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S.O.A.H. DOCKET NO. 473-95-1563

P.U.C. DOCKET NO. 14965

APPLICATION OF CENTRAL POWER AND LIGHT COMPANY FOR AUTHORITY TO CHANGE RATES RATES	§ § § §	PUBLIC UTILITY COMMISSION OF TEXAS

GENERAL COUNSEL'S REPLIES TO EXCEPTIONS TO THE PROPOSAL FOR DECISION

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TO THE HONORABLE CHAIRMAN AND COMMISSIONERS:

COMES NOW the General Counsel of the Public Utility Commission (PUC or Commission), representing the public interest, and files these Replies to Exceptions to the Proposal for Decision.

I. INTRODUCTION AND EXECUTIVE SUMMARY

Central Power and Light Company (CPL or Company) begins its exceptions by stating that this is "the last of the major plant in service cases of the late 1980s and early 1990s." CPL Exceptions, at 1. Apparently, CPL is attempting to justify its $71 million request by suggesting that it is seeking to reflect major plant construction costs into rates. This is incorrect. This is not a "major plant in service case." All of CPL's investment in the South Texas Project (STP), including deferred costs, are already in rates. Moreover, there is no major construction program underway or even planned. In fact, the total amount of additional plant requested by CPL to be placed in service in this case is less than $152 million. In contrast, the Cities accurately note that:

> The electric industry is a declining cost industry. With reorganization promising cost reductions and continued depreciation of major generating facilities most utilities are reducing rates.

Cities Exceptions, at 1. Further, the Cities correctly noted that the cost of capital is down, interest rates are relatively low, the restructuring of Central and Southwest (CSW) has reduced costs, and that CPL expects increased revenues due to load growth. Cities Exceptions, at 1-2. These and other factors were revealed throughout the proceeding and resulted in the ALJs' significant reductions to the Company's request.

CPL further argues in its introduction that this case "is a direct consequence of rate moderation settlement agreements approved by this Commission in CPL's two STP plant in service cases, Docket No. 8646 and Docket No. 9561." CPL Exceptions, at 1. CPL observes that these cases contained a "number of rate moderation concessions." CPL Exceptions, at 1. CPL claims that this discussion "is not provided to suggest that the Commission has an obligation to grant CPL a base rate increase in this case solely because of the agreements" but to "demonstrate that CPL has a legitimate, good faith claim to recover those costs which were deferred in the 1990 agreements." CPL Exceptions, at 1-2. Presumably, CPL made its "legitimate, good faith claim to recover" such costs in this proceeding. Based upon these claims, the ALJs reached their decisions. Moreover, the ALJs concluded that the obligations under the non-unanimous agreements in Docket Nos. 8646 and 9561 were fulfilled. PFD, at 20. The possibility that CPL's STP investment necessitated rate moderation and that "CPL avoided requesting the full amount of rate relief projected in the agreements" is irrelevant to this proceeding except to the extent that the rate reduction in this case would have been larger had those events not occurred.

At page 3 of its exceptions, CPL alleges that in order to reach its recommendation the Judges' had to resort to "unconventional approaches to deciding the revenue requirement issues."

CPL Exceptions, at 3. In support of its position, CPL lists eight "unconventional approaches" taken by the ALJs. These consists of the following:

1. an extraordinarily low rate of return;
2. a reduction of CPL's depreciation rates which have been in effect for 15 years;
3. rejection of a depreciation methodology previously approved by the Commission;
4. denying CPL's proposal to amortize the STP deferred accounting asset on a straight-line basis thereby treating CPL differently from every other utility in the state;
5. adoption of a contorted interpretation of the post test year adjustment rule;
6. removