPS in its averaging calculations used to define normal weather.[10]

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4 AXM Exh. 1, Direct Testimony of Michael Brosch at 5.

5 SPS Exh. 55, Direct Testimony of Jannell Marks at 17-18.

6 AXM Exh. 1, Direct Testimony of Michael Brosch at 5.

7 *Id*.

8 SPS Exh. 55, Direct Testimony of Jannell Marks at 18.

9 AXM Exh. 1, Direct Testimony of Michael Brosch at 8.

10 *Id*.

Mr. Brosch's uncontroverted testimony is that the best available data for defining normal weather in a particular geographic area is the more recent observed data for that area.[11] SPS simply has provided no evidence that supports a conclusion that Texas Panhandle weather data observed after 2012 is any less valid or indicative of normal conditions than the older weather data that SPS relied on. Using information provided by SPS in discovery, Mr. Brosch graphed the fluctuations in historical actual Heating Degree Day ("HDD") and Cooling Degree Day ("CDD") data for the Texas Panhandle that SPS serves.[12] Mr. Brosch's graphs demonstrate a meaningful downward trend in HDDs and a corresponding upward trend in CDDs, which is consistent with a conclusion that Panhandle weather is trending noticeably toward warmer conditions.[13] SPS does not dispute that there is a discernable trend towards warmer temperatures in SPS' service territory. The Company acknowledged "[f]or the time period 1948-2014, a simple trend line fitted to average annual temperature indicates a trend toward warmer temperatures in the SPS Texas service territory."[14] Including the more current data through at least the end of the test year in the ten-year average calculations would better capture any trends occurring in normal Texas Panhandle weather, rather than intentionally using the older 10-year period ending in 2012, as proposed by SPS.[15]

Finally, while Mr. Brosch did not calculate the impact of his proposed ten-year period on jurisdictional allocation factors, he testified, that any shift in jurisdictional allocations from use of the more recent weather average would not be significant.[16] *(AXM Exh. 1, Direct Testimony of Michael Brosch at 9.)* Updated weather calculations would likely have a directionally proportionate load impact in the Company's New Mexico and FERC jurisdictions.[17]

Further, the impact of using Mr. Brosch's proposal to use the current 10-year average through the test year to calculate and define normal weather is about $1.7 million on SPS's Texas retail revenues. This is shown in AXM Exh. 5 – Carver Direct at Attachment SCC-3, Schedule C-2. However, in SPS's rebuttal case, SPS updated its billing determinants through

11 *Id*. at 6.
12 *Id*.
13 *Id*. at 7.
14 *Id*., Attachment MLB-4.
15 *Id*. at 8.
16 *Id*. at 9.
17 *Id*.

December 31, 2014, but failed to account for updated weather data in determining normal weather.

In AXM RFI No. 32-3(e)-R part (a), AXM asked SPS to "[e]xplain whether, in his updating of billing determinants and revenues at present rates to reflect 2014 billing determinants, Mr. Luth also updated the normal weather period address by Ms. Marks to include any 2013 weather data in the calculation of 'normal' weather," and SPS responded that Mr. Luth had not updated its billing determinants and stated, "The normal period was not updated to include any 2013 weather data in the calculation of normal weather."

Part (e) of AXM RFI No. 32-3(e) asked, "What would be the impact upon Mr. Luth's revised level of revenues at present rates if normal weather was defined to include the 120 month period ending in June 2014 (test year end), as advocated by AXM witness Brosch?" SPS's responses stated were Mr. Brosch's approach approved, then SPS's test-year revenue at present rates would increase by $1,098,687.[18]

AXM urges the ALJs and the Commission to adopt Mr. Brosch's recommendation to use the more recent 10-year period for determining "normal" weather, and further to include the impact on SPS's test test-year revenue at present rates, which would be an increase of $1,098,687.

B. Annualize Revenue for Transmission-level Customer 8

C. Adjustment to Post Test Year Billing Determinants

In its revenue requirement brief, AXM explains why the Commission should deny SPS' request to make a post-test year adjustment ("PTYA") to reflect the future reduction in load from Golden Spread Electric Cooperative ("GSEC"). If the Commission appropriately denies SPS' PTYA request, it should also deny SPS' corresponding request to make GSEC-related adjustments to SPS' twelve coincident peak ("12CP") and energy allocation factors.[19] SPS' PTYA improperly changes one part of the jurisdictional allocation equation – the future GSEC

[18] AXM Exh. 45 (Exhibit SPS-AXM 32-3(e)-R, page 40, line 199). AXM notes that AXM Exh. 45 is a late-filed exhibit subject to its motion filed on July 27, 2015. AXM conferred with SPS regarding late-filed exhibit AXM Exh. No. 45 and SPS did not object to admission of AXM Exh. No. 45.

[19] AXM Ex. 6, Direct Testimony of Clarence Johnson at 6-7.

load – without also looking at the future jurisdictional loads for other customers.[20] The Commission rejected this piecemeal approach in Docket No. 39896, reasoning that Entergy Texas' proposed PTYA would "depend on future costs and loads for each of the Entergy operating companies."[21] The Commission should similarly reject SPS' proposed piecemeal approach.

III. Inter-class Cost Allocation [PO Issue 39]

A. Demand Allocation

1. Determination of Load Factor for AED Method

AXM recommends approving SPS' use of the system four coincident peak ("4CP") load factor method that the Commission recently ordered in Docket No. 40443.[22] To minimize the number of litigated issues in this case, AXM accepts the Commission's recent decision on this issue, despite the fact that using SPS' retail load factor or a 12CP methodology would also be reasonable and would produce a higher load factor for the Average and Excess Demand ("AED") model.[23] However, given the Commission's recent decision on this issue, AXM also recommends rejecting any attempts to reduce the load factor, such as through TIEC or OPL's proposed use of a one coincident peak ("1CP") or a three coincident peak ("3CP") method. Put simply, the Commission has spoken very recently on this issue and the parties should follow that precedent. Furthermore, if GSEC's production loads are included in the jurisdictional cost of service, the system load factor should also reflect the inclusion of GSEC's demand and energy.[24]

2. 4CP vs. 3 CP [including weather effects]

For the reasons discussed above in Section III.A.1, AXM recommends approving SPS'

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20 *Id*. at 7.

21 *Application of Entergy Texas Inc. for Authority to Change Rates*, Docket No. 39896, Order on Rehearing at 20, Finding of Fact No. 89 (November 2, 2012) ("*Docket No. 39896 Order on Rehearing*").

22 AXM Exh. 6, Direct Testimony of Clarence Johnson at 15-16; *see also Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at 46, Findings of Fact No. 283 (March 6, 2014)("*Docket No. 40443 Order on Rehearing*") ("[t]he appropriate load factor for use in the A&E/4CP methodology is the system load factor.").

23 AXM Exh. 6, Direct Testimony of Clarence Johnson at 16 and Attachment CJ-2.

24 *Id*., Attachment CJ-2.

proposal to use the AED-4CP method that the Commission ordered in Docket No. 40443. AXM's witness Mr. Johnson reviewed the Company's development of the AED-4CP method in this case and confirmed that it is consistent with the AED-4CP methodology ordered by the Commission for SWEPCO in Docket No. 40443 and the A&E 4CP methodology ordered for Entergy Texas Inc. in Docket No. 39896.[25]

B. Radial Lines

AXM recommends approving SPS' proposal for allocating the costs of radial lines.[26] SPS' proposes to allocate the costs of radial lines that serve more than one customer class in the same manner as other transmission lines.[27] This makes sense, as SPS lacks the data to directly assign the costs of multi-class radial lines to each class.[28] Instead, in the past, SPS used the system AED-4CP factors to allocate the costs of those multi-class lines.[29] Since this is not a true "direct assignment," SPS' proposal in this case to simply treat these multi-class radial lines the same as other transmission lines is reasonable.[30]

C. General Plant and Intangible Plant

SPS should allocate general and intangible plant using a plant-based allocator, not a labor-based allocator. Accordingly, AXM recommends rejecting SPS' proposal to change the allocation for general plant and intangible plant from "plant in service-production, transmission, and distribution" ("PIS-PTD") to "labor excluding A&G" ("LABXAG").[31] As the names reflect, PIS-PTD is a plant-based allocator, while LABXAG is a labor-based allocator. Allocating plant using a labor-based allocator produces distorted, non-cost based, results.[32] Finally, the

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25 *Id*. at 15; *Docket No. 39896 Order on Rehearing* at 31, Findings of Fact Nos. 183 and 184.

26 AXM Exh. 6A, Cross-Rebuttal Testimony of Clarence Johnson at 9.

27 *Id*.

28 *Id*. at 9-10.

29 *Id*. at 10.

30 Staff's proposal to allocate the costs all radial lines, including radial lines serving one customer class, the same as other transmission lines has some validity as well, although SPS' proposal in this case addresses many of Staff's concerns. *Id*. at 9.

31 AXM Exh. 6, Direct Testimony of Clarence Johnson at 8.

32 *Id*. at 8-9.

Commission itself recognizes that it is appropriate to use plant-based allocators for general plant, by specifying the use of a plant-based allocation in its rate-filing package for transmission and distribution utilities ("TDUs").[33]

D. Miscellaneous Revenue

1. Miscellaneous Revenue from Service Charges and Returned Check Fees

2. Mutual Aid Revenue

E. Electric Vehicle and Fuel Tax Credit

F. Separating Residential and Residential Space Heating for Purposes of Allocating Distribution Costs

G. Labor Expense Allocator

H. Salary and Wage Expense for Lighting Services

SPS incorrectly assigned $456,449 of customer installation (account 587) costs to street lighting instead of guard lighting and incorrectly assigned $306,881 of street lighting salary cost (account 585) to guard lighting.[34] SPS agreed with AXM's correction and is adjusting its CCOS to reflect the correction.[35]

I. Distribution Substations Allocator

AXM recommends rejecting SPS' proposal to change SPS' allocation of distribution substation costs from the AED-4CP method to the non-coincident peak ("NCP") method.[36] SPS uses AED-4CP to allocate transmission costs and NCP to allocate distribution costs.[37] Substations are at the transition point between SPS' transmission and distribution networks.[38] SPS historically treated substations as part of its transmission network and used the AED-4CP

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[33] *Id*. at 9; *citing to* Rate Filing Package Instructions for Investor Owned Transmission and Distribution Utilities (2003) at 44.

[34] AXM Exh. 6, Direct Testimony of Clarence Johnson at 18-19.

[35] SPS Exh. 57, Rebuttal Testimony of Richard Luth at 10.

[36] AXM Exh. 6, Direct Testimony of Clarence Johnson at 19-20.

[37] *Id*. at 19.

[38] *Id*.

allocation method.[39] It is appropriate to continue this historical practice for several reasons. SPS designs substations to carry the power from adjacent substations in the event that an emergency causes lines on that circuit to be de-energized.[40] Furthermore, substations may have to carry power to re-energize feeders of the adjacent substation.[41] Thus, the sizing of the substation will exceed the loads associated with its local distribution area.[42] For all of these reasons, AXM recommends using the AED-4CP method to allocate distribution substation costs.

J. Account 368 - Distribution Line Transformers

K. Account 556 - System Control and Dispatching-Generation

L. Accounts 561.1-.3 - Load Dispatch-Transmission

M. Regional Market Expenses (Accounts 575.1, .2, .5, .6, .7, and .8)

N. Account 581 - Load Dispatching-Distribution

O. Account 593 - Distribution Maintenance of Overhead Lines

P. Account 902 - Meter Reading Costs

Q. Account 904 - Uncollectible Accounts

AXM recommends approving SPS' proposal to allocate uncollectible expenses on the basis of class revenues.[43] Direct assignment of uncollectible expenses to specific customer classes on the grounds that certain classes "caused" the costs makes no sense, since the customers that would pay the expenses are responsibly paying their bills and did not in any way "cause" the uncollectible expenses.[44] As the Commission explained in Docket No. 16705:

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39 *Id*.

40 *Id*. at 20.

41 *Id*.

42 *Id*.

43 AXM Exh. 6A, Cross-Rebuttal Testimony of Clarence Johnson at 5. If the Commission elects to deviate from its long-standing precedent of allocating uncollectible expenses on the basis of class revenues, AXM proposes the compromise approach of excluding public authority and street lighting classes from any allocation, given the minimal likelihood of default by those public entities, and then using a 50% - 50% weighting of SPS' and Staff's proposals. *Id*. at 8-9.

44 *Id*. at 6-7.

> Just as it may seem unfair to have the industrial customers absorb the bad debts of a few individuals, it is just as unfair to have the great majority of dutiful residential ratepayers pay those debts. The passing on of such costs to others is generally factored into the cost of doing business. It is a cost that is better absorbed by the many. Therefore, uncollectible expense should be allocated at both the jurisdictional and class levels on the basis of jurisdictional and class operating revenues.[45]

The Commission has consistently followed this approach, both for vertically integrated utilities and TDUs.[46] Finally, direct assignment does not work in this case because the data is not available for any customer classes other than the residential classes.[47]

R. Major Account Representatives (Account 908 - Customer Assistance Expenses and Account 912 - Demonstrating and Selling Expenses)

S. Outside Services-Legal (Account 923)

AXM recommends allocating the costs of outside legal costs using the "total operation and maintenance expense minus fuel and purchase power" ("TOMXFPP") allocator.[48] SPS currently uses "labor excluding A&G" ("LABXAG").[49] An O&M-based allocator, such as TOMXFPP, is more appropriate for outside legal expenses than a labor-based allocator, such as LABXAG, because general corporate activities trigger outside legal expenses and O&M allocators better track general corporate activities.[50] Furthermore, the Commission's rate-filing

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[45] *Application of Entergy Gulf States, Inc. for Approval of its Transition to Competition Plan and the Tariffs Implementing the Plan, and for the Authority to Reconcile Fuel Costs, to Set Revised Fuel Factors, and to Recover a Surcharge for Under-recovered Fuel Costs*, Docket No. 16705, Second Order on Rehearing at 96, Finding of Fact No. 231 (Oct. 14, 1998).

[46] AXM Exh. 6A, Cross-Rebuttal Testimony of Clarence Johnson at 6; *citing. e.g., Application of El Paso Electric Company for Authority to Change Rates*, Docket No. 9945, 18 P.U.C. BULL 9 (Feb. 1992); *Application of Houston Lighting & Power Company for Authority to Change Rates*, Docket No. 6765, 13 P.U.C. BULL 1 (Nov. 1986); *Application of Gulf States Utilities Company for Authority to Change Rates*, Docket No. 7195, 14 P.U.C. BULL . 1943, 2425 (1989) (May 1988); *Application of Texas Utilities Electric Company for Authority to Change Rates*, Docket No. 11735, Order on Rehearing, Finding of Fact No. 162 (Apr. 20, 1994).

[47] AXM Exh. 6A, Cross-Rebuttal Testimony of Clarence Johnson at 7; *see also* PUC Staff Exh. 1A, Direct Testimony of Brian Murphy at 37 ("In response to discovery, SPS provided actual bad debt expense information for 'industrial,' 'residential,' and 'commercial' customer groupings, which are bundles of classes. It appears that SPS may not currently track bad debt expense by class." [Footnotes omitted]).

[48] AXM Exh. 6, Direct Testimony of Clarence Johnson at 10.

[49] *Id*.

[50] *Id*.

package for TDUs specifies the use of the TOMXFPP allocator for outside legal expenses.[51]

T. Contributions, Dues, and Donations

U. Account 926 - Employee Pensions and Benefits

V. Historical Energy Efficiency Costs

AXM recommends approving SPS' proposal to allocate pre-2009 energy efficiency costs to all customer classes, including transmission voltage customers.[52] In Docket No. 35763, the Commission authorized SPS to create a regulatory asset, which SPS could amortize over ten years, for energy efficiency costs that SPS had incurred up to December 31, 2008.[53] Transmission voltage and other industrial customers had access to those energy efficiency programs until March 26, 2008. For example, the Commission's August 23, 2005 amendments to PUC Subst. R. 25.181(e)(3)(D) stated "[t]he incentive for load management programs targeted to transmission or distribution constrained areas shall not exceed: (i) Large Commercial and Industrial projects: 35% …"[54] On March 26, 2008, the Commission amended PUC Subst. R. 25.181 to limit energy efficiency programs to residential and commercial customers.[55] Given that transmission voltage customers had access to the energy efficiency programs during a significant portion of the time in question,[56] it is appropriate to allocate those historical costs to all customer classes, including the transmission voltage customers. Furthermore, transmission

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51 *Id*. at 10; *citing to* Rate Filing Package Instructions for Investor Owned Transmission and Distribution Utilities (2003) at 45.

52 AXM Exh. 6A, Cross-Rebuttal Testimony of Clarence Johnson at 10.

53 *Application of Southwestern Public Service Company for Authority to Change Rates, to Reconcile Fuel and Purchased Power Costs for 2006 and 2007, and to Provide a Credit for Fuel Cost Savings*, Docket No. 35763, Order at 8 (June 2, 2009)("*Docket No. 35763 Order*").

54 *Amendments to Energy Efficient Rules and Templates*, Project No. 30331, Order Adopting Amendments to §25.181 and §25.184 As Approved at the August 18, 2005 Open Meeting at 23 (August 23, 2005).

55 *Amendments to Energy Efficiency Rules and Templates*, Project No. 33487, Order Approving the Repeal of §25.181 and §25.184 and of New §25.181 as Approved at the March 26, 2008 Open Meeting (April 14, 2008)(approving new §25.181 that was limited to residential and commercial customers).

56 It is unclear from the Commission's Order in Docket No. 35763 when the time frame for the energy efficiency costs in question began. It likely began well before 2008, since the balance as of December 31, 2008 was $12.4 million and SPS was allowed to recover $2 million per year prospectively. *Docket No. 35763 Order* at 8, Finding of Facts Nos. 22(a) and (b). In any event, the time frame clearly started before the Commission's March 26, 2008 change in the energy efficiency rules, since the energy efficiency costs were directly assigned "beginning with 2008 expenditures." *Id*., Finding of Fact No. 22.

voltage customers benefit from energy efficiency programs even if they do not have direct access to the programs, since they enjoy the lower system costs associated with avoided generation and transmission costs.[57]

W. Municipal Franchise Fees [PO Issues 22 and 40]

1. Collection

AXM recommends approving SPS' proposed (and current) method for collecting a base amount (two to three percent, depending on the franchise agreement) of franchise fees in SPS' base rates and collecting any incremental amounts above that base amount through a surcharge to the customers in the city that sets the higher franchise fee rate.[58] AXM and SPS are in agreement on this collection issue.

2. Allocation

AXM differs, however, with SPS on the method for allocating the franchise fees to different customer classes. AXM recommends allocating the franchise fees to customer classes on the basis of a class' total revenues, instead of SPS' proposal to allocate the costs on the basis of a class' revenues inside city limits. AXM's allocation proposal is consistent with the Commission's decision in Docket No. 16705, where the Commission issued the following findings of fact:

> "224. Current cost of services studies are not based on geographical differences. Classes are not divided based on geography, and industrial sites are not self-sufficient islands. The use of city streets and property enables EGS to have an integrated utility system from which all ratepayers benefit.
>
> 225. EGS' allocation of local gross receipt and franchise taxes to the classes based on total rate schedule revenues is reasonable."[59]

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[57] AXM Exh. 6A, Cross-Rebuttal Testimony of Clarence Johnson at 11.

[58] AXM Exh. 6B, Errata to the Direct Testimony of Clarence Johnson at 3 (correcting page 22 of Mr. Johnson's testimony).

[59] *Application of Entergy Gulf States, Inc. for Approval of its Transition to Competition Plan and the Tariffs Implementing the Plan, and for the Authority to Reconcile Fuel Costs, to Set Revised Fuel Factors and to Recover a Surcharge for Under-recovered Fuel Costs*, Docket No. 16705, Second Order on Rehearing at 95-96 (Oct. 14, 1998).

While the Commission in Docket No. 40443 approved the allocation of franchise fees based on a class' in-city kilowatt hour ("kWh") use, no party in that case contested that allocation.[60] AXM is contesting that allocation in this case. Moreover, unlike SWEPCO, the franchise agreements for SPS are based on revenues rather than kWh usage. For that reason, the SWEPCO allocation is not an apt precedent for this case. Finally, while TDUs in ERCOT typically assign franchise fees on the basis of class revenues inside city limits, the statutory provision that addresses franchise fees in ERCOT, PURA Sec. 33.008, does not apply to SPS.[61]

IV. Determination of Customer Classes for Allocation and Rate Design Purposes [PO Issue 37]

AXM recommends grouping individual classes into the following major classes for revenue distribution purposes: Residential, Secondary, Primary, Large General Service, Public, and Lighting.[62] This helps mitigate rate shock to individual classes.[63] It also recognizes that significant customer migration can occur between individual classes, such as the small general service and secondary general service classes.[64] The Commission approved a similar "grouping" approach in Docket No. 40443.[65] For all of these reasons, a similar grouping approach is reasonable in this case.

V. Revenue Distribution

A. Gradualism Adjustment

AXM recommends four gradualism adjustments. First, AXM recommends the grouping of individual classes into the major classes that AXM describes above in Section IV. Second, AXM recommends setting class revenue targets midway between the current revenue

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60 *Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Proposal for Decision at 256 (May 20, 2013) ("as to the *allocation* of SWEPCO's municipal franchise fees, all parties agree that SWEPCO should allocate the amounts based on the amount of electricity used by the classes within the jurisdiction of each city charging the fee.").

61 AXM Exh. 6, Direct Testimony of Clarence Johnson at 21-22.

62 *Id*. at 27.

63 *Id*.

64 *Id*. at 28.

65 *Docket No. 40443 Order on Rehearing* at 47, Findings of Fact Nos. 287-290.

distribution and the revenue distribution associated with equalized class rates of return.[66] Third, AXM recommends limiting the increase for individual customer classes to 175 percent of the system average increase.[67] Fourth, AXM recommends not increasing any individual class' rates if the Commission orders a material reduction in SPS' total base revenues.[68] Attachments CJ-4 and CJ-5 to AXM's witness Mr. Johnson's direct testimony outline the numerical impact of AXM's adjustments.[69]

AXM's proposed gradualism adjustments are reasonable. They help moderate rate increases, mitigating rate shock to individual rate classes.[70] Without the adjustments, individual rate classes could see severe rate increases. For example, if the Commission adopted SPS' proposed rate increase and Staff's primary recommendation to forego any gradualism adjustments, Staff's CCOS recommendation would increase rates for the Area Lighting class by 35.84 percent.[71] Such an increase would cause significant rate shock to Area Lighting customers. As another example, based on the Company's rebuttal CCOS study, Street and Municipal lighting would incur a 30.9 percent base revenue increase absent gradualism, which would severely affect local governmental budgets.[72] Such increases would also be inconsistent with the Commission's historical policy of moderating increases to lighting classes, given the public good served by those classes. For example, in Docket No. 35717, the Commission explained how "[]he lighting class is unique in the combination of the public good it performs and its demand characteristics" and also found that "Oncor's proposal to limit a rate increase to the unmetered lighting service to 10% is reasonable and in the best interest of the public."[73] AXM's gradualism adjustments protect the lighting classes from unreasonable increases, such as 35.84 and 30.9 percent increases.

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66 AXM Exh. 6, Direct Testimony of Clarence Johnson at 27.

67 *Id*. at 28.

68 AXM Exh. 6A, Cross-Rebuttal Testimony of Clarence Johnson at 13.

69 AXM Exh. 6, Direct Testimony of Clarence Johnson, Attachments CJ-4 and CJ-5.

70 *Id*. at 27; AXM Exh. 6A, Cross-Rebuttal Testimony of Clarence Johnson at 14.

71 PUC Staff Exh. 1B, Cross-Rebuttal Testimony of Brian Murphy at 61, Table BTM-15 (last line, third column).

72 SPS Exh. 54, Direct Testimony of Richard Luth at Attachment RML-RD-4, l. 15, fourth column.

73 AXM Exh. 35, *Application of Oncor Electric Delivery Company, LLC for Authority to Change Rates*, Docket No. 35717, Order on Rehearing at 32, Findings of Fact Nos. 192 and 193 (November 30, 2009).

AXM's gradualism adjustments also recognize that CCOS studies do not produce exact, absolutely correct results.[74] The assumptions underlying the CCOS studies involve a certain degree of subjectivity and judgment.[75] CCOS studies produce a reasonable band of cost based rates, rather than exact prices.[76] Gradualism adjustments reflect this fact, by moderating unreasonable rate increases that could flow from a strict application of the oft-disputed CCOS results.

B. Proposed Revenue Distribution [PO Issue 41]

For all of the reasons that AXM outlines in Sections IV and V, AXM recommends the revenue distribution that Mr. Johnson describes in Attachments CJ-4 and CJ-5 of his direct testimony.[77]

C. Classes for Revenue Distribution in Future Cases

If the Commission elects to specify the rate classes that apply to future energy efficiency cost recovery factor ("EECRF") cases, AXM recommends the use of the rate classes that the Commission reviewed in Docket No. 42454.[78] Those rate classes have an established track record for the delivery of energy efficiency services.[79]

VI. Rate Design [PO Issue 36]

A. Residential Service

1. Customer Charge

If the Commission reduces SPS' overall rates, AXM recommends reducing SPS' residential customer charges at least proportionately to the reductions in overall residential

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74 AXM Exh. 6, Direct Testimony of Clarence Johnson at 25.

75 *Id*.

76 *Id*.

77 *Id*., Attachments CJ-4 and CJ-5.

78 AXM Exh. 6A, Cross-Rebuttal Testimony of Clarence Johnson at 14; *citing to Application of Southwestern Public Service Company to Adjust its Energy Efficiency Cost Recovery Factor*, Docket No. 42454, Order (November 24, 2014).

79 *Id*.

revenues.[80] If the Commission increases SPS' overall rates, AXM recommends maintaining the existing $7.60 rate or, at most, increasing the residential service charge by no more than the percentage increase in overall residential revenues.[81] AXM's witness Mr. Johnson's estimate of the residential customer costs directly attributable to the number of residential customers is $3.94 per month.[82] Thus, SPS' existing rate of $7.60 is more than compensatory. Increasing the customer charge above the compensatory rate of $3.94, and certainly above SPS' current rate of $7.60, distorts price signals for residential customers.[83] As a prominent example, the Company's customer charge increase is inconsistent with the state of Texas' energy efficiency goals. By increasing the customer charge, a smaller portion of the customer's bill is consumption sensitive, thereby reducing the bill savings associated with more energy efficient appliances. As a result, over the long term, increases in the customer charge will reduce the effectiveness of state mandated energy efficiency programs and increase the size of program incentives borne by the general body of ratepayers.

2. Design of Residential Space Heating Rates

AXM recommends approving SPS' proposal to close the residential space heating rate, but recommends rejecting SPS proposal to increase the winter discount for grandfathered residential space heating customers.[84] Discounts for residential space heating unfairly subsidize electric heaters over natural gas heaters and encourage potentially uneconomic use of electric space heaters, contrary to the policy goal of energy conservation.[85]

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80 AXM Exh. 6, Direct Testimony of Clarence Johnson at 31.

81 *Id*.

82 *Id*. at 29-30; *see also id*., Attachment CJ-6 (outlining Mr. Johnson's calculation of the $3.94 cost).

83 *Id*. at 30-31.

84 *Id.* at 32-33.

85 *Id*.

3. Residential TOU

4. Future of RSH

B. Small General Service

1. Design of SGS

2. SGS TOU

C. Secondary General Service

D. Primary General Service

E. LGS-T

F. Collection of Account 908 - Customer Assistance Expenses and Account 912 - Demonstration and Selling Expenses

G. Rule of 70

1. Rule of 70 in Place of Rule of 80

AXM recommends rejecting SPS' proposal to replace the Rule of 80 with the Rule of 70.[86] The Commission encouraged utilities in Texas to implement the Rule of 80 to protect non-profit, religious, municipal, and school customers such as local ballparks and churches from dramatic increases in their bills when the utilities started applying demand charges to those customers.[87] SPS' proposal to implement a Rule of 70 would dramatically water down the protection for these customers – for example, 8,611 of 11,605 secondary general customers that are currently protected by the Rule of 80 would pay full demand charges if SPS implements the Rule of 70.[88] Furthermore, SPS' proposed experimental low load factor rate will not address most customers' concerns, as most affected customers, such as local ballparks and churches, will not fully understand the new rate.[89] AXM urges the Commission to retain the existing Rule of 80.

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[86] *Id*. at 33-36.

[87] *Id*. at 34-35.

[88] *Id*. at 35.

[89] *Id*. at 35-36.

Respectfully submitted,

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ATTORNEYS FOR ALLIANCE OF XCEL MUNICIPALITIES

CERTIFICATE OF SERVICE

I certify that I have served a copy of the ***Alliance of Xcel Municipalities' Initial Brief – Cost Allocation/Rate Design*** upon all known parties of record by fax, First Class Mail, and/or hand delivery on this the 28th day of July, 2015.

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Alfred R. Herrera

SOAH DOCKET NO. 473-15-1556
PUC DOCKET NO. 43695

APPLICATION OF SOUTHWESTERN PUBLIC SERVICE COMPANY FOR AUTHORITY TO CHANGE RATES	**§ § § §**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

ALLIANCE OF XCEL MUNICIPALITIES'

INITIAL BRIEF

REVENUE REQUIREMENT

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JULY 24, 2015

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ALLIANCE OF XCEL MUNICIPALITIES' INITIAL BRIEF – REVENUE REQUIREMENT

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ALLIANCE OF XCEL MUNICIPALITIES' INITIAL BRIEF – REVENUE REQUIREMENT

The Alliance of Xcel Municipalities ("AXM") hereby submits its Initial Brief in the above numbered and styled proceeding. AXM notes that for those parts of the outline for this Brief where AXM provides no comment, AXM reserves the right to respond to other parties' remarks regarding such sections. Also, the fact that AXM does not address an issue in its Brief that it may have addressed through the testimony of its witnesses, should not be interpreted as a waiver of AXM's position as presented in its testimony.

REVENUE REQUIREMENT PHASE

I. Summary of Revenue Requirement [PO Issues 1, 2, 3]

Southwestern Public Service Company ("SPS") submitted its application to increase rates on December 8, 2014. In its as-filed application, SPS sought an increase of approximately $64.75 million. *Transcript (Tr.) Volume (Vol.) 1 at 332.*

On March 2, 2015, SPS modified its application to request an increase of approximately $58.85 million. *AXM Exh. 5 – Carver Direct at 4; Tr. Vol. 1 at 333.* With severance of rate case expenses to a separate proceeding, SPS's proposed increase became $57.2 million. *Id.*

Finally, in its rebuttal case, SPS once again modified its request and now seeks an increase of approximately $42.07 million. *Id.*

Included in SPS' request to increase rates by $42.07 million are its request to include in rates the revenue requirement associated with SPS's request (1) for a post, test-year adjustment ("PTYA") related to certain capital additions and expenses that occurred after the end of the test year of June 30, 2014 ("Test Year"); and (2) its request that the Public Utility Commission of Texas ("Commission") recognize the "ramp-down" of SPS's wholesale, power-sales contract with Golden Spread Electric Cooperative, Inc. ("Golden Spread"). SPS's PTYA adjustment represents approximately $8.09 million of the $42.07 million and the ramp-down of the Golden Spread wholesale contract represents an additional approximately $10 million. When those two items are removed from SPS's proposed increase, its proposed increase in rates is approximately $23.98 million. *Tr. Vol. 1 at 333 and 339.*

While the PTYA and Golden Spread issues present novel issues, the Administrative Law Judges' ("ALJs") decision on theses issues is not a difficult one. The Commission's rules and the provisions of PURA make clear that the ALJs should reject SPS's proposed ratemaking treatment of the PTYA and Golden Spread contract. Ramp down of the Golden Spread contract occurred a year after the end of the Test Year in this proceeding; and SPS simply does not meet the criteria of P.U.C. Substantive Rule § 25.231 ("P.U.C. Subst. R. 25.___") to warrant recognition in rates of additions to SPS's invested plant that it made after the end of its Test Year.

Two additional crucial issues in this proceeding are the proper return on equity ("ROE") to employ in setting SPS's rates and the appropriate depreciation rates, and in particular, the appropriate value to employ for "net salvage value" ("NSV"). In this proceeding the Alliance of Xcel Municipalities' ("AXM") witness, Mr. David Parcell, presented testimony that showed a fair ROE is 9.40%. *AXM Exh. 4 – Parcell Direct at 2.* Mr. Parcell's proposed ROE is the highest of the ROEs presented by all parties that presented testimony on the cost of capital, other than SPS.

But telling is that only SPS's witness, Mr. Robert Hevert, presented a recommended ROE well outside the range of ROEs presented by all other witnesses. On the low end Department of Energy's witness recommends a ROE of 9.00%;, *see DOE Exh. 1;* TIEC's witness proposed a ROE of 9.15%; *see TIEC Exh. 4*; Office of Public Utility Counsel ("OPUC") recommended a ROE of 9.20%; *see OPUC Exhs. 9 and 10;* Staff recommended a ROE of 9.3%; *see STAFF Exh. 6A;* and on the high end is Mr. Parcell proposed a ROE of 9.40%. *See AXM Exh. 4.* Mr. Hevert proposed a ROE of 10.25%; *see SPS Exh. 9.* Mr. Hevert can't be the only one in step while the remainder of the band is out of step. The impact on revenue requirement in the difference between Mr. Parcell's ROE and Mr. Hevert's ROE is approximately $10.4 million.

Regarding net salvage value (NSV), Mr. Jacob Pous, among other things, recommends that the Commission maintain the status quo of a positive NSV of 5% (+5%), while SPS's witness Mr. Dane Watson proposes a NSV of -5%. The Staff supported a NSV of -5%, but as the record established, neither Mr. Watson nor the Staff's witness, Ms. Katie Rich, presented a sound basis to warrant a departure from the status quo, or to support a +5% NSV. Moving from a +5% NSV to a -5% NSV impacts SPS's revenue requirement by approximately $9.3 million. *AXM Exh. 3 – Pous Direct at 8 and 17.*

These four adjustments alone – PTYA, Golden Spread, ROE, and NSV – reduce SPS's proposed increase of $42.07 million to a *decrease* of about $5.33 million.

AXM Limited List of Adjustments	In Millions
SPS's Proposed Increase at Time of Hearings	**$42.07**
Reject Plant- and Expense-Related PTYA	-$14.10
Reject Jurisdictional Allocation of Golden Spread Sales	-$13.20
Reject -5% NSV and Maintain +5% NSV	-$9.30
Reject ROE of 10.25% and approve ROE of 9.4%	-$10.80
Net Increase Based on Handful of Adjustments	**-$5.33**

But neither AXM's nor the other parties' adjustments to SPS's proposed increase are limited to the issues of PTYA, Golden Spread, ROE, or Net Salvage Value. In their totality, AXM's adjustments establish that SPS's base rates should be decreased by at least $13,570,117. *AXM Exh. 5 – Carver Direct at 3 and Attachment SCC-3).*

AXM also notes that because its witnesses testimony was filed before SPS's rebuttal, AXM's witnesses' testimonies use as their starting point SPS's proposed increase of approximately $58.85 million. Thus, in it reply brief AXM anticipates it will have the opportunity to reply to SPS's and other parties' briefs regarding SPS's modified request for an increase of approximately $42.07 million.

AXM's adjustments to SPS's requested increase of about $58.85 million is set forth in *AXM Exh. 5 – Carver Direct at Attachment SCC-3, at Schedule E.* AXM's "Schedule E" is presented below and presents to the ALJs and the Commission the totality of AXM's witnesses' adjustments to SPS's proposed increase of $58.85 million.

SOUTHWESTERN PUBLIC SERVICE COMPANY
RECONCILIATION OF POSITIONS
TEST YEAR ENDING JUNE 30, 2014
ALL AMOUNTS TEXAS RETAIL

LINE NO.	SCH./ ADJ. NO.	DESCRIPTION	REFERENCE	TEXAS RETAIL REVENUE REQUIREMENT
		(A)	(B)	(C)
1	SCH. A	SPS Asserted Revenue Requirement		$58,852,473
2		Correction to SPS Distribution Accumulated Depreciation Posting		-513,683
3	SCH. B	Return Difference At SPS' Rate Base - Case Update		-10,800,940
4		AXM Jurisdictional Allocations on SPS Case Update		-13,156,753
5		Subtotal Revenue Requirement	Lines 1..4	$34,381,097
6				
7		**AXM RATE BASE ADJUSTMENTS:**		
8	B-1	REVISE JURISDICTIONAL ALLOCATIONS - RATE BASE	Included in line 4.	
9	B-2	POST-TEST YEAR ADJUSTMENT - NET PLANT & ADIT RESERVE		-8,039,607
10	B-3	CASH WORKING CAPITAL ADJUSTMENT		-10,419
11	B-4	PENSION ASSET		-6,725,035
12	B-5	FAS 106 & FAS 112 LIABILITIES		805,624
13	B-6	DEFERRED INCOME TAX CLASSIFICATIONS		-243,057
14		Total Value of AXM Rate Base Adjustments	Lines 8..13	-14,212,494
15				
16		**AXM NET OPERATING INCOME ADJUSTMENTS:**		
17	C-1	REVISE JURISDICTIONAL ALLOCATIONS - OPERATING INCOME	Included in line 4.	
18	C-2	WEATHER NORMALIZATION - UPDATED 10 YEAR NORMAL		-1,670,788
19	C-3	CUSTOMER 8 SALES VOLUME ADJUSTMENT		-524,207
20	C-4	SPP SCHEDULE 11 BPU WHEELING EXPENSE		-1,925,612
21	C-5	SPP SCHEDULE 11 REVENUE CREDITS		5,844,243
22	C-6	POST-TEST YEAR ADJUSTMENT - DEPRECIATION EXPENSE		-2,714,549
23	C-7	RATE CASE EXPENSE		-5,645,394
24	C-8	AMORTIZATION RESCHEDULING ADJUSTMENT		-683,410
25	C-9	ANNUALIZE PURCHASED POWER EXPENSE		121,830
26	C-10	LABOR COST ADJUSTMENT		-1,975,445
27	C-11	INCENTIVE COMPENSATION		-3,161,667
28	C-12	PROPERTY TAX EXPENSE ADJUSTMENT		-4,427,450
29	C-13	REVERSE SPS-PROPOSED POST TEST YEAR PRICE CHANGES		-27,263
30	C-14	DEPRECIATION ANNUALIZATION -- AXM ACCRUAL RATES		-13,308,549
31	C-15	TAXES OTHER FACTOR UP REMOVAL		-2,413,388
32	C-16	RESEARCH AND EXPERIMENTATION (R&E) TAX CREDIIT ADJUSTMENT		-98,392
33	C-17	INTEREST SYNCHRONIZATION ROR is Pretax	Included in line 3.	
34	C-18	2015 ACTIVE HEALTH CARE COSTS		-322,202
35	C-19	2014 PENSION & OPEB COSTS		-1,174,206
36	C-20	ADVERTISING,CONTRIBUTIONS & DUES PER PUCT RULES		-381,937
37		Total Value of AXM Operating Income Adjustments	Lines 17..36	-34,488,386
38				
39				
40		REVENUE REQUIREMENT AS RECONCILED	Lines 5+14+37	($14,319,782)
41		NOL Synchronization		749,665
42	SCH. A	AXM REVENUE REQUIREMENT AS CALCULATED		($13,570,117)

II. Jurisdictional Allocation [PO Issue 39]

A. Adjustment for Golden Spread

In its Cost Allocation/Rate Design Brief, AXM explains why the Commission should deny SPS' request to make a post-test year adjustment ("PTYA") to reflect the future reduction in load from Golden Spread Electric Cooperative ("GSEC"). If the Commission appropriately denies SPS' PTYA request, it should also deny SPS' corresponding request to make GSEC-related adjustments to SPS' twelve coincident peak ("12CP") and energy allocation factors. SPS' PTYA improperly changes one part of the jurisdictional allocation equation – the future GSEC load – without also looking at the future jurisdictional loads for other customers. The Commission rejected this piecemeal approach in Docket No. 39896, reasoning that Entergy Texas' proposed PTYA would "depend on future costs and loads for each of the Entergy operating companies." The Commission should similarly reject SPS' proposed piecemeal approach.

B. General and Intangible Plant

C. Account 923 – Outside Service-Legal

III. Rate Base [PO Issues 6, 7]

A. Reasonableness and Prudence of Capital Additions from July 1, 2012 through June 30, 2014 [PO Issue 9]

B. Post Test Year Adjustment for Capital Additions after June 30, 2014 [PO Issue 16]

As the ALJs are well aware, rate setting in Texas is based on evaluation of a utility's plant in service and other investments, operations and maintenance expenses ("O&M"), taxes, and a return on the utility's investment based on an historical "test year." PURA § 11.03(20) defines "test year" to be "the most recent 12 months, beginning on the first day of a calendar or fiscal year

quarter, for which operating data for a public utility are available." In this proceeding SPS's test year is the twelve-month period ending June 30, 2014.

Subchapter B of Chapter 36 sets forth the criteria the Commission must follow in computing a utility's rates. Crucial to the setting SPS's rates in this proceeding is P.U.C. Subst. R. 25.231, which provides the details for a utility's cost of service for setting rates. Rule 25.231(a) requires that a utility's cost of service "be based upon an electric utility's cost of rendering service to the public during a historical test year, adjusted for known and measurable changes. The two components of cost of service are allowable expenses and return on invested capital."

P.U.C. Subst. R. 25.231(c)(2) sets forth the details for that which comprises a utility's "invested capital." And P.U.C. Subst. R. 25.231(c)(2)(F) presents the criteria that must be met with regard to a utility's request to include in its rates additions to its rate base above those shown in the utility's historical test year.

In this proceeding SPS seeks a waiver from the requirements of Rule 25.231(c)(2)(F). On a company-wide basis, SPS's request would add as a post, test-year adjustment to invested capital over $300 million. AXM Adjustment B-2 presents details related to SPS's PTYA regarding plant investment, accumulated depreciation, and accumulated deferred income tax reserves. The following table summarizes the Company's PTYA proposed plant additions on a Total SPS basis, excluding New Mexico direct distribution plant:

	PYTA Plant (excl. NM Distr.)	Percentage
Intangible Plant	$ 18,074,120	5.47%
Steam Production	13,086,703	3.96%
Other Production	271,506	0.08%
Transmission	300,134,871	90.84%
Distribution Plant – TX	(18,166,004)	-5.49%
General Plant	16,988,475	5.14%
Total	$ 330,389,672	100.00%

As the table above shows, over 90% of the PTYA plant additions are attributable to transmission plant. Depending on the nature and function of the underlying transmission projects, SPS may receive immediate compensation from other members of the Southwest Power Pool ("SPP") that would provide for recovery of depreciation expense, operations and maintenance expense, and a return on such transmission plant investment between rate cases. The immediate recovery of the majority of the annual transmission revenue requirements associated with SPS's investment in transmission projects designated as "Base Plan Upgrade Projects" is discussed in the direct testimony of Mr. James Dittmer. *AXM Exh. 5 – Carver Direct at 18 – 19.*

Turning first to SPS's request for a waiver of the Commission's PTYA Rule, SPS seeks two waivers from the Commission's PTYA Rule. SPS's first request is that the Commission waive the requirement of Rule 25.231(c)(2)(F)(i)(II), which requires that each capital addition must comprise at least 10% of the electric utility's requested rate base, exclusive of post test year adjustments and CWIP. The second waiver SPS seeks is from the requirement in Rule 25.231(c)(2)(F)(ii)(I) that the PTYA be included in rate base at the test-year-end balance for construction work in progress ("CWIP"). *AXM Exh. 5 – Carver Direct at 14.*

Waiver of 10% Threshold

SPS concedes that its PTYAs do not meet the 10% threshold found in the Commission's PTYA Rule. *AXM Exh. 5 – Carver Direct at 14 - 15.* AXM urges the ALJs and the Commission to deny SPS's request for a wavier of the 10% threshold found in the PTYA Rule. SPS could have sought relief under PURA § 36.054 and P.U.C. Subst. R Rule 25.231(c)(2)(D) (the Commission's "CWIP Rule"), but elected not to do so. As Mr. Carver noted, at least if the Commission had allowed SPS to earn a return on its CWIP balances as of December 31, 2014, the ratepayers would have avoided the continued incurrence of "allowance for funds used during construction" ("AFUDC"). *AXM Exh. 5 – Carver Direct at 15 – 16.* "The inclusion of CWIP in rate base would produce a current return on investment in exchange for the cessation of carrying costs (i.e., … "AFUDC") that would no longer be capitalized to those capital projects. While exchanging a current return (via rate base inclusion) for a deferred return (AFUDC) on CWIP should only be considered when dire financial conditions have no acceptable alternative remedies, ratepayers would benefit from the avoided AFUDC in future rate cases. But SPS's request for a waiver of the Commission's PTYA Rule provides no such benefit."

Further, SPS has simply failed in its burden of proof to warrant a waiver: the PTYA SPS seeks represents almost 46% of the increase proposed in its initial requested increase in revenue of approximately $64.75 million. *AXM Exh. 5 – Carver Direct at 16 – 17.* The primary support for SPS's request for a waiver of the Commission's PTYA Rule is found on five pages of Mr. Evan Evan's direct testimony. *AXM Exh. 5 – Carver Direct at 17.* Mr. Evan's testimony provides scant evidence of the need for a waiver of the Commission's PTYA Rule.

Nor can SPS point to any precedent where the Commission has granted a waiver along the lines SPS requests. *Id.* And critically, SPS provided no detailed analysis of the effect that granting

the waiver or not granting the waiver would have on SPS's financial integrity. *AXM Exh. 5 – Carver Direct at 18*. All SPS provided was general testimony regarding concerns with regulatory lag and the *potential* credit-rating pressure that could occasion, but SPS provided no quantification of the impact on its financial integrity of waving or not waiving the Commission's PTYA Rule.

Additionally, over 90% of SPS's request to include plant additions occurring post Test Year are related to transmission plant. As the ALJs and the Commission are aware, the Legislature provided a mechanism to minimize the effects of regulatory lag related to investments in transmission plant. PURA § 36.209 and P.U.C. Subst. R. 25.239 allow SPS to recover certain transmission-related costs and to do so on an annual basis, through a transmission cost recovery factor ("TCRF").

Stated simply, SPS has not demonstrated that its financial condition has been or is expected to be sufficiently dire to support SPS's extraordinary request for a waiver of the Commission's PTYA Rule. During calendar years 2013 and 2014, SPS achieved an average ROE of 8.84% and 8.72%, respectively.[1] These ROEs are quite healthy particularly in the context of SPS having added over $1.1 billion of new plant on a company-wide basis since July 2012. And as demonstrated by SPS's 2014 Earnings Monitoring Report (admitted in the record as *AXM Exh. 27*) and cross-examination of Ms. Deborah Blair regarding SPS's 2014 Earnings Monitoring Report, *conservatively*, SPS's ROE for 2014 was 9.94%. *Tr. Vol. 3 at 750 – 760 and Tr. Vol. 6 at 1431 – 1433*. For a monopoly utility, by any measure, a ROE of 9.00% or higher in today's economy does not represent dire financial circumstances.

[1] *See* the SPS responses to RFIs AXM 17-16 and 17-17 (Docket No. 43695) and 11-8 (Docket No. 42004). Also, *see* Attachment SCC-6 for these responses.

Expenses Related to SPS's Proposed PTYA

Mr. Carver and Mr. James Dittmer also propose adjustments to expenses related to SPS's PTYA. These adjustments are presented in AXM Adjustment C-6 (depreciation expense related to SPS's PTYA to plant balances), Adjustment C-12 (property taxes related to SPS's PTYA to plant balances), and Adjustment C-14 (annualized depreciation accrual rates based on depreciable investment related to SPS's PTYA to plant balances). These adjustments are to remove from rates, expenses related to SPS's plant balances occurring after the Test Year (June 30, 2014).

AXM Adjustment C-6 reduces SPS's depreciation expense related to SPS's PTYA to plant balances by $2,174,549. *AXM Exh. 5 – Carver Direct at Attachment SCC-3.*

AXM Adjustment C-12 reduces property taxes related to SPS's PTYA to plant balances by $4,427,450. *AXM Exh. 5 – Carver Direct at Attachment SCC-3 and AXM Exh. 2 – Dittmer Direct at 32 – 37.*

AXM Adjustment C-14 reduces annualized depreciation expense by $13,308,549 to reflect AXM's accrual rates based on depreciable investment related to SPS's PTYA to plant balances. *AXM Exh. 5 – Carver Direct at Attachment SCC-3.*

Attendant Impacts of SPS's Proposed PTYA

For ratemaking purposes, it may at times be appropriate to adjust a utility's per-book, test-year revenue, expense, and rate-base amounts to exclude out-of-period expenditures or items that are an aberration from the utility's normal expenditures. But any such adjustments must be for known-and-measurable events and must be applied consistently for a specified period. Crucial to identifying and quantifying adjustments to a utility's per-book amounts, is that its investments, expenses, and revenue be matched to a specified date or period. *AXM Exh. 5 – Carver Direct at 7.*

To the extent that these components are not synchronized, a utility may not have the opportunity to earn its authorized return or, alternatively, may have the opportunity to earn in excess of the return authorized. By synchronizing or maintaining the comparability of revenues, expenses and investment, the integrity of the test year can be maintained with the reasonable expectation that the resulting rates will not significantly misstate the ongoing cost of providing utility service.

With regard to its rate base, and based on the Company's request for a waiver from the Commission's PTYA Rule, SPS presented plant balances as of December 31, 2014. But with regard to the revenue side of the ratemaking equation, SPS used customer counts and weather-normalized sales at average test-year levels without adjusting for growth occurring during or subsequent to the Test Year. *AXM Exh. 5 – Carver Direct at 10; see AXM Exh. 1 – Brosch Direct at 3 - 14.*

Further, SPS failed to properly synchronize revenue credits received under Southwest Power Pool ("SPP") Schedule 11 related to SPS's investment in transmission plant that it proposes to reflect with a valuation as of December 31, 2014. See *AXM Exh. 2 – Dittmer Direct at 2 - 27* (Mr. Dittmer's testimony regarding SPP Schedule 11 wheeling charges and revenue credits). On this basis, too, SPS's request for a PTYA, fails.

SPS was highly selective with regard to the attendant impacts of its requested PTYA. *AXM Exh. 5 – Carver Direct at 20*. P.U.C. Rule 25.231(c)(2)(F)(i)(IV) addresses "attendant impacts" as follows:

> Where the attendant impacts on all aspects of a utility's operations (including but not limited to, revenue, expenses and invested capital) can with reasonable certainty be identified, quantified and matched. Attendant

> impacts are those that reasonably follow as a consequence of the post test-year adjustment being proposed.

While the attendant impacts Mr. Evans presents in his Table EDE-RR-7 represent PTYA-specific items, he excludes other quantifiable and matching changes that have occurred subsequent to June 2014 that tend to offset the revenue requirement SPS contends is associated with its request for a PTYA. As discussed above, the test year approach should be balanced and consistently applied to the various elements of the ratemaking equation in order to introduce minimal quantification distortions into the calculation of overall revenue requirement. *Id*.

AXM witness Mr. Michael Brosch identified additional revenues that should be recognized in the event the Commission adopts SPS's requested waiver of the PTYA Rule. SPS failed to recognize any growth in the number of customers in the residential and smaller commercial classes occurring after the end of the Test Year. Also, in the six months following the test year, billing determinants for large transmission-level customers increased. Adjustments to recognize the growth in the number of customers and the growth in sales in these areas would increase revenue and partially offset the revenue requirement related to SPS's PTYA. *AXM Exh. 1 – Brosch Direct at 2 - 14*.

Similarly, Mr. James Dittmer identified additional revenue credits tied to SPP Schedule that should be synchronized with the SPS's transmission investment as of December 31, 2014 that SPS proposes to include in rate base via its requested PTYA. *AXM Exh. 2 – Dittmer Direct at 2 – 26.*

Likewise, while Mr. Carver proposes elimination of the SPS's prepaid pension asset from rate base, if the Commission approves SPS's PTYA and the pension asset is included in rate base, the pension asset should instead be limited to the lower balance at December 31, 2014 of

$153,681,000 (Total SPS), net of related ADIT reserves. *AXM Exh. 5 – Carver Direct at 20 and Attachment SCC-4, Column F, Line 29.* AXM urges the ALJs and the Commission to deny SPS's request for a waiver of the Commission's PTYA Rule. But if the Commission grants the requested waivers, the resulting change in Texas retail revenue requirement would be improperly quantified if these additional offsetting adjustments identified by Messrs. Brosch and Dittmer were not also included.

C. Depreciation Reserve Balance [PO Issue 8]

D. Prepaid Pension Asset

The Commission's treatment of SPS's pension asset – that is whether to include it in, or exclude it from rate base – is a case of first impression for SPS. SPS has had seven base-rate cases in Texas dating back to the early 1980's, including the Company's last rate case and the pending rate case:

Docket No.	Test Year Ending	Order Date
43695	June 2014	Pending
42004	June 2013	December 19, 2014
40824	June 2012	June 19, 2013
32766	September 2005	July 27, 2007
11520	September 1992	December 20, 1993
6465	June 1985	February 19, 1986
4387	August 1981	June 23, 1982

Each of these prior base-rate cases has been resolved by black-box settlement that did not specify the components of rate base or the treatment afforded a pension asset (or liability). The two earliest proceedings predate the pension accounting requirements that resulted in SPS recording the pension asset. *AXM Exh. 5 – Carver Direct at 52.*

AXM Adjustment B-4 (Attachment SCC-3) eliminates or reverses SPS's proposed rate base inclusion of a pension asset. This adjustment also removes the related accumulated deferred

income tax ("ADIT") reserve from rate base. *AXM Exh. 5 – Carver Direct at 49.* Mr. Carver's direct testimony discusses in great detail the basis for AXM's recommendation to exclude SPS's proposed pension asset from rate base. This brief will attempt to touch on the highlights of Mr. Carver's testimony and given the complexity of the issue AXM respectfully also refers the ALJs to Mr. Carver's testimony on this issue.

The ADIT reserve associated with the pension asset must be reversed as part of AXM Adjustment B-4 if the Commission concurs with the elimination of the pension asset from rate base. The pension asset recorded on the Company's balance sheet is shown gross of the accumulated deferred income tax reserves that are associated with the pension asset. SPS proposes to include the pension asset in rate base as a component of prepayments. The ADIT reserves are attributable to the cumulative timing difference arising from the differing amounts recorded as pension costs on SPS's financial statements and the pension fund contributions deductible on the Company's Federal income tax return. Thus, for consistency purposes, if the Company's pension asset is to be excluded from rate base, the companion ADIT reserve balance should be similarly removed. *Id.*

AXM Adjustment B-4 removes SPS's pension asset by decreasing total Company rate base by about $168.6 million. This reduction is partially offset by an increase to rate base of $59.6 million because of elimination of the related ADIT reserve balance. Based on SPS's Texas retail jurisdictional allocation factors from its March 2, 2015 update, the net effect of AXM's adjustment reduces total Company rate base by approximately $109.0 million. The net reduction to rate base would be about $64.9 million (i.e., $100.3 million reduction for the pension asset offset by related ADIT reserve balance of $35.4 million). *AXM Exh. 5 – Carver Direct at 50.*

A utility's request for inclusion in rate base of its Pension Asset should not be automatically presumed to benefit ratepayers. The pension asset is basically the cumulative difference between pension contributions (i.e., cash payments) and pension accruals (i.e., non-cash accounting entries). If the contributions *exceed* accruals, then a pension asset is recorded. Some utilities and regulators assume that, simply because a pension asset has been recorded on the balance sheet, the utility must have disbursed cash (i.e., in the form of contributions to an external pension fund) that benefit ratepayers by generating additional earnings (i.e., a return on higher pension plan assets) which are used to decrease actuarial determined pension accruals. It is questionable whether ratepayers have substantially realized the benefits of the reduced pension costs underlying the pension-asset balance typically recorded by a regulated utility. It is inappropriate to include a pension asset in rate base absent a utility demonstrating substantial ratepayer benefit. Here SPS has failed to demonstrate that including its Pension Asset in rate base benefitted ratepayers. *AXM Exh. 5 – Carver Direct at 51.*

Each year, with assistance from its actuarial consultants, the Company records a journal entry in its accounting records to accrue Net Periodic Pension Costs ("NPPC") pursuant to Statement of Financial Accounting Standards No. 87 ("FAS87"), as updated and revised by Statement of Financial Accounting Standards No. 158 ("FAS158").[2] At the risk of being overly general, the Company's actuarial consultants also provide assistance in quantifying the range of pension contributions that are required, or permitted, under existing regulations. *AXM Exh. 5 – Carver Direct at 51.* But neither FAS87 nor FAS158 were designed or intended to quantify the amount of pension costs that should be recognized in the revenue requirement of regulated entities

[2] References to Net Periodic Pension Costs ("NPPC") and Net Periodic Benefit Costs ("NPBC") are in the context of Statement of Financial Accounting Standards No. 87 ("FAS87") and No. 106 ("FAS106"), now known as American Standards Codification 715 ("ASC 715"). FAS87 and FAS106 will continue to be used as the reference for testimony purposes. *AXM Exh. 5 – Carver Direct at 53.*

and recovered from their customers. Instead, these accounting pronouncements set forth the required framework for all publicly traded companies to quantify and record net periodic pension costs. *Id.*

The pension asset that SPS proposes to include in rate base does not represent SPS's cumulative contributions to the pension fund. Rather, the pension asset represents the cumulative *difference* between the actual annual contributions, if any, and the accruals for Net Periodic Pension Costs that SPS determined in accordance with FAS87. This pension asset represents nothing more than a financial accounting difference that is not, and absent studies demonstrating otherwise, should not be equated with any benefit conveyed to or received by the SPS's ratepayers. *AXM Exh. 5 – Carver Direct at 53.*

Mr. Carver presents an example of how a company's pension asset grows over time. The following examples show how pension accruals that are determined based on actuarial studies conducted annually, and annual pension contributions interact over time to form a pension asset. These examples illustrate how uniquely different circumstances can lead a company to record an identical pension asset balance:

Example 1

Year	Pension Accruals	Pension Contributions	Difference	Pension Asset (Liability)
1	$ 1,000,000	$ 1,000,000	$ 0	$ 0
2	0	1,000,000	1,000,000	1,000,000
3	0	1,000,000	1,000,000	2,000,000
4	0	1,000,000	1,000,000	3,000,000
5	0	1,000,000	1,000,000	4,000,000
Totals	$ 1,000,000	$ 5,000,000	$ 4,000,000	

Example 2

Year	Pension Accruals	Pension Contributions	Difference	Pension Asset (Liability)
1	$ 1,000,000	$ 1,000,000	$ 0	$ 0
2	(1,000,000)	0	1,000,000	1,000,000
3	(1,000,000)	0	1,000,000	2,000,000
4	(1,000,000)	0	1,000,000	3,000,000
5	(1,000,000)	0	1,000,000	4,000,000
Totals	$ (3,000,000)	$ 1,000,000	$ 4,000,000	

Under both examples, as shown in the column labeled "Difference," the cumulative pension contributions exceed cumulative pension accruals by $4 million at the end of Year 5 – a theoretical amount that is analogous to the prepaid pension asset SPS proposes to include in rate base. *AXM Exh. 5 – Carver Direct at 54.*

However, in Example 1, SPS would have made total out-of-pocket cash contributions to the pension fund of $5 million. But in Example 2 its contribution would have been only $1 million. In Example 1, the utility would have made $5 million of cash contributions to the pension fund that it could invest in qualifying investments with the opportunity of generating higher returns on plan assets, which would reduce future NPPC accruals. In Example 2, a much lower contribution of $1 million would generate lower returns on plan assets (i.e., because the available assets to invest are less). All else remaining constant, future NPPC accruals would be higher for the utility whose unique history resembles Example 2.

In Example 2, it is the negative pension accruals, or pension credits, in relation to pension contributions of "zero" in Years 2 through 5 that cause the utility to record a pension asset balance identical to Example 1. Even though pension-fund contributions would cause the utility to be out-of-pocket $4 million more under Example 1 ($5 million) than under Example 2 ($1 million), utility rate filings typically treat the rate base inclusion of the pension-asset balance resulting from both examples in an identical manner – that is, regulated utilities tend to seek rate base inclusion

regardless of the magnitude of cash contributions to the pension fund. *AXM Exh. 5 – Carver Direct at 55.*

Example 2 is more indicative of SPS's pension asset history than is Example 1. Attachment SCC-4 to Mr. Carver's direct testimony (*AXM Exh. 5 – Carver Direct*) presents actual SPS data. It is clear that the primary reason that SPS's cumulative pension contributions have exceeded recorded pension costs is because the financial accounting requirements of FAS87 resulted in SPS recording significant pension credits (i.e., negative pension costs) for thirteen consecutive years (i.e., 1997-2009). During this period, the Company recorded *negative* pension costs totaling about $177.1 million pursuant to FAS87 but only made pension fund contributions (i.e., cash payments) of about $10.4 million. *AXM Exh. 5 – Carver Direct at 54.*

During these thirteen years, the pension asset balance increased by $166.7 million (i.e., $177.1 million *negative* pension costs less $10.4 million of out-of-pocket pension fund contributions). While the $10.4 million of actual pension contributions did increase the plan assets in the external fund and were available to produce additional pension fund earnings over the years, the $166.7 million "difference" merely represents a series of accounting journal entries that resulted in $0 of investable assets in the pension fund.

The negative pension costs, or pension credits, have no connection to whom it is that benefitted – ratepayers or investors – from SPS "recording" those negative costs on its books and records. Further, the existence of such negative pension costs is not informative regarding who provided monies contributed to the pension fund in any year. *AXM Exh. 5 – Carver Direct at 56.*

About 105.0%[3] of the average test year pension asset balance SPS proposes to include in rate base is directly and *solely* attributable to the negative NPPC recorded by SPS in calendar years 1997-2009. The *negative pension costs recorded* during this 13-year period exceeds SPS's proposed pension asset balance and illustrates that the pension asset did not arise from actual cash contributions to the pension fund.

Further, the $177.1 million of negative pension costs were recorded during accounting periods that largely fell between the Company's December 1993 and July 2007 rate orders. *Id.* Except for the negotiated settlement resolving Docket No. 32766 (i.e., a test year ending September 2005), none of the negative NPPC amounts recorded during this period have been explicitly recognized in setting utility rates or separately refunded to customers. *AXM Exh. 5 – Carver Direct at 56.*

Subsequent to the adoption of FAS87, SPS's pension costs slightly exceeded the amounts contributed to the pension fund during the period 1988 through 1996.[4] The relatively modest pension asset/liability recorded by SPS during this period ranged from an asset of $4.5 million to a liability of $7.3 million. Beginning in 1997, fund contributions began to consistently exceed the amount recorded for financial statement purposes under NPPC accounting. This "excess" caused SPS to record a growing pension asset. It should be noted, however, that for pension asset accounting purposes, a contribution of "zero" is still a contribution. *AXM Exh. 5 – Carver Direct at 57.*

In 1997, the pension costs recorded for financial statement purposes pursuant to FAS87 became significantly "negative" (i.e., pension credits), rather than the "positive" amounts recorded

[3] *See* Attachment SCC-4.

[4] SPS's pension asset accounting is summarized on Attachment SCC-4.

in prior years. The Company recorded *negative* pension costs for thirteen consecutive years (1997 through 2009), in the aggregate amount of $(177.1) million and made *no* (i.e., zero) contribution to the pension fund in ten of those years. *AXM Exh. 5 – Carver Direct at 58.*

Similar to Example 2 above, SPS made no (i.e., zero) contribution to the pension fund in ten of the thirteen years during the period 1997-2009. *AXM Exh. 5 – Carver Direct at 58.* However, the "zero" contribution amounts still exceeded the significantly "negative" NPPC, which directly caused a significant escalation in the pension asset account balance recorded by the Company that SPS now seeks to include in rate base.[5] Thus, under FAS87 accounting, the actual balances grew from a pension liability of $(6.5) million at December 1996 to a peak pension asset balance of $184.5 million at December 2009 – a swing of about $191 million. *AXM Exh. 5 – Carver Direct at 59.*

It is the accumulation of contributions to the pension fund (i.e., a contribution of "zero" is still a contribution for pension accounting purposes) in excess of pension costs determined in accordance with FAS87 (i.e., the large "negative" amounts for thirteen years), that primarily caused the pension asset balance to grow by $160.2 million between December 1996 (negative $6,548,000) and December 2014 (positive $153,681,000). SPS proposes to include in rate base a pension asset balance of $168.6 million, the Test-Year average of the cumulative differential between pension accruals and pension contributions. *AXM Exh. 5 – Carver Direct at 59.*

It bears repeating: FAS87 merely provides accounting guidance with respect to the financial accounting disclosure of pension costs, related assets, and liabilities. FAS87 does not prescribe or impose any regulatory guidance or authoritative ratemaking treatment for the pension

[5] As set forth on Attachment SCC-4, the primary factor contributing to SPS's large pension asset balance is the recording of negative NPPC, or pension credits, during the period 1997-2009. [Source: SPS witness Mr. Schrubbe, Attachment RRS-RR-9 and Exhibit SPS-AXM 11-2(b).] *AXM Exh. 5 – Carver Direct at 58.*

asset. While SPS recorded the pension asset pursuant to FAS87, this asset is not directly analogous to other types of assets included on the Company's balance sheet that are recognized for rate base purposes. SPS did not expend substantial funds to purchase or acquire the pension asset, unlike the Company's investment in other assets (e.g., fuel inventory, prepaid insurance, electric poles, generating plants, overhead lines, etc.). *AXM Exh. 5 – Carver Direct at 61.*

Since the adoption of FAS87, SPS has only contributed about $64.1 million to the pension fund, far less than the $168.6 million pension asset it seeks to include in rate base. The pension asset merely represents the cumulative difference between FAS87 based NPPC and actual contributions to the pension fund. Not a single dollar of this "difference" has been contributed to the external pension fund. *Id.*

The ALJs and the Commission should include SPS's proposed pension-asset balance in rate base only if SPS could reasonably demonstrate that reduced FAS87 pension costs (i.e., negative NPPC for SPS) have been directly flowed through to the benefit of utility ratepayers. SPS has not so demonstrated; SPS has not provided any convincing evidence that ratepayers have benefited in a cumulative amount at least equal to the $168.6 million pension asset SPS seeks to include in rate base. *AXM Exh. 5 – Carver Direct at 62.* And the mere fact that SPS recorded negative NPPC or that NPPC was less than fund contributions in some years does not automatically translate into ratepayer benefits in the form of decreased costs.

The prepaid pension asset amount that SPS proposes to include in rate base is merely the accounting difference between pension accruals and pension contributions over time. About $157 million of the prepaid pension asset is directly related to a period between SPS rate cases (i.e., 1994-2007) when there was no mechanism to return the negative pension costs to ratepayers outside of a rate case. During this same period, SPS made contributions to the external pension

fund in the amount of only $5.5 million. *AXM Exh. 5 – Carver Direct at Attachment SCC-4, line 32.* Consequently, those negative pension accruals were retained by SPS for the benefit of shareholders but were not used to reduce the electric rates charged to SPS ratepayers. *Id.*

Lastly, the ALJs and the Commission should not "prepaid pension assets" with the assets in the external pension fund; the two are distinctly different. The prepaid pension asset is neither invested nor produces a return that lowers FAS87 expense (i.e., NPPC). At December 31, 2014 the balance for the cumulative prepaid pension asset since the issuance of FAS87 in 1987 is $153.7 million.[6] Here, SPS is requesting rate base inclusion of $168.6 million for the prepaid pension asset, which represents the test year average, rather than the much lower balance of $153.7 million at December 2014. *AXM Exh. 5 – Carver Direct at Attachment SCC-4.* During this same period, SPS has only contributed $64.1 million to the external pension fund that have been commingled with other plan assets existing prior to 1988 and related earnings on all plan assets. *AXM Exh. 5 – Carver Direct at 63.*

Only the assets actually in the *external pension fund* generate investment returns that lower NPPC. As noted above, the primary cause of the prepaid pension asset is negative NPPC (totaling negative $177.1 million) recorded by SPS during the period 1997-2009. The annual negative NPPC recorded by SPS during these years was not contributed to the external pension fund and was never explicitly recognized by this Commission in reducing SPS's Texas retail rates. *Id.* Consequently, the accounting difference between cumulative NPPC and pension contributions does not represent funds sitting in an external pension trust fund earning interest. And the

[6] SPS is requesting rate base inclusion of $168.6 million for the prepaid pension asset, which represents the test year average, rather than the much lower balance of $153.7 million at December 2014. *See AXM Exh. 5 – Carver Direct at* Attachment SCC-4.

Company has presented no studies quantifying the cumulative benefits SPS's customers are alleged to have received as a result of the negative NPPC.

Therefore, SPS's attempt to take retroactive credit for past negative NPPC to support including the prepaid pension asset in quantifying prospective rates is not supported with evidence. *AXM Exh. 5 – Carver Direct at 62 – 63.*

SPS is attempting to receive retroactive credit for past negative NPPCs in support of its request for inclusion of its pension asset in rate base, but it has failed to provide any evidence that ratepayers benefitted from its prior actions.

SPS has provided no factual support to quantify the cumulative extent of claimed ratepayer benefits to the detriment of Company investors. Rate base inclusion is appropriate only if it can be reasonably demonstrated that reduced FAS87 pension costs, including the pension credits, on a cumulative basis have been flowed through to the benefit of ratepayers in an amount at least equal to the pension asset to be included in rate base. AXM's analysis supports rejection of the Company's request to include the pension asset in rate base.

AXM urges the ALJ and the Commission to exclude prepaid pension asset from SPS's rate base. The Commission should reach this conclusion because SPS's rates do not and have not changed on an annual basis (i.e., between rate cases), SPS has not refunded or otherwise returned the negative NPPC to customers, the prepaid pension asset does not represent funds contributed to the external pension fund that is generating earnings to reduce NPPC, and AXM's estimate of the amount of NPPC historically included in utility rates reasonably challenges SPS's claim for rate base inclusion. *AXM Exh. 5 – Carver Direct at 73 and Attachment SCC-5.*

Therefore, AXM urges the ALJs and the Commission to exclude from SPS's rate base it proposed prepaid pension asset.

Also, as discussed above, if the Commission adopts SPS's proposed waiver of the Commission's PTYA Rule, the account balances for major components of rate base and other related costs would be advanced from the June 30, 2014, Test-Year end amounts to those recorded as of December 31, 2014. If that were to occur, the rate base should not reflect the Test-Year average balance of $168.6 million for pension asset, less related ADIT reserves, but should instead reflect only the lower pension asset balance at December 31, 2014 of $153,681,000, also net of related ADIT reserves. *AXM Exh. 5 – Carver Direct at 77 and Attachment SCC-4, column F, line 29.*

E. FAS 106 and FAS 112 Liabilities

Regarding FAS 106 (postretirement benefits other than pensions) and FAS 112 (postemployment benefits) Liabilities, AXM presents its adjustment to SPS's rate-filing package at AXM's Adjustment B-5 found in Mr. Carver's direct testimony (*AXM Exh. 5 – Carver Direct*).

SPS witness Ms. Blair recommended a reduction to SPS's rate base to recognize the liabilities associated with FAS106 (postretirement benefits other than pensions) and FAS112 (postemployment benefits) SPS recorded in its books and did so for purposes of consistency with the Company's proposal to include the pension asset in rate base. *AXM Exh. 5 – Carver Direct at 77 – 78.* As discussed above regarding pension assets, Mr. Carver recommends that the ALJ and the Commission exclude the pension asset from rate base, net of related ADIT reserve balances. Thus, consistent with Mr. Carver's proposal to exclude pension asset from rate base, he also recommends that the ALJs and the Commission exclude from rate base SPS's proposed FAS106

and FAS112 liabilities, net of the related ADIT reserve balances. *AXM Exh. 5 – Carver Direct at 78.*

If the ALJ or the Commission includes SPS's pension asset in rate base, then AXM Adjustment B-5 is not necessary.

F. Accumulated Deferred Federal Income Taxes [PO Issue 14]

Mr. Michael Brosch addresses AXM's adjustment related to Accumulated Deferred Federal Income Taxes ("ADIT"). See generally, *AXM Exh. 1 – Brosch Direct at pp. 17 -23.*

ADIT are assets or liabilities that represent the cumulative amounts of additional income taxes that are estimated to become receivable or payable in future periods, because of differences between book accounting and income tax accounting regarding the timing of revenue or expense recognition. *AXM Exh. 1 – Brosch Direct at pp. 17.*

Differences in accounting requirements under Generally Accepted Accounting Principles ("GAAP") versus the Internal Revenue Code ("Code") cause what are characterized as book/tax differences. Many of these book/tax differences are temporary because they arise from timing differences, where a specific cost is deductible for tax purposes in a different year than for book purposes – the primary example being depreciation expenses that are recorded on a straight-line basis for book accounting, but are based upon accelerated lives and methods and/or "bonus" depreciation for income tax accounting and reporting purposes. Timing differences can also occur where an anticipated expense is recognized on an accrual-basis for book purposes, but is not deductible until later, when the expense is actually paid in cash by the taxpayer. Specific

provisions within GAAP[7] require recognition of income tax impacts from these book/tax timing differences by recording ADIT assets or liabilities. *AXM Exh. 1 – Brosch Direct at pp. 17.*

ADIT assets generally occur when revenue taxation occurs prior to book recognition of the revenues or when the tax deductibility for expenses is subsequent to the book recognition of the expense. *AXM Exh. 1 – Brosch Direct at pp. 17 – 18.*

ADIT liabilities, on the other hand, represent delayed taxation of revenues or advance deduction of expenses, in relation to the timing of the same transactions on the books. ADIT balances exist to recognize that certain tax expenses are determinable today, but actually become payable in the future whenever book/tax timing differences ultimately reverse. *AXM Exh. 1 – Brosch Direct at pp. 18.*

GAAP requires a full and complete accounting for income tax expenses to recognize that filing tax returns and paying income taxes will impact expenses payable in more than one accounting period. *AXM Exh. 1 1 – Brosch Direct at pp. 18.* There are two primary objectives related to Accounting Standards Codification 740 ("ASC 740"):

a. To recognize the amount of taxes payable or refundable for the current year, and

b. To recognize deferred tax liabilities and assets associated with the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. *Id.*

The amount of ADIT a company records arises from part (b) of this standard. It is here that a company's books recognize the future tax consequences of transactions that are treated differently in financial statements than on tax returns. *AXM Exh. 1 – Brosch Direct at pp. 18 – 19.*

[7] GAAP Accounting for Income Taxes is set forth within Financial Accounting Standards Board Accounting Standards Codification 740 ("ASC 740").

ADIT balances are a crucial element in determining a utility's revenue requirement. Because of the capital-intensive nature of utilities, these large annual capital investments generate persistently large income tax deductions for bonus/accelerated depreciation and other tax deductions and credits that must be normalized. These differences are normalized by recording ADIT. From a ratemaking perspective ADIT balances represent a form of zero-cost capital to the utility created by the income tax savings permitted under tax laws and regulations that are not immediately "flowed through" to ratepayers and would benefit only shareholders unless properly recognized as a reduction to rate base so as to properly quantify the net amount of investor-supplied capital. SPS included ADIT balances in presenting it rate base. *AXM Exh. 1 – Brosch Direct at pp. 19.*

But SPS did not include in rate base all of the elements of its ADIT balances recorded in its books at Test Year end. Generally, SPS excluded items related to transactions or specific investments that are treated as non-jurisdictional or that are excluded from rate base. For example, SPS excluded from rate base ADIT associated with charitable-contribution, carry-forwards because contributions are not included for ratemaking purposes. *AXM Exh. 1 – Brosch Direct at 19 – 20.*

1. Bad Debt Reserve Accrual

2. Vacation Accrual Reserves

AXM addresses Bad Debt Reserve Accrual and Vacatioin Accrual Reserves in a single section below.

Mr. Brosch's review of SPS's ADIT accounts revealed that while most of the Company's proposed classifications of individual ADIT elements were appropriate, Mr. Brosch recommends excluding from SPS's test-year rate base the debit ADIT amounts that SPS recorded for the

following two specific book/tax timing differences:

- Bad Debt Reserve Accruals[8]
- Vacation Accrual Reserves[9]

AXM's adjustment related to Bad Debt Reserves and Vacation Accruals are presented in *AXM Exh. 5 – Carver Direct at Attachment SCC-3*. This adjustment quantifies the reduction to rate base to eliminate these two ADIT elements. Mr. Brosch proposes that the deferred tax balances for these elements of recorded ADIT be excluded from rate base because for each of these ADIT amounts, there is a corresponding recorded asset or liability balance on the SPS balance sheet that has not been recognized as a rate base reduction. Mr. Brosch's analysis revealed that SPS had not reduced its rate base by an amount equal to its reserve for uncollectible accounts (bad debts). This means the corresponding ADIT amount should not be included in rate base. It is unreasonable to include the ADIT balance associated with a recorded reserve or liability in rate base when the corresponding reserve/liability balance is, itself, not part of rate base. *AXM Exh. 1 – Brosch Direct at 21*.

Subtracting the recorded reserve for uncollectible accounts from SPS's rate base would reduce its rate base by more than $3 million as of June 30, 2014. It is not reasonable to include the bad debt-related ADIT balance as an increase to rate base when the associated bad debt reserve on the Company's books has not been included to reduce rate base. *AXM Exh. 1 – Brosch Direct at 21*.

Similarly, subtracting from rate base the recorded reserve for costs related to accrued but not taken vacation would reduce SPS's rate base by more than $6 million as of June 30, 2014. It is

[8] *AXM Exh. 1 – Brosch Direct at 20*.

[9] *Id.*

not reasonable to include the vacation accrual-related ADIT balance as an increase to rate base when the vacation accrual reserve on the Company's books has not been included to reduce rate base. *AXM Exh. 1 – Brosch Direct at 21 – 22.*

Notwithstanding SPS's protestations, SPS has not demonstrated that any provisions of its lead-lag study actually accomplish the inclusion of the reserve/liability balances associated with these Bad Debts and Vacation Accruals. *AXM Exh. 1 – Brosch Direct at 22 – 23.*

With respect to Vacation Accrual balances that are not in rate base, the result is the same. SPS admitted that its cash working capital calculations do not include a lead-day calculation performed to explicitly include the effects of delayed payments of accrued vacation amounts. Regular payroll is included in the cash working capital calculation, which includes payments for vacation pay." *AXM Exh. 1 – Brosch Direct at 23 and at Attachment MLB- 12.*

Therefore, AXM urges the ALJs and the Commission to adopt Mr. Brosch's recommendations to exclude the disputed ADIT amounts shown on Schedule B-6.

3. NOL Carryforward

G. Cash Working Capital [PO Issue 12]

1. Federal Income Tax Expense Lag

AXM recommends rejecting SPS' request for a negative cash working capital ("CWC") balance for federal income taxes.[10] SPS seeks a negative CWC balance for federal income taxes, even though SPS is not receiving any refunds for those taxes.[11] SPS is accruing net operating losses ("NOLs"), which have no cash impact, but SPS wants to treat those accounting entries as

[10] AXM Exh. 2, Direct Testimony of James Dittmer at 30-31.

[11] *Id.* at 31.

though they were cash events for the CWC calculation.[12] This is inconsistent with the purpose of CWC – changes in cash balances – and should be rejected. AXM's recommendation decreases SPS' rate base by $98.705 million.[13]

2. PUCT Assessment Tax

H. Other Prepayments [PO Issue 14]

I. Regulatory Assets [PO Issue 15]

IV. Rate of Return [PO Issues 4, 5]

Summary

AXM recommends a rate of return of 7.82 percent[14], using a return on equity ("ROE") of 9.4 percent[15], a cost of debt of 5.98 percent[16], and a capital structure of 53.97 percent equity with 46.03 percent debt[17]. Approving numbers at or near these levels is appropriate for the following reasons:

* AXM's witness David Parcell calculates an ROE of 9.4 percent, applying calculation methods long accepted by the Commission.[18]
* The other intervenors in this case calculate ROEs between 9 and 9.3 percent[19], also applying calculation methods long accepted by the Commission.
* The Commission set an ROE of 9.65 percent for SWEPCO in Docket No. 40443, the last time the Commission approved a fully litigated ROE for a vertically integrated utility.[20]

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12 *Id*.

13 AXM Exh. 5, Direct Testimony of Steve Carver, Att. SCC-3, Schedule B.

14 AXM Exh. 4, Direct Testimony of David Parcell at 2.

15 *Id*.

16 *Id*.

17 *Id.* at 16; Tr. at 1225, lines 19-21 (June 30, 2015) (AXM accepts SPS' proposed capital structure).

18 AXM Exh. 4, Direct Testimony of David Parcell at 16-29.

19 SPS Exh. 40, Rebuttal Testimony of Robert Hevert at 12 (outlining intervenors' recommendations in Table RBH-RR-R1).

20 *Application of Southwestern Power Electric Company for Authority to Change Rates and Reconcile Fuel Costs,*

* 9.51 percent is the nationwide average ROE in fully litigated cases for vertically integrated utilities in 2015.[21]

* As Moody's explained in a recent research paper, regulators can lower ROEs to the levels justified by current economic conditions without harming the credit profiles of regulated utilities.[22]

* Since 2006, in every case where SPS' witness Robert Hevert proposed an ROE and where the Commission specified an ROE, the Commission has adopted an ROE at least 100 basis points lower than Mr. Hevert's proposed ROE.[23]

* SPS' witness Robert Hevert's ROE recommendation in this case assumes a nominal long-term growth rate for the Gross Domestic Product ("GDP") of 5.54 percent, despite the fact that the Social Security Administration ("SSA"), Energy Information Administration ("EIA"), and Blue Chip Economic Indicators estimate nominal long-term GDP growth rates of between 4.2 and 4.7 percent.[24]

* Interest rates and inflation are at historically low levels, with interest rates fluctuating moderately up and down at these historically low levels.[25] For example, the 10 year Treasury Bond rate was 1.94 percent in April of this year, well below the still low (by historical standards) rate of 2.9 percent in December 2013.[26]

* AXM is not contesting SPS' proposed cost of debt.[27]

* AXM is not contesting SPS' proposed capital structure.[28]

Docket No. 40443, Order on Rehearing at 31, Finding of Fact No. 150 (March 6, 2014); *see also* SPS Exh. 40, Rebuttal Testimony of Robert Hevert, at RBH-RR-R7 (listing ROE decisions of vertically integrated utilities and showing that last litigated decision by the Commission was Docket No. 40443).

[21] SPS Exh. 40, Rebuttal Testimony of Robert Hevert, at RBH-RR-R7, rows 51, 53, and 56 (listing ROEs of 9.5 (Wyoming), 9.5 (Washington), and 9.53 (Missouri) percent, for an average of 9.51 percent).

[22] AXM Exh. 44, "Lower Authorized Equity Returns Will Not Hurt Near-Term Credit Profiles," Moody's Investor Services (March 10, 2015).

[23] AXM Exh. 34, Exh. SPS-AXM 11-58 (listing recommended and awarded ROEs in cases where Mr. Hevert submitted ROE recommendations to the Commission).

[24] AXM Exh. 4, Direct Testimony of David Parcell, at 35 (SSA and EIA estimate long-term GDP growth rates of 4.42 and 4.2 percent, respectively); TIEC Exh. 4, Direct Testimony of Michael Gorman, at 25 (Blue Chip Economic Indicators estimate long-term GDP growth rates of between 4.4 and 4.7 percent).

[25] AXM Exh. 4, Direct Testimony of David Parcell, at 35 (discussing trends in interest rates and inflation) and Attachment DCP-3, p. 4 (listing historical interest rates).

[26] *Id*., Attachment DCP-3, p. 4. April of this year is the most recent 10 Year Treasury Bond rate that AXM could find in the record. While not in the record, the most current 10 Year Treasury Bond rates are still far below the 2.9 percent rate from December 2013, showing that interest rates are still fluctuating up and down within a historically low range.

[27] *Id*. at 2-3.

[28] *Id*.

A. Return on Equity [PO Issue 5]

AXM recommends an ROE of 9.4 percent.[29] AXM's witness David Parcell provided a detailed analysis supporting an ROE of 9.4 percent.[30] Mr. Parcell's analysis included an application of the discounted cash flow ("DCF") model and capital asset pricing model ("CAPM")[31] that the Commission has reviewed in several recent cases, including Docket Nos. 39896[32] and 40443[33].

The other intervenors in this case calculated ROEs between 9 and 9.3 percent.[34] The other intervenors similarly used the DCF and (with one exception) the CAPM methodologies, among others, for their recommended ROEs.[35] The fact that five different experts applied the Commission-accepted DCF methodology, and four applied the Commission-accepted CAPM methodology, to recommend ROEs in the tight range of 9 to 9.4 percent strongly supports that range of ROEs.

The Commission's most recently awarded ROEs also support an ROE at or near 9.4 percent. The Commission set an ROE of 9.65 percent for SWEPCO in Docket No. 40443, the last

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29 *Id*. at 2.

30 *Id*. at 16-29.

31 *Id*. at 17-24.

32 *Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing at 18, Finding of Fact No. 65 (November 2, 2012) (relying on DCF and CAPM models).

33 *Application of Southwestern Power Electric Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at 31, Finding of Fact No. 151 (March 6, 2014) (relying on DCF and CAPM models).

34 SPS Exh. 40, Rebuttal Testimony of Robert Hevert at 12 (outlining intervenors' recommendations in Table RBH-RR-R1).

35 TIEC Exh. 4, Direct Testimony of Michael Gorman at 18-31, 37-42; Staff Exh. 6A, Direct Testimony of Anjuli Winker, at 18-25, 28-31; Department of Energy Exh. 1, Direct Testimony of Maureen Reno, at 16-30; OPUC Exh. 10, Direct Testimony of David Mass, Adopted by Carol Szerszen at 23-26 (applying the DCF, but not the CAPM, model).

time the Commission approved a fully litigated ROE for a vertically integrated utility.[36] The Commission also set an ROE of 9.6 percent for Lone Star Transmission, a transmission-only utility, in Docket No. 40200.[37]

Recent decisions in other jurisdictions also support an ROE at or near 9.4 percent. The nationwide average ROE for 2015 in fully litigated cases for vertically integrated utilities is 9.51 percent.[38] This includes ROEs of 9.5 percent in Wyoming, 9.5 percent in Washington, and 9.53 percent in Missouri.[39]

In a recent research paper, Moody's explains why ROEs are dropping towards the levels recommended by the intervenors.[40] As Moody's states:

> The credit profiles of US regulated utilities will remain intact over the next few years despite our expectation that regulators will continue to trim the sector's profitability by lowering the authorized returns on equity (ROE). Persistent low interest rates and a comprehensive suite of cost recovery mechanisms ensure a low business risk profile for utilities …[41]

Moody's also states "falling authorized ROEs are not a material credit driver at this time, but rather reflect regulators' struggle to justify the cost of capital gap between the industry's authorized ROEs and persistently low interest rates."[42] Moody's analysis provides additional justification for

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36 *Application of Southwestern Power Electric Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at 31, Finding of Fact No. 150 (March 6, 2014); *see also* SPS Exh. 40, Rebuttal Testimony of Robert Hevert, at RBH-RR-R7 (listing ROE decisions of vertically integrated utilities and showing that last litigated decision by the Commission was Docket No. 40443).

37 *Application of Lone Star Transmission, LLC for Authority to Establish Interim Final Rates and Tariffs*, Docket No. 40020, Order on Rehearing at 13, Finding of Fact No. 70A (February 12, 2013).

38 SPS Exh. 40, Rebuttal Testimony of Robert Hevert, at RBH-RR-R7, rows 51, 53, and 56.

39 *Id*.

40 AXM Exh. 44, "Lower Authorized Equity Returns Will Not Hurt Near-Term Credit Profiles," Moody's Investor Services (March 10, 2015).

41 *Id*. at 1.

42 *Id*. at 2.

AXM's proposed ROE since, applying Moody's analysis, SPS' credit profile will remain intact even if the Commission lowers SPS' ROE to a level that matches current economic conditions.[43]

Finally, the record in this case does not support SPS' witness Robert Hevert's recommended ROE of 10.25 percent. As a preliminary matter, in every case since 2006 where Mr. Hevert proposed an ROE and where the Commission specified an ROE, the Commission has adopted an ROE at least 100 basis points lower than Mr. Hevert's proposed ROE.[44] Mr. Hevert's recommended ROE also assumes a nominal long-term growth rate for the GDP of 5.54 percent, despite the fact that the SSA, EIA, and Blue Chip Economic Indicators estimate nominal long-term GDP growth rates of between 4.2 and 4.7 percent.[45] Moreover, as AXM explains above, Mr. Hevert's recommended ROE of 10.25 percent is 60-65 basis points higher than the Commission's most recently awarded ROEs[46], 74 basis points higher than the average ROE for litigated cases for vertically integrated utilities in 2015[47], and 85 to 125 basis points higher than the recommendations of the other experts in this proceeding[48].

For all of these reasons, AXM recommends an ROE of 9.4 percent.

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43 Interest rates and inflation are at historically low levels, with interest rates fluctuating moderately up and down at those historically low levels. *See* AXM Exh. 4, Direct Testimony of David Parcell at 35 (discussing trends in interest rates and inflation) and Attachment DCP-3, p. 4 (listing historical interest rates). For example, the 10 year Treasury Bond rate was 1.94 percent in April of this year, well below the still low (by historical standards) rate of 2.9 percent in December 2013. *Id*., Attachment DCP-3, p. 4.

44 AXM Exh. 34, Exh. SPS-AXM 11-58 (listing recommended and awarded ROEs in cases where Mr. Hevert submitted ROE recommendations to the Commission).

45 AXM Exh. 4, Direct Testimony of David Parcell, at 35 (SSA and EIA estimate long-term GDP growth rates of 4.42 and 4.2 percent, respectively); TIEC Exh. 4, Direct Testimony of Michael Gorman at 25 (Blue Chip Economic Indicators estimate long-term GDP growth rates of between 4.4 and 4.7 percent).

46 Comparing 10.25 percent to the 9.65 percent decision in Docket No. 40443 and the 9.6 percent decision in Docket No. 40020.

47 Comparing 10.25 percent to the 9.51 percent national average ROE for fully litigated cases for vertically owned utilities in 2015.

48 Comparing 10.25 percent to the 9 to 9.4 percent recommended ROEs of the intervenors.

B. Cost of Debt [PO Issue 5]

AXM is not contesting SPS' proposed cost of debt.[49]

C. Capital Structure [PO Issue 4]

AXM is not contesting SPS' proposed capital structure.[50]

D. Overall Rate of Return [PO Issue 5]

AXM recommends an overall rate of return of 7.82 percent.[51]

V. Operation & Maintenance Expenses (includes Depreciation and Taxes) [PO Issues 17, 18, 20]

A. Payroll Expense

1. Base Pay

AXM Adjustment C-10 (*AXM Exh. 5 – Carver Direct at Attachment SCC-3*) Mr. Carver recommends a reduction to a portion of the Company's estimated labor costs allocated to operation and maintenance ("O&M") expense attributable to wage increases that may not be effective until November 2014 and March 2015, well after the end of the Test Year. *AXM Exh. 5 at 25-26.*

SPS based its request for these expenses on the total of three months' of employee wages for April through June 2014 and multiplied that total by four, to arrive at an annual amount of employee wage expense at the end of the Test Year. *AXM Exh. 5 at 26.* SPS's adjustment increased Test Year expense by about $5.1 million (total Company). *Id.* Additionally, SPS is requesting recovery in rates of a *budgeted* increase in wages projected to be effective November 2014 (3.0% for SPS bargaining employees) and March 2015 (3.0% for SPS and XES non-bargaining employees).

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[49] AXM Exh. 4, Direct Testimony of David Parcell at 2-3.

[50] *Id*.

[51] *Id*. at 2.

These wage increases result in additional in an increase in Test-Year expense of about $3.1 million (total Company). *AXM Exh. 5 at 26.*

AXM urges the ALJs and the Commission to reject SPS's adjustments to its wage expenses. As Mr. Carver explained, it is crucial to maintain a balanced and consistent approach in quantifying the various test-year elements of the ratemaking equation (i.e., rate base, revenues, expenses, capital costs, etc.). "The recognition of these post-test year wage increases is only one element of the distortive approach SPS has taken in quantifying and supporting the requested rate increase." *AXM Exh. 5 at 27.*

Further, beyond being budgeted amounts and not historical costs, and well outside the Test Year, SPS is apparently in negotiations with its bargaining unit employees regarding wages. To evaluate the validity of these expenses AXM and other parties submitted a series of discovery requests, the gist of which sought data establishing the product of SPS's negotiations. *AXM Exh. 5 at 27.* But SPS's responses were less than fruitful: The common theme in SPS's initial responses was that the requested information was not available. Thus, Mr. Carver proposes removal of SPS's proposed increases in wages. *AXM Exh. 5 at 27 – 28.*

2. Incentive Compensation

In AXM's adjustment C-11 (*AXM Exh. 5 – Carver at Attachment SCC* 3) Mr. Carver proposed two adjustments to operations and maintenance ("O&M") expense relating to incentive compensation. Mr. Carver removed from Test-Year expense the cost of the financial-based "affordability trigger" element of SPS's Annual Incentive Plan ("AIP"). *AXM Exh. 5 at 28.*

SPS contends it has removed from its Long-Term Incentive Compensation plan ("LTI") from its proposed O&M expenses and seeks only to recover in rates $5,202,078 (total Company)

for the AIP plan and $1,343,457 (total Company) for the Xcel Energy Wholesale Energy Marketing and Trading Supplemental Incentive Programs ("SIP").. *AXM Exh. 5 at 28.* The following table summarizes the test year amounts SPS included in O&M expense for these programs:

	Total Company Amounts			
	AIP	LTI	SIP	Total
Adjusted Per Book:				
XES	$ 4,813,909	$ 1,567,248	$ 1,343,457	$ 7,724,614
SPS	2,657,633	436,446		3,094,079
Subtotal	7,471,542	2,003,694	1,343,457	10,818,693
SPS Adjustments:				
XES	(1,526,517)	(1,567,248)		(3,093,765)
SPS	(735,117)	(436,446)		(1,171,563)
Subtotal	(2,261,634)	(2,003,694)	-	(4,265,328)
SPS Proposed:				
XES	3,287,392	-	1,343,457	4,630,849
SPS	1,922,515	-	-	1,922,515
Total	$ 5,209,907	$ -	$ 1,343,457	$ 6,553,364
Sources:				
AIP: "DAB-RR-2_1.3 - non-plant Input - Dec Update.xlsx", tab "Incentive to Target".				
LTI: "DAB-RR-2_1.2 - Adjustments - Dec Update.xlsx", tab "Long Term Incentive".				
SIP: SPS witness Reed direct at 41. [AXM attributed to XES.]				

AXM Exh. 5 – Carver Direct at 29.

Beginning with the 2012 plan year, SPS modified its AIP plan to remove "earnings as a Corporate goal"; this resulted in a significant reduction of the percentage of AIP related to a financial component for 2012 and beyond. *AXM Exh. 5 – Carver Direct at 31.* But the "affordability trigger" is a broader factor in terms of determining whether an employee is eligible to receive incentive pay under the AIP plan. The AIP plan is based on consolidated earnings per share ("EPS"), not on company-specific (i.e., SPS) or state-specific (i.e., Texas) financial results. *AXM Exh. 5 – Carver Direct at 31. AXM Exh. 5 – Carver Direct at 31.* The table below shows the

minimum consolidated EPS trigger, below which payments under the AIP plan will not be made, and actual EPS results for 2012 through 2014:

Performance Level	2012 Plan Year EPS	2013 Plan Year EPS	2014 Plan Year EPS
Threshold	$1.75	$1.85	$1.90
Actual Result	$1.82	$1.95	$2.03

AXM Exh. 5 – Carver Direct at 31.

If the consolidated EPS exceed the threshold levels noted in the table above, the AIP will be "funded" at a 50% level. *AXM Exh. 5 – Carver Direct at 31 – 32.* Higher EPS levels increase the level of AIP available to employees up to a maximum of 150% of the target amount. The following table compares the target and actual AIP amounts for plan years 2012 through 2014:

Total SPS O&M	**2012**	**2013**	**2014**
Target AIP			
SPS	$2,000,255	$2,088,313	$2,016,489
XES	3,532,116	3,685,187	3,994,079
Actual AIP			
SPS	2,731,256	2,619,586	N/A
XES	4,970,059	5,167,019	N/A

Source: SPS response to AXM RFI 17-12.

AXM Exh. 5 – Carver Direct at 32.

The table below shows SPS's contribution to the consolidated net income and EPS threshold trigger achieved in 2013 and 2014:

Net Income (000s)	**2014 YE**	**2014 EPS**	**2013 YE**	**2013 EPS**
PSCO	$ 454,494	$ 0.90	$ 453,289	$ 0.91
NSPM	404,915	0.80	393,346	0.79
SPS	129,852	0.26	115,368	0.23
NSPW	70,642	0.14	59,468	0.12
Wyco/West Gas	17,964	0.04	17,633	0.04
Total Regulated	**$ 1,077,867**	**$ 2.14**	**$ 1,039,104**	**$ 2.09**
Eloigne	(451)	-	(810)	-
Holding Co.	(56,408)	(0.11)	(70,549)	(0.14)
Other	(396)	-	587	-
Total Nonreg	**$ (57,255)**	**$ (0.11)**	**$ (70,772)**	**$ (0.14)**
Total Xcel-Ongoing	**$ 1,020,612**	**$ 2.02**	**$ 968,332**	**$ 1.95**
PSRI	694	-	94	-
FERC 205 Filing	0	-	(20,192)	(0.04)
Total Xcel-Cont Ops	**$ 1,021,306**	**$ 2.03**	**$ 948,234**	**$ 1.91**

AXM Exh. 5 – Carver Direct at 32.

SPS's contribution to Xcel Energy's consolidated operating results was below all other entities comprising the regulated operations in terms of average achieved return on equity ("ROE") in 2013 and the second lowest in 2014. SPS's average ROE was also below Xcel Energy's return on a consolidated basis:

Average ROE	**2014**	**2013**
NSP-M	8.70%	9.24%
NSP-W	10.77%	10.44%
PSCO	9.47%	9.62%
SPS	8.72%	8.84%
Total Regulated	9.14%	9.42%
Xcel Energy	10.29%	10.40%

AXM Exh. 5 – Carver Direct at 33.

Nonetheless, because in both 2013 and 2014, on a consolidated basis Xcel Energy's achieved the EPS threshold level necessary to trigger incentive payments under the AIP plan, the "affordability trigger" of the AIP plan provides an incentive and opportunity to motivate an individual SPS employee to make a meaningful contribution to achieve the consolidated EPS threshold.

Achievement of the threshold level is the minimum consolidated EPS trigger that must be met for any incentive payout to occur. If the consolidated EPS is below the threshold EPS, no payout occurs regardless of individual employee performance. SPS reduced the amount of AIP expense to the 100% target, not the 50% threshold, from the achieved 120.22% for XES (i.e., Xcel Energy Services Inc.) and 122.75% for SPS. *AXM Exh. 5 – Carver Direct at 33 – 34.*

When Xcel restructured its AIP plan in 2012, the entire incentive plan mechanism was shifted from a mix of financial and non-financial metrics to a financial based plan that as a pre-condition must achieve an "affordability trigger" before any otherwise qualifying employees will receive any payout. The performance of the individual employee only determines that employee's level of participation in any payout. An incentive payout and the overall magnitude of such a payout are determined by consolidated EPS. Consequently, the AIP expense amount that SPS did not remove from its O&M expenses represents the financial component. The Company provided detailed calculations supporting the portion of the AIP adjustment removed by SPS's witness, Ms. Blair. Those same calculations, prepared on a total SPS basis, serve as the foundation for Mr. Carver's adjustment at AXM Adjustment C-11. *AXM Exh. 5 – Carver Direct at 34.*

AXM urges the ALJ and the Commission to disallow recovery in rates of all incentive compensation based on corporate financial metrics. Incentive plans often focus on corporate-wide financial results. Those employees directly or indirectly supporting the provision of regulated electric service in Texas may have limited ability or opportunity to materially affect the consolidated, or even segment, financial results through their day-to-day work activities. For example, in 2013 and 2014, SPS contributed only $0.23 and $0.26, respectively, of the $1.95 and $2.02 consolidated EPS from Xcel's continuing operations actually achieved in both years. *AXM Exh. 5 – Carver Direct at 34.*

Also, an SPS employee's efforts to enhance (i.e., increase) consolidated financial results may not be consistent with the interests of SPS's Texas retail customers or reasonable pricing of regulated services. *Id.* SPS's witness Ms. Reed's testimony makes clear that funding of the AIP plan is determined by achieving consolidated financial targets (e.g., the threshold affordability trigger, target and maximum payout range) that, by definition, are not directly linked to customer service, employee safety, cost reductions, individual employee performance, or operational achievements or efficiencies unique to SPS's Texas service territory. *AXM Exh. 5 – Carver Direct at 35.*

Further, to the extent that the inclusion of financial targets in the incentive plan assist the Company in achieving improved financial results, the plans should pay for themselves. Between 2013 and 2014, Xcel's consolidated net income from continuing operations increased by about $73 million and SPS's net income contribution by about $14.5 million – after recognizing actual cost of AIP.[52]

Absent a showing that such costs provide direct, tangible benefits to ratepayers, the Commission should not allow above-the-line ratemaking treatment for all discretionary costs incurred by management. The Commission should only permit recovery of the cost of incentive plan metrics reasonably identifiable with customer service, employee safety, cost reduction, individual employee performance, or operational achievements or efficiencies. The current AIP structure relegates these types of desirable non-financial metrics to a secondary status below consolidated EPS.

[52] *AXM Exh. 5 – Carver at 36. See* SPS response to AXM RFI 17-16(e). Total Xcel continuing operations net income increased by $73,072,000, from $948,234,000 (2013) to $1,021,306,000 (2014) while SPS net income increase by $14,484,000 from $115,368,000 (2013) to $129,852,000 (2014). Also, *see AXM Exh. 5 – Carver at Attachment SCC-6*.

The mere incurrence of a cost by a utility is not sufficient to ensure recoverability from ratepayers. Costs must be actually incurred, reasonable in amount, necessary for utility purposes, and of direct benefit to ratepayers. Utility management has broad discretion as to how it spends its available resources. However, the ultimate question is the extent to which ratepayers should bear the burden of the utility's costs. *AXM Exh. 5 – Carver Direct at 36 – 38.* Mr. Carver's AXM's approach follows the conceptual framework of the "benefit-burden" test. The party who benefits from a particular transaction or activity should bear the related financial burden. SPS's Texas ratepayers should not be responsible for that portion of incentive plan costs related to financial metrics unless SPS's Texas ratepayers benefited from the achievement of the incentive targets (i.e., improvement in consolidated financial results), or the Company employees supporting SPS's Texas operations substantially contribute to or otherwise impact the achievement of those results. *AXM Exh. 5 – Carver Direct at 38.*

Because incentive compensation is "at-risk" to the employee, the amount of such compensation from year-to-year is not fixed, regular, nor even certain to occur – provided the target objectives are not easily attainable. Employees do not receive incentive payments and the Company would not incur any incentive compensation expense if minimum financial targets are not met. In other words, if the EPS affordability trigger is not met, there will be no AIP awards regardless of individual employee performance. *AXM Exh. 5 – Carver Direct at 39.*

Thus, if the Commission allows SPS to recover through rates incentive compensation but SPS does pay out part or any of that compensation to its employees, the amount embedded in rates would directly contribute to increased utility profits if minimum financial targets are not met. Utility rates would have been set to allow recovery of incentive compensation costs that the utility did not incur. From the customer's perspective, incentive compensation, including SPS's AIP

plan, becomes a fixed cost to the extent that incentive costs are included in base rates and the underlying financial targets are set at attainable levels. For these reasons, AXM urges the ALJs and the Commission to disallow recovery of all incentive compensation costs.

B. Pension and Related Benefits [PO Issue 28]

1. Active Health and Welfare Expense

At AXM Adjustment C-18 (*AXM Exh. 5 – Carver Direct at SCC-3*), Mr. Carver addresses SPS's "Active Health and Welfare Expenses." Mr. Carver proposes to reverses the effect of the 2015 forecast amount in excess of SPS's revised test year actual amount. This AXM adjustment reduces SPS's proposed health care expense by $540,820 (total Company). *AXM Exh. 5 – Carver Direct at 44 – 46.*

SPS proposed an adjustment of $540,820 (total Company) to reflect its 2015 health-care forecast. *AXM Exh. 5 – Carver Direct at 44.* Mr. Carver recommends that for this expense, that SPS' revised Test-Year actual amount of $13,814,106 be used to set rates. As Mr. Carver explained, "SPS has been selective in reaching for post-test year changes that introduce unnecessary inconsistencies in the quantification of and that are distortive of overall revenue requirement. The Company's proposed reliance on the 2015 health care forecast in another example of this selective approach – an approach that SPS has not demonstrated as necessary or warranted. *AXM Exh. 5 – Carver Direct at 45.* SPS's adjusted test-year expense is well above historical levels and compares quite favorably to (i.e., is nearly the same as) active health care costs for calendar year 2014. *AXM Exh. 5 – Carver Direct at 45 – 46.*

2. Qualified Pension

In AXM Adjustment C-19 (*AXM Exh. 5 – Carver at SCC*-3) Mr. Carver revises SPS's the test year amounts for pensions and retiree medical expense (i.e., FAS106) to recognize a full year,

not just six months, of the 2014 actuarial study results prepared by Towers Watson. *AXM Exh. 5 – Carver at 46.* SPS's proposed expense for pensions and retiree medical expense was based on the Towers Watson 2013 actuarial report for the first half of the Test Year (*i.e.*, the last six months of 2013), and on the 2014 actuarial report for the second half of the Test Year (*i.e.*, the first six months of 2014). *Id.*

The table below summarizes the amounts of these expenses SPS recorded in the Test Year:

Total Company Pension and Benefits (in $)			
Benefit	**Test Year**	**Known and Measurable Adjustment**	**Adjusted Test Year**
Qualified Pension	16,202,277		16,202,277
FAS 106 Retiree Medical	250,653		250,653

AXM Exh. 5 – Carver at 47.

SPS provided a calculation of the amount of qualified pension cost associated with the 2014 actuarial study in the amount of $14,308,146. Mr. Carver's AXM Adjustment C-19 applies the same methodology as SPS used for calculating both pension and FAS106 costs to quantify an adjustment to recognize the 2014 Towers Watson actuarial study.

Mr. Carver's Adjustment C-19 is appropriate because: (1) the test year in this case ends June 30, 2014. The results of the 2014 Towers Watson actuarial study for both pensions and FAS106 relate to 2014 operations, were known and were measurable for ratemaking purposes; (2) it is appropriate to recognize such known and measurable changes to maintain test-year consistency, along with the many other annualization adjustments presented in this rate case; and (3) while the final 2015 Towers Watson actuarial reports for qualified pension and retiree medical costs includes the mortality table update, SPS was not able to readily determine the isolated effect of that change as there were other study updates (i.e., discount rate, expected return on assets,

demographics and retiree claims experience) that were also included in the 2015 study. *AXM Exh. 5 – Carver at 48.*

Therefore, Mr. Carver recommends the ALJ approve a total SPS reduction of $1,970,919 to pensions and retiree medical expense (i.e., FAS106) as compared to SPS's proposed reduction of $1,761,889. *AXM Exh. 5 – Carver at 48.*

3. Non-Qualified Pension (and other post-retirement benefits)

4. Stock Equivalent Plan

5. FAS 106 Retiree Medical Costs

6. FAS 112 Costs

7. Executive Perquisites

8. Moving and Relocation Expenses

C. Deferred Pension and OPEB Expense Recovery [PO Issue 28]

AXM's Adjustment C-8 (*AXM Exh. 5 – Carver Direct at Attachment SCC-3*) presented by Mr. Carver, proposes a modification to the amortization of two separate items: deferred pension and OPEB costs and the gain on the sale of certain assets by SPS to Lubbock Power & Light ("LP&L"). *AXM Exh. 5 – Carver Direct at 23 - 24.* Ms. Blair on behalf of SPS proposed an amortization of one year for these items adding added $3,583,510 to SPS's cost of service. *AXM Exh. 5 – Carver Direct at 24.* The $3,583,510 is in large measure the product of the settlement agreement the parties reached in Docket No. 42004. In the settlement agreement in Docket No. 42004, the parties agreed that $6.6 million of pension and OPEB costs deferred as of December 31, 2012, should be amortized over a three-year period beginning on June 1, 2014. The settlement agreement further specified that SPS may include any unamortized balance of the pension and OPEB deferral in its next rate case, if the three-year amortization has not been completed.

Assuming the rates in the pending docket become effective on July 1, 2015, the unamortized portion of the $6.6 million deferral would be $4,274,171 on a total-company basis. In addition, SPS has deferred a net negative pension and OPEB credit of $690,662 since June 2014. The $3,583,510 of pension and OPEB costs is the sum of the unamortized amount from the last rate case ($4,274,171) and the net negative deferral ($690,662). *AXM Exh. 5 – Carver Direct at 25.*

Consistent with Mr. Carver's amortization period for unamortized rate case expenses for Docket Nos. 42084 and 42004, and in light of the agreement the parties reached in Docket No. 42004, Mr. Carver proposes a two-year amortization for both the deferred pension and OPEB costs as well as the LP&L gain. *AXM Exh. 5 – Carver Direct at 25.*

D. Depreciation Expense [PO Issue 20]

In AXM's Adjustment C-14 (*AXM Exh. 5 – Carver Direct at Attachment SCC-3 and* at 41 – 43), AXM presents its proposed annualized book depreciation rates based on the depreciation accrual rates recommended by AXM witness Mr. Pous (*AXM Exh. 3 – Pous Direct*). Consistent with AXM's proposal to deny SPS's PTYA, AXM's proposed depreciation accrual rates are based on SPS's depreciable plant balances as of June 30, 2014, the end of the Test Year.

1. Production and Related General Plant

SPS proposes a marked change in the net salvage value ("NSV") for production plant. The existing NSV for the Company's production facilities is a positive 5%. This positive 5% net salvage level has been adopted in each of the Company's last four rate proceedings. The Company proposes to change from a positive 5% net salvage (+5%) to a negative 5% net salvage (-5%). The difference between a +5 NSV and a -5% NSV is approximately $9.3 million in annual depreciation expense. AXM urges the ALJs and the Commission to reject SPS's proposal. Fatal to SPS's proposal, presented by Mr. Dane Watson, is that the change from +5% to -5% NSV, is not based on

any study but instead is premised on NSV factors the Commission has approved for other utilities in other rate cases in prior proceedings, none of which Mr. Watson, or any other witness, has shown have any relation to SPS's cost characteristics. *See SPS Exh. 13 – Watson Direct at 19.* Neither Mr. Watson's proposal nor SPS's request is based on any SPS-specific analysis. *AXM Exh. 3 – Pous Direct at 8*.

Oddly, SPS retained TLG Services ("TLG") to estimate the cost to dismantle its various generating facilities but did not rely on that study for to set depreciation rates. TLG's dismantlement study can only be characterized as a high-side cost estimate for the worst-case scenario associated with the retirement of generating facilities. Even SPS recognizes that it would be inappropriate to set or even consider setting revenue requirements for the final retirement of generating facilities on the TLG study. For the many reasons Mr. Pous notes in his testimony, AXM urges the ALJs and the Commission to do as SPS and Mr. Watson did and not rely on the TLG study for purposes of determining SPS's depreciation rates. See Mr. Pous' testimony at *AXM Exh. 3 – Pous Direct at 9 – 14.*

The only basis for Mr. Watson's and SPS's change from a +5% NSV to a -5% NSV is what Mr. Watson refers to as long-standing Commission precedent. Cross-examination of Mr. Watson established that he considers settled cases to merit consideration as "precedent." *Tr. Vol. 3 at 675-677.* Among the list of cases Mr. Watson cites as precedent are numerous settled cases. *Id.; see also, SPS Exh. 44 - Watson Rebuttal at 14.*

While the Commission has adopted a -5% net salvage in numerous cases, the most recent ruling on production net salvage established by the Commission is the adoption of a -2.6% net salvage in Docket No. 40443, the recent Southwest Electric Power Company ("SWEPCO") proceeding. *AXM Exh. 3 – Pous Direct at 14 – 15*. Further, as Mr. Pous testified, "SWEPCO's

effective net salvage percentage declines to a -1.4% when placed on a comparable basis to that proposed by the Company." *AXM Exh. 3 – Pous Direct at 15.* If precedent is to be the basis of a utility's cost NSV, then the most recent precedent would suggest at worst a -1.4% and -2.6% NSV, but not a -5% NSV as Mr. Watson proposes. And for SPS, more recent precedent for SPS's NSV is a +5% NSV, the NSV factor approved by the Commission in each of SPS's preceding four rate cases. *AXM Exh. 3 – Pous Direct at 15 – 16.*

AXM urges the ALJs and the Commission to maintain the status quo with regard to SPS's NSV and adopt a +5% NSV as Mr. Pous recommends. Mr. Pous' testimony establishes that, while the Company's presentation assumes that the only alternative at the time of retirement is the dismantlement of a generating facility, the vast majority of generating units that were previously owned and operated by utilities in Texas were not dismantled by the utility but instead were sold resulting in significant levels of positive net salvage, rather than the negative salvage that had been collected from customers historically through rates. *AXM Exh. 3 – Pous Direct at 16 – 17.* AXM's proposal in a reduction of $9.3 million to SPS's annual depreciation revenue requirements based on plant as of June 30, 2014.

2. Transmission and Related General Plant

Mr. Pous addresses his proposed "average service lifes" for various transmission-related accounts in his direct testimony at *AXM Exh. 3 – Pous Direct at 33 – 50.* AXM will not here repeat Mr. Pous' rationale for his proposals but instead respectfully refers the ALJs and the Commission to Mr. Pous' testimony for each of the following accounts and incorporates his rational into AXM's brief, by reference. AXM urges the ALJs and the Commission to adopt Mr. Pous' recommended ASLs for the accounts shown below:

2. Transmission and Related General Plant				
Record Cite	**Account**	**Pous' Proposed ASL**	**Watson's Proposed ASL**	**Rev. Impact on Depreciation Exp.**
AXM Exh. 3 – Pous Direct at 33 – 50	Account 350.2 – Transmission Depreciable Land Rights	100	80	-$225,202
AXM Exh. 3 – Pous Direct at 36 – 41	Account 353 – Transmission Substation Equipment	62	57	-$1,310,915
AXM Exh. 3 – Pous Direct at 41 – 46	Account 355 – Transmission Poles and Fixtures	62	53	-$3,148,089
AXM Exh. 3 – Pous Direct at 46 – 50	Account 356 – Transmission Overhead Conductors and Devices	55	47	-$1,257,852

a. Account 350.2 - Land Rights

b. Account 353 - Transmission Substation Equipment

c. Account 355 - Transmission Poles and Fixtures

d. Account 356 - Transmission Overhead Conductors and Devices

3. Distribution and Related General Plant

Mr. Pous addresses his proposed "average service lifes" for various distribution-plant related accounts in his direct testimony at *AXM Exh. 3 – Pous Direct at 51 – 61*. AXM will not here repeat Mr. Pous' rationale for his proposals but instead respectfully refers the ALJs and the Commission to Mr. Pous' testimony for each of the following accounts and incorporates his rational into AXM's brief, by reference. AXM urges the ALJs and the Commission to adopt Mr. Pous' recommended ASLs for the accounts shown below:

3. Distribution and Related General Plant				
Record Cite	**Account**	**Pous' Proposed ASL**	**Watson's Proposed ASL**	**Rev. Impact on Depreciation Exp.**
AXM Exh. 3 – Pous Direct at 51 – 54	Account 365 – Distribution Overhead Conductors and Devices	50	47	-$555,389
AXM Exh. 3 – Pous Direct at 54 – 59	Account 368 – Distribution Line Transformers	48	45	-$449,371
AXM Exh. 3 – Pous Direct at 59 – 61	Account 369 – Distribution Services	51	47	-$198,850

a. Account 365 - Distribution Overhead Conductors and Devices

b. Account 368 - Distribution Line Transformers

c. Account 369 - Distribution Services

4. General Plant Related to Information Technology and Software

a. Account 303 – Miscellaneous Intangible Plant

See discussion below at "c. Amortization Study for Software.

b. Account 391.004 – Computer Equipment

Mr. Pous addresses his depreciation proposals regarding accounts for "General Plant Related to Information Technology and Software," Account 391.004 – Computer Equipment, in his direct testimony at *AXM Exh. 3 – Pous Direct at 60 – 66*.

AXM will not here repeat Mr. Pous' rationale for his proposals but instead respectfully refers the ALJs and the Commission to Mr. Pous' testimony regarding "Account 391.004 – Computer Equipment," but instead respectfully refers the ALJs to Mr. Pous' testimony on this issue. AXM incorporates by reference Mr. Pous' rationale for his recommended ASL for Account 391.004. His recommendation is shown in the table below:

4. b. General Plant Related to Information Technology and Software				
Record Cite	**Account**	**Pous' Proposed ASL**	**Watson's Proposed ASL**	**Rev. Impact on Depreciation Exp.**
AXM Exh. 3 – Pous Direct at 61 - 67	Account 391.004 – Computer Equipment	6	5	-$253,324

c. Amortization Study For Software

Regarding amortization of investment in Account 303 – Intangible Plant – Software, AXM urges the ALJs and the Commission to adopt Mr. Pous' recommended amortizations for this account for the reasons he explains. See, *AXM Exh. 3 – Pous Direct at 17 – 24.* As Mr. Pous explained, "The Company proposes artificially short amortization periods for its investment in software. At a minimum, it is necessary to increase the proposed five-year amortization period to six years, and to increase the proposed 10-year amortization period proposal for large software projects to 15 years, when and if such software is added to plant in service." *AXM Exh. 3 – Pous Direct at 17 – 18.*

The company's proposed amortization for Account 303 – Intangible Plant – Software, for accounting purposes the Company does not identify when a particular software system is physically retired and no longer provides useful service to customers. In other words, a software system can remain in service long after the Company has fully recovered its investment and continue to provide benefits beyond the date that was initially assumed for the amortization period. This situation, in conjunction with the Company's accounting practices, creates intergenerational inequity and results in unintended incremental return. *AXM Exh. 3 – Pous Direct at 18.*

The Company identified 137 different software systems that have been fully recovered and retired for accounting purposes, yet were still in use during the past eight-years; that number grows throughout the balance of 2014 and continues to increase in 2015. Further, investment in the

number of software systems that were still in use but fully amortized exceeds $52 million and amount grows by an additional $19 million by the end of 2014 if there is no physical retirement of systems in the latter part of 2014. As of June 30, 2014, 33% of the entire investment in software systems has been fully recovered yet is still used and useful in providing service to customers. *AXM Exh. 3 – Pous Direct at 19.* Mr. Pous found that there is a system identified by the Company that was placed in service in January 1997 and assigned a five-year amortization period. Yet that system was removed from service in 2014. Mr. Pous identified numerous examples of software systems that have been fully recovered for many years, but are still in service. *Id.*

The reliance on artificially short amortization periods violates the regulatory principles of intergenerational equity and the matching principle requiring one generation of customers to pay fully for an asset that is then used by future generations of customers that will not pay either amortization expense or a return on the investment, but still receive service from the asset. Secondly, to the extent the base rates being charged to customers reflect an amortization expense for a particular software system and that system continues to provide service after it is fully accrued, then the base-rate revenues recovered for that amortization expense become additional return on investment. *AXM Exh. 3 – Pous Direct at 19 – 20.*

Fatal to SPS's proposed amortization periods for this account is that it has not studies to support its proposal. Through discovery AXM requested that the Company provide "each separate study, analysis, report, etc. relied upon … to support its current five-year and 10-year amortization periods" for its software systems, but SPS provided no studies in response to AXM's request. *AXM Exh. 3 – Pous Direct at 21*.

Therefore, while significant extension in amortization periods is warranted, Mr. Pous recommend: (1) only a nominal one-year increase for the Company's proposed five-year

amortization category; (2) a five-year increase for any new software systems to which the Company would normally "assign" a 10-year amortization period; (3) at a minimum, that the three software systems with an identifiable fully accrued date of June 30, 2014 be removed; and (4) that the Commission order the Company to perform a detailed and well-supported study of amortization periods for software systems to be presented in the next rate case.

The effect of Mr. Pous' recommendations result in reduction of $3,796,076 for plant balances as of June 30, 2014, and a reduction of $2,553,848 for plant balances as of December 31, 2014. *AXM Exh. 3 – Pous Direct at Attachment JP-3.*

5. General Plant Related to Equipment, Facilities, and Property Services

Mr. Pous addresses "mass property" life analyses at *AXM Exh. 3 – Pous Direct at 24 – 33*. As Mr. Pous explains, "The life analysis produces an ASL combined with a dispersion curve, a standardized Iowa Survivor Curve. This information is used to calculate the remaining life of the investment, which is an integral component of the depreciation rate calculation." Based on his analyses, Mr. Pous recommends longer average service lifes ("ASLs") for 11 mass property accounts as compared to the Company's proposals. *AXM Exh. 3 – Pous Direct at 24.*

Mr. Pous performed an independent review of the actuarially or SPR-derived life indications. He then reviewed and analyzed all significant or meaningful information provided by the Company's operation and maintenance personnel. He relied on additional information obtained either through discovery or from performing hundreds of depreciation analyses relating to United States and Canadian based utilities to develop sound, realistic and representative ASL and dispersion patterns that best reflect future expectations for the investment in numerous accounts.

Further, Mr. Pous has substantial experience in dealing with an extensive number of utilities, which provides him with a deep understanding of the electric utility industry Mr. Pous' analyses ensures that the most appropriate life parameters are selected for the plant at issue.

By comparison, Mr. Watson's approach is dependent on his personal judgment – a judgment that finds no basis in demonstrated facts. Mr. Watson presents, at best, generalized statements normally relying on unsubstantiated "judgment," generalized statements from Company personnel that normally do not identify any specific life, and a generalized illustrative overview from an academic text as his narrative basis. Mr. Watson also provides numerous curve-fitting analyses for each account that yield a wide range of results. Mr. Watson then presents a declaratory statement identifying his ultimate proposal. In other words, Mr. Watson normally establishes a range of results that he believes may be appropriate and selects a value within that range without any specific basis supporting his selection other than a claim of judgment. Mr. Watson provides very limited specific evidence that can be reviewed, analyzed, or tested in support of his specific proposals.

Mr. Watson admits, "[j]udgment is a synthesizing process." (Emphasis added). Mr. Watson further admits that "[w]here there are multiple factors, activities, actions, property characteristics, statistical inconsistencies, property mix in accounts or a multitude of other considerations that affect the analysis (potentially in various directions), judgment is used to take all of these considerations and synthesize them into a general direction or understanding of the characteristics of the property." (Emphasis added). *AXM Exh. 3 – Pous Direct at 28 – 29.*

Through the discovery process, AXM attempted to obtain data that supported Mr. Watson's judgment calls. Yes. In spite of a request to obtain only the top two or three factors out of the "multiple factors" that are inputs to his "synthesizing process", or to provide the information

requested "in any manner other" than the generalize statements made in his study or notes, Mr. Watson claims that given "the intrinsic nature of judgment, it is not possible" to respond to such requests. *AXM Exh. 3 – Pous Direct at 28 – 29.* Mr. Watson failed to provide or identify what meaningful or significant steps he undertook to arrive at the proposed average service life and corresponding dispersion curve, other than that set forth in the depreciation study, he proposes. *AXM Exh. 3 – Pous Direct at 29.*

Based on his analyses of SPS's plant assests, Mr. Pous recommends adjustments to 11 "mass-property" accounts. His recommendations, as well as the Company's proposals for each of the accounts where AXM proposes a change are summarized in the table below:

Summary of AXM's Recommended Mass Property Life Adjustments

Account	SPS Existing	SPS Proposed	AXM Recommendation	AXM Adjustment	Impact
350.2	70R4	80R4	100R4	20	-$225,202
353	55R3	57R2.5	62R2	5	-$1,310,915
355	38R4	53R2.5	62R2	9	-$3,148,089
356	49R2	47R2	55S0.5	8	-$1,257,852
365	44R0.5	47R0.5	50R0.5	3	-$555,389
368	45R1.5	45R1	48R0.5	3	-$449,371
369	48R1.5	47R1.5	51R1	4	-$198,850
391	5R2	5SQ	6SQ	1	-$253,324
392.02	12L2.5	10SQ	12SQ	2	-$332,822
392.04	12L2.5	12SQ	14SQ	2	-$397,528
397	23SQ	15SQ	20SQ	5	-$195,199
Total					$8,324,541

The standalone impact of these 11 adjustments is an $8.3 million reduction to depreciation expense based on plant as of June 30, 2014.[53]

[53] In order to minimize the areas of dispute, the functional actual reserve has been reallocated based on the revised theoretical reserve. Therefore, even though only one account in each function has been adjusted, all accounts within each function are impacted.

a. Account 390 – General Plant Structures and Improvements

AXM is not addressing this account in its initial brief but reserves the right to respond to parties' briefs on this issue.

b. Account 392.02 – Transportation Equipment-Light Trucks

c. Account 392.04 – Transportation Equipment-Heavy Trucks

AXM addresses Accounts 392.02 and 392.04 collectively. The Company proposes a 10SQ life-curve combination for Account 392.02 – Light Trucks and 12SQ for Account 392.04 – Heavy Trucks. The existing 12L2.5 life-curve combination applied to all assets in Account 392. The current proposal represents a two-year decrease for Light Trucks and the retention of the existing ASL for Heavy Trucks, but both with a different dispersion pattern. The current proposals also represent a three-year reduction in life compared to Mr. Watson's recommendation in the 2012 Study, which is the last study based on actuarial analyses. *AXM Exh. 3 – Pous Direct at 66.*

Mr. Watson states that he based his recommendation on discussions with SPS personnel. However, Mr. Watson's interview notes are silent regarding estimations for life expectancies from Company personnel in this case. Mr. Watson's interview notes from the last case do say that "12 years is reasonable" for Light Trucks and "14 years matches their [Heavy Trucks] internal analysis and is what funding is based on." Therefore, the Company fails to present any supported basis for its offering in this case. *AXM Exh. 3 – Pous Direct at 66 – 67.*

Mr. Pous' analyses shows that SPS's proposals are unjustified and artificially short. Mr. Pous recommends a 12SQ and a 14SQ life-curve combination for Accounts 392.02 and 392.04, respectively. Mr. Pous bases his recommendation on input from Company personnel as well as a review of actuarial results. Mr. Pous' found that, while Mr. Watson elected to cease performing actuarial analyses for this account in this case, he did perform actuarial analyses for this account in

the prior two rate cases for SPS. Mr. Watson presents 32 curve fits associated with actuarial results in his 2013 Study; 13 of the analyses corresponded to placement bands dating back to 1905. Reliance on such analyses supports an ASL of 13 to 14 years. The actuarial results coupled with the life references in Mr. Watson's interview notes support minimum ASLs of 12 years and 14 years for Accounts 392.02 and 392.04, respectively. *AXM Exh. 3 – Pous Direct at 67.*

Further, Mr. Pous' review of Mr. Watson's 2012 Study identified that he proposed a 14-year ASL for Account 392. Mr. Watson's proposal in that case was based on actuarial analyses. Therefore, the most recent statistical analyses available refute Mr. Watson's ASL proposals in this case. *AXM Exh. 3 – Pous Direct at 67.*

Other considerations for a longer life for trucks are the advancements in transportation manufacturing and problem warning systems. Transportation vehicles are more dependable today than in the past. Indeed, Mr. Watson's workpapers clearly identify between 27% and 30% of the investment exceeding the artificially short amortization periods he proposed. In addition, the artificially low positive net salvage values offered in this case better match vehicles with longer lives than that proposed by Mr. Watson. Therefore, synchronization with the proposed net salvage levels requires recognition of a longer ASL. *AXM Exh. 3 – Pous Direct at 67 – 68.*

Whether based on actuarial results or from the life-expectancy input from Company personnel, longer ASLs than proposed by Mr. Watson are warranted. There is no basis for Mr. Watson's proposal to utilize a 10-year and 12-year ASL for Accounts 392.02 and 392.04, respectively, other than to artificially increase depreciation expense. *AXM Exh. 3 – Pous Direct at 67 – 68.*

Therefore, based on Mr. Pous' evaluation, AXM urges the ALJs to adopt Mr. Pous' recommendations of a 12SQ and a 14SQ life-curve combination for Accounts 392.02 and 392.04,

respectively. The standalone impact of Mr. Pous' recommendation results in a $332,822 and $397,528 reduction in annual depreciation expense in a total Company basis for plant as of June 30, 2014 for Accounts 392.02 and 392.04, respectively. *AXM Exh. 3 – Pous Direct at 68.*

d. Account 397 – Communication Equipment

Mr. Pous addresses Account 397 – Communication Equipment at *AXM Exh. 3 – Pous Direct at 69 – 72.*

The Company proposes a 15SQ life-curve combination. This proposal represents a reduction of eight years from both the existing ASL and from the ASL Mr. Watson recommended in his 2013 Study. *AXM Exh. 3 – Pous Direct at 68.*

SPS's witness Mr. Watson states that he based his recommendation on input from SPS personnel. *AXM Exh. 3 – Pous Direct at 69.* Mr. Pous' analysis establishes that the Company's proposal to reduce ASL by eight years, which represents reduction of 35% in the average service life for this account. is unsubstantiated and excessive. Mr. Pous recommends a 20SQ life-curve combination for Account 397.

Mr. Pous' recommendation is based on input from Company personnel, prior proposals by Mr. Watson for SPS, and consideration of potential mix of investment. In Docket No. 35763 SPS requested to switch many of its general plant assets to a vintage year accounting method. *AXM Exh. 3 – Pous Direct at 69.* Mr. Watson stated the switch would eliminate the need to track individual assets and that "the determination of useful life can be made appropriately with the use of market forces, manufacturer expected life, technological obsolescence, business planning, known causes of retirement, and changes in expected future utilization." *AXM Exh. 3 – Pous*

Direct at 69. That is, future changes in ASL could be made based on meaningful and verifiable support that "appropriately" demonstrated the validity of a proposed change. *Id.*

Another concept or standard established by Mr. Watson applicable to proposed changes in ASL for SPS was that a large or "dramatic" change (i.e., a PUC staff proposed 33% increase in ASL) is not warranted when uncertain or changing life characteristics of an account exists. *AXM Exh. 3 – Pous Direct at 69.*

Therefore, applying the standards Mr. Watson expressed in his prior testimony regarding SPS, to this case, Mr. Watson's passing reference to "input from SPS subject matter experts" fails to establish any appropriate basis for his proposal for a "dramatic" 35% ((23-15)/23) decrease. Oddly, based on the identical (verbatim) interview notes from SPS subject matter experts Mr. Watson relied upon to propose a 23-year life in SPS's last case, now uses those same notes to propose a 15-year life in this case. Such cannot be the case. *AXM Exh. 3 – Pous Direct at 69 – 70.*

Moreover, when Mr. Watson was given another opportunity to provide additional support for his proposed "dramatic" change in ASL, he simply referred back to his 2014 Study and testimony. *AXM Exh. 3 – Pous Direct at 70.* Employing Mr. Watson's own standard, "given the uncertain and changing characteristics of the account," a "dramatic" 35% proposed reduction in life "does not seem warranted." *AXM Exh. 3 – Pous Direct at 70.*

Another consideration is the fact that the level of investment in the account has changed by only $116,440 between this case and SPS's last case, Docket No. 42004. When compared to the account balance of more than $53 million, the mix of short life versus long life could not have changed in a manner that warrants an eight-year reduction in the 23-year life that currently exists and as was proposed by Mr. Watson in the last case. *AXM Exh. 3 – Pous Direct at 70.*

Finally, a review of vintage balances set forth in Mr. Watson's workpapers clearly identifies that the majority of the investment in this account already exceeds the proposed 15-year life.

In summary, while the retention of the existing 23-year ASL is warranted based on available information, Mr. Pous' recommendation for a 20-year ASL is conservative, yet still yields movement to capture some level of change in investment mix that may be occurring.

The standalone impact of Mr. Pous' recommendation results in a $195,199 reduction in annual depreciation expense in a total Company basis for plant as of June 30, 2014.

6. Comments Regarding Net Salvages for Mass Accounts

Earlier, AXM discussed the net salvage value SPS proposed for its production plant. As with its proposal for NSV for production plant, SPS over states the "negativeness" of its NSV for its Mass Plant Accounts. Based on Mr. Pous' analyses of SPS's plant records, Mr. Pous recommends adjustments to several plant accounts with regard to their NSV factors. His discussion regarding NSVs for SPS's mass property accounts is found at *AXM Exh. 3 – Pous Direct at 71 – 84*. The accounts for which Mr. Pous proposes different NSV factors, along with Mr. Pous' proposed NSV factors, are shown in the table below.

Summary of AXM's Recommended Mass Property Net Salvage Adjustments

Account	SPS Proposed	AXM Recommended	AXM Adjustment	Impact
353	(20%)	(10%)	10	$1,338,097
355	(60%)	(35%)	25	$3,279,553
390	(10%)	15%	25	$394,455
392.02	7%	15%	8	
392.04	6%	15%	9	639,845[54]
Total				$5,651,950

[54] Reflects combined impact of both subaccounts 392.02 and 392.04.

The combined impact of these various adjustments is a $5.7 million reduction in annual depreciation expense based on plant as of June 30, 2014. *AXM Exh. 3 – Pous Direct at 74*.

As with Mr. Watson's testimony regarding NSV for production plant and average service lifes, Mr. Watson again fails to provide supporting documentation for his "judgment" calls. *AXM Exh. 3 – Pous Direct at 71*. In many instances, Mr. Watson simply selects an alternative value without any identifiable support or justification, other than an occasional reference to the concept of gradualism or movement towards the values indicated in his historical averaging process. *Id.*

While depreciation analysts do review and often rely upon historical averages to obtain information, the information must be tested for reasonableness and credibility. Indeed, while Mr. Watson apparently performed some unidentified test of reasonableness, his modifications to the historical data are unexplained other than indications of "informed judgment." As noted with regard to Mr. Watson's testimony regarding NSV for production plant and ASLs for other plant accounts, Mr. Watson has failed to reduce to writing any specific analysis supporting his professional judgment on an account-by-account basis. Thus, Mr. Watson's testimony relies on unknown and unsubstantiated bases for his various proposals.

Mr. Pous explained the importance of testing the validity of the historical database upon which the depreciation analyst relies:

> The problem with blind reliance on historical data can best be identified by analogy. If a taxicab company had a fleet of vehicles where 70% of the vehicles retired were Yugos and the remaining 30% were Toyotas, a historic average of values could be obtained. However, if the current fleet of taxis is 100% Toyotas, then the historical averages of net salvage values predominantly based on the sale of Yugos (which would imply basically no value due to the poor quality of the vehicles) would not be representative of future net salvage associated with the retirement of a fleet of Toyotas. In other words, Mr. Watson cannot reasonably

> presume that the historical averaging of data is representative of what will transpire in the future without some analysis of the underlying facts. …
>
> A utility can obtain gross salvage due to the sale of various scrap metals. The price obtainable for many scrap metals has increased dramatically during the last decade. For example, the price of scrap copper has increased several hundred percent in the past 10 years, and at one point was closing in on a 1,000% increase. … Therefore, a historical average that does not reflect the current price of copper in an appropriate or meaningful manner would distort the level of net salvage that can be expected in the future. *AXM Exh. 3 – Pous Direct at 72.*

Failure to take into account changes in costs over time can affect the NSV in a variety of ways from the cost of scrap metals, to excessive costs incurred for emergency retirements of plants, to the retire different plant under different circumstances. *AXM Exh. 3 – Pous Direct at 73.* Economies of scale also affect the relationship between historical averages and future expectations, and thus, a utility's NSV factors. *AXM Exh. 3 – Pous Direct at 73.* In relying on historical data with only limited testing of the validity and applicability of that data, Mr. Watson's analysis fails to account fully for these variances that occur over time. As Mr. Pous notes:

> [T]he historical "recorded" negative net salvage for Account 355 – Transmission Poles & Fixtures currently is in the -200% to -700% range. However, Mr. Watson proposes what he will claim is a conservative value of -60%. … a -60% is a small fraction of the actual historical database averages. Therefore, it is obvious that Mr. Watson recognized the illogical results from historical averages in this case, but apparently only because the results were so extreme. It appears Mr. Watson has accepted other values that are not as extreme, but does so without performing adequate or appropriate investigation into the underlying data. Mr. Watson chooses to rely on a claim of informed judgment without providing any underlying documents or information associated with his ultimate proposal, in spite of being specifically asked to provide such support in discovery.

Below AXM discusses the basis for Mr. Pous' recommendations regarding the specific accounts for which he proposes NSV factors different from those proposed by Mr. Watson.

a. Account 353 – Transmission Station Equipment (SPS: -20%, AXM: -10%)

For Account 353 - Transmission Station Equipment, Mr. Watson proposes a -20% net salvage. This is a 400% increase over the existing -5% NSV. *AXM Exh. 3 – Pous Direct at 75.* Mr. Watson relies on the 5-year and 10-year historical averages reflect a -23% and -20% net salvage rate, respectively and notes that most recent years are fairly constant and "more indicative" of future net salvage expectations. *AXM Exh. 3 – Pous Direct at 75.* However, Mr. Watson does not provide any support or justification for his claim that the historical values are "more indicative" of future expectations. *AXM Exh. 3 – Pous Direct at 75.*

Mr. Pous recommends a -10% net salvage for Account 353 - Transmission Station Equipment. Mr. Pous' recommendation is based on his review of historical data, along with a more detailed investigation of the data. Mr. Pous' analysis revealed that that the account contains a wide variety of different types of assets. Normally, transformers comprise a significant portion of the investment in this account. The identifiable level of transformer investment for this Company is approximately 35%, but if the historical database relied upon to draw conclusions is skewed so that the retirement of transformers is not representative of the investment level, a distortion of results is highly probable. *AXM Exh. 3 – Pous Direct at 76.*

The Company cannot identify the type of equipment retired in its historical database at a level other than at the total account level, but it did provide information associated with the retirement of transformers. With the benefit of the additional information that Mr. Watson did not incorporate into his analyses, and absent the impact of an outlier, Mr. Pous identified an approximate -12% net salvage for the years where retirement of transformers is more proportionately represented. Alternatively, in years where the retirement of transformers was underrepresented, the net salvage level is much more negative. *AXM Exh. 3 – Pous Direct at 76*

Another consideration is the price of scrap copper. While the scrap price of copper has increased hundreds of percent since 2003, coupled with the fact that transformers contain large quantities of copper, it appears that the Company's historical recording of gross salvage is not consistent. Indeed, while the Company retired the largest annual number of transformers in 2005, it did not report any gross salvage in either 2005 or 2006. Therefore, the credibility of the Company's historical database is further called into question. The Company's proposal for a negative net salvage four times the current level is an excessive movement given the available facts and circumstances. Moreover, Mr. Watson's proposal does not take into account the concept of gradualism in moving from a -5% NSV to a -20% NSV, as would be expected in association with the quality of the underlying data.

Further, Mr. Watson's assessment is inconsistent with his judgmental-based proposal for an affiliate of SPS in a current proceeding in Colorado. For Colorado Public Service Company ("CPSC"), Mr. Watson was faced with similar information and circumstances. However, there he did not propose as significant an increase in negative net salvage. In particular, the existing net salvage for CPSC and SPS are both -5%. Mr. Watson performed his standard 5- and 10-year averaging analyses for both utilities. However, even though Mr. Watson had identified a -27.25% and a -22.61% for the 5- and 10-year bands for CPSC, his judgment-based analysis yielded a -15% proposal. It is significant to note that in this case for SPS, the same 5- and 10-year averages are a -23% and a -20%, respectively. *AXM Exh. 3 – Pous Direct at 76 – 77.*

Thus, when faced with the same starting point but more negative values for CPSC than for SPS, Mr. Watson proposes a -15% for CPSC, but proposes a -20% for SPS. Also, CPSC has agreed to retain the existing -5% net salvage as part of an overall settlement. *AXM Exh. 3 – Pous Direct at 77.*

For these reasons, AXM urges the ALJs and the Commission to adopt Mr. Pous' recommendation of a -10% NSV for Account 353 - Transmission Station Equipment. Mr. Pous' recommended NSV results in a reduction of $1,323,117 in annual depreciation expense based on plant as of June 30, 2014.

b. Account 355 – Transmission Poles and Fixtures (SPS: -60%, AXM: -35%)

For Account 355 – Transmission Poles and Fixtures, SPS proposes reducing the existing level of negative net salvage so that it is three times lower than its current -20% value, which results in a -60% value. *AXM Exh. 3 – Pous Direct at 78 – 80.* As with Mr. Watson's proposed change to Account 353, neither he nor SPS has justified tripling the existing negative net salvage level. Therefore, AXM urges the ALJs and the Commission to adopt Mr. Pous's recommendation of a -35% net salvage value.

Review of industry information confirms that the Company's actual recorded values are significant outliers, far outside the normal range of what is adopted by regulators. A broader review of the industry also indicates a -20% to -25% is more in line with industry averages. Even more significant is what Mr. Watson proposed for CPSC, SPS's geographically closest affiliate. Mr. Watson proposed only -25% for CPSC in its contemporaneous filing in Colorado. Therefore, a negative net salvage value as high as a -60% appears to be excessive. *AXM Exh. 3 – Pous Direct at 79.*

In addition to Mr. Pous' specific NSV factors, AXM urge the ALJs and the Commission to order the Company to conduct a meaningful investigation as to why its reported negative net salvage values are so much greater than the level reported by the vast majority of the industry. Based on the concept of gradualism, trends in the recorded data, and quality of the Company's

database, nothing more negative than a -35% should be adopted for Account 355 – Transmission Poles and Fixtures.

Mr. Pous' proposed -35% NSV for Account 355 – Transmission Poles and Fixtures results in a reduction of $3,268,401 in annual depreciation expense based on plant as of June 30, 2014.

c. Account 390 – General Plant Structures & Improvements (SPS: -10%, AXM: +15%)

For Account 390 – General Plant Structures & Improvements SPS proposes a -10% net salvage. *AXM Exh. 3 - Pous Direct at 80 – 82.* This represents a significant change from the existing 0% net salvage and the 0% level proposed by Mr. Watson in the 2012 Study. *Id.*

Again, Mr. Watson does not support or justify his proposal versus any other value that is less negative than the historical averages. The Company's proposal inappropriately characterizes the historical net salvage as being representative for the current investment.

Mr. Pous recommends a positive 15% net salvage. Investment in this account can be owned or leased, which makes a difference in the level of net salvage that can be expected. *AXM Exh. 3 - Pous Direct at 81.* If the Company owns a given facility in this account, then when the Company retires the facility it can sell it and properly obtain a positive net salvage. Alternatively, if the Company instead leases a facility, then at the end of the lease the Company cannot sell it to obtain positive net salvage. In fact, under those circumstances, the Company may incur negative levels of net salvage. The majority of the investment in this account is associated with its investment in the nine largest facilities that it owns. *AXM Exh. 3 - Pous Direct at 81.*

Mr. Pous' review of the Company's largest owned facilities establishes that they are in metropolitan areas and thus have greater potential for positive net salvage at the time of retirement (i.e., sale of the facilities). Further, a review of the Company's historical data for the retirement of

what appear to be facilities other than entire office facilities, distribution centers, or service centers yields a -22% net salvage. *AXM Exh. 3 - Pous Direct at 81.* This level of negative net salvage appears to be more indicative of the retirement of leasehold improvements or components of buildings owned by the Company such as roofs and air conditioning systems. Thus, the database that Mr. Watson averaged and relied on for his proposal is not representative of the majority of the assets in the account. *AXM Exh. 3 - Pous Direct at 81.*

Mr. Pous conservatively estimated a positive 19% net salvage value for this account, but reduced it further to a positive 15% in order to establish a conservative estimate to be used for ratemaking purposes in this proceeding. *AXM Exh. 3 - Pous Direct at 81 – 82.*

Mr. Pous' analysis is bolstered by Mr. Watson's 2012 Study, where Mr. Watson proposed a 0% net salvage for this account in his 2012 Study. In Mr. Watson's 2012 Study, he noted -27% and -17% net salvage values for the 5- and 10-year moving averages. *AXM Exh. 3 - Pous Direct at 82.* But in this proceeding without any documented support or explanation, Mr. Watson now proposes a -10% net salvage. Mr. Watson's proposal is simply not credible.

AXM urges the ALJs and the Commission to adopt Mr. Pous' recommendation of a +15% NSV for Account 390 – General Plant Structures & Improvements. Mr. Pous' recommendation results in a reduction of $448,528 in annual depreciation expense based on plant as of June 30, 2014.

d. Account 392.02 and 392.04 – Transportation Equipment – Light and Heavy Trucks (SPS: 7% and 6%, respectively, AXM: 15%)

For Account 392.02 and 392.04 – Transportation Equipment – Light and Heavy Trucks the Company proposes a significant reduction in net salvage to 7% and 6% for light and heavy trucks,

respectively. *AXM Exh. 3 – Pous Direct at 82 – 84.* The Company's proposals represent the elimination of approximately 2/3rds of the positive 20% net salvage currently approved by the Commission. *Id.*

Mr. Watson's primary rationale for his proposal is that the Company "is expected" to reverse course again and "discontinue the like kind exchange program" it implemented in 2006. *AXM Exh. 3 – Pous Direct at 83.* But as with other aspects of Mr. Watson's testimony, his recommendation is the opposite of his statement in the 2013 Study that SPS "will continue this [like kind exchange program] in the future." *AXM Exh. 3 – Pous Direct at 83.*

Neither Mr. Watson's nor the Company's proposal is supported by credible evidence. Therefore, for the reasons explained by Mr. Pous (see *AXM Exh. 3 – Pous Direct at 83 – 84*), AXM urges the ALJs and the Commission to adopt Mr. Pous' recommendation of a positive 15% net salvage for Account 392.02 and 392.04 – Transportation Equipment – Light and Heavy Trucks. The effect of Mr. Pous' recommendation results in a reduction of $639,845 in annual depreciation expense based on plant as of June 30, 2014.

E. Affiliate Charges [PO Issue 29]

1. External Affairs Class

2. General Counsel Class (employee discrimination claims)

3. Charges to New Mexico Work Orders

4. Shared Facilities Charge (carrying costs) [PO Issue 10]

5. Life Events

6. Timekeeping Entry Error

F. Purchased Capacity Costs

AXM recommends rejecting SPS' request for a PTYA to SPS' purchased capacity costs,

which increases SPS' operating expenses by $240,000.[55] AXM is recommending an increase to SPS' cost of service for this specific item in order to remain consistent in its position that the Commission should reject SPS' PTYAs in this proceeding.[56]

1. Borger Energy

2. Calpine I

3. Calpine II

4. GSEC MW Effective June 1, 2014

G. Coal Procurement Expenses

H. SPP and Other Transmission Charges and Revenue [PO Issue 32]

1. Schedule 1-A Charges

AXM recommends rejecting SPS' proposed PTYAs that SPS used when it calculated its Schedule 1-A charges.[57] AXM proposes instead to annualize the Schedule 1-A charges that were in effect at the end of the test year.[58] AXM's adjustment reduces SPS' cost of service by $167,297.[59]

2. Schedule 11 Charges and Revenues

Proper Return on Equity for Schedule 11 Revenue Credits

AXM recommends rejecting SPS' request to artificially lower SPS' Schedule 11 revenue credits by $440,521 through the use of the Commission's return on equity ("ROE") in making the credit calculation.[60] SPS receives revenue credits from other Southwest Power Pool ("SPP")

[55] AXM Exh. 2, Direct Testimony of James Dittmer at 28-29.

[56] *Id*. at 29.

[57] *Id*. at 36.

[58] *Id*.

[59] AXM Exh. 5, Direct Testimony of Steve Carver, Att. SCC-3, Schedule C-13.

[60] AXM Exh. 2, Direct Testimony of James Dittmer at 14-20.

members based on the Federal Energy Regulatory Commission's ("FERC's") approved ROE, which is significantly higher than the Commission's approved ROE.[61] However, SPS is asking the Commission to ignore the revenue credits that SPS *actually* receives, and instead to artificially lower the revenue credits by using the Commission's approved ROE.

The net effect of SPS' proposal is to allow SPS to receive the FERC's approved ROE on its overall net Schedule 11 costs, since SPS' use of the Commission's approved ROE for revenue credits *increases* SPS' net costs (i.e., costs net of revenue credits).[62] In other words, SPS is trying to earn the FERC approved ROE on its net Schedule 11 costs, when this Commission has consistently approved the lower Commission approved ROE. AXM urges the Commission to reject SPS' request.

Schedule 11 PTYA

AXM recommends rejecting SPS' proposed PTYAs that SPS used when it calculated its Schedule 11 revenues and costs.[63] AXM provides an alternate method for calculating the net Schedule 11 costs.[64] After reviewing the intervenors' testimony on this issue, AXM sees merit in rejecting SPS' PTYAs for net Schedule 11 costs altogether as well.

3. Lamar Tie

AXM recommends rejecting SPS' proposed PTYAs that SPS used when it calculated its Lamar Tie capacity charges.[65] AXM proposes instead to annualize the Lamar Tie capacity

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61 *Id*. at 14.

62 *Id*. at 16.

63 *Id*. at 20-26.

64 *Id*. at 20-25.

65 *Id*. at 37.

charges that were in effect at the end of the test year.[66] AXM's adjustment reduces SPS' cost of service by $93,121.[67]

4. Point-to-Point Revenue

AXM recommends rejecting SPS' proposed PTYAs that SPS used when it calculated its SPP point-to-point revenue.[68] AXM proposes instead to annualize the SPP point-to-point revenue that it was receiving at the end of the test year.[69] AXM's adjustment reduces SPS' cost of service by $250,188.[70]

I. O&M Cost Containment

1. Administrative and General Expense

2. Distribution O&M Expense

J. Fleet Fuel Expense

K. Renewable Energy Credits [PO Issues 34, 35]

1. Price Imputed for Texas-Generated Unbundled RECs

2. Sales Revenue Recognized in Base Rates or as a Credit to Eligible Fuel

3. SPS's Proposal to Split Sales Revenue 90% to Customers and 10% to SPS

L. Advertising, Contributions, and Dues [PO Issue 25]

AXM recommends reducing SPS' requested advertising, contributions, and dues expenses to the 0.3 percent limit set in PUC Subst. R. §25.231(b)(1)(E).[71] This adjustment lowers SPS' cost

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66 *Id*.

67 AXM Exh. 5, Direct Testimony of Steve Carver, Att. SCC-3, Schedule C-13.

68 AXM Exh. 2, Direct Testimony of James Dittmer at 37.

69 *Id*.

70 AXM Exh. 5, Direct Testimony of Steve Carver, Att. SCC-3, Schedule C-13.

71 AXM Exh. 2, Direct Testimony of James Dittmer at 38.

of service by $365,955.[72]

M. Amortization Expense for Regulatory Assets (Other than Pension and OPEBs)

N. Rate Case Expenses [PO Issue 19]

In AXM's Adjustment C-7, AXM presents its adjustments to the amortization period related to SPS's proposed rate-case expenses for SPS's current rate case and its unamortized balance of rate case expense associated with SPS's rate cases in Docket Nos. 40824 and 42004. *AXM Exh. 5 – Carver Direct at Attachment SCC-3 at Sched. E, Line 23.* Because the issue of rate case expenses for the current proceeding (Docket No. 43695) will be addressed in a separate proceeding,[73] Mr. Carver has removed those expenses from SPS's proposed revenue requirement. The amount of those expenses is $4,345,400. *AXM Exh. 5 – Carver Direct at 21*.

The second adjustment related to rate case expenses that Mr. Carver recommends is with respect to the amortization period for SPS's unamortized balance of rate case expense associated with Docket Nos. 40824 and 42004. SPS proposed that its unamortized balance of rate case expenses from these dockets totaling $2,521,940 (comprised of $784,724 and $1,737,216 for Docket Nos. 40824 and 42004, respectively), be amortized over a one-year period. *AXM Exh. 5 – Carver Direct at 22*. Mr. Carver recommends an amortization period of two years. *AXM Exh. 5 – Carver Direct at 23.*

SPS now is heard to argue that it should be allowed to recover the remaining balance of unamortized rate case expenses over a 12-month period because SPS "remains in a significant multi-year capital spending cycle, and during that time SPS will place numerous capital projects in

[72] AXM Exh. 5, Direct Testimony of Steve Carver, Att. SCC-3, Schedule C-20.

[73] SOAH Order No. 6, Granting Motion to Sever and Establishing New Docket, severed the review of rate case expenses relating to the current rate case to Docket No. 44498. The recovery of rate case expenses associated with Docket Nos. 40824 and 42004 remain subject to recovery and consideration in Docket No. 43695.

service, which will make it necessary for SPS to continue filing frequent rate cases, approximately 12 months apart." *AXM Exh. 5 – Carver Direct at 22.*

Mr. Carver explained that a two-year amortization period is appropriate for two reasons. First, the parties to the settlement agreement, including SPS, in SPS's last base rate case – Docket No. 42004 – agreed that SPS could recover the cost of processing Docket Nos. 42084 and 42004 over a three-year amortization period. *AXM Exh. 5 – Carver Direct at 22. See also, Docket No. 42004, Final Order at 4 (Finding of Fact 23).* The Commission issued its final order in Docket No. 42004 on December 19, 2014 but the rates agreed to in Docket No. 42004 went into effect on June 1, 2014. *See Docket No. 42004, Final Order at 4 (Finding of Fact 15).* Thus, the parties are about a year into the 3-year amortization period the parties agreed to, to settle Docket No. 42004. Soley based on the settlement agreement, the ALJs should reject SPS's proposed 1-year amortization period.

Second, whether SPS files another rate case within a year is not sufficient reason to amortize rate case expenses over a one-year period. The magnitude of cumulative rate case expense SPS is seeking to recover through rates in this proceeding raises significant concerns of a potential over-collection. If $2.5 million were included in rates and the interval between rate cases was precisely twelve months, the Company would theoretically recover the intended amount in revenues and no remaining amortization would carry-over to the next rate case.

However, there is no certainty that the interval between rate cases will be exactly twelve months. For every month that the twelve-month period is extended, the Company would continue to recover a proportionate share of the approximate $2.5 million through rates without any matching offset to account for the fully recovered amount. This could lead to the material over-recovery of these costs. *AXM Exh. 5 – Carver Direct at 23.*

For these reasons AXM urges the ALJ and the Commission to approve a two-year amortization period. A 2-year amortization period is consistent with the terms of the settlement in Docket No. 42004 and mitigates against the risk of over-collection of rate case expenses.

O. Miscellaneous Service Revenue (Revenue Credits)

P. Pole Attachment Fee Revenue

Q. Interest on Customer Deposits

R. Uncollectible Expense

S. Federal Income Tax [PO Issue 23]

Mr. Brosch presents AXM's adjustments regarding SPS's federal income taxes ("FIT"). In its rate-filing package, SPS calculates its income taxes on a stand-alone basis, reflecting the SPS amounts of permanent and temporary book/tax timing differences and various deductions and credits related to the Company's Texas retail business. *AXM Exh. 1 – Brosch Direct at 14 – 15.*

Mr. Brosch's analysis identified the need to correct SPS' income-tax expense with regard to the issue of "Research and Experimentation Credit." This is discussed in the section with the heading "Research and Experimentation Credit" below.

1. Net Operating Losses

2. Research and Experimentation Credit

Mr. Brosch's review of SPS's FIT calculation revealed that SPS has improperly excluded Test Year federal income tax credits associated with Research and Experimentation ("R&E") costs pursuant to Internal Revenue Code § 41. *AXM Exh. 1 – Brosch Direct at 15 – 16.*

The R&E credit is based upon various qualified research expenditures that are identified by analyzing costs and the project level to determine the amount of the current tax year credit. *AXM Exh. 1 – Brosch Direct at 15.* In its response to AXM 11-16, part (e) the SPS stated, "SPS agrees

that the R&E tax credit should not have been excluded from the cost of service in this case. In its rebuttal cost of service, SPS will restore the R&E tax credit to the calculation of income tax expense. Because the R&E tax credit will be included in the cost of service, it is appropriate for the deferred tax asset associated with the R&E credit to be included as part of rate base." *AXM Exh. 1 – Brosch Direct at 16.*

AXM's adjustment related to the R&E Credit is shown at *AXM Exh. 5 – Carver Direct at SCC-3, Schedule C-16.* It is AXM's understanding that SPS does not contest AXM's adjustment.

3. Interest Synchronization

At AXM Adjustment C-17, Mr. Brosch presents AXM's adjustment related to Interest Synchronization. *AXM Exh. 5 – Carver Direct at Attachment SCC-3, Sched. C-17.* SPS is allowed to deduct on its Federal income tax return the amounts paid for interest expense. In the Company's asserted revenue requirement, tax-deductible interest expense is quantified by multiplying the weighted cost of debt times the SPS-proposed rate base. This approach is referred to as "Interest Synchronization" because it matches the income tax deduction for interest with the amount of interest recovery included in the revenue requirement as the result of a percent rate of return being applied to rate base. *AXM Exh. 1 – Brosch Direct at 16.*

Mr. Brosch's adjustment at Schedule C-17 is needed because of the difference in rate base between SPS's requested rate base and the rate base AXM recommends. AXM urges the ALJs and the Commission to adopt Mr. Brosch's adjustment related to Interest Synchronization.

T. Taxes Other Than Income Tax [PO Issue 21]

1. Property Tax

AXM recommends rejecting SPS' calculation of SPS' property tax expense on three grounds. First, AXM recommends using the actual amount of property taxes that SPS paid instead of SPS' estimated accruals.[74] Second, AXM recommends accounting for property taxes associated with construction work in progress ("CWIP") in the CWIP accounts instead of the accounts for current revenues.[75] Third, AXM recommends denying SPS' PTYA for property taxes, for all the reasons that AXM discusses above in its sections opposing SPS' PTYAs.[76] AXM's adjustments lower SPS' cost of service by $1,355,551.[77]

2. Texas Margins Tax

Mr. Brosch presents AXM's recommendation regarding the Texas Gross Margin tax. The margin tax is payable on a Texas-apportioned share of the SPS gross margin revenues, which includes sales revenues less certain narrowly defined expenses. Additionally, Texas Gross Receipts Tax and Franchise Fees are based upon SPS revenue levels. *AXM Exh. 1 – Brosch Direct at 17.*

Because the Company's asserted revenue requirement includes a calculation of the higher Texas Gross Margin Tax, Texas Gross Receipts Tax and Franchise Fee amounts that would be caused by the proposed revenue increase, it is necessary to revise downward the Company's estimate to remove the SPS-proposed factor up of these taxes to account for the SPS-proposed revenue change. The adjustment at Schedule C-15 removes the Company's factor-up adjustments

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74 AXM Exh. 2, Direct Testimony of James Dittmer at 33-34.

75 *Id*. at 34-36.

76 *Id*. at 33.

77 AXM Exh. 5, Direct Testimony of Steve Carver, Att. SCC-3, Schedule C-12.

for these revenue taxes that were included in the Company's asserted revenue requirement. The corresponding AXM factor-up adjustment is set forth in the revenue "Conversion Factor per AXM" that appears at Schedule A-1. *AXM Exh. 1 – Brosch Direct at 17 and AXM Exh. 5 – Carver Direct at Attachment SCC-3, Schedule A-1.*

3. Payroll Taxes

4. Texas Gross Receipts Tax

5. PUCT Assessment Tax

VI. Baselines [PO Issue 44]

A. Procedure to Establish the Baselines

Subsequent SPS's original filing in this case, in the update SPS submitted in March, 2015, SPS revised its baseline amounts for its transmission cost recovery factor ("TCRF"), distribution cost recovery factor ("DCRF"), purchased power cost recovery factor ("PCRF"), and for its tracker for pension and other post-employment benefits ("OPEBs"). *AXM Exh. 5 – Carver Direct at 78.*

Unlike the approach used in SPS's last rate case (Docket No. 42004), these baseline amounts are no longer calculated within the revenue requirement model sponsored by SPS witness Ms. Blair but instead are developed within the proprietary class cost of service ("CCOS") model developed by Management Applications Consulting, Inc. ("MAC"). *AXM Exh. 5 – Carver Direct at 79.*

No AXM witness is sponsoring or proposing any baseline amounts for TCRF, DCRF, or PCRF. As Mr. Carver explained in his testimony:

The development of the appropriate baseline amounts pursuant to applicable Commission rules is a very complicated process. The quantification of revenue requirement for SPS's Texas

retail operations is also complex and requires reliance on thousands of rows of data and detailed calculations contained in numerous spreadsheet files. The process of extracting and compiling the appropriate data, as well as reviewing and confirming the values for the multiple elements comprising the appropriate baseline amount for each of these tracking mechanisms, is both a complex and time-consuming process.

> This process is complicated when focusing solely on the Company's original or Case Update filing. Further, as is evident from AXM's revenue requirement recommendation in this proceeding and the likely recommendation of other Parties, there are substantive differences between SPS and AXM on the appropriate revenue requirement and class allocations that should result from this proceeding. Many of these differences may affect these baseline amounts. It is unlikely that the cost of service underlying the final resolution of this case will ultimately reflect the precise positions of any party to this proceeding because resolution will be achieved either by negotiated settlement or by a Commission Final Order.

Given the limited opportunity the intervenor parties have had to review the logic and algorithms of the MAC model, AXM's review of that model is on going. Therefore, at this juncture, AXM urges the Commission to direct SPS to prepare a compliance filing containing the final revised TCRF, DCRF and PCRF amounts that reflect the final resolution of revenue requirement, jurisdictional allocations, and class allocations in this proceeding based on the Commission's final order in this proceeding. The parties to this proceeding should then be afforded the opportunity to review and comment on those baseline amounts given the complex nature of compiling this data.

B. TCRF

C. DCRF

D. PCRF

E. Pension & OPEB Expense Tracker

VII. Miscellaneous Preliminary Order Issues [PO Issues 26, 27, 33, 46, 47]

Respectfully submitted,

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ATTORNEYS FOR ALLIANCE OF XCEL MUNICIPALITIES

CERTIFICATE OF SERVICE

I certify that I have served a copy of the **Alliance of Xcel Municipalities' Initial Brief – Revenue Requirement** upon all known parties of record by fax, First Class Mail, and/or hand delivery on this the 24th day of July, 2015.

_____

Alfred R. Herrera

SOAH DOCKET NO. 473-15-1556
PUC DOCKET NO. 43695

APPLICATION OF SOUTHWESTERN PUBLIC SERVICE COMPANY FOR AUTHORITY TO CHANGE RATES	**§ § § §**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

ALLIANCE OF XCEL MUNICIPALITIES'

REPLY BRIEF

COST ALLOCATION/RATE DESIGN

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AUGUST 7, 2015

SOAH DOCKET NO. 473-15-1556
PUC DOCKET NO. 43695

APPLICATION OF SOUTHWESTERN PUBLIC SERVICE COMPANY FOR AUTHORITY TO CHANGE RATES	**§**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

ALLIANCE OF XCEL MUNICIPALITIES' REPLY BRIEF – COST ALLOCATION/RATE DESIGN

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AUTHORITY TO CHANGE RATES	**§**	**ADMINISTRATIVE HEARINGS**

ALLIANCE OF XCEL MUNICIPALITIES' REPLY BRIEF – COST ALLOCATION/RATE DESIGN

I. Summary of Cost Allocation / Rate Design [PO Issues 1, 2, 3]

The Alliance of XCEL Municipalities ("AXM") respectfully provides the following replies to the parties' arguments on cost allocation and rate design issues. AXM's silence on a particular issue does not necessarily mean AXM agrees to another party's position.

II. Present Revenue [PO Issues 31, 38]

A. Weather Normalization [including Revenue Requirement effect]

Southwestern Public Service Company's ("SPS") arguments against using available and reliable data from the test year for the weather normalization lack merit. SPS first argues that including the test year data "may" create a bias[1], but provides no empirical support. If the most recent data is available, why not use it? SPS's selective omission of available data is simply an attempt to skew the weather normalization adjustment in SPS's favor. AXM's witness Mr. Brosch provided uncontroverted evidence that weather in SPS's service territory is trending toward warmer conditions:[2]

[1] SPS's Initial Brief at 10.

[2] AXM Exh. 1 – Brosch Direct at 7.

TABLE 1: TEXAS PANHANDLE HEATING DEGREE DAYS ("HDD" - DAYS THAT REQUIRE HEATING) WEATHER TREND:

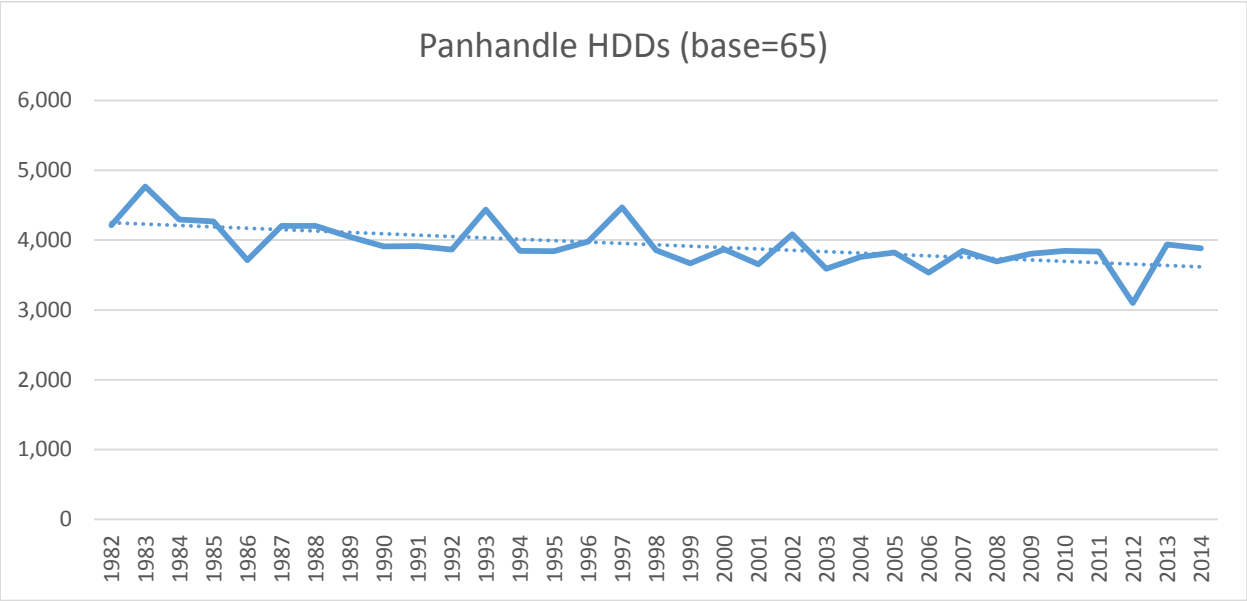
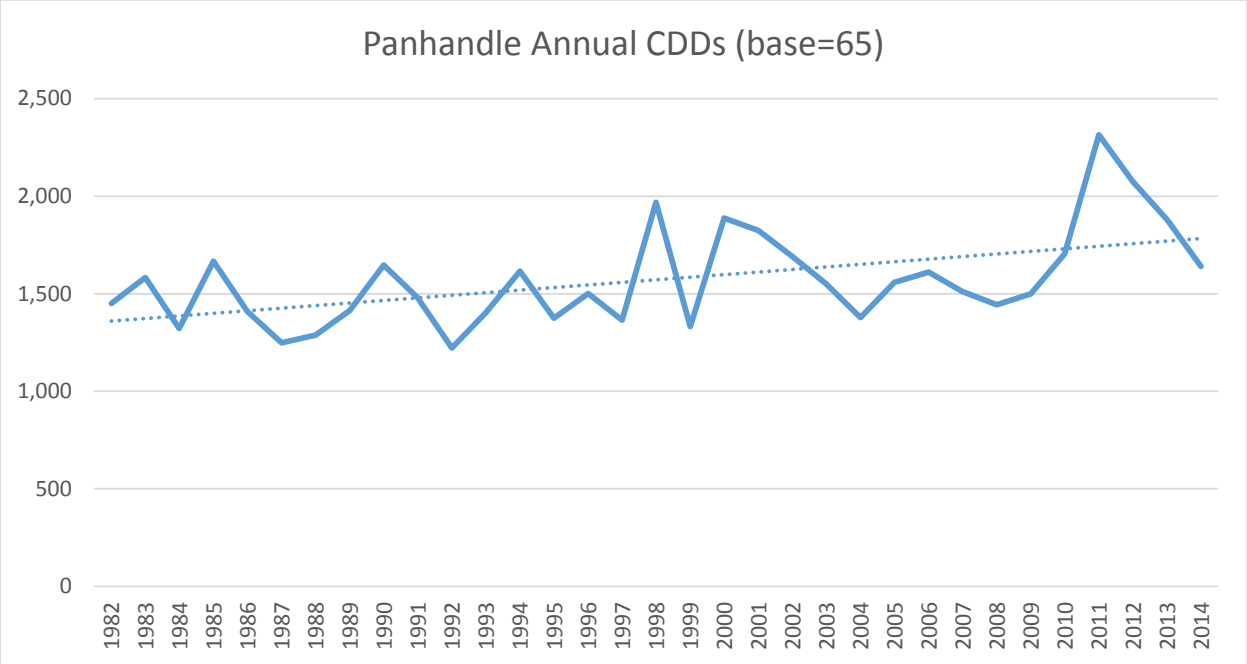


TABLE 2: TEXAS PANHANDLE COOLING DEGREE DAYS ("CDD" - DAYS THAT REQUIRE COOLING) WEATHER TREND:



Mr. Brosch's testimony also quotes SPS's response to AXM RFI 16-2 that admits the following: "a simple trend line fitted to average annual temperature indicates a trend toward warmer

temperatures in the SPS Texas service territory."[3] SPS's witness Ms. Marks similarly conceded in cross-examination that the test year data was reliable, stating "the test year weather data, there's nothing unreliable about the test year weather data."[4] The test year data is reliable, probative, and part of an overall trend. AXM respectfully urges the Commission to use it.

SPS next argues that the National Oceanic and Atmospheric Administration ("NOAA") excludes current year data when calculating its thirty year average.[5] This argument is irrelevant for at least two reasons. First, the weather normalization adjustment in this case uses ten years, not thirty years, of data. Thus, the NOAA approach for a thirty year average has no bearing on the ten year period for this case, particularly since a single year of data will have little impact on a thirty year average but a significant impact on a ten year average. Second, the NOAA does not prepare its thirty year average for electric rate cases or anything associated with the electric industry.[6]

SPS also argues that a prior AXM witness, Mr. John Hutts, used thirty years of weather data, without the test year data, more than six years ago in Docket No. 35763.[7] SPS's argument is irrelevant on its face given the long time frame since that docket. SPS's argument is also irrelevant since the Commission ordered the use of ten years of data in Docket No. 40443. AXM's use of thirty years of data in a long past docket has no significance given the Commission's recent decision in Docket No. 40443. Moreover, SPS was contesting doing any weather adjustment at all in Docket No. 35763, so the use of test year data was not at issue.[8]

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3 *Id*., Attachment MLB-4.

4 Tr. at 1834.

5 SPS's Initial Brief at 10.

6 *See* Tr. at 1837 ("Q. [AXM counsel Mr. Sifuentes] … But the National Oceanic and Atmospheric Administration does not engage in any analysis concerning electric utility rates; correct? A. [SPS's witness Ms. Marks] No. They produce the weather. They report weather, and they develop normal weather, and they provide that for others to use.")

7 SPS's Initial Brief at 13-14.

8 *See Application of Southwestern Public Service Company for Authority to Change Rates, to Reconcile Fuel and Purchased Power Costs for 2006 and 2007, and to Provide a Credit for Fuel Cost Savings*, Docket No. 35763, Direct Testimony and Exhibits of John W. Hutts at 2 (Oct. 13, 2008) ("My testimony addresses the fact that SPS failed to make adjustments to test-year, base-rate revenue to quantify the impacts of abnormal weather and year-end customers.") (Mr. Hutt's testimony is in the record of this case as Attachment JEM-RD-R2 to SPS's witness Ms. Mark's rebuttal testimony.).

Finally, SPS implies that AXM is being results oriented on this issue.[9] The facts indicate that it is SPS that is being results oriented. SPS asks the Commission to ignore the more recent and reliable test year weather data to determine what is "normal weather," in the face of compelling and uncontroverted evidence that actual weather is trending hotter in West Texas, in order to increase SPS's base rate increase. For all of these reasons, AXM respectfully urges the Commission to use the test year weather data.

B. Annualize Revenue for Transmission-level Customer 8

C. Adjustment to Post Test Year Billing Determinants

SPS addressed this issue in its revenue requirement brief, so AXM replied to SPS's arguments in Section II. A. of AXM's revenue requirement reply brief.

III. Inter-class Cost Allocation [PO Issue 39]

A. Demand Allocation

1. Determination of Load Factor for AED Method

The Texas Industrial Electric Consumers ("TIEC")[10] and Occidental Permian Ltd. ("OPL")[11] seek to change the four coincident peak ("4CP") system load factor method that the Commission recently ordered in Docket No. 40443[12]. Put simply, there is no sound policy reason to make TIEC's and OPL's requested changes. So long as the system load factor is utilized within the AED-4CP methodology, the load factor should be calculated in a manner consistent with the 4CP demand component of the formula. SPS, the Office of Public Utility Counsel ("OPUC"), and AXM have provided persuasive evidence why the Commission should retain its decision in Docket No. 40443.[13] AXM respectfully urges the Commission to use the 4CP system load factor, as it did in Docket No. 40443 and Docket No. 39896. Prior to Docket

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9 SPS's Initial Brief at 15.

10 TIEC's Initial Brief at 22-27.

11 OPL's Initial Brief at 11-14.

12 AXM Exh. 6 - Johnson Direct at 15-16; *see also Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at 46, Findings of Fact No. 283 (March 6, 2014)("*Docket No. 40443 Order on Rehearing*") ("[t]he appropriate load factor for use in the A&E/4CP methodology is the system load factor.").

13 SPS's Initial Brief at 24-32; OPUC's Initial Brief at 6-14; and AXM's Initial Brief at 5-6.

No. 42004, SPS's last rate case before this one, SPS utilized the retail 1 CP load factor to develop the AED-4CP allocation factors in its class cost of service studies. [14] If the retail 1 CP load factor had been used in this case, the load factor would be higher than the 4 CP load factor used in the AED-4CP in this application, and the allocation to TIEC's and OPL's customers would be higher.[15] Therefore, the 4 CP load factor used by SPS in this case is conservative, compared to the retail 1 CP load factor historically relied upon by SPS.

2. 4CP vs. 3 CP [including. weather effects]

For the reasons discussed above in Section III. A. 1., AXM recommends approving SPS's proposal to use the AED-4CP method that the Commission ordered in Docket No. 40443.

B. Radial Lines

AXM recommends approving SPS's proposal for allocating the costs of radial lines for all of the reasons that AXM addressed in its initial brief.[16] AXM has one factual reply to TIEC, who opposes SPS's proposal. TIEC includes a diagram on page 29 of its initial brief and states on page 30 of its initial brief that "[t]he right side line, which serves two customer classes, would be allocated only to those two customer classes." TIEC's statement is incorrect. In the past, SPS used the system AED-4CP factors, not direct allocation, to allocate the costs of multi-class lines such as the right side line.[17] SPS' witness Mr. Luth confirmed this statement in cross-examination.[18] Since this is not a true "direct assignment," SPS' proposal in this case to simply treat these multi-class radial lines the same as other transmission lines is reasonable.

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14 AXM Exh. 6 - Johnson Direct at 16, footnote 9.

15 *Id.* at 16; *also see* Attachment CJ-2.

16 AXM's Initial Brief at 6.

17 AXM Exh. 6A – Johnson Cross-Rebuttal at 10.

18 Tr. at 1009-1010 (Mr. Luth: "That would have been the method of allocating the relative shares of that particular radial line, the one that is in the diagram, has two customer classes on a residential and large general service transmission. So the respective AED 4-CPs for the entire customer class populations would have been used to allocate the cost of that line.")

C. General Plant and Intangible Plant

SPS addressed this issue pertaining to jurisdictional allocation in its revenue requirement brief, so AXM replied to those arguments in Section II. B. of AXM's revenue requirement reply brief.

Furthermore, in its cost allocation and rate design brief, SPS disagrees with AXM's witness Mr. Johnson's position that the labor allocation used by SPS over-assigns costs to the transmission function, asserting that "the mere fact that the distribution function bears more costs than the transmission function does not prove that the allocation wrong."[19] SPS's argument lacks merit. The labor allocator excludes expenses associated with contract labor, outside services, and other payments to third parties; this can understate the allocation across functions, such as transmission, which rely disproportionately on those types of expenditures.[20] Transmission comprises 34 percent of plant but only 11 percent of labor.[21] For the two alternative methods, these percentages reflect how much of general and intangible plant is allocated to a customer class based on the class' responsibility for transmission costs. As a result, transmission customers receive a disproportionately small allocation of general plant and intangible plant. As stated by AXM's witness Mr. Johnson, "[t]he investment cost devoted to production, transmission, or distribution resources is a reasonable representation of the relative magnitude of system resources associated with each function."[22]

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19 SPS's Initial Brief at 40.

20 AXM Exh. 6 - Johnson Direct at 17.

21 *Id.* at 17.

22 *Id.* at 8.

D. Miscellaneous Revenue

1. Miscellaneous Revenue from Service Charges and Returned Check Fees

2. Mutual Aid Revenue

E. Electric Vehicle and Fuel Tax Credit

F. Separating Residential and Residential Space Heating for Purposes of Allocating Distribution Costs

G. Labor Expense Allocator

H. Salary and Wage Expense for Lighting Services

SPS accepted AXM's proposed correction[23], so SPS and AXM are in agreement on this issue.

I Distribution Substations Allocator

The dispute between SPS and AXM on this issue is at its core a factual dispute about the role of distribution substations. SPS bases its factual assertions on Mr. Luth's rebuttal testimony[24], while AXM bases its facts on a discovery response from SPS. As AXM's witness Mr. Johnson testified, SPS stated in discovery that SPS designs substations to carry the power from adjacent substations in the event that an emergency causes lines on that circuit to be de-energized.[25] Thus, substations are appropriately viewed as an extension of SPS' transmission network. Given that, and the other reasons outlined by Mr. Johnson,[26] AXM recommends allocating substation costs using the AED-4CP method that SPS uses for transmission costs.

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23 SPS's Initial Brief at 43-44.

24 *Id*. at 44.

25 SPS Response to AXM Request Nos. 23-20 and 23-21 (attached as part of the workpapers to the Direct Testimony of Clarence Johnson, AXM Ex. 6).

26 AXM Exh. 6 - Johnson Direct at 19-20.

J. Account 368 - Distribution Line Transformers

K. Account 556 - System Control and Dispatching-Generation

L. Accounts 561.1-.3 - Load Dispatch-Transmission

M. Regional Market Expenses (Accounts 575.1, .2, .5, .6, .7, and .8)

N. Account 581 - Load Dispatching-Distribution

O. Account 593 - Distribution Maintenance of Overhead Lines

P. Account 902 - Meter Reading Costs

Q. Account 904 - Uncollectible Accounts

TIEC argues that uncollectible accounts should be allocated directly to customer classes because, TIEC asserts, the residential classes cause the bulk of the uncollectible expenses.[27] AXM's witness Mr. Johnson testified that allocation of uncollectibles on a revenue basis is one of the most consistent allocation policies of the Commission over the past 25 years.[28] For example, the Commission ruled as follows in Docket No. 16705:

> Just as it may seem unfair to have the industrial customers absorb the bad debts of a few individuals, it is just as unfair to have the great majority of dutiful residential ratepayers pay those debts. The passing on of such costs to others is generally factored into the cost of doing business. It is a cost that is better absorbed by the many. Therefore, uncollectible expense should be allocated at both the jurisdictional and class levels on the basis of jurisdictional and class operating revenues.[29]

Similarly, it is impossible for SPS to allocate uncollectible expenses to customer classes, because SPS does not have data for uncollectible expenses available for any customer classes other than the residential classes.[30] The problem in trying to derive allocation factors without data is

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27 TIEC's Initial Brief at 40.

28 AXM Exh. 6A - Johnson Cross-Rebuttal at 6.

29 *Application of Entergy Gulf States, Inc. for Approval of its Transition to Competition Plan and the Tariffs Implementing the Plan, and for the Authority to Reconcile Fuel Costs, to Set Revised Fuel Factors, and to Recover a Surcharge for Under-recovered Fuel Costs*, Docket No. 16705, Second Order on Rehearing at 96, Finding of Fact No. 231 (Oct. 14, 1998).

30 AXM Exh. 6A – Johnson Cross-Rebuttal at 7; *see also* PUC Staff Exh. 1A – Murphy Direct at 37 ("In response to discovery, SPS provided actual bad debt expense information for 'industrial,' 'residential,' and

illustrated by Staff's testimony, which "directly assigns" uncollectible expense to municipalities and schools even though it is very unlikely that either type of governmental entity will default.[31] For all of these reasons and the other reasons outlined by AXM's witness Mr. Johnson, AXM recommends approving SPS' proposal to allocate uncollectible expenses on the basis of class revenues.[32]

R. Major Account Representatives (Account 908 - Customer Assistance Expenses and Account 912 - Demonstrating and Selling Expenses)

S. Outside Services-Legal (Account 923)

SPS addressed the jurisdictional aspects of this issue in its revenue requirement brief, so AXM replied to those arguments in Section II. B. of AXM's revenue requirement reply brief. AXM's reply to the same allocation issue as a jurisdictional matter is equally applicable to the class cost of service study.

In addition to AXM's arguments in its revenue requirement reply brief, AXM has two additional replies to SPS. First, the Company disagrees with AXM's witness Mr. Johnson's testimony that the account 923 outside services-legal account includes outside services associated with general corporate purposes and corporate strategy. SPS claims that outside services includes only over flow legal work normally handled by the utility's legal staff.[33] However, RFP schedule G-6.1 shows that account 923 includes outside services retained by the affiliated parent company for corporate purposes.[34] Second, SPS asserts that it is "immaterial" whether account 923 costs are smoothly spread across functions.[35] The issue is not whether the costs are spread "smoothly." As AXM explains in the discussion of general plant and intangible

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'commercial' customer groupings, which are bundles of classes. It appears that SPS may not currently track bad debt expense by class." [Footnotes omitted.]).

31 AXM Exh. 6A – Johnson Cross-Rebuttal at 8.

32 *Id*. at 5. If the Commission elects to deviate from its long-standing precedent of allocating uncollectible expenses on the basis of class revenues, AXM proposes the compromise approach of excluding public authority and street lighting classes from any allocation, given the minimal likelihood of default by those public entities, and then using a 50% - 50% weighting of SPS's and Staff's proposals. *Id*. at 8-9.

33 SPS's Initial Brief at 54.

34 SPS Rate Filing Package schedule G-6.1; *see,* for example, account 923 items at lines 393-394, lines 389 and 406.

35 SPS's Initial Brief at 55.

plant, a salary and wage allocator omits contract labor and other outside services. Consequently, functions which rely more strongly on those "substitutes" for employee expense will be under-allocated account 923 costs by the salary and wage allocator. An indication of this shortcoming is demonstrated by the fact that transmission function expense is comprised of only 10 percent labor expense, while distribution expense is comprised of 58 percent labor expense.[36] The total O&M allocator corrects this problem.

T. Contributions, Dues, and Donations

U. Account 926 - Employee Pensions and Benefits

V. Historical Energy Efficiency Costs

TIEC argues that "[i]ndustrial customers did not receive assistance with energy efficiency measures prior to 2008." TIEC's argument is factually wrong. Transmission voltage and other industrial customers had access to those energy efficiency programs until March 26, 2008. For example, the Commission's August 23, 2005 amendments to PUC Subst. R. 25.181(e)(3)(D) stated "[t]he incentive for load management programs targeted to transmission or distribution constrained areas shall not exceed: (i) Large Commercial and Industrial projects: 35% …"[37] For this reason and the reasons outlined by AXM's witness Mr. Johnson, AXM recommends approving SPS' proposal to allocate pre-2009 energy efficiency costs to all customer classes, including transmission voltage customers.[38]

W. Municipal Franchise Fees [PO Issues 22 and 40]

1. Collection

There is no dispute between the parties on this issue.

2. Allocation

TIEC argues that AXM's recommendation to allocate municipal franchise fees ("MFFs")

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36 AXM Exh. 6 – Johnson Direct at 11.

37 *Amendments to Energy Efficient Rules and Templates*, Project No. 30331, Order Adopting Amendments to §25.181 and §25.184 As Approved at the August 18, 2005 Open Meeting at 23 (August 23, 2005).

38 AXM Exh. 6A – Johnson Cross-Rebuttal at 10.

based on total revenues is contrary to Commission precedent.[39] TIEC's argument is incorrect. AXM's allocation proposal is consistent with the Commission's decision in Docket No. 16705, where the Commission issued the following findings of fact:

> "224. Current cost of services studies are not based on geographical differences. Classes are not divided based on geography, and industrial sites are not self-sufficient islands. The use of city streets and property enables EGS to have an integrated utility system from which all ratepayers benefit.
>
> 225. EGS' allocation of local gross receipt and franchise taxes to the classes based on total rate schedule revenues is reasonable."[40]

Furthermore, the Commission's decision in Docket No. 40443 is not directly on point. Unlike SWEPCO, the franchise agreements for SPS are based on revenues rather than kWh usage. Finally, TIEC points to the Commission's MFF decisions applicable to SWEPCO and Entergy Texas ("ETI"), which are both non-ERCOT utilities.[41] However, SPS's municipal franchise fee assessment is controlled by a statute applicable only to SPS, PURA Sec. 39.402 (b). In other words, SWEPCO and ETI are subject to a different MFF assessment basis than SPS. As AXM's witness Mr. Johnson states: "Sec. 39.402(b) of PURA instead provides for an MFF assessment in SPS' service area that is essentially the same revenue basis which existed throughout Texas prior to passage of electric competition."[42] For all of these reasons and the other reasons outlined by AXM's witness Mr. Johnson, AXM recommends allocating the franchise fees to customer classes on the basis of a class' total revenues.[43]

IV. Determination of Customer Classes for Allocation and Rate Design Purposes [PO Issue 37]

AXM has no reply to other parties' initial briefs on this issue and respectfully reiterates

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39 TIEC's Initial Brief at 46.

40 *Application of Entergy Gulf States, Inc. for Approval of its Transition to Competition Plan and the Tariffs Implementing the Plan, and for the Authority to Reconcile Fuel Costs, to Set Revised Fuel Factors and to Recover a Surcharge for Under-recovered Fuel Costs*, Docket No. 16705, Second Order on Rehearing at 95-96 (Oct. 14, 1998).

41 TIEC's Initial Brief at 46-47.

42 AXM Exh. 6 – Johnson Direct at 22.

43 *Id.* at 21-22.

the arguments from its initial brief[44].

V. Revenue Distribution

AXM's recommended revenue distribution falls in the middle of the parties' recommendations. Parties that face a high rate increase advocate for gradualism, while parties that face relatively low rate increases argue for movement to cost of service. AXM provides a reasonable compromise approach. Rather than reply to the various parties' positions, AXM respectfully reiterates the arguments from its initial brief.[45]

A. Gradualism Adjustment

B. Proposed Revenue Distribution [PO Issue 41]

C. Classes for Revenue Distribution in Future Cases

VI. Rate Design [PO Issue 36]

A. Residential Service

1. Customer Charge

SPS argues that its proposed residential customer charge will not recover the entire customer-related cost for the residential class.[46] AXM disagrees with SPS' factual assertion. AXM's witness Mr. Johnson's estimate of the residential customer costs directly attributable to the number of residential customers is $3.94 per month.[47] Thus, SPS' existing rate of $7.60 is more than compensatory. Furthermore, the Company's proposed customer charge increase will inhibit energy conservation and, therefore, is contrary to Texas energy efficiency policy.

AXM's proposed residential customer charge also is substantially less than the customer charge proposed by Staff witness Mr. Murphy. The Staff's initial brief states: "SPS's residential customer charge should be increased from $7.00 to $8.75, which represents the midpoint

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44 AXM's Initial Brief at 12.

45 AXM's Initial Brief at 12-14.

46 SPS's Initial Brief at 72.

47 AXM Ex. 6 – Johnson Direct at 29-30; *see also id*., Attachment CJ-6 (outlining Mr. Johnson's calculation of the $3.94 cost).

between the current charge and the residential customer unit cost of $10.56."[48] An initial error in this recommendation is that SPS's current customer is $7.60, which logically means that $8.75 is not a mid-point. Mr. Murphy's method for quantifying a customer charge is also based upon an incorrect assumption. Staff claims that the customer charge increase is due to the lack of demand charges within the residential rate design.[49] According to the Staff brief, raising the customer charge is "one method" to mitigate SPS's inability to recover demand costs through a residential demand charge.[50] The flaw in this argument is that the customer charge is fixed and will not vary with changes in demand. Energy charges are variable and are, therefore, more similar to a demand charge than fixed customer charges. For that reason, another method -- the preferred method -- is to recover the costs at issue through the energy charges in the residential rate design.

For these reasons and the other reasons outlined by AXM's witness Mr. Johnson, AXM recommends reducing SPS' residential customer charges at least proportionately to the reductions in overall residential revenues or, if the Commission increases SPS' overall rates, AXM recommends maintaining the existing $7.60 rate or, at most, increasing the residential service charge by no more than the percentage increase in overall residential revenues.[51]

2. Design of Residential Space Heating Rates

SPS argues that increasing the discount for residential space heating rates in the winter is warranted due to cost of service factors.[52] But SPS does not address the anticompetitive impacts of its proposal. Discounts, particularly increasing discounts, for residential space heating unfairly subsidize electric heaters over natural gas heaters and encourage potentially uneconomic use of electric space heaters, contrary to the policy goal of energy conservation.[53] For this reason and the other reasons outlined by AXM's witness Mr. Johnson, AXM recommends rejecting SPS proposal to increase the winter discount for grandfathered residential space heating

48 PUC Staff's Initial Brief at 22.

49 *Id.* at 18.

50 *Id.*

51 AXM Exh. 6 – Johnson Direct at 28-31.

52 SPS's Initial Brief at 73.

53 AXM Exh. 6 – Johnson Direct at 32-33.

customers.[54]

3. Residential TOU

4. Future of RSH

B. Small General Service

1. Design of SGS

2. SGS TOU

C. Secondary General Service

D. Primary General Service

E. LGS-T

F. Collection of Account 908 - Customer Assistance Expenses and Account 912 - Demonstration and Selling Expenses

G. Rule of 70

1. Rule of 70 in Place of Rule of 80

SPS acknowledges that its proposal to move to a Rule of 70 is really "the first step in a process to eliminate this cap on billing metered demand."[55] In other words, SPS wants to reverse all the hard work the Commission did to protect non-profit, religious, municipal, and school customers, such as local ballparks and churches, from dramatic increases in their bills when SPS and other utilities started applying demand charges to those customers. For all of these reasons and the reasons outlined by AXM's witness Mr. Johnson, AXM recommends rejecting SPS' proposal to replace the Rule of 80 with the Rule of 70.[56]

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54 *Id*.

55 SPS's Initial Brief at 81.

56 AXM Exh. 6 – Johnson Direct at 33-36.

2. Rule of 70 for Secondary General Service

3. Rule of 70 for Large Municipal Service

4. Rule of 70 for Large School Service

H. Amarillo Recycling

I. Substation Leases

VII. Miscellaneous Preliminary Order Issues [PO Issues 42, 43, 45]

VIII. Procedures and Model for Number Runs and Compliance Tariff

Respectfully submitted,

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ATTORNEYS FOR ALLIANCE OF XCEL MUNICIPALITIES

CERTIFICATE OF SERVICE

I certify that I have served a copy of the **Alliance of Xcel Municipalities' Reply Brief – Cost Allocation/Rate Design** upon all known parties of record by fax, First Class Mail, and/or hand delivery on this the 7th day of August, 2015.

_____

Jason Wakefield

SOAH DOCKET NO. 473-15-1556
PUC DOCKET NO. 43695

APPLICATION OF SOUTHWESTERN PUBLIC SERVICE COMPANY FOR AUTHORITY TO CHANGE RATES	**§ § § §**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

ALLIANCE OF XCEL MUNICIPALITIES'

REPLY BRIEF

REVENUE REQUIREMENT

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August 5, 2015

SOAH DOCKET NO. 473-15-1556
PUC DOCKET NO. 43695

APPLICATION OF SOUTHWESTERN PUBLIC SERVICE COMPANY FOR AUTHORITY TO CHANGE RATES	**§**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

ALLIANCE OF XCEL MUNICIPALITIES' REPLY BRIEF – REVENUE REQUIREMENT

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AUTHORITY TO CHANGE RATES	**§**	**ADMINISTRATIVE HEARINGS**

ALLIANCE OF XCEL MUNICIPALITIES' REPLY BRIEF – REVENUE REQUIREMENT

The Alliance of Xcel Municipalities ("AXM") hereby submits its Reply Brief in the above numbered and styled proceeding. AXM notes that for those parts of the outline for this Brief where AXM provides no comment, the lack of comment should not be interpreted as agreement by AXM with other parties' position on those issues. Also, the fact that AXM does not address an issue in its Reply Brief that it may have addressed through the testimony of its witnesses should not be interpreted as a waiver of AXM's position as presented in its testimony.

REVENUE REQUIREMENT PHASE

I. Summary of Revenue Requirement [PO Issues 1, 2, 3]

AXM urges the ALJs and the Commission to adopt AXM's adjustments to SPS's requested increase as set forth in *AXM Exh. 5 – Carver Direct at Attachment SCC-3, at Schedule E.* The evidence in the record simply does not support the notion that SPS is dire financial circumstances or that its financial integrity is somehow threatened. The standard in the Public Utility Regulatory Act ("PURA") for setting a monopoly utility's rates is not to maximize profits for the utility. It is instead to set rates at a level that allows the utility to recover its reasonable and necessary expenses and to provide it an opportunity to earn a fair return.[1] SPS instead wants to maximize profits at the expense of ratepayers.

[1] See generally, PURA Subchapter B. Computation of Rates.

SOUTHWESTERN PUBLIC SERVICE COMPANY
RECONCILIATION OF POSITIONS
TEST YEAR ENDING JUNE 30, 2014
ALL AMOUNTS TEXAS RETAIL

LINE NO.	SCH./ ADJ. NO.	DESCRIPTION	REFERENCE	TEXAS RETAIL REVENUE REQUIREMENT
		(A)	(B)	(C)
1	SCH. A	SPS Asserted Revenue Requirement		$58,852,473
2		Correction to SPS Distribution Accumulated Depreciation Posting		-513,683
3	SCH. B	Return Difference At SPS' Rate Base - Case Update		-10,800,940
4		AXM Jurisdictional Allocations on SPS Case Update		-13,156,753
5		Subtotal Revenue Requirement	Lines 1..4	$34,381,097
6				
7		**AXM RATE BASE ADJUSTMENTS:**		
8	B-1	REVISE JURISDICTIONAL ALLOCATIONS - RATE BASE	Included in line 4.	
9	B-2	POST-TEST YEAR ADJUSTMENT - NET PLANT & ADIT RESERVE		-8,039,607
10	B-3	CASH WORKING CAPITAL ADJUSTMENT		-10,419
11	B-4	PENSION ASSET		-6,725,035
12	B-5	FAS 106 & FAS 112 LIABILITIES		805,624
13	B-6	DEFERRED INCOME TAX CLASSIFICATIONS		-243,057
14		Total Value of AXM Rate Base Adjustments	Lines 8..13	-14,212,494
15				
16		**AXM NET OPERATING INCOME ADJUSTMENTS:**		
17	C-1	REVISE JURISDICTIONAL ALLOCATIONS - OPERATING INCOME	Included in line 4.	
18	C-2	WEATHER NORMALIZATION - UPDATED 10 YEAR NORMAL		-1,670,788
19	C-3	CUSTOMER 8 SALES VOLUME ADJUSTMENT		-524,207
20	C-4	SPP SCHEDULE 11 BPU WHEELING EXPENSE		-1,925,612
21	C-5	SPP SCHEDULE 11 REVENUE CREDITS		5,844,243
22	C-6	POST-TEST YEAR ADJUSTMENT - DEPRECIATION EXPENSE		-2,714,549
23	C-7	RATE CASE EXPENSE		-5,645,394
24	C-8	AMORTIZATION RESCHEDULING ADJUSTMENT		-683,410
25	C-9	ANNUALIZE PURCHASED POWER EXPENSE		121,830
26	C-10	LABOR COST ADJUSTMENT		-1,975,445
27	C-11	INCENTIVE COMPENSATION		-3,161,667
28	C-12	PROPERTY TAX EXPENSE ADJUSTMENT		-4,427,450
29	C-13	REVERSE SPS-PROPOSED POST TEST YEAR PRICE CHANGES		-27,263
30	C-14	DEPRECIATION ANNUALIZATION -- AXM ACCRUAL RATES		-13,308,549
31	C-15	TAXES OTHER FACTOR UP REMOVAL		-2,413,388
32	C-16	RESEARCH AND EXPERIMENTATION (R&E) TAX CREDIIT ADJUSTMENT		-98,392
33	C-17	INTEREST SYNCHRONIZATION ROR is Pretax	Included in line 3.	
34	C-18	2015 ACTIVE HEALTH CARE COSTS		-322,202
35	C-19	2014 PENSION & OPEB COSTS		-1,174,206
36	C-20	ADVERTISING,CONTRIBUTIONS & DUES PER PUCT RULES		-381,937
37		Total Value of AXM Operating Income Adjustments	Lines 17..36	-34,488,386
38				
39				
40		REVENUE REQUIREMENT AS RECONCILED	Lines 5+14+37	($14,319,782)
41		NOL Synchronization		749,665
42	SCH. A	AXM REVENUE REQUIREMENT AS CALCULATED		($13,570,117)

II. Jurisdictional Allocation [PO Issue 39]

A. Adjustment for Golden Spread

As AXM noted in its Initial Brief, if the Commission appropriately denies SPS's post test year adjustment ("PTYA") request, it should also deny SPS's corresponding request to make Golden Spread Electric Cooperative ("GSEC") related adjustments to SPS's twelve coincident peak ("12CP") and energy allocation factors. SPS's PTYA improperly changes one part of the jurisdictional allocation equation – the future GSEC load – without also looking at the future jurisdictional loads for other customers. The Commission rejected this piecemeal approach in Docket No. 39896, reasoning that Entergy Texas' proposed PTYA would "depend on future costs and loads for each of the Entergy operating companies."[2] The Commission should similarly reject SPS's proposed piecemeal approach.

SPS argues that the GSEC ramp down adjustment to the jurisdictional cost of service study meets the requirements for a known and measurable adjustment. The adjustment is, in fact, known. However, SPS ignores the fact that a known and measurable adjustment must comply with the matching principle. The adjustment is not fully measurable unless all of the matching components related to that expense can be measured with reasonable certainty. From the earliest days of regulation the Commission has recognized that for an adjustment to a utility's expenses to meet the known-and-measurable standard, all expenses and revenues related to that adjustment must be matched one to the other. That is, if there an increase in an expense during the period to which that expense relates, the utility must also establish that the revenues during that same period are not already recovering the increased expense.

[2] *Application of Entergy Texas Inc. for Authority to Change Rates*, Docket No. 39896, Order on Rehearing at 20, Finding of Fact No. 89 (November 2, 2012) ("*Docket No. 39896, Order on Rehearing*").

In Docket No. 3871, the Commission explicitly adopted the following language from the Examiner's Report:

> Historic test year is used to approximate the utility's anticipated cost of operation during the period when rates will be in effect. When necessary to reflect changes in conditions since the test year, adjustments can be made to those historical costs for known and measurable costs which are certain to be incurred. *Still there is a matching of expense and revenues.*[3] [emphasis added]

Similarly, in Docket No. 39896, the Commission disallowed Entergy's requested post-test year adjustment for purchase-power expense "because Entergy had failed to prove that the adjustment was known and measurable, and because the request violated the matching principle."[4]

At a grasp at straws SPS claims that Mr. Johnson's standard for applying the known-and-measurable principle to SPS's cost of service are undermined by AXM witness Mr. Carver's testimony.[5] Absent context, SPS's claim is misleading and self-serving. SPS selectively cites Mr. Carver's testimony and ignores his discussion regarding the need for the matching of expenses and revenues and the need for internal consistency in identifying the end date up to which expenses and revenues are considered; Mr. Carver stated:

> Consequently, it is critical that the ratemaking process <u>properly synchronize</u> only those known and measurable changes which occur <u>during the test year or within a reasonable allowable period subsequent thereto</u>, rather than establish utility rates on inappropriate factors or inconsistent post-test year events. In this manner, regulators can best be assured that rates are reasonably based on ongoing, relative cost levels.[6]

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3 Docket No. 3781, *Application of Gulf States Utilities Company for Authority to Change Rates*, 7 P.U.C. Bull. 410 (Sept. 17, 1981); *see* Examiner's Report at 3-4 and Final Order at Ordering Para. No. 8 at 3.

4 *Docket No. 39896, Order on Rehearing* at 7.

5 SPS's Initial Brief at 31 – 32.

6 AXM Exh. 5 – Carver Direct at 7 – 9.

In this case, the Company has quantified only the effect of the post test-year reduction in GSEC sales without quantifying the matching jurisdictional billing determinants for all components of the jurisdictional allocators – Texas, New Mexico, wholesale – for the same post test-year period.

SPS claims in its brief that quantifying all jurisdictional demands and sales for the identical time period is an "unachievable standard,"[7] which is equivalent to an admission that the adjustment to the jurisdictional allocation does not comply with the matching principle. Instead, SPS has made a piecemeal adjustment to the allocation factors.

If the matching principle is an "unachievable standard" as claimed by SPS, this result is due to decisions within the control of SPS. SPS chooses when to file its rate case and selects the test year for the rate application. Although the GSEC load reduction has already occurred, SPS makes no effort to update all components of the jurisdictional allocators for an annual period consistent with the date of that reduction.

As the Third Court of Appeals stated in its review of the regulatory plan approved in Docket No. 8585:

> In this case, as in ordinary rate cases, rates are fixed until the next rate case. *The inquiry into reasonable operating costs is a "snapshot" inquiry based on the test year. It is not intended to account for future cost changes. Adjustment for these changes will be made in future rate cases.* While SW Bell is free to incur any additional costs it chooses, it may not recover any of these additional costs through higher rates absent a proceeding under PURA section 43 and a Commission order. [Emphasis added.][8]

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[7] SPS's Initial Brief at 30.

[8] *Cities of Abilene, et al. v. Public Utility Commission of Texas*, 854 S.W.2d 932, 943 (Tex. App.—Austin 1993, writ granted), aff'd in part, rev'd in part on other grounds, *City of Abilene v. Public Utility Commission*, 909 S.W.2d 493 (Tex. 1995) (Per Curiam).

SPS exercised its prerogative to select a test year that did not include a known change in jurisdictional billing determinants, but then chose to make a piecemeal adjustment to the jurisdictional allocation without recognizing all changes to the jurisdictional loads for the post test-year period. Thus, SPS's proposed adjustment cannot be said to be measurable because SPS failed to account for the change in billing determinants associated with the demand for power in the other jurisdictions in which SPS provides service.

The post test year adjustment for the jurisdictional allocation is different than a known and measurable adjustment for new or higher costs incurred in providing retail service.[9] The jurisdictional known and measurable adjustment is applied to load ratios which are used to divide up the total company costs into Texas, New Mexico, and wholesale shares.[10] The denominator of the 12 CP load ratio is the sum of 12 CP demands for each jurisdiction.[11] The GSEC adjustment, as proposed by SPS, "updates" the GSEC load to reflect the post test-year period, thereby reducing one component of the load-ratio denominator without also updating the other jurisdictional loads in the denominator of the load-ratio fraction. Consistency in matching jurisdictional demands is the most important equitable consideration in development of a jurisdictional allocation.[12] If the jurisdictional ratios are not consistent and matching, the utility may recover more than 100% of total company costs from the sum of rates it charges in its various jurisdictions.

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9 SPS Exh. 54 – Luth Direct at RML-RD-14 (wholesale adjustments) to SPS's Rate Applicationat Schedule B-1.4 (rate base capital additions and attendant impacts).

10 AXM Exh. 6 – Johnson Direct at 7. *See,* SPS Exh. 54 – Luth Direct at RML-RD-14 (wholesale adjustments) and at RML-RD-2.

11 SPS Exh. 54 – Luth Direct at RML-RD-2.

12 AXM Exh. 6 – Johnson Direct at 7.

SPS criticizes AXM witness Johnson's recommendation denying the GSEC adjustment.[13] First, the Company cites Mr. Evans' testimony that Mr. Johnson has only speculated that changes have occurred in other jurisdiction's loads. This is a recurring theme in the SPS's Initial Brief of shifting the burden of proof to intervenors and Staff to "prove" that other post test-year changes have occurred. The Company has the responsibility for meeting all elements of proof for the requested post test year adjustment.[14] But no speculation is required to know that jurisdictional loads are not static.[15] It would be an incredible coincidence if the 12 monthly demands for non-GSEC jurisdictions during the test year, are the same as the annual 12CP calculation ending with the period associated with SPS's post test-year adjustment. Regardless whether SPS wants to characterize the changes as significant or not, the objective of the jurisdictional allocation is accuracy. Without accuracy, the jurisdiction allocation is inequitable. And accuracy requires that the all jurisdictions' billing determinants be presented and calculated on the same, consistent, annual period.

Second, the Company's disagrees with Mr. Johnson's and Staff witness Murphy's position regarding the applicability of the Commission's decision in ETI Docket No. 39896 to disallow post test-year-transmission equalization payments. SPS attempts to distinguish the Docket No. 39896 by noting that the formula used to calculate the transmission equalization payments required "assumptions about a great number of variables."[16] However, SPS's formulae for adjusting its jurisdictional allocators also require assumptions regarding the jurisdictional

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[13] SPS's Initial Brief at 29 – 30.

[14] SPS bears the burden of proof to establish that its proposed rates conform to PURA. PURA § 36.006.

[15] *Id.*

[16] SPS's Initial Brief at 31.

relationships between demands and load factors[17] SPS's methodology assumes that the relationship among non-GSEC demands and load factors remains unchanged in the post test-year period. This unproven assumption flows through numerous allocator calculations, including many indirect allocation factors.

Thus, not only does SPS's proposed adjustment to its jurisdictional allocators as may be related to the ramp down of its sales to GSEC not meet the known-and-measurable standard, SPS has failed in its burden of proof to support its proposed adjustment.

B. General and Intangible Plant

SPS historically allocated intangible and general plant in its jurisdiction study on the basis of total plant in service (PIS-Production-Transmission-Distribution (PIS-PTD)). AXM witness Mr. Johnson recommended continuation of this practice.[18] In a marked departure from its testimony in prior cases, SPS proposes to change the basis for allocation of labor expense by excluding A&G expense (LABXAG). SPS argues that it should not be prevented from "improving" its jurisdictional methods "even when new information comes to light or SPS discovers a better cost allocation method."[19] SPS's argument is at best suspect.

SPS historically has used the PIS-PTD allocation factor for intangible and general plant in all of its previous rate cases.[20] We are now supposed to believe that SPS consistently used this

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[17] 12 CP Demand and Annual Energy are the two external inputs to the jurisdictional study. *See*, SPS Exh. 54 – Luth Direct at RML-RD-2. As shown there, the allocation ratios for energy and demand vary considerably by jurisdiction. Load factor measures the relationship between demand and annual energy use. AXM Exh. 6 – Johnson Direct at 14. GSEC has a lower load factor than the retail jurisdictions, and, therefore, changes will affect the system relationship between demand and energy. AXM Exh. 6 – Johnson Direct at 15 – 16. However, the jurisdictional results are uncertain, because the load factors of other jurisdictions are assumed to be unchanged. AXM Exh. 6 – Johnson Direct at 7.

[18] AXM Exh. 6 – Johnson Direct at 3.

[19] SPS's Initial Brief at 37.

[20] AXM Exh. 6 – Johnson Direct at 8.

method in prior rate cases even though it is contrary to cost causation. However, as explained in Mr. Johnson's testimony, for the accounts in question, the total plant allocation method is widely accepted as consistent with cost causation. SPS never explains what type of "new information" came to light which caused SPS to change its previous method.

Intangible and general plant accounts have always contained the types of costs described in SPS Initial Brief.[21] The implication that SPS suddenly discovered a new cost-allocation methodology is not credible. SPS has always included the LABXAG allocation factor in its jurisdictional studies as a method for allocating labor-related costs, like pension and benefits. The allocation change is not caused by discovering better methods or "new information." The more plausible explanation is that SPS discovered that the allocation change would increase the Texas retail revenue requirement, thereby increasing the Company's net income.

A distinguishing characteristic of the electric-utility industry is its capital-intensive nature. Capital investment fulfills the utility's fundamental goal of generating and delivering electricity. Most of the utility's labor resources are devoted to planning, building, operating, maintaining, and financing plant. For this reason, the plant investment devoted to production, transmission and distribution is a reasonable representation of system resources devoted to each function.[22] As stated by the NARUC Cost Allocation Manual, "general plant supports the other plant functions."[23]

The Company's brief selectively lists several software uses which are included in intangible plant in an attempt to argue that intangible plant is related to employees.[24] However, it

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[21] SPS's Initial Brief at 37 – 38.

[22] AXM Exh. 6 – Johnson Direct at 8.

[23] *Id.*

[24] SPS's Initial Brief at 37.

is not credible to suggest that none of the software or data processing functions support capital investment. And, at a broader level, the utility's employees ultimately carry out the planning, construction, operation, and maintenance of utility plant investment.

SPS also contends that general plant structures are related to the number of employees who work in the structures.[25] This is an argument in favor of directly assigning general plant on the basis of square footage devoted to production, transmission, or distribution functions. However, SPS has not attempted to measure the general office space associated with those functions. The Commission's rate filing package for investor owned transmission-distribution utilities requires, first, the direct assignment of general plant costs based on the square footage use of the structures; and, second, for any general plant costs which cannot be assigned in this manner, the general plant investment must be allocated in proportion to total plant for each function.[26]

The Company's attempts to discount the TDU rate filing package requirement because it addresses functionalization rather than jurisdictional allocation.[27] But, the functionalization requirement serves a very similar purpose for ERCOT utilities. Because ERCOT is self-contained and subject only to the Texas PUC's jurisdiction, jurisdictional allocation is unnecessary. And because transmission costs are pooled among all ERCOT utilities, functionalization of those utilities' costs has the same objective as jurisdictional allocation: providing a consistent and unbiased allocation of indirect general costs in order to prevent the utilities from exporting excessive costs to the ERCOT pool.[28] And the TDU rate-filing-package requirement

[25] *Id.* at 38.

[26] AXM Exh. 6 – Johnson Direct at 9.

[27] SPS's Initial Brief at 39 – 40.

[28] AXM Exh. 6 – Johnson Direct at 9.

demonstrates that the total-plant allocation method provides a reasonable and unbiased methodology for allocating intangible and general plant.

C. Account 923 – Outside Service-Legal

SPS allocates Account 923 (outside services) on the basis of labor, excluding A&G expense. AXM witness Johnson recommends a jurisdictional allocation based on Total O&M expense.

Mr. Johnson pointed out that the labor allocator produces a distorted assignment of this expense across the production, transmission, distribution and customer functions. SPS states that it is "immaterial" whether account 923 outside services are allocated smoothly across functions.[29] However, labor cost constitutes a widely varying proportion of total expense for each function. This is due to the fact that outside contractors and third parties are used in lieu of in-house employees for certain functions. Therefore, a labor allocation, which is based on employee salaries within each function, will allocate too small a share of account 923 costs to functions which rely more heavily on contract labor instead of in-house employees. As a result, and based on the Company's jurisdictional method, an excessive portion of the cost in Account 923 is attributed to distribution and customer functions, and too small a share of the cost is attributed to the transmission function. The end result of the Company's allocation is to over-assign Account 923 to retail customers. Mr. Johnson's recommendation corrects the distorted jurisdictional allocation.

[29] SPS's Initial Brief at 42.

III. Rate Base [PO Issues 6, 7]

A. Reasonableness and Prudence of Capital Additions from July 1, 2012 through June 30, 2014 [PO Issue 9]

B. Post Test Year Adjustment for Capital Additions after June 30, 2014 [PO Issue 16][30]

SPS intimates that Mr. Carver's position is that post-test year adjustments are "forbidden or discouraged."[31] But SPS misreads, misunderstands, or is being misleading in its reading of Mr. Carver's testimony. Instead Mr. Carver testifies that post-test year adjustments should be consistent, balanced, and matched with the overall approach "typically and regularly allowed by the Commission." SPS again over-reaches.

SPS claims that its request for a waiver of the criteria found in 16 TAC § 25.231(c)(2)(F)(i) meets three of the four criteria in the Commission's rule.[32] SPS concedes that each addition included in its PTYA does not comprise at least 10% of rate base. But that is not the only failure in SPS's request. Even if the Commission were inclined to grant SPS a waiver of the Commission's rule, SPS's request for an adjustment to its rate base would nonetheless fail because as AXM and the other parties note, SPS also fails to meet the attendant-impacts criterion.

SPS also cites to Mr. Evans' rebuttal testimony arguing that dozens of projects can be an equivalent investment to a single large qualifying project that can still "threaten a utility's financial integrity."[33] As addressed in AXM's Initial Brief, SPS has failed to demonstrate that its financial condition is dire so as to justify the waiver. What the evidence established is that SPS achieved a

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[30] AXM's Initial Brief at page 23, stated, "Lastly, the ALJs and the Commission should not [confuse the] "prepaid pension assets" with the assets in the external pension fund; the two are distinctly different." In that passage the words "confuse the" were inadvertently excluded. The sentence should read as shown in this footnote with the previously excluded words shown in brackets.

[31] SPS's Initial Brief at 45 at Footnote 163.

[32] *Id.* at 47 – 48.

[33] *Id.* at 48.

return on equity ("ROE") in excess of 9% in 2014. SPS also chooses to ignore that 90.84% of its PTYA (excluding New Mexico distribution) is transmission plant that may produce additional SPP Schedule 11 revenues and that it may also seek recovery of through a TCRF proceeding.[34]

For a monopoly utility that has added over $1.1 billion of new plant on a company-wide basis since July 2012, by any measure, a ROE of 9.00% or higher in today's economy does not represent dire financial circumstances.[35]

C. Depreciation Reserve Balance [PO Issue 8]

D. Prepaid Pension Asset

SPS argues that the "Commission routinely allows prepaid pension assets to be included in rate base, [footnote omitted] and SPS's proposal is consistent with that practice."[36] As AXM noted in its Initial Brief, whether to include or exclude pension assets in SPS's rate base is a question of first impression with regard to SPS. None of the cases to which SPS cites involve SPS. Whether rate-base treatment should or should not be afforded a utility's prepaid pension is a fact driven question based on facts unique to each utility and the answer to the question is likewise unique to each utility.[37] So, simply because the Commission has previously determined that a utility's pension asset should be included in rate base does not in and of itself mean that the same treatment is appropriate for all electric utilities. The decision is driven by the facts in the proceeding, and here, the facts do not support SPS's proposal to include pension assets in its rate base.

Moreover, the Commission's prior decisions to which SPS cites highlight the key question

[34] AXM's Initial Brief at 10.

[35] *Id.*

[36] SPS's Initial Brief at 66.

[37] AXM Exh. 5 – Carver Direct at 51.

Mr. Carver raises in his testimony in this proceeding: Should a utility be allowed to earn a return on and recover that return from ratepayers, for monies it did not actually contribute to its pension fund? The fallacy of the utility's arguments in prior cases is that the pension asset is somehow synonymous with money sitting in the pension trust and churning out a return on those assets; as Mr. Carver's testimony underscores it is not. Absent *negative* pension costs over a period of years, where the pension asset is the excess of positive pension contributions over positive (or zero) pension costs, the Commission's decisions in Docket No. 33309 and Docket No. 40443 can be understood. But that is not the situation with SPS, where large negative pension costs arose between rate cases and drove the pension asset balance upward during a period when there was no tracking mechanism or refunds to flow those credits to ratepayers and during a period where SPS was not and did not make actual contributions of cash equal to the value of the pension asset.

SPS has not established that the fact situations in Docket No. 33309 and Docket No. 40443 parallel SPS's historical detail laid out in Mr. Carver's direct testimony. Interestingly, in Docket No. 33309 and Docket No. 40443, the Commission disallowed a portion of the pension asset allocable to construction work in progress ("CWIP"). SPS has certainly not proposed to comply with that part of the Commission's decisions in those dockets. Whether record evidence even exists to perform that calculation in this proceeding is questionable, which again would mean a burden-of-proof failure on SPS'S part. But here, SPS just wants to cherry pick that the Commission allowed the pension asset in rate base but not account for the CWIP disallowance.

SPS's Initial Brief makes AXM's point: "The existence of negative pension expense can reduce the cumulative amount of recognized pension expense, but it does not change the amount of pension contributions made by SPS to the pension trusts."[38] AXM wholeheartedly agrees.

[38] SPS's Initial Brief at 68.

Negative pension costs (known as "net periodic pension costs" or "NPPC") are the key driver underlying SPS's asserted pension "asset" of $168.6 million (total company) that SPS proposes to include in rate base.[39] Negative pension costs do not change or affect the Company's pension contributions; but SPS's proposal to include its *negative* pension costs as a positive element of its rate base would treat those *negative* pension costs (e.g., a negative $10 million NPPC) as if they were the same as an actual cash contribution to its pension – both would be factored into the pension asset and be included in rate base. That is, even assuming a contribution of zero dollars ($0.00), and booking a negative "contribution" of $10 million, thereby increasing the pension asset by $10 million, and assuming hypothetically a rate of return of 7.50%, SPS would garner a return of $750,000 but it would not have outlaid any cash. Similarly, and assuming NPPC of $0, in a year in which SPS actually made a cash outlay, for example, of $10 million, that too, would increase the pension asset by $10 million.

Only one of these situations requires a disbursement of cash that increases the assets, which may be invested in the pension trust. But the Company's proposal treats these two distinct situations in an identical manner as if *negative NPPC* were cash affecting. Mr. Carver's testimony establishes that the pension asset represents a non-cash asset that SPS recorded in its books but that produces no demonstrable earnings or benefits for ratepayers.[40]

SPS contends that since inception of the pension trusts "it has contributed approximately $170 million (total company) more than the amount that has been recognized in qualified pension cost calculated under FAS 87."[41] While a factually accurate statement, it is misleading in its

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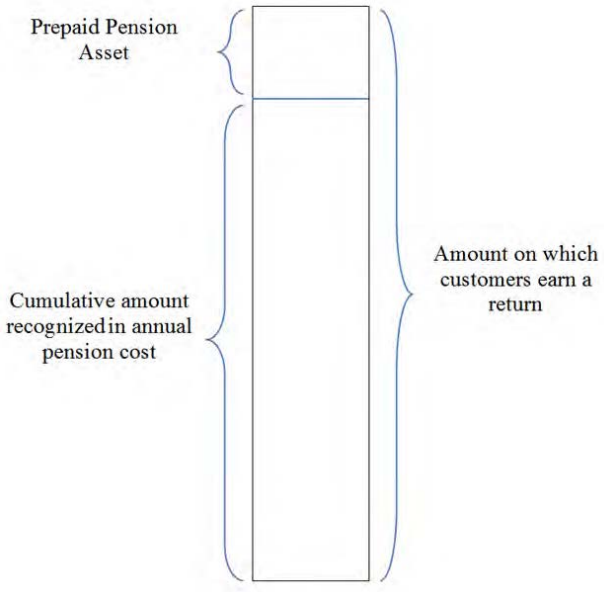
[39] *See* AXM's Initial Brief at 14 – 25 and AXM Exh. 5 – Carver Direct at 49 – 77 (and particularly the charts at 58, 59 and 72).

[40] AXM Exh. 5 – Carver Direct at 53 – 54, 56, 66 – 67, 69 – 70, and 77.

[41] SPS's Initial Brief at 70.

simplicity. The primary reason that cumulative contributions are approximately $170 million more than pension costs, is because SPS recorded *negative* pension costs of $177.1 million during the period 1997-2009 but it is *not* because of $170 million of out-of-pocket cash contributions SPS implies or would want the ALJs and the Commission to infer.[42]

SPS's and AXM's positions regarding the pension asset begins to starkly diverge with respect to the discussion surrounding the chart SPS presented in its Initial Brief and reproduced below:[43]



The pension asset is the difference between pension contributions and pension costs; the primary element of SPS's recorded pension asset is negative NPPC. Presumably SPS included this chart in its brief to demonstrate that SPS's customers "earn a return" on the prepaid pension asset. To the contrary: Negative NPPC does not result in any incremental cash contribution to the pension trust, so there are no additional assets on which a return may be earned. Instead, it is SPS who is seeking to earn a return on the pension asset by including it in rate base. SPS failed to

[42] AXM Exh. 5 – Carver Direct at Attachment SCC-4.

[43] SPS's Initial Brief at 71 – 72.

demonstrate in its direct or rebuttal testimony how the phantom earnings were allegedly earned on the $0 in the pension trust that are tied to the $177.1 million of negative NPPC. And SPS's failure can be readily understood through rudimentary algebra: The product of any number multiplied by zero, is zero; and the product of any positive number multiplied by a negative number produces a negative number. Thus, "0 x $177.1 million = $0" and a rate of return at any percentage multiplied by -$168 million produces a negative number. In either situation, there is no return. Simply put, SPS is trying to earn a return on a phantom investment. SPS refers to AXM's (through Mr. Carver) and OPUC's (through Ms. Ramas) arguments as "red herrings."[44] SPS's criticism is based on the argument that SPS actually made a contribution of $168.6 million to the pension trust in the exact amount of the pension asset. That is factually incorrect and unsupported by the record. And, oddly, a "red herring" actually exists. A red herring "is a dried smoked herring, which is turned red by the smoke;" or pejoratively, "something intended to divert attention from the real problem or matter at hand; a misleading clue."[45] Wikipedia, notes that the origin of the expression is not known, but that conventional wisdom suggests its origin to have arisen from the use of a "kipper" (a strong-smelling smoked fish) to train hounds to follow a scent, or to divert them from the correct route when hunting.[46] But relevant to SPS's argument, the rate base upon which it wants a return – the pension asset – is as real as a unicorn or the "puca" that was Harvey's rabbit – thus not qualifying even as strong smelling fish turned red by smoke with which it was prepared. SPS's arguments do however, meet the second definition of a "red herring" – something intended to divert attention from the real problem or matter at hand; a misleading clue. No amount of smoke and mirrors can turn SPS's phantom "contributions" into an actual cash contribution to the pension

[44] SPS's Initial Brief at 74.

[45] *See*, www.Dictionary.Reference.com.

[46] *See*, https://en.wikipedia.org/wiki/Red_herring.

trust fund. SPS has not made a "prepayment of pension contributions" and customers are not "earning a return on that prepayment" as SPS contends.[47]

SPS contends that Mr. Carver and Ms. Ramas have "conflated contributions and expense" and asserts that the cumulative amount contributed by SPS does not change unless SPS makes a contribution to the trust fund and therefore, "regardless of whether the pension expense is negative or positive, it does not affect the amount of SPS's contributions. Only additional SPS contributions can change the cumulative amount of contributions."[48] Neither Mr. Carver nor Ms. Ramas has confused contributions with expenses or conflated them. And, AXM wholeheartedly agrees: Only additional SPS contributions can change the cumulative amount of contributions. It is SPS that seeks to fuse contributions with negative pension costs to create a phantom element of its rate base upon which it may garner a return.[49] It is SPS, not AXM, that proposes to treat $10 million of *negative* pension costs in the same manner as if an actual cash contribution of $10 million were made.

SPS continues to claim that the Company experiences some alleged detriment when negative NPPC is recorded "because SPS cannot remove the unneeded amounts from the pension trust."[50] If SPS had used those negative pension costs to reduce rates or otherwise returned to ratepayers through some tracking mechanism, AXM could understand SPS's claim that it was out-of-pocket and that it was due some return on those amounts since it was unable to withdraw an equal amount of funds from the pension trust. But in the end, SPS has not demonstrated, nor could

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47 *See* SPS's Initial Brief at 71 – 72.

48 *Id.* at 74-75.

49 *See*, AXM Exh. 5 – Carver Direct at 62 – 63.

50 *See* SPS's Initial Brief at 76.

it, that its customers have experienced reduced rates or some form of refund from the negative NPPC.

AXM Exhibit 20 confirms that during the period 1998-2009, SPS had negative net periodic pension costs that would have reduced O&M expense and increased net operating income and net income, all else remaining equal. In the absence of some flow through of the negative NPPC to customers, SPS and its shareholders retained the positive financial benefit of the reduced expense. So, SPS has no reasonable basis to claim a return on the negative NPPC amounts driving the pension asset; it has not been harmed financially by the inability to withdraw funds from the pension trust assets.[51]

SPS proposes an alternative proposal if the Commission adopts AXM's position regarding rate-base treatment of SPS's negative pension asset, and proposes that the Commission calculate SPS's annual pension costs without allowing a return on the prepaid pension asset and suggests that doing so "would avoid the inequitable result of denying SPS a return on the prepaid pension asset while allowing customers to realize all of the benefits arising from the existence of the asset."[52]

First, there is no evidence in the record to support SPS's alternative proposal. But more importantly, SPS's claimed alternative treatment as being equitable or fair to customers is simply not the case. In AXM Exh. 20, SPS admitted that recording negative NPPC would reduce O&M expense while simultaneously increasing operating income and net income. Absent some mechanism to flow those past negative costs through to the benefit of ratepayers – an action that AXM is not recommending – SPS's alternative proposal would allow it to not only retain 100% of

[51] AXM Exh. 5 – Carver Direct at 62, 66, and 74 – 76; and AXM Exh. 18.

[52] SPS's Initial Brief at 78.

the positive financial benefits it realized from recording the negative NPPC, but would also allow the Company to shelter a portion of the pension-trust earnings from being recognized for determining annual pension costs for purposes of setting its rates. SPS's primary and alternative recommendations would allow it to double-dip at the expense of its customers – either through a return on the pension asset as a pseudo element of rate base, or through the retention of a return on a portion of the pension-trust assets. Either way, the Company's proposals are tantamount to "heads SPS wins and tails ratepayers lose."

AXM Adjustment B-4[53] removes from rate base, SPS's pension asset. This adjustment also removes the related accumulated deferred income tax ("ADIT") reserve from rate base.[54] AXM urges the ALJs and the Commission to adopt Mr. Carver's recommendation to exclude SPS's proposed pension asset from rate base.

E. FAS 106 and FAS 112 Liabilities

For the reasons discussed above regarding pension assets, Mr. Carver recommends that the ALJ and the Commission exclude the pension asset from rate base, net of related accumulated federal income tax ("ADIT") reserve balances.[55]

F. Accumulated Deferred Federal Income Taxes [PO Issue 14]

Mr. Michael Brosch addresses AXM's adjustment related to ADIT. See generally, *AXM Exh. 1 – Brosch Direct at 17 -23*.

SPS alleges that AXM and Staff's witnesses failed to provide any support "… for their assertion that an ADIT balance associated with a deferred tax asset must have a corresponding

[53] AXM Exh. 5 – Carver Direct at Attachment SCC-3.

[54] *Id.* at 49.

[55] *Id.* at 78.

liability included in rate base" and then cite an Oncor case said to contain "an identical argument" where the court found this logic "illusory."[56] Mr. Brosch's testimony regarding the relationship between an ADIT balance and the corresponding liability is premised on sound regulatory logic and the same matching principles that are acknowledged to be appropriate by the SPS's own witness and in the Company's Brief. SPS admits that its "practice is to include the ADIT assets in rate base if the related expense or liability is included in rate base or otherwise is included in the cost of service."[57] Thus, the principle is not disputed, as explained below, only the facts are contested.

1. Bad Debt Reserve Accrual

The relevant fact regarding the Bad Debt Reserve Accrual is that this liability balance is *not* included in rate base, directly or indirectly. If the bad debt reserve had been included, rate base would be "reduced by more than $3 million as of June 30, 2014."[58]

Further, SPS's allegation that it includes the bad debt reserve in rate base because bad debt is a components of cash working capital is inaccurate and misleading. As Mr. Brosch's unrefuted testimony noted:

> SPS has been unable to demonstrate that any provisions of its lead lag study actually accomplish this inclusion. For instance, in AXM 18-4, SPS confirmed that its lead lag study revenue collection lag is quantified by a, "…sampling process [that] selects customer bills that have outstanding balances of varying ages," rather than analysis of Accounts Receivable ("A/R") balances reduced by subtracting the bad debt reserve. Obviously, if revenue lag is determined by sampling studies of when its customers actually pay their bills, such a study is not impacted by customers' bills that remain unpaid and that

[56] SPS's Initial Brief at 82.

[57] *Id*.

[58] AXM Exh. 1 – Brosch Direct at 21.

ultimately become bad debts.[59]

SPS also admitted that, "The revenue lag is not affected by the uncollectible accounts or by the timing of customer non-payments for bad debts because the accounts that remain unpaid after 180 days are not considered in the revenue calculation."[60]

And when given the opportunity to explain whether the Company contends that its cash working capital study measures any *specific* cash disbursements or cash receipts associated with bad debts the Company provided only a general statement that "an increase in the overall age of outstanding bills results in a higher working capital requirement but no specific calculations to show that any specific measurement of bad debt timing is accomplished.[61]

The bottom line is that the Bad Debt Reserve liability is not included in rate base and this fact dictates that the ADIT asset that is directly associated and arises from the Bad Debt Reserve liability must also be excluded from rate base.

2. Vacation Accrual Reserves

With respect to Vacation Accrual balances that are not in Rate Base, the Company has made similar admissions as it did regarding Bad Debt Reserve. The response to AXM 11-15(d) includes the statement, "In SPS's case working capital calculations, there are no lead day calculations performed to explicitly include the effects of delayed payments of accrued vacation amounts. Regular payroll is included in the cash working capital calculation, which includes payments for vacation pay."[62]

The crucial point regarding the Vacation Accrual is again that this liability balance is <u>not</u>

[59] AXM Exh. 1 – Brosch Direct at 22.

[60] *Id.*

[61] AXM Exh. 1 – Brosch Direct at 22 and at Attachment MLB-11, parts (b) and (d).

[62] *See* AXM Exh. 1 – Brosch Direct at Attachment MLB-12, part (d).

included in rate base, directly or indirectly. If the vacation accrual balance had been included, rate base would be "reduced by more than $6 million as of June 30, 2014."[63] SPS's contention that the "vacation-accrual liability is, however, reflected in the cash working capital factor for labor expense," is untrue.[64] SPS admitted in response to AXM 11-15(d) that "there are no lead day calculations performed to explicitly include the effects of delayed payments oaf accrued vacation amounts" in the Company's lead lag study. Only "regular pay" is reflected within these calculations.[65]

3. NOL Carryforward

G. Cash Working Capital [PO Issue 12]

1. Federal Income Tax Expense Lag

SPS's initial brief outlines how it calculates a negative cash working capital ("CWC") for federal income taxes[66], but does not attempt to explain why it should receive that negative balance when SPS is not receiving any actual refunds for those taxes.[67] At its core, SPS wants to treat net operating losses ("NOLs"), which have no cash impact, as though they were cash events for the CWC calculation.[68] This is inconsistent with the purpose of CWC – changes in cash balances – and should be rejected.

SPS's basic argument is that it is appropriate to rigidly apply a "payment lag" to a negative current income tax amount since there are other examples of CWC wherein a payment lag is

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63 *Id.* at 21.

64 SPS's Initial Brief at 85.

65 AXM Exh. 1 – Brosch Direct at 22 – 23; and at Attachment MLB-12.

66 SPS's Initial Brief at 87.

67 AXM Exh. 2 – Dittmer Direct at 31.

68 *Id*.

applied to negative expenses. However, in those instances, line item negative expense amounts are consolidated with much large amounts of positive cash values to arrive at an average payment lag to be applied to "net" expenses in a given category. In the case of negative current income taxes the entire expense line item consists exclusively of negative current income tax expense – for which no payment lag can exist. There is no blending or averaging of a number of positive and negative expense values in the development of CWC associated with current income tax expense - as SPS cites in support of its position.

2. PUCT Assessment Tax

H. Other Prepayments [PO Issue 14]

I. Regulatory Assets [PO Issue 15]

IV. Rate of Return [PO Issues 4, 5]

Summary

SPS's arguments in favor of a return on equity ("ROE") of 10.25 percent lack merit for the following reasons:

* AXM's witness Mr. Parcell's financial analysis[69] and Moody's recent research paper "Lower Authorized Equity Returns Will Not Hurt Near-Term Credit Profiles" [70] persuasively rebut SPS's arguments that SPS needs such an elevated ROE to maintain its financial integrity[71].
* AXM's witness Mr. Parcell persuasively rebuts[72] SPS's arguments that SPS faces special risk factors[73]. For example, the ratings agencies have provided SPS with strong credit ratings, which undercut SPS' argument that it has a special risk profile.

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69 AXM Exh. 4 – Parcell Direct at 30.

70 AXM Exh. 44 – "Lower Authorized Equity Returns Will Not Hurt Near-Term Credit Profiles," Moody's Investor Services (March 10, 2015).

71 SPS's Initial Brief at 91 and 103-111.

72 AXM Exh. 4 – Parcell Direct at 40-42.

73 SPS's Initial Brief at 93-94 and 103-111.

* SPS's assertion that the nationwide average ROE over "the past year" is 9.95 percent[74] is really for 2014 and ignores the fact that the average ROE in fully litigated cases for vertically integrated utilities in 2015 is 9.51 percent[75].

* SPS's argument that AXM's recommended ROE of 9.4 percent is far below the nationwide average ROE[76] is wrong, given that the average ROE in 2015 is 9.51 percent.[77] Indeed, it is SPS' recommended ROE of 10.25 percent that is 74 basis points above the current nationwide average ROE.

* SPS's concession that "recent GDP growth has been lower than its long-term historical average"[78] undercuts SPS' use of a 5.54 percent historical GDP growth rate for SPS' long-term growth rate. SPS also has no response to the fact that the Social Security Administration ("SSA"), Energy Information Administration ("EIA"), and Blue Chip Economic Indicators estimate nominal long-term GDP growth rates of between 4.2 and 4.7 percent.[79]

* SPS's criticisms of AXM's witness Mr. Parcell's methodology[80] are the same criticisms that SWEPCO (which also sponsored Mr. Hevert as their ROE witness) unsuccessfully made against Mr. Parcell in Docket No. 40443[81]. The Commission appropriately did not adopt any of the criticisms in Docket No. 40443[82], given the fact that Mr. Parcell applied calculation methods long accepted by the Commission.

For all of these reasons and the reasons that AXM outlines in its initial brief, AXM recommends an ROE of 9.4 percent.

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74 *Id*. at 94.

75 SPS Exh. 40 – Hevert Rebuttal at RBH-RR-R7, rows 51, 53, and 56 (listing ROEs of 9.5 (Wyoming), 9.5 (Washington), and 9.53 (Missouri) percent, for an average of 9.51 percent).

76 SPS's Initial Brief at 94, 142.

77 SPS Exh. 40 – Hevert Rebuttal at RBH-RR-R7, rows 51, 53, and 56.

78 SPS's Initial Brief at 99.

79 AXM Exh. 4 – Parcell Direct at 35 (SSA and EIA estimate long-term GDP growth rates of 4.42 and 4.2 percent, respectively); TIEC Exh. 4 – Gorman Direct at 25 (Blue Chip Economic Indicators estimate long-term GDP growth rates of between 4.4 and 4.7 percent).

80 SPS's Initial Brief at 139-142.

81 *See Application of Southwestern Power Electric Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Proposal for Decision at 97, 127, 133 (March 6, 2014) ("*Docket No. 40443 PFD*") (describing arguments by SWEPCO that are the same arguments made by SPS in this docket).

82 The Proposal for Decision ("PFD") in Docket No. 40443 did not specifically adopt any of SWEPCO's criticisms of Mr. Parcell, *see Docket No. 40443 PFD* at 137-141, and the Commission adopted the recommendations of the PFD on rate of return, *Application of Southwestern Power Electric Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at 11 (March 6, 2014) ("*Docket No. 40443 Order on Rehearing*").

A. Return on Equity [PO Issue 5]

SPS's arguments in favor of its recommended ROE of 10.25 percent lack merit.

1. Financial Integrity

SPS first argues that it needs such an elevated ROE to maintain its financial integrity.[83] AXM's witness Mr. Parcell provides a financial analysis that persuasively rebuts SPS's argument.[84] Mr. Parcell's Attachment DCP-14 shows the pre-tax coverage that would result if SPS earned AXM's ROE recommendation.[85] AXM's recommended ROE provides SPS with a coverage level consistent with the benchmark range for A rated utilities.[86] In addition, the debt ratio (which reflects SPS' proposed capital structure) is consistent with the benchmark for an A rated utility.[87] In other words, AXM's proposed ROE would still allow SPS to maintain its strong financial integrity through an A rating.

Moreover, Moody's recent research paper "Lower Authorized Equity Returns Will Not Hurt Near-Term Credit Profiles" similarly refutes SPS' argument that SPS needs an elevated ROE to preserve its financial integrity.[88] As Moody's states:

> The credit profiles of US regulated utilities will remain intact over the next few years despite our expectation that regulators will continue to trim the sector's profitability by lowering the authorized returns on equity (ROE). Persistent low interest rates and a comprehensive suite of cost recovery mechanisms ensure a low business risk profile for utilities …[89]

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83 SPS's Initial Brief at 91 and 103-111.

84 AXM Exh. 4 – Parcell Direct at 30.

85 *Id*. at Attachment DCP-14.

86 *Id*. at 30.

87 *Id*.

88 AXM Exh. 44 – "Lower Authorized Equity Returns Will Not Hurt Near-Term Credit Profiles," Moody's Investor Services (March 10, 2015).

89 *Id*. at 1.

Moody's observations apply equally to SPS. SPS's credit profile will remain intact even as regulators lower SPS's ROE to the levels justified by the low interest rates.

2. Risk Factors

SPS argues that it faces special risk factors that warrant an elevated ROE.[90] AXM's witness Mr. Parcell persuasively rebuts those arguments.[91] First, SPS has higher credit ratings, reflecting lower risk, than the typical electric utility.[92] Stated differently, SPS is perceived to have lower risks that the typical electric utility, including SPS's proxy group, in spite of the existence of SPS's alleged "risk factors."[93] Indeed, SPS has access to a host of cost recovery mechanisms in Texas, such as the transmission cost recovery factor ("TCRF"), distribution cost recovery factor ("DCRF"), and fuel factors, that substantially lower SPS's risk. Consequently, there is no justification for providing SPS with a higher ROE relative to that of other similar electric utilities.[94]

Second, while SPS alleges that it faces a higher risk due to environmental compliance costs, utilities have been investing in environmental compliance equipment for decades; there is nothing about the current set of regulations that changes the fundamental risk profile of SPS.[95] Indeed, as Moody's stated in its June 29, 2011 credit opinion for a comparable company, American

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90 SPS's Initial Brief at 93-94 and 103-111.

91 AXM Exh. 4 – Parcell Direct at 40-42.

92 *Id.* at 40.

93 *Id*.

94 *Id*.

95 *Id*.

Electric Power ("AEP"), "in our opinion, the costs of environmental compliance will largely be recoverable in rates in regulated jurisdictions."[96]

Third, while SPS alleges that it faces a higher risk due to its allegedly smaller size, SPS is a subsidiary of the large Xcel holding company. SPS does not raise its equity capital directly from investors, but rather does so through Xcel.[97] Thus, SPS's "small size" risk does not exist at all, given the size of Xcel. Furthermore, AXM's witness Mr. Parcell provides historical data that shows that size and risk are not correlated.[98]

3. Current Nationwide Average ROE

SPS asserts that the nationwide average ROE over "the past year" is 9.95 percent.[99] However, SPS cites to Mr. Hevert's direct testimony, which SPS filed on December 8, 2014, for that proposition.[100] That means "the past year" is really 2014, not 2015. The average ROE in fully litigated cases for vertically integrated utilities in 2015 is actually 9.51 percent.[101]

4. Proximity of the Parties' ROE Recommendations to the Nationwide Average ROE

SPS also argues that AXM's recommended ROE of 9.4 percent is far below the nationwide average ROE.[102] SPS' argument is factually wrong, given that the average ROE in 2015 is 9.51

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96 *Id*.; *citing to* Moody's Credit Opinion for American Electric Power (June 29, 2011), Page 2 of 46 (attached to Mr. Parcell's testimony as Attachment DCP-18).

97 *See* AXM Exh. 4 – Parcell Direct at 41 (explaining how subsidiaries raise capital through the consolidated entity).

98 *Id*..

99 SPS's Initial Brief at 94.

100 *Id*., n.429 (citing to "SPS Exh. 9 at 10:9-10 (Hevert Direct).").

101 SPS Exh. 40 – Hevert Rebuttal at RBH-RR-R7, rows 51, 53, and 56 (listing ROEs of 9.5 (Wyoming), 9.5 (Washington), and 9.53 (Missouri) percent, for an average of 9.51 percent).

102 SPS's Initial Brief at 94 and 142.

percent.[103] Indeed, it is SPS's recommended ROE of 10.25 percent that is 74 basis points above the current nationwide average ROE, compared to AXM's ROE that is only 11 basis points below the average.

5. SPS's Inflated GDP Growth Rate

SPS makes the concession that "recent GDP growth has been lower than its long-term historical average."[104] SPS's concession fundamentally undercuts SPS's use of a 5.54 percent long-term historical average GDP growth rate for SPS' long-term growth rate. SPS also has no response to the fact that the SSA, EIA, and Blue Chip Economic Indicators estimate nominal long-term GDP growth rates of between 4.2 and 4.7 percent well below SPS's proposed GDP growth rate.[105]

6. SPS's Criticisms of AXM's Witness Mr. Parcell

SPS's criticisms of AXM's witness Mr. Parcell's methodology[106] are the same criticisms that SWEPCO (which also sponsored Mr. Hevert as their ROE witness) unsuccessfully made against Mr. Parcell in Docket No. 40443.[107] The Commission did not specifically adopt any of

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[103] SPS Exh. 40 – Hevert Rebuttal at RBH-RR-R7, rows 51, 53, and 56.

[104] SPS's Initial Brief at 99.

[105] AXM Exh. 4 – Parcell Direct at 35 (SSA and EIA estimate long-term GDP growth rates of 4.42 and 4.2 percent, respectively); TIEC Exh. 4 – Gorman Direct at 25 (Blue Chip Economic Indicators estimate long-term GDP growth rates of between 4.4 and 4.7 percent).

[106] SPS's Initial Brief at 139-142.

[107] *See Docket No. 40443 PFD* at 97 ("Mr. Hevert responded, stating that it was his view that analysts' earnings projections are the relevant measure of growth. Mr. Parcell's analysis, on the other hand, includes both historical and projected growth in dividends per share, book value per share, and earnings per share, as well as historical and projected measures of sustainable growth. … SWEPCO further argues that Mr. Parcell's approach is flawed by its disregard for a variety of consensus analyst growth estimates, in favor of singular reliance on Value Line."); *id*. at 127 ("[i]n his [Mr. Hevert's] opinion, Mr. Parcell's [CAPM] analysis ignores the inverse relationship between market risk premium and interest rates."); *id*. at 133 ("Mr. Hevert disagreed with Mr. Parcell's [comparable earnings] assumption that the earned return on common equity is the sole determinant of the market-to-book ratio.").

SWEPCO's criticisms of Mr. Parcell in Docket No. 40443.[108] This is not surprising given the fact that Mr. Parcell applied calculation methods, such as the discounted cash flow ("DCF") model and capital asset pricing model ("CAPM")[109] long accepted by the Commission[110]. SPS's criticisms are also factually wrong, as, for example, Mr. Parcell used First Call in addition to Value Line.[111]

For all of these reasons and the reasons that AXM outlines in its initial brief, AXM recommends an ROE of 9.4 percent.

B. Cost of Debt [PO Issue 5]

AXM is not contesting SPS's proposed cost of debt.[112]

C. Capital Structure [PO Issue 4]

AXM is not contesting SPS's proposed capital structure.[113]

D. Overall Rate of Return [PO Issue 5]

AXM recommends an overall rate of return of 7.82 percent.[114]

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[108] *See Docket No. 40443 PFD* at 137-141 (not specifically adopting any of SWEPCO's criticisms of Mr. Parcell in the "ALJ's Analysis" section); *see also Docket No. 40443 Order on Rehearing* at 11 (adopting the recommendations of the PFD on rate of return).

[109] AXM Exh. 4 – Parcell Direct at 17-24.

[110] *See Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing at 18, Finding of Fact No. 65 (November 2, 2012) and Docket No. 40443 Order on Rehearing at 151 (relying on DCF and CAPM models).

[111] AXM Exh. 4 – Parcell Direct at 20.

[112] *Id*. at 2-3.

[113] *Id*.

[114] *Id*. at 2.

V. Operation & Maintenance Expenses (includes Depreciation and Taxes) [PO Issues 17, 18, 20]

A. Payroll Expense

1. Base Pay

SPS concedes that the bargaining wage increase has not been finalized.[115] Even though a bargaining wage increase might be finalized at some point in time, it remains unknown, not measurable with any accuracy regardless whether the increase is retroactively applied and falls substantially beyond the historic test year in this proceeding.

SPS also states that the non-bargaining increase was granted on March 16, 2015. Nonetheless, the fact remains that the increase occurred substantially beyond the end of the Test Year and should be denied.[116]

2. Incentive Compensation

In AXM's adjustment C-11 (*AXM Exh. 5 – Carver Direct at Attachment SCC*-3) Mr. Carver proposed two adjustments to operations and maintenance ("O&M") expense relating to incentive compensation. Mr. Carver removed from Test-Year expense the cost of the financial-based "affordability trigger" element of SPS's Annual Incentive Plan ("AIP").[117]

SPS contends that its AIP expense is based solely on operational measures and that Mr. Carver (AXM) and Mr. Ramas (OPUC) ignore the design of AIP.[118] SPS's argument ignores several key facts relevant to the design of its AIP. First, AIP is not eligible for funding unless the

[115] SPS's Initial Brief at 161 – 163.

[116] AXM Exh. 5 – Carver Direct at 27 – 28.

[117] *Id* at 28.

[118] SPS's Initial Brief at 164 – 167.

consolidated EPS reaches the consolidated EPS affordability trigger.[119] From 2012 through 2014, year over year, the threshold for the consolidated EPS trigger has increased from $1.75 to $1.85 to $1.90, as compared to actual achieved results of $1.82, $1.92 and $2.03, respectively. So, increasing profitability is a key element of design for the AIP.

Second, the amount of AIP awards available to employees increases if consolidated EPS are higher than the threshold levels – from the 50% level, a larger incentive award pool is available at target 100% and up to 150% of target.[120] So, SPS to state that it "also removed AIP expense that exceeded the target level of AIP for the Test Year,"[121] ignores that AIP is designed to partially award employees for a range of consolidated financial targets.

Third, by design, SPS has structured AIP in a manner that awards employees for achieving specified financial targets.[122] When SPS criticizes Mr. Carver for ignoring "the actual design of AIP and the operational-based measures," that criticism is misses the mark. The operational-based measures simply determine how much of the financial-based AIP pool an individual employee receives based on that employee's unique performance. But those measures do not independently determine the total amount of the AIP pool of funds available to eligible employees.

Fourth, SPS fails to mention that in 2013 and 2014 SPS made a relatively modest contribution to consolidated EPS and that the Company's Texas jurisdiction is a portion of the total financial contribution of SPS.[123] As much as SPS would like to distance its AIP awards from being a financial-based program, the facts of plan design say otherwise.

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[119] The affordability triggers for 2012 through 2014 are summarized at AXM Exh. 5 – Carver Direct at 31.

[120] AXM Exh. 5 – Carver Direct at 31 – 32.

[121] SPS's Initial Brief at 161.

[122] AXM Exh. 5 – Carver Direct at 31 – 32.

[123] *Id.* at 32 – 33.

Finally, from 2013 through 2014, Xcel's consolidated net income from continuing operations increased by about $73 million and SPS's net income contribution by about $14.5 million – after recognizing the actual cost of AIP.[124] So, funding of the Company's discretionary incentive plan through increased levels of net income, cash flow, or other related financial resources – as opposed to forcing ratepayers to fund the incentive plan – is reasonable. Fundamentally, the AIP is a financially-based incentive plan intended to benefit shareholders and thus, shareholders should fund the plan.

Lastly, while SPS may view the AIP as not a "permanent fixed cost," once included in base rates, from a ratepayer's perspective, those costs take on the nature of permanent fixed costs. Unless those costs are expressly removed from rates in future proceeding, those costs remain in rates; and, because retroactive ratemaking for base rates is prohibited, there is no way to extract those costs paid by ratepayers.[125]

B. Pension and Related Benefits [PO Issue 28]

1. Active Health and Welfare Expense

At AXM Adjustment C-18 (*AXM Exh. 5 – Carver Direct at Attachment SCC-3*), Mr. Carver addresses SPS's "Active Health and Welfare Expenses." Mr. Carver proposes to reverses the effect of the 2015 forecast amount in excess of SPS's revised test year actual amount. This AXM adjustment reduces SPS's proposed health care expense by $540,820 (total Company). SPS's Initial Brief provides no new or persuasive arguments that should lead the ALJs to a conclusion other than as proposed by Mr. Carver. Thus, Mr. Carver's proposed, revised test-year

[124] *Id.* at 35 – 36.

[125] *See* SPS's Initial Brief at 170; *see also*, AXM Exh. 5 – Carver Direct at 39 – 40.

amount of $13,814,106 for this expense is reasonable.[126] SPS has not provided any detailed evidence that a higher number is more appropriate or that the amount should be based on calendar 2014 actuals instead of test year actuals.

2. Qualified Pension

SPS's initial brief at 176-178, qualified pension. SPS is agreeable to using the 2014 actuarial report as recommended by AXM Mr. Carver or even using the 2015 actuarial amount, since the numbers are close and will form the baseline for the pension tracker. For test year consistency purposes, AXM recommends that the ALJs adopt the 2014 actuarial study amounts proposed by AXM.

3. Non-Qualified Pension (and other post-retirement benefits)

4. Stock Equivalent Plan

5. FAS 106 Retiree Medical Costs

As with expenses for Qualified Pensions, SPS is agreeable to use of the actuarially-determined amounts for Retiree Medical Costs.[127] For test year consistency purposes, AXM recommends that the ALJs adopt the 2014 actuarial study amounts proposed by AXM.

6. FAS 112 Costs

7. Executive Perquisites

8. Moving and Relocation Expenses

C. Deferred Pension and OPEB Expense Recovery [PO Issue 28]

SPS has raised no new or persuasive argument to modify the amortization period for

[126] *See* AXM Exh. 5 – Carver Direct at 44 – 46.

[127] SPS's Initial Brief at 180.

Deferred Pension and OPEBs. AXM's proposed 2-year amortization is a continuation of the 3-year amortization the parties, including SPS, agreed to SPS's prior rate case, Docket No. 42004, and thus AXM urges the ALJs to adopt AXM's proposal.[128]

D. Depreciation Expense [PO Issue 20]

In AXM's Adjustment C-14 (*AXM Exh. 5 – Carver Direct at Attachment SCC-3 and* at 41 – 43), AXM presents its proposed annualized book depreciation rates based on the depreciation accrual rates recommended by AXM witness Mr. Pous (*AXM Exh. 3 – Pous Direct*). Consistent with AXM's proposal to deny SPS's PTYA, AXM's proposed depreciation accrual rates are based on SPS's depreciable plant balances as of June 30, 2014, the end of the Test Year.

Mr. Watson presents SPS's proposed depreciation rates and related expenses. But fatal flaw to Mr.Watson's analysis is that he provides little to no data to support his recommendations in those instances where he bases his decision on his "judgment." This is particularly true with regard to his "SPR" analysis.[129] When provided the opportunity in responses to RFIs, Mr. Watson and SPS simply turn to generalities. As the ALJs are aware, establishing depreciation rates for purposes of setting a utility's rates is a laboroius process dependent on detailed data unique to each utility. And that is what is missing in Mr. Watson's recommendations.[130]

1. Production and Related General Plant

The Company proposes to significantly change the existing positive 5% net salvage approved by the Commission for its generating facilities to a negative 5% net salvage.[131] SPS

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[128] AXM Exh. 5 – Carver Direct at 25.

[129] AXM notes that the transcript refers to "SPR" as "SBR." The correct reference is to SPR. *See*, e.g., Tr. 3 at 678.

[130] *See*, e.g., AXM Exh. Nos. 23, 24, 30, 31, and 32.

[131] SPS Exh. 13 – Watson – RR – Direct at DAW-RR-2 at 55.

bases its proposal on two claims, neither of which is accurate or correct. First, SPS claims that a negative 5% net salvage for production plant is "consistent with the Commission's standard practice regarding net salvage for Production Plant."[132] Second, SPS claims that its production dismantlement cost study performed by TLG Services, Inc. ("TLG") supports a negative 5% net salvage because "SPS's actual cost estimates indicate a net salvage rate that is higher than SPS is proposing."[133] From either a high-level or a more detailed perspective, neither basis is correct. Production plant net salvage is a fact-driven issue, and the correct facts do not support SPS's reliance on Mr. Watson's perception of precedent, or on TLG's high-side cost estimate.

SPS has not met its burden of proof in establishing reasonable and necessary depreciation expense levels. SPS presents generalities, vague responses to requests for information, and testimony that relies on the unsubstantiated process of judgment, the results of which are presented as conclusory statements that can only be verified by Mr. Watson. While in the area of depreciation as in, e.g., determining a utility's cost of capital, the expert's judgment is involved, that judgment must be based on identifiable and substantiated data. The exercise of judgment is a process that blends experience with hard data, just as ratemaking is a process that blends the results of numerous elements – the utility's revenue, its rate base, a fair return, and reasonable and necessary expenses. Simply stating that a utility employed a ratemaking process to arrive at its revenue requirement says nothing about the actual basis for the resulting levels of revenues, rate base, return and expenses. Fundamentally, that is the flaw in Mr. Watson's testimony: he fails to provide the specific data and pathway upon which his judgment is based.

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[132] SPS's Initial Brief at 187.

[133] *Id.*

Also, while the Staff joined in SPS's proposal to set NSV for production plant at -5%, it is clear from cross-examination of Ms. Katie Rich that the Staff's recommendation is not based on any credible data or other evidence. Ms. Rich is not a depreciation expert; she conducted no studies of her own; she did not analyze Mr. Watson's proposals; and admittedly is based simply on the notion that the Commission has in the past approved a -5% NSV for other utilities. But Ms. Rich agreed that it would be inappropriate for the Commission, for example, to adopt a particular ROE for any utility simply as a matter of policy. Instead, the ROE for each utility should be based on each utility's unique circumstances. And the same holds true for depreciation.[134] Simply put: the Staff's testimony regarding NSV does not, cannot, and should not form the basis for SPS's NSV for its production facilities.

The estimated net salvage associated with the retirement of a generating facility is dependent on many variables: whether disposed of through the total sale, partial sale, limited demolition, full demolition, the type of facility, the location of the facility, the fuel source of the facility, the infrastructure associated with the facility, the water rights, and numerous other factors.[135] But here the primary basis for Mr. Watson's proposal to go from a positive 5% (+5%) net salvage value (NSV) to a negative 5% (-5%) NSV is Commission precedent.[136]

There is no Commission standard practice of a -5% NSV. Indeed, if there is a standard practice, the Commission standard practice for SPS for the past four rate cases has been a +5%.[137] While each of the past four SPS cases is the product of a settlement, Mr. Watson notes other settled

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134 *See* generally cross-examination of Ms. Rich at Tr. Vol. 3 at 655 – 668 and 673; *see also*, Tr. Vol. 3 at 258 – 260 (cross-examination of Mr. Watson).

135 *See*, AXM Exh. 3 – Pous Direct at 9 – 10.

136 *See*, SPS Exh. 13 – Watson – RR – Direct at DAW-RR-2 at 55.

137 *Id.* at 10 – 11.

cases in his testimony as precedent.[138] If precedent alone were to determine the outcome of SPS's NSV for its production plant, on that basis the Commission should retain the existing +5% NSV. And crucially, recent precedent from a fully-litigated proceeding would suggest a NSV of about -1.4%.[139] In Docket No. 40443, Southwestern Electric Power Company's recent rate case, the Commission approved a -2.6% NSV, a that value declines to a -1.4% net salvage when based on a comparable basis to that presented by SPS.[140]

Thus, to the extent consideration is given to Commission precedent for the establishment of net salvage for production plant, which is the primary basis for SPS's position, then a positive 5% net salvage is the specific percent for SPS. Moreover, if precedent rests with the most recent litigated case for production plant before this Commission, then a -1.4% net salvage is appropriate. Neither value approaches SPS's proposed -5% NSV.

Moreover, SPS's assertion that its move from a +5% NSV to a -5% NSV is "based on different expectations relating to moving to a competitive marketplace and was subsequently retained as part of stipulated agreements"[141] is flawed. First, SPS's allegation rests on the premise that "different expectations" existed in the past, than exit now. But the status of PURA with regard to "competition" coming to SPS's service area is the same today as it was in the prior rate cases and thus the "expectation" of a competitive market remain the same. Further, SPS failed to show that its plans to divest its generation has changed during the corresponding time period. Also, the

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138 *Id., (*for example Docket No. 37690 and Docket No. 40940, both El Paso Electric cases, both of which resulted in settlements as referenced in footnote 1052 of SPS's Initial Brief.

139 Docket No. 40443, *Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs* (Final Order – March 6, 2014).

140 AXM Exh. 3 – Pous Direct at 14 - 15.

141 SPS's Initial Brief at 191.

"foreseeable future" for a generating plant should reflect the expected overall period associated with the life of that plant.

Not only is SPS's argument that "precedent" supports a -5% NSV without foundation, its arguments that AXM's +5% NSV is unrealistic and would prevent SPS from collecting the cost of dismantlement over the life of the plant is but a diversion.

AXM is not and did not suggest that all or even the majority of generating facilities will be sold, which is not required to obtain a positive 5% net salvage level. Rather, SPS's proposed -5% NSV is unrealistic because SPS's and Mr. Watson's assessment focuses on the most costly approach to dismantlement of such a facility – a brick-by-brick "deconstruction" of the unit. But what Mr. Pous' testimony established is that there are numerous alternatives to total dismantlement, including the full sale of the facility, partial sale of the facility, partial sale of the equipment at a level greater than scrap value, and other alternatives.[142]

Moreover, both AXM and TIEC identified actual instances where even under the process of full dismantlement, demolition contractors *paid the utility for the right to dismantle a generating facility*.[143] SPS brushes Mr. Pous' and Mr. Duane's testimonies as "one-off examples" not applicable to SPS's units.[144] But the burden of proof is on SPS to establish by a preponderance of the evidence why SPS would not be able to employ the same approach for its production units and SPS did not do so either in its direct case, in its rebuttal testimony, or through cross-examination of AXM's or TIEC's witnesses.

What AXM's and TIEC's evidence established is that alternatives to a brick-by-brick "deconstruction" of a production unit are viable and used in the industry, and are available to SPS:

[142] AXM Exh. 3 – Pous Direct at 9.

[143] *Id.* at 14.

[144] SPS's Initial Brief at 95.

- Entire stations have been sold to demolition contractors where the demolition contractor has paid for the right to demolish units.[145]
- The vast majority of Texas generating units owned by utilities were sold rather than demolished by the utility.[146]
- Generating units have been sold to be reassembled elsewhere.[147]
- Portions of SPS generating assets have been transferred to other generating facilities.[148]
- SPS has sold items of generating units to other entities.[149]
- SPS has repurposed assets for continued use.[150]
- SPS has utilized portions of generating assets in repowering projects.[151]
- SPS and other have not demolished all facilities at generating sites at the time of retirement.[152]

Mr. Pous' testimony provides credible evidence that alternatives to total demolition exist, are used by the industry and, for purposes of SPS's rate case, demonstrates that positive net salvage is more than a credible outcome when generating units are retired. Neither SPS's unsupported assertions in its brief nor its presentation that relies solely on the concept of full dismantlement and ignores any other possibility for removal of a production plant, provides the basis for a 10-point swing (to go from a +5% NSV to a -5% NSV) in the NSV for purposes of setting SPS's rates. Alternatives to total demolition are precisely what have already transpired for

[145] AXM Exh. 3 – Pous Direct at 14.

[146] *Id.* at 16.

[147] *Id.* at 14.

[148] SPS Exh. 46 – Davidson Rebuttal at 9.

[149] *Id.* at 15.

[150] SPS Exh. 46 – Davidson Rebuttal at 17.

[151] *Id*.

[152] *Id.* at 10.

SPS and other utilities in spite of SPS's position that no probability of such occurrence should be taken into account in establishing net salvage in this proceeding.

SPS next argues that even if a generating unit had the potential to be sold, SPS would still need to collect dismantling costs over the life of the unit."[153] But irrespective of the sales price of a generating facility, it would result in a positive net salvage. Plus, it is axiomatic that if the unit is being sold, it is not being demolished, and thus there are no demolition costs.

The notion that the sale of a unit leads to demolition costs is not only illogical, but is refuted by its SPS's actions associated with other assets; in particular, SPS proposes a positive net salvage for vehicles.[154] Just as with the sale of a vehicle, which does not produce net costs at retirement, there should be no presumption that SPS would still need to collect dismantling costs over the life of a generating unit.[155]

Further, SPS leaves the impression that all investment at a generating station will be 40, 50, or 60 years old at the time of retirement, but such is not the situation. To keep a generating unit operating, the Company will continue to replace individual components of a plant prior to the final retirement of a unit. Thus, many assets at a power plant, even at the time of the unit's retirement, may have only been in service for as little as one, five or 10 years, and thus possess substantial economic value above scrap value. Indeed, this is why demolition companies have offered to pay a utility for the right to dismantle a generating unit.[156]

TLG's study also includes costs attributable to back filling, grading, landscaping, and pond removal. These costs are incurred to improve the site above and beyond the removal of actual

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153 SPS's Initial Brief at 192; and SPS Exh. 44 – Watson Rebuttal at 13.

154 SPS Exh. 13 – Watson Direct at Watson's electronic workpapers "SPS Accrual Final tab Appendix A1".

155 AXM Exh. 3 – Pous Direct at 6.

156 *Id.* at 14.

depreciable equipment. However, SPS takes the position that since land is not depreciable, it in theory cannot include such off-setting site values in its decommissioning cost estimate. But the estimate is for decommissioning costs on a net basis to customers. Thus, if costs for improving the site are to be included in the costs to dismantle a unit, then the value of the *improved* site should also be recognized in determining the net cost to dismantle the unit. Alternatively, those costs should be excluded from the cost of removing depreciable assets, element TLG, SPS and Mr. Watson ignore.[157]

SPS failed in its burden of proof regarding production-plant net salvage value. SPS presents nothing more than generalized statements, vague assertions, and conclusory statements none of which rise to the level of credible evidence. AXM urges the ALJs and the Commission to give no credence to the Company's attempt to shift the burden of proof to intervenors through SPS's claims that it is somehow the intervenors' responsibility to present detailed alternative engineering studies related to the cost to retire a production. Further, if precedent is a guide, then the more appropriate net salvage value for SPS's production units is a +5%.

2. Transmission and Related General Plant

a. Account 350.2 - Land Rights

SPS's initial brief simply states that its proposal is based on the movement in life of the underlying assets on which the land rights is based.[158] SPS further claims that Mr. Pous' proposal of a service of 100 years is extreme and unsupported by data.[159] But what SPS fails to note is that

[157] *Id.* at 17; TLG's study also fails to account for the value of water rights related to the plant's site. Proper recognition of the sale value of water rights to a water deficient area of the state could have a dramatic impact on the establishment of a proper net salvage value.

[158] SPS's Initial Brief at 199.

[159] *Id.* at 199 - 200.

Mr. Watson limited his increase in average service life due in part to his claim of gradualism.[160] Rather than rely on the information applicable to the account, Mr. Watson chose an alternative to limit the increase, but did not identify a basis for his proposal. In addition, SPS ignores that almost all of the land rights were perpetual in nature.[161] Moreover, SPS's proposal fails to recognize that the land rights must be in place for at least one complete life cycle of the assets that rest upon the land rights.

As Mr. Pous' established, one complete life cycle results in a minimum of 114-year use of a land right.[162] Simply claiming reliance on judgment fails to establish any valid basis upon which to limit the average service life as proposed by SPS and Mr. Watson.

b. Account 353 - Transmission Substation Equipment

SPS attempts to create the impression that Mr. Watson relied on the specific feedback from SPS's subject matter experts who work with the substation equipment every day, and that Mr. Pous discounts the feedback of the subject matter experts.[163] First, Mr. Pous' testimony places Mr. Watson's generalized and unsupported statements into perspective.[164] Second, while implying that Watson accepted "the specific feedback from SPS subject matter experts who work with the substation equipment every day" without modification, SPS conveniently neglected to mention that Watson also chose an ASL longer than the "specific feedback from SPS subject matter experts who work with the substation equipment every day."[165] Here Watson "discounted" the input from

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160 AXM Exh. 3 – Pous Direct at 33.

161 *Id*.

162 *Id.* AXM notes that in a recent proceeding before the Railroad Commission of Texas, that agency rejected Mr. Watson's proposal and adopted Mr. Pous' recommendation of 100 years. AXM Exh. 3 – Pous Direct at 35.

163 SPS's Initial Brief at 200.

164 AXM Exh. 3 – Pous Direct at 39 – 40.

165 Compare SPS Exh. 44 – Watson Rebuttal at 25 – 26 to Mr. Watson's categorized plant balances in electronic

SPS's personnel because it did not match what the Company specific actual number indicated through actuarial analyses, but he fails to explain why he ignored SPS's personnel's input. SPS would have the Commission believe that Watson is the only individual who may be permitted to "discount" such values when they are not based on hard data.

By comparison, Mr. Pous provides credible, data-based testimony for an ASL of 62 years for Account 353 and AXM urges the ALJs to adopt Mr. Pous' recommendation.

c. Account 355 - Transmission Poles and Fixtures

SPS makes the conclusory statement that Watson properly considered all information specific to the assets and implies that Mr. Pous did not.[166] But Mr. Pous' testimony establishes that not only did he take into account all input from Company personnel, he also accounted for the impact of cross-arms and chemical treatment of poles, each of which individually and collectively have significant impact on the ASL for these assets.[167] Rather than demonstrate if and how Mr. Watson considered these components, all SPS does is to rely on Mr. Watson's general statement they "are appropriately factored into the analysis and evaluation for this account."[168]

Further, as Mr. Pous noted, Mr. Watson failed to note in his depreciation study that SPS's personnel informed Mr. Watson that they "[w]ould expect *transmission* poles to have a longer life than *distribution* poles."[169] Yet Mr. Watson ignores SPS personnel's input and proposes the same ASL for both.[170]

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workpapers tab at "Data by RTU at June 2014."

166 SPS's Initial Brief at 202.

167 AXM Exh. 3 – Pous Direct at 41 and 45.

168 SPS Exh. 44 – Watson Rebuttal at 41.

169 AXM Exh. 3 – Pous Direct at 45.

170 SPS also fails to explain why Mr. Watson's proposed ASL for poles is much longer for its sister company in Colorado, than in Texas. *See,* SPS's Initial Brief at 202.

d. Account 356 - Transmission Overhead Conductors and Devices

Regarding the ASL for Account 356, Mr. Pous identified the average, median and mode of ASLs found in Mr. Watson's analysis as additional support for his recommended "more logical result".[171] SPS and Mr. Watson criticize Mr. Pous for doing so.[172] Mr. Watson never states what ranking he gives to any of the 24 curves shown for Account 356 in his workpaper instead he simply recommends the outlier in his analysis, the one showing a shorter ASL. Given the lack of explanation on why Mr. Watson landed on the outlier in his analysis, it is appropriate, as Mr. Pous did, to take the average, median and mode of the ASLs to further support the logic of his actuarially and Company subject matter expert provide information based recommendation.[173]

Moreover, what SPS and Mr. Watson ignore is that SPS's subject matter experts informed Mr. Watson they would expect conductor to last longer than 50 years. Yet, Mr. Watson chose the only actuarially-based result out of 24 values that was shorter than 50 years.[174]

Similarly, the Company's subject matter experts informed Mr. Watson that they expected *transmission* conductor to have a longer life than *distribution* conductor. But again, Mr. Watson ignored SPS's personnel and chose a 47-year ASL, which is an outlier value equal to the ASL value he proposed for distribution conductor.[175]

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171 AXM Exh. 3 – Pous Direct at 46-47.

172 SPS's Initial Brief at 204 and SPS Exh. 44 – Watson Rebuttal at 48.

173 AXM Exh. 3 – Pous Direct at 46-49.

174 *Id*. at 48.

175 *Id*. And again, SPS also fails to explain why Mr. Watson's proposed an ASL for Account 356 of 68 years in Colorado for SPS's sister company there, but 47 years in Texas. *See*, SPS's Initial Brief at 204

3. Distribution and Related General Plant

a. Account 365 - Distribution Overhead Conductors and Devices

With regard to Mr. Watson's proposed ASL for Account 365, Mr. Watson's interview notes establish that SPS's subject matter experts expected conductors to have a longer life than poles, but Mr. Watson ignored SPS's experts.[176] Had Mr. Watson taken into account SPS's experts' input, presumably he would have recommended an ASL of longer than 53, given that he proposed a 53-year ASL for Account 364 – Distribution Poles.[177] Instead, Mr. Watson's response is that "SPS personnel indicated that some of the smaller cable installed on the system is deteriorating around 35-40 years."[178] But as cross-examination of Mr. Watson established, Mr. Watson does not know the size of the conductor SPS's personnel characterizes as "small," does not know the extent to which that "small" conductor is deployed in SPS's system, and does not know the cost of such conductor.[179] Mr. Watson ignores the subject matter experts and focuses on some limited but undefined portion of the account that is starting to deteriorate around 35-40 years, and proposes an ASL much shorter than SPS's own experts expect.

b. Account 368 - Distribution Line Transformers

Regarding Account 368, Mr. Watson does rely on SPS's experts' expectations that a *shorter* life for Distribution Line Transformers may be expected. As noted above, where SPS's experts suggest a longer life, Mr. Watson inexplicably ignores those comments, but when those

[176] AXM Exh. 3 – Pous Direct at 51 – 52; Tr. Vol. 3 at 692 – 693; and AXM Exh. 29.

[177] An ASL of 49 to 52.5 years is also what Mr. Watson's SPR analysis for Account 365 shows. *See* AXM Exh. 28.

[178] SPS Exh. 44 – Watson Rebuttal at 53.

[179] Tr. Vol. 3 at 690.

same experts estimate a shorter life, he accepts it without question. But as Mr. Pous' testimony established, the life for these assets is actually lengthening.[180]

c. Account 369 - Distribution Services

With regard to Account 369, Mr. Watson again takes at face value SPS's expert's expectations of a shorter life for this asset. Yet, as Mr. Pous' data in his simulated plant records (SPR) analysis show, the "lifes" for these assets are actually getting longer.[181] Instead, Mr. Watson takes the averages of all values in the SPR runs to demonstrate that they produce lower ASLs but he cites to no authority to establish that taking the average of those values produces a statistically valid result.

4. General Plant Related to Information Technology and Software

a. Account 303 – Miscellaneous Intangible Plant

SPS's and Mr. Watson's testimony with regard to Account 303 – Miscellaneous Intangible Plant (software), make clear that SPS has no credible data to support its proposals. In response to a straight-forward request for each study, analysis, or report relied upon to support is software amortization periods, SPS could not and did not provide a single document to support its current 5-year and 10-year amortization periods."[182] Instead all SPS provides as basis for it request is a general statement that it "assigns" the appropriate life based on "its experience and knowledge of current industry practices," which it claims "represent the upper end of the vendor servicing time frame."[183]

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[180] AXM Exh. 3 – Pous Direct at 54 – 57.

[181] *Id.* at 59 – 60.

[182] AXM Exh. 3 – Pous Direct at 21.

[183] *Id*.

Moreover, when given another opportunity to provide support for the amortization period or life used for its software systems, again all SPS provided was its conclusory statement that it "assigns" the appropriate life for it proposed amortization periods.[184] As it relates only to its proposed five-year amortization period, SPS also stated that is "using the upper end of the vendor servicing time frame" as "the most reasonable fit for the range of software applications that fall into this category."[185] But again, SPS provides no data to support its selection.

The long and short of it is that SPS has no basis for its proposals. SPS may "assign" an amortization period for software, but assigning a period is a far cry from supporting the selection of that period. Yet, rather than admit to the lack of basis and support for its proposal, SPS accuses Mr. Pous of misunderstanding the data he reviewed."[186] It is not hard to understand why SPS waived cross-examination of Mr. Pous.

Moreover, Mr. Pous could not have misunderstood SPS's basis and support for its proposal because SPS did not provide any support. SPS failed to provide a single study, analysis, or report, its relied upon to support is software amortization periods. SPS failed to provide a single vendor servicing contract. SPS failed to provide a single item of support for "its experience and knowledge of current industry practices" that corresponds to its proposed amortization periods. Mr. Pous did not misunderstand that SPS has a "remarkable 137 to 0" track record during the past eight years when it come to "underestimation versus overestimations of useful life" for its software systems.[187]

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184 *Id*.

185 *Id*

186 SPS's Initial Brief at 210.

187 AXM Exh. 3 – Pous Direct at 21.

SPS has not and cannot show that Mr. Pous misunderstood that (1) SPS's software typically has multiple releases or version upgrades; (2) SPS's software systems serving the same purpose often have overlapping lives; and (3) that SPS uses a different method of retiring software than for other types of plant, as it claims[188] because it simply is not true.

Also, Mr. Pous did not misunderstand that it "is difficult for SPS to determine what part of previous software versions have been replaced, and therefore an accurate life for each version is almost impossible to measure."[189] But that does not mean that SPS can "assign" any amortization period it so desires for software systems without a reasonable basis for doing so; SPS in effect has simply picked a number out of the air.

Turning to the concerns with creating intergenerational inequities in establishing depreciation rates or amortization periods, SPS states that its "intent is to match the amortization period billed to customers with the useful life of the software." But SPS admits that its software "may periodically last longer than SPS expects, but the current amortization periods represent the appropriate useful life on average."[190] SPS's claimed "intent" does not match reality given its "remarkable 137 to 0" track record during the past eight years when it comes to "underestimation versus overestimations of useful life" for it software systems.[191] SPS's claim that its proposals "represent the appropriate useful life on average" is nothing more than an unsupported and unsubstantiated conclusory claim.

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188 SPS's Initial Brief at page 210.

189 *Id*.

190 *Id*. at 212.

191 AXM Exh. 3 – Pous Direct at 21.

Moreover, SPS's assertion that "despite Mr. Pous' claim to the contrary, SPS does not continue to include software investment in its rate base after it has been fully amortized."[192] SPS even sites to the record in an attempt to legitimize such claim.[193] But Mr. Pous did not claim any such thing. The record site is to Ms. Perkett's rebuttal testimony, which does not identify anywhere that Mr. Pous claims that SPS "continue[s] to include software investment in its rate base after it has been fully amortized."

The issue Mr. Pous raised with regard to intergenerational inequity is the "dollars the Company will convert from recovery of amortization expense to additional return in between base rate cases."[194] This conversion process is driven by the artificially short amortization periods "assigned," but not supported or justified by SPS.

SPS also claims "there will be other amortizable assets that will be placed in service after the test year that have not been included in the revenue requirement."[195] As is the case with SPS's other proposals, SPS provided no support or justification for this claim. The reality is that SPS will place into service some new software system after the test year that have not been included in the revenue requirement, but that could transpire two, three or even eight years or longer after the test year in this case. Indeed, Mr. Pous noted that "the Company has continued to use some of the "assigned" five-year software systems for up to 17 years, with many for eight years or longer."[196]

Moreover, SPS had every opportunity to actually provide the amount of new software placed into service after the end of the test year, but chose not to do so. Again, SPS attempts to rely

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[192] SPS's Initial Brief at 212 – 213.

[193] *Id*. referencing SPS Exh. 42 at 17.

[194] AXM Exh. 3 – Pous Direct at 23.

[195] SPS's Initial Brief at 212.

[196] AXM Exh. 3 – Pous Direct at 22.

on unsubstantiated and unsupported assertions in an effort to distract from the real issue of intergenerational inequity that flows to its bottom line between rate cases.

Turning to the final issue in this area, that being Mr. Pous' recommendation that the Commission order SPS to conduct a study of its amortization periods for software. SPS speculates that it believes Mr. Pous misunderstands the essential characteristics of software lives.[197] SPS then claims that it has "presented ample evidence to justify the establishment of its software lives and the method of amortization and no further study is needed.[198] But the only evidence presented is its conclusory statement that it "assigns" amortization periods to this asset. Since SPS will not do so on its own, AXM again urges the Commission to order SPS to perform the necessary study to actually support the appropriate amortization period for software.

b. Account 391.004 – Computer Equipment

As with Mr. Watson's other proposals, the only support Mr. Watson provides for his recommended 5-year life for computers is that the Commission adopted that in Docket No. 35763 – a settled case.[199] But SPS ignores that in Docket No. 40824, Mr. Watson prepared an actuarial analysis that showed an ASL of 6 years for Account 391.004 – Computer Equipment.[200] SPS also ignores Mr. Watson's analysis from Docket No. 42004, where he derived ASLs ranging from 5-9 year "with the average in excess of six years."[201]

Again, the only explanation SPS provides is that Mr. Watson relied on his personal judgment, but he could not and did not in Docket No. 42004, and cannot now provide any further

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197 SPS's Initial Brief at 212.

198 *Id*. at 213.

199 SPS Exh. 44 – Watson Rebuttal at 60.

200 AXM Exh. 3 – Pous Direct at 61.

201 *Id.* at 62.

support for his "professional judgment." The exercise of "professional judgment" is a process that relies on hard data. Mr. Watson refuses to provide a single significant item of information that influences his "professional judgment."[202] Mr. Watson's proposed ASL of 5 years is based on unsubstantiated "expectations." There is no objective explanation as to why SPS and Mr. Watson shifted from a 6-year ASL to a 5-year ASL, other than it is worth $2 million per year to SPS's bottom line.[203]

c. Amortization Study For Software

5. General Plant Related to Equipment, Facilities, and Property Services

a. Account 390 – General Plant Structures and Improvements

b. Account 392.02 – Transportation Equipment-Light Trucks

c. Account 392.04 – Transportation Equipment-Heavy Trucks

With regard to Account 392.02 and Account 392.04, as SPS did with regard to Account 391.004, SPS ignores that Mr. Watson performed an actuarial analysis using SPS's data in Docket No. 42004 and derived ASLs for Account 392.02 and Account 392.04 of 13 to 14 years.[204]

Furthermore, Mr. Watson again ignores the input that SPS's subject matter experts provided him. Mr. Watson's interview notes in Docket No. 42004 show that SPS's subject matter experts believed that "12 years is reasonable" for Light Trucks and "14 years matches their [Heavy Trucks] internal analysis and is what funding is based on."[205]

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202 *Id.*

203 *Id.* at 63.

204 AXM Exh. 3 – Pous Direct at 67.

205 *Id.*

d. Account 397 – Communication Equipment

Regarding SPS's criticism of Mr. Pous' proposed ASL for Account 397 – Communication Equipment, SPS has it backwards. SPS claims "Mr. Pous' proposal fails to account for all of the information available regarding the assets and extends the proposed life without basis."[206] To be clear: Mr. Pous is not recommending an increase in life, but a three-year decrease.[207] More critically, however is that SPS's claim that its proposal to reduce the existing life from 23 to 15 years "accounts for all input from personnel"[208] is controverted by the evidence; Mr. Watson did not undertake any new interview with Company personnel but relied on "previous interviews."[209] Fatal to SPS's argument is that Mr. Watson's interview notes regarding Account No. 397 in this case, are identical word for word, to his notes for the same account in Docket No. 42004, but here he proposes a 15 –year life, whereas in Docket No. 42004, the same notes from SPS's subject matter experts led Mr. Watson to propose a 23-year life for Account 397.[210]

Mr. Watson's failure to identify or quantify a single difference in life characteristics, investment mix, or any other item of information from subject matter experts since Docket No. 42004 cannot possibly be considered credible evidence that meets SPS's burden of proof to support Mr. Watsons' marked change in life for this account.

SPS attempts to shift the burden of proof to AXM, born out of SPS's failure to present credible evidence or in many cases no evidence at all for its proposals. The Commission should

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206 SPS's Initial Brief at 220.

207 AXM Exh. 3 – Pous Direct at 68-70.

208 SPS's Initial Brief at 220.

209 SPS Exh. 44 – Watson – RR – Direct (*See* Workpapers to Depreciation Study DAW-RR-3 (CD at "Interview Notes").

210 AXM Exh. 3 – Pous Direct at 70.

adopt AXM's recommendation as the only credible presentation in this proceeding regarding depreciation rates.

6. Comments Regarding Net Salvages for Mass Accounts

a. Account 353 – Transmission Station Equipment (SPS: -20%, AXM: -10%)

Regarding the net salvage value for Account 353, SPS claims that Mr. Watson's simple averaging of historical data suffices, but neither SPS nor Mr. Watson point to any evidence showing Mr. Watson undertook an investigation that what is reflected in those data is adequate or representative of the existing investment. SPS in passing also notes that historical retirements include transformers.[211] However, given the wide variety of different assets in Account 353, and apparently due to Watson's failure to properly analyze what SPS actually retired within the historical database, SPS attempts to minimize the investment mix versus retirement mix issue Mr. Pous raised.

Mr. Pous performed a detailed analyses of the retirement history for Account 353 and found that (1) transformers comprise 35% of the investment; (2) are not proportionately reflected in the retirement database; (3) a -12% NSV occurs when proportionate level of transformers are included in a particular year; and (4) a much more negative NSV occurs when proportionate level of transformers are not included in most years.[212]

But instead of cross-examining Mr. Pous on his findings, SPS instead attempts to create the impression in its brief that Mr. Pous failed to recognize the various costs incurred when retiring a

[211] SPS's Initial Brief at 201.

[212] AXM Exh. 3 – Pous Direct at 75 – 76.

transformer.[213] Pous did not state that it does not cost a significant level of dollars to retire a transformer. By analyzing the relationships of NSV percentages and not dollars, in years with and without transformer retirements, Mr. Pous recognized that the per-unit cost of removal is lower for a high-dollar investment such as a transformer, even though the total cost in dollars to remove a transformer is high. For illustrative purposes, assume a transformer cost $2.5 million with a $175,000 cost of removal and a $50,000 gross salvage, compared to a $75 lighting arrestor with a $50 cost of removal and a $0 gross salvage. Even though the cost of removal for a transformer is 3500 times the cost of removal for a lighting arrestor, the investment in the transformer is 33,333 times that of the arrestor. Therefore, the resulting NSV for a transformer is -5% (($50,000-$175,000)/$2.5 million), while the NS for the arrestor is -66.67%. This type of relationship is why Mr. Watson's simplistic averaging of different lengths of database fails unless it is shown to be representative of the existing investment mix.

Finally, when Mr. Pous pointed out that Mr. Watson provided inconsistent proposals under similar circumstances in a contemporaneous case for SPS's affiliate in Colorado, SPS choose to claim there are different patterns.[214] But SPS continues its pattern of providing conclusory statement without providing supporting data and thus, its proposal cannot be said to be credible. Moreover, Mr. Pous' analysis is based on actual and consistent values.[215]

[213] SPS's Initial Brief at 201.

[214] AXM Exh. 3 – Pous Direct at 76 – 77; SPS Exh. 44 – Watson Rebuttal at 75.

[215] AXM Exh. 3 – Pous Direct at 76 – 77.

b. Account 355 – Transmission Poles and Fixtures (SPS: -60%, AXM: -35%)

SPS claims that Mr. Watson's marked departure from historical values regarding the NSV for Account 355 is the application of gradualism.[216] Mr. Watson provides no definition to conclusory statement regarding the application of gradualism. But as with his many other recommendations, Mr. Watson provides only the resulting 250 percentage point reduction from his average values to arrive at a NSV of -60%. In Docket No. 42004, SPS's prior rate case, Mr. Watson dropped as much as 320 percentage points seemingly based on his application of gradualism to get to the same -60%[217] Inconsistency in his approach of averaging historical data does not appear to be an obstacle to Mr. Watson's recommendations. Given the lack of data and inconsistent application of gradualism to support Mr. Watson's proposal, Mr. Pous' recommendation of -35% is the more credible one.

c. Account 390 – General Plant Structures & Improvements (SPS: -10%, AXM: +15%)

With respect to the NSV for Account 390, SPS wants to rely on historical data associated with replacing air conditioners, roofs, and carpeting, and ignore that the majority of the investment is in the building. But SPS makes a U-turn in criticizing Mr. Pous' analysis for suggesting that SPS might just sell the building rather than tear it down in spite of the fact that it has previously sold buildings. SPS also makes the unsupported declaration that "most of the proceeds of any sales would be in the value of the land."[218]

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[216] SPS's Initial Brief at 203.

[217] AXM Exh. 3 – Pous Direct at 78.

[218] SPS's Initial Brief at 215.

SPS ignores the fact that it sold buildings in 2003 for a positive 41% NSV.[219] SPS now claims that SPS it not sell buildings on an ongoing basis. But that is not the issue: the point is that when SPS's does sell a building it produces a positive NSV, as Mr. Pous testified. SPS has failed to establish that it will change its historical practice and now begin tearing down buildings rather then selling them.

d. Account 392.02 and 392.04 – Transportation Equipment – Light and Heavy Trucks (SPS: 7% and 6%, respectively, AXM: 15%)

With regard to the NSV for Account 392 – Transportation Equipment – Light and Heavy Trucks, SPS ignores the fact that AXM challenged the "like-kind" exchange program SPS initiated in 2006 in SPS's prior rate cases.[220] In spite of Mr. Watson's statement in Docket No. 42004 that SPS will continue this program in the future, it apparently has taken to heart AXM's testimony in that case that its actions violated the Uniform System Of Accounts.[221] While SPS has now rescinded its program, which is the correct step to take, it failed to maintain the data to establish what the net salvage would have been absent the like-kind exchange program and thus the actual data during that period is lost.

Given its failure to maintain salvage data as required by the USOA, SPS now claims it relies on the JJ Kane auction house for its proposal. Unfortunately, neither SPS nor Mr. Watson provided such information. The only credible evidence of value for a used truck in the Company's service territory is that presented by Mr. Pous.

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219 AXM Exh. 3 – Pous Direct at 81 – 82.

220 *Id.* at 83.

221 *Id.*

E. Affiliate Charges [PO Issue 29]

1. External Affairs Class

2. General Counsel Class (employee discrimination claims)

3. Charges to New Mexico Work Orders

4. Shared Facilities Charge (carrying costs) [PO Issue 10]

5. Life Events.

6. Timekeeping Entry Error

F. Purchased Capacity Costs

SPS's initial brief recognizes the fact that the key dispute between SPS and AXM on this issue is whether SPS should receive a PTYA for these costs.[222] For all of the reasons that AXM discusses above, AXM respectfully urges the Commission to reject SPS's proposed PTYAs.

1. Borger Energy

2. Calpine I

3. Calpine II

4. GSEC MW Effective June 1, 2014

G. Coal Procurement Expenses

H. SPP and Other Transmission Charges and Revenue [PO Issue 32]

1. Schedule 1-A Charges

SPS's initial brief recognizes the fact that the key dispute between SPS and AXM on this issue is whether SPS should receive a PTYA for these charges.[223] For all of the reasons that AXM discusses above, AXM respectfully urges the Commission to reject SPS's proposed PTYAs.

[222] SPS's Initial Brief at 235.

[223] *Id.* at 239-240.

2. Schedule 11 Charges and Revenues

Proper Return on Equity for Schedule 11 Revenue Credits

SPS's arguments in its initial brief on this issue cannot hide the fact that SPS wants to earn the ROE approved by the Federal Energy Regulatory Commission ("FERC") on Schedule 11 costs that SPS seeks to place into the Texas jurisdictional rate base. SPS's own calculations in Table 3 on page 248 of SPS's initial brief illustrate this unmistakable conclusion. SPS's table states:[224]

TABLE 3	
Total cost of service (including both rate base and Schedule 11 components)	$17.13 million
Credit attributable to payments from SPS Zone	- $7.13 million
Credit attributable to payments from other zones	- $2.87 million
Net cost of service	$7.13 million

Table 3 illustrates the flow of revenue under Schedule 11. For purposes of the ROE discussion, the third row – "Credit attributable to payments from other zones" – is the key row. As shown in Table 3, SPS would *actually receive* $2.87 million in credits from other zones. This $2.87 million would be based on SPS's FERC approved ROE, which is what SPS uses to bill other zones.[225]

However, SPS proposes to adjust the $2.87 million in the third row to reflect the Commission's approved ROE. The Commission's approved ROE is lower than FERC's ROE and will likely be so for the foreseeable future.[226] Thus, using the Commission's approved ROE will produce a value lower than $2.87 million. Hypothetically, if the effect of the difference between

[224] SPS's Initial Brief at 248, Table 3.

[225] *See id*. at 242, footnote 1414 ("SPS uses a Net Plant Carrying Charge ("NPCC"), which is a percentage derived from its FERC-approved rate formula, and it multiplies that NPCC by the project's capital cost and then adds in depreciation expense.").

[226] AXM Exh. 2 – Dittmer Direct at 14.

the FERC's ROE and the Commission's ROE is $200,000, then, as illustrated in the table below, SPS would net $7.33 million. The revised Table 3 would be as follows:

Total cost of service (including both rate base and Schedule 11 components)	$17.13 million
Credit attributable to payments from SPS Zone	- $7.13 million
Credit attributable to payments from other zones **minus $200,000 from using the Commission's approved ROE**	- $2.67 million
Net cost of service	$7.33 million

SPS would receive $7.33 million from Texas ratepayers, rather than the $7.13 million that SPS concedes it should receive. SPS would receive a $200,000 windfall or, stated another way, SPS would earn the FERC approved ROE (which, in this example, was $200,000 higher than the Commission approved ROE) on the Schedule 11 credits that it receives from other zones. The only way to ensure that SPS receives the Commission approved ROE on the "net cost of service" in the fourth row is to use the "credit attributable to payments from other zones" that SPS *actually receives* - $2.87 million in SPS'S example in its Table 3 – rather than adjusting those credits to give SPS a windfall.

SPS, on the other hand, includes calculations on pages 255 through 257 of its initial brief, supposedly to support its request to alter the credits that it actually receives from other zones. These calculations are wrong and inconsistent with its earlier calculations in Table 3 discussed above. SPS's key error is that it assumes that some of the Schedule 11 investments in the calculations on pages 255 through 257 are subject to the FERC jurisdiction. However, the Schedule 11 costs at issue in this case are under this Commission's jurisdiction, not the FERC's jurisdiction. Any costs that are subject to the FERC's jurisdiction should be removed from SPS's cost of service in this case, since the Commission has no jurisdiction to assess those costs on Texas

retail ratepayers. Therefore, SPS's assumption that it should receive the FERC approved ROE on a portion of the illustrated costs is simply wrong.[227]

Finally, SPS argues that the FERC may set an ROE that is lower than the Commission's approved ROE,[228] but for the foreseeable future, SPS's argument is premised at best on an unrealistic assumption.[229] Moreover, as AXM illustrates above, any deviation from the credits that SPS actually receives will cause SPS to receive an ROE that is different from the Commission approved ROE, which is an inappropriate result.

For all of these reasons, AXM respectfully urges the Commission to require SPS to use the revenue credits that it actually receives from other zones in calculating SPS's Schedule 11 cost of service.

Schedule 11 PTYA

SPS contests AXM's witness Mr. Dittmer's method for annualizing SPS's Schedule 11 costs.[230] AXM does not oppose using actual Schedule 11 costs, which is part of SPS's calculation.[231] However, AXM retains the remainder of its objections to SPS's calculations, for all of the reasons that AXM's witness Mr. Dittmer addresses in his testimony.[232]

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[227] *See* SPS's Initial Brief at 255 and 257.

[228] *See id.* at 260 – 261.

[229] AXM Exh. 2 – Dittmer Direct at 14.

[230] SPS's Initial Brief at 252.

[231] Mr. Dittmer's approach of using budgeted costs and then taking into account the later true-up would also still work, but AXM can accept using actual costs as well.

[232] AXM Exh. 2 – Dittmer Direct at 2-27.

Furthermore, having reviewed the intervenors' briefs and the Commission's Order in Docket No. 42448[233], AXM agrees that the costs associated with SPS's Schedule 11 should be based on SPS' test year costs, without any PTYA.

3. Lamar Tie

SPS's initial brief recognizes the fact that the key dispute between SPS and AXM on this issue is whether SPS should receive a PTYA for these charges.[234] For all of the reasons that AXM discusses above, AXM respectfully urges the Commission to reject SPS's proposed PTYAs.

4. Point-to-Point Revenue

SPS's initial brief recognizes the fact that the key dispute between SPS and AXM on this issue is whether SPS should receive a PTYA for these charges.[235] For all of the reasons that AXM discusses above, AXM respectfully urges the Commission to reject SPS's proposed PTYAs.

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[233] *See Application of Southwestern Electric Power Company for Approval of a Transmission Cost Recover Factor*, Docket No. 42448, Order at 6, Finding of Fact No. 41 (November 24, 2014) ("SWEPCO's proposed post-test-year and pro-forma adjustments to its SPP charges are not known and measurable.").

[234] SPS's Initial Brief at 268-269.

[235] *Id*. at 269.

I. O&M Cost Containment

1. Administrative and General Expense

2. Distribution O&M Expense

J. Fleet Fuel Expense

K. Renewable Energy Credits [PO Issues 34, 35]

1. Price Imputed for Texas-Generated Unbundled RECs

2. Sales Revenue Recognized in Base Rates or as a Credit to Eligible Fuel

3. SPS's Proposal to Split Sales Revenue 90% to Customers and 10% to SPS

L. Advertising, Contributions, and Dues [PO Issue 25]

SPS did not address this issue in its initial brief, but conceded the issue in Deborah Blair's rebuttal testimony.[236] This adjustment lowers SPS's cost of service by $365,955.[237]

M. Amortization Expense for Regulatory Assets (Other than Pension and OPEBs)

SPS raises no new persuasive arguments in its initial brief regarding Amortization Expense for Regulatory Assets (Other than Pension and OPEBs), Rate Case Expenses to warrant an amortization period of less than two years as proposed by AXM.

N. Rate Case Expenses [PO Issue 19]

SPS raises no new persuasive arguments in its initial brief regarding Amortization of Rate Case Expenses to warrant an amortization period of less than two years as proposed by AXM. Mr. Carver recommends an amortization period of two years.[238]

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[236] SPS Exh. 53 – Blair Rebuttal at Attachment DAB-RR-R1, page 1, line 10.

[237] AXM Exh. 5 – Carver Direct at Attachment SCC-3, Schedule C-20.

[238] *Id.* at 23.

For these reasons AXM urges the ALJ and the Commission to approve a two-year amortization period. A 2-year amortization period is consistent with the terms of the settlement in Docket No. 42004 and mitigates against the risk of over-collection of rate case expenses.

O. Miscellaneous Service Revenue (Revenue Credits)

P. Pole Attachment Fee Revenue

Q. Interest on Customer Deposits

R. Uncollectible Expense

S. Federal Income Tax [PO Issue 23]

1. Net Operating Losses

2. Research and Experimentation Credit

SPS agreed that AXM correctly identified SPS's omission of the Research and Experimentation Credit. SPS corrected its cost of service for this omission and included Research and Experimentation Credit, thereby reducing its cost of service by $330,071.[239]

3. Interest Synchronization

Interest synchronization is a derivative adjustment that is not disputed. The method is agreed upon, but AXM made an adjustment in its case to quantify the impact upon tax-deductible interest and income tax expense of AXM's adjustments to SPS's rate base. Ultimately, the Commission's final order can be expected to calculate the amount of synchronized interest that is needed after all of the rate base issues have been resolved.

[239] SPS's Initial Brief at 309.

T. Taxes Other Than Income Tax [PO Issue 21]

1. Property Tax

SPS accepts AXM's initial recommendation to use the actual amount of property taxes that SPS paid instead of SPS's estimated accruals.[240] This approach is appropriate.

With regard to AXM's second recommendation, that SPS should account for property taxes associated with CWIP in the CWIP accounts instead of the accounts for current revenues[241], SPS merely argues that it should be able to deviate from the standard treatment outlined in the FERC Uniform System of Accounts ("USOA") because of a de minimus or "cost-prohibitive" exception.[242] However, SPS provides no support for such an exception. AXM urges the Commission to follow the USOA standards.

AXM's third recommendation is to deny SPS's property tax-related PTYA. SPS's initial brief reiterates its general PTYA arguments.[243] For all of the reasons that AXM discusses above, AXM respectfully urges the Commission to reject SPS's proposed PTYAs.

2. Texas Margins Tax

3. Payroll Taxes

4. Texas Gross Receipts Tax

5. PUCT Assessment Tax

VI. Baselines [PO Issue 44]

A. Procedure to Establish the Baselines

SPS appears to be agreeable to AXM's recommendation that once the Commission

[240] SPS's Initial Brief at 312.

[241] AXM Exh. 2 – Dittmer Direct at 34-36.

[242] SPS's Initial Brief at 313.

[243] *Id*. at 269.

resolves all issues in the case, SPS is to prepare and the other parties are to review the baseline amounts that roll out from the Company's model.[244]

B. TCRF

C. DCRF

D. PCRF

E. Pension & OPEB Expense Tracker

VII. Miscellaneous Preliminary Order Issues [PO Issues 26, 27, 33, 46, 47]

Conclusion

For the foregoing reasons AXM and those presented in AXM's Initial Brief and in its witnesses' testimony and exhibits presented at hearing, AXM urges the ALJs and the Commission to adopt AXM's recommendations in this proceeding and requests such other relief to which it shows itself entitled.

Respectfully submitted,

HERRERA & BOYLE, PLLC
816 Congress Avenue, Suite 1250
Austin, TX 78701
(512) 474-1492 (voice)
(512) 474-2507 (fax)

By: _____

ALFRED R. HERRERA
State Bar No. 09529600

Jason Wakefield
State Bar No. 00789849

ATTORNEYS FOR ALLIANCE OF XCEL MUNICIPALITIES

[244] *See* SPS's Initial Brief at 316 – 318.

CERTIFICATE OF SERVICE

I certify that I have served a copy of the **Alliance of Xcel Municipalities' Reply Brief – Revenue Requirement** upon all known parties of record by fax, First Class Mail, and/or hand delivery on this the 5th day of August, 2015.

Alfred R. Herrera

ATTACHMENT C:

Certifications

Non-Discrimination Certification – Section 0800
Non-Suspension or Debarment Certification – Section 0805
Non-Collusion, Non-Conflict of Interest , and Anti-Lobbying – Section 0810

Attachment C - Certifications

Non-Discrimination Certification – Section 0800

Mr. Herrera hereby certifies that he and Herrera and Boyle, PLLC, conform to the Code of the City of Austin, Section 5-4-2 as set forth in "City of Austin, Texas Section 0800 – Equal Employment/Fair Housing Office Non-Discrimination Certification."

Non-Suspension or Debarment Certification – Section 0805

Mr. Herrera hereby certifies that he, Herrera & Boyle, PLLC and its principals, and CJ Energy Consulting, are not currently suspended or debarred from bidding on any Federal, State, or City of Austin Contracts.

Non-Collusion, Non-Conflict of Interest, and Anti-Lobbying – Section 0810

Mr. Herrera hereby certifies that he and Herrera and Boyle, PLLC are in conformance with the requirements and prohibitions set forth in "City of Austin, Texas Section 0810 – Non-Collusion, Non-Conflict of Interest, and Anti-Lobbying Certification."

Not Currently a Member Nor have been a Member in the Past 2 Years of the Austin Electric Utility Commission, the Austin Resource Management Commission, or the Austin City Council

Mr. Herrera hereby certifies that he, any personnel at Herrera and Boyle, PLLC, are not currently a member nor have they been a member in the Past 2 Years of the Austin Electric Utility Commission, the Austin Resource Management Commission, or the Austin City Council.

Compliance with All Applicable Federal, State, and Local Rules and Regulations

Mr. Herrera hereby certifies that he, Herrera and Boyle, PLLC, is in compliance with all applicable Federal, State, and Local governing entities and its response to RFP Solicitation No. RFP 2200 MDD0104 is in compliance with the terms of that RFP.

Alfred R. Herrera

ATTACHMENT D:

Affidavit of Alfred R. Herrera
Non-Conflict of Interest

STATE OF TEXAS §
§
COUNTY OF TRAVIS §

Affidavit of Alfred R. Herrera

Alfred R. Herrera, being first duly sworn, on his oath states:

1. My name is Alfred R. Herrera. I am the principal of Herrera & Boyle, PLLC, Inc., having its principal place of business at 816 Congress Ave., Suite 1250, Austin, Texas 78701.

2. I have undertaken a check of conflicts with regard to Herrera & Boyle's response to the City of Austin's RFP Solicitation No. 2200 MDD0104 and found no conflicts that would interfere with or call into question Mr. Herrera's ability, and the personnel from Herrera & Boyle who would assist Mr. Herrera and that are identified in response to RFP Solicitation No. 2200 MDD0104, to preside independently over the review process.

3. I hereby swear and affirm that my statements in this affidavit are true and correct.

Alfred R. Herrera

Subscribed and sworn to before me this 2nd day of May, 2017.

Notary Public

LESLIE W. LINDSEY
Notary Public, State of Texas
Comm. Expires 03-10-2019
Notary ID 128548419

ATTACHMENT E:

Brennan J. Foley
Resume

BRENNAN J. FOLEY

6506 Blarwood Drive
Austin, Texas 78745
Cell Phone: (512) 922-3801
E-mail: foley_brennan@yahoo.com

BAR ADMISSION
Texas (2006)
United States District Courts for the Southern and Eastern Districts of New York (2003)

EDUCATION
Benjamin N. Cardozo School of Law, **Yeshiva University**, New York, New York
J.D., June 2001
Honors: Dean's Merit Scholarship
Corporation Counsel Appellate Externship

Reed College, Portland, Oregon
B.A., Anthropology, June 1995

EXPERIENCE
Herrera & Boyle, PLLC, Austin, Texas
Associate, 2016 to present
Practice administrative law in the area of public utility regulation. Represent primarily municipalities in contested cases, rule-making proceedings and appeals of agency decisions. Have extensive experience in electric utility rate proceedings and transmission line certification proceedings. Additional areas of experience include water utility and gas utility rate matters.

Health and Human Services Commission – Office of the Inspector General, Austin, Texas
Associate Counsel, 2014 to 2016
Served as attorney in the agency's Litigation Division. Responsible for the development and prosecution of enforcement cases against Medicaid providers in violation of state and federal law.

Public Utility Commission of Texas, Austin, Texas
Attorney, 2007 to 2014
Performed legal work related to electric and telecommunications regulation. Represented the public interest through advocacy of agency staff's positions in various contexts, including contested case and enforcement proceedings before the State Office of Administrative Hearings and the Commission. Prepared legal briefs and memoranda, testimony of agency staff witnesses and conducted cross-examination of expert witnesses at hearing. Participated in arbitration proceedings under the Federal Telecommunications Act and various rulemakings with other agency personnel.

Vance & Sailors, P.C., San Antonio, Texas
Counsel, 2007
Handled a variety of litigation matters for a general practice firm with an emphasis on family law.

Lumen Legal, Austin, Texas & San Antonio, Texas
Contract Attorney, 2006 to 2007
Conducted electronic document review on behalf of a large, multinational firm in major securities litigation case. Reviewed documents for responsiveness and privilege utilizing specialized electronic document review software. Responsible for reviewing other contract attorneys' work product.

Silverson, Pareres & Lombardi, LLP, New York, New York
Associate, 2005 to 2006
Handled civil litigation matters in the areas of medical malpractice, toxic torts, auto and premises liability, contracts and insurance coverage. Drafted pleadings, discovery demands and responses, motions, settlement agreements and reports to insurance carriers. Attended court hearings and conferences, conducted and defended witnesses at depositions, responsible for retaining expert witnesses, and prepared cases for trial.

Shapiro, Beilly, Rosenberg, Aronowitz, Levy & Fox, LLP, New York, New York
Associate, 2002 to 2004
Litigated civil matters in the areas of personal injury, medical malpractice, premises liability, subrogation, property damage, and insurance coverage. Drafted pleadings, discovery demands and responses, and motions. Conducted and defended witnesses at depositions. Made frequent court appearances for the purposes of discovery and settlement conferences, oral argument of motions and trial.

Joelson & Rochkind, Esqs., New York, New York
Associate, 2002
Handled a variety of civil litigation matters for a general practice firm with an emphasis on personal injury litigation.

PROFESSIONAL ASSOCIATIONS
State Bar of Texas
New York County Lawyers Association

COMMUNITY SERVICE
YMCA Youth Sports, Austin, Texas
Community Justice Program, San Antonio, Texas
Yellow Brick Road Youth Assistance Program, Portland, Oregon

Section 0900: SUBCONTRACTING/SUB-CONSULTING UTILIZATION FORM

MINORITY- AND WOMEN-OWNED BUSINESS ENTERPRISE (MBE/WBE)
PROCUREMENT PROGRAM
Subcontracting/Sub-Consulting ("Subcontractor") Utilization Form

SOLICITATION NUMBER: MDD0104
SOLICITATION TITLE: Impartial Hearing Examiner

In accordance with the City of Austin's Minority and Women-Owned Business Enterprises (M/WBE) Procurement Program (Program), Chapters 2-9A/B/C/D of the City Code and M/WBE Program Rules, this Solicitation was reviewed by the Small and Minority Business Resources Department (SMBR) to determine if M/WBE Subcontractor/Sub-Consultant ("Subcontractor") Goals could be applied. Due to insufficient subcontracting/subconsultant opportunities and/or insufficient availability of M/WBE certified firms, SMBR has assigned no subcontracting goals for this Solicitation. However, Offerors who choose to use Subcontractors must comply with the City's M/WBE Procurement Program as described below. Additionally, if the Contractor seeks to add Subcontractors after the Contract is awarded, the Program requirements shall apply to any Contract(s) resulting from this Solicitation.

Instructions:
a.) Offerors who do not intend to use Subcontractors shall check the "NO" box and follow the corresponding instructions.
b.)Offerors who intend to use Subcontractors shall check the applicable "YES" box and follow the instructions. **Offers that do not include the following required documents shall be deemed non-compliant or nonresponsive as applicable, and the Offeror's submission may not be considered for award.**

☒ **NO, I DO NOT intend to use Subcontractors/Sub-consultants.**
Instructions: Offerors that do not intend to use Subcontractors shall complete and sign this form below (Subcontracting/Sub-Consulting ("Subcontractor") Utilization Form) and include it with their sealed Offer.

☐ **YES, I DO intend to use Subcontractors /Sub-consultants.**
Instructions: Offerors that do intend to use Subcontractors shall complete and sign this form below (Subcontracting/Sub-Consulting ("Subcontractor") Utilization Form), and follow the additional Instructions in the (Subcontracting/Sub-Consulting ("Subcontractor") Utilization Plan). Contact SMBR if there are any questions about submitting these forms.

Offeror Information			
Company Name	Herrera & Boyle, PLLC		
City Vendor ID Code			
Physical Address	816 Congress Ave., Suite 1250		
City, State Zip	Austin, Texas 78701		
Phone Number	512-474-1492	Email Address	sherrera@herreraboylelaw.com
Is the Offeror City of Austin M/WBE certified?	☒ NO ☐ YES Indicate one: ☐ MBE ☐ WBE ☐ MBE/WBE Joint Venture		

Offeror Certification: I understand that even though SMBR did not assign subcontract goals to this Solicitation, I will comply with the City's M/WBE Procurement Program if I intend to include Subcontractors in my Offer. I further agree that this completed **Subcontracting/Sub-Consulting Utilization Form,** and if applicable my completed **Subcontracting/Sub-Consulting Utilization Plan**, shall become a part of any Contract I may be awarded as the result of this Solicitation. Further, if I am awarded a Contract and I am not using Subcontractor(s) but later intend to add Subcontractor(s), before the Subcontractor(s) is hired or begins work, I will comply with the City's M/WBE Procurement Program and submit the **Request For Change** form to add any Subcontractor(s) to the Project Manager or the Contract Manager for prior authorization by the City and perform Good Faith Efforts (GFE), if applicable. I understand that, if a Subcontractor is not listed in my **Subcontracting/Sub-Consulting Utilization Plan,** it is a violation of the City's M/WBE Procurement Program for me to hire the Subcontractor or allow the Subcontractor to begin work, unless I first obtain City approval of my **Request for Change** form. I understand that, if a Subcontractor is not listed in my **Subcontracting/Sub-Consulting Utilization Plan,** it is a violation of the City's M/WBE Procurement Program for me to hire the Subcontractor or allow the Subcontractor to begin work, unless I first obtain City approval of my **Request for Change** form.

Alfred R. Herrera

Name and Title of Authorized Representative (Print or Type)

Signature/Date May 1, 2017

CERTIFICATE OF INTERESTED PARTIES

FORM 1295

Complete Nos. 1 - 4 and 6 if there are interested parties.
Complete Nos. 1, 2, 3, 5, and 6 if there are no interested parties.

OFFICE USE ONLY
CERTIFICATION OF FILING

Certificate Number:
2017-224231

Date Filed:
06/15/2017

Date Acknowledged:

1 Name of business entity filing form, and the city, state and country of the business entity's place of business.
Herrera & Boyle, PLLC
Austin, TX United States

2 Name of governmental entity or state agency that is a party to the contract for which the form is being filed.
City of Austin

3 Provide the identification number used by the governmental entity or state agency to track or identify the contract, and provide a description of the services, goods, or other property to be provided under the contract.
NA170000165
Impartial Hearing Examiner

4 Name of Interested Party	City, State, Country (place of business)	Nature of interest (check applicable)	
		Controlling	Intermediary

5 Check only if there is NO Interested Party. [X]

6 AFFIDAVIT

I swear, or affirm, under penalty of perjury, that the above disclosure is true and correct.

Signature of authorized agent of contracting business entity

LESLIE W. LINDSEY
Notary Public, State of Texas
Comm. Expires 03-10-2019
Notary ID 128548119

AFFIX NOTARY STAMP / SEAL ABOVE

Sworn to and subscribed before me, by the said Alfred R. Herrera, this the 15 day of June, 20 17, to certify which, witness my hand and seal of office.

Signature of officer administering oath	Printed name of officer administering oath	Title of officer administering oath
	Leslie Lindsey	Notary Public

City of Austin
SMBR
Small & Minority Business Resources
Opening the door to opportunities

GOAL DETERMINATION REQUEST FORM

Buyer Name/Phone	Matthew Duree / 974-6346	**PM Name/Phone**	Andy Ramirez / 972-0310
Sponsor/User Dept.	Austin Water	**Sponsor Name/Phone**	Same
Solicitation No	MDD0104	**Project Name**	Impartial Hearing Examiner Services
Contract Amount	$300,000	**Ad Date (if applicable)**	4/10/17

Procurement Type

☐ AD – CSP	☐ AD – CM@R	☐ AD – Design Build
☐ AD – Design Build Op Maint	☐ AD – JOC	☐ IFB – Construction
☐ IFB – IDIQ	☐ PS – Project Specific	☐ PS – Rotation List
☒ Nonprofessional Services	☐ Commodities/Goods	☐ Cooperative Agreement
☐ Critical Business Need	☐ Interlocal Agreement	☐ Ratification
☐ Sole Source*		

Provide Project Description**

RFP to contract with a qualified, independent individual experienced in performing highly advanced, senior-level administrative hearing work and preside over any hearing addressing the cost of service and rate schedule for Austin Water.

Project History: Was a solicitation previously issued; if so were goals established? Were subcontractors/subconsultants utilized? Include prior Solicitation No.

AE recently issued a no goals solicitation for the similar services. RMJ0305

List the scopes of work (commodity codes) for this project. ***(Attach commodity breakdown by percentage; eCAPRIS printout acceptable)***

96105 - Arbitration Services

Matthew Duree	4/3/17
Buyer Confirmation	**Date**

** Sole Source must include Certificate of Exemption*
***Project Description not required for Sole Source*

FOR SMBR USE ONLY

Date Received	4/3/2017	**Date Assigned to BDC**	4/3/2017

In accordance with Chapter2-9(A-D)-19 of the Austin City Code, SMBR makes the following determination:

☐ Goals	% MBE	% WBE
☐ Subgoals	% African American	% Hispanic
	% Asian/Native American	% WBE
☐ Exempt from MBE/WBE Procurement Program	☒ No Goals	

City of Austin
SMBR
Small & Minority Business Resources
Opening the door to opportunities

GOAL DETERMINATION REQUEST FORM

This determination is based upon the following:	
☐ Insufficient availability of M/WBEs ☐ Insufficient subcontracting opportunities ☐ Sufficient availability of M/WBEs ☐ Sole Source	☐ No availability of M/WBEs ☑ No subcontracting opportunities ☐ Sufficient subcontracting opportunities ☐ Other
If Other was selected, provide reasoning:	
MBE/WBE/DBE Availability	
There are 3 MBE/WBEs available	
Subcontracting Opportunities Identified	
No subcontracting opportunities.	

Arturo Salinas	
SMBR Staff	**Signature/ Date**
Arturo Salinas	4/3/17
SMBR Director or Designee	**Date** 4.6.17
Returned to/ Date:	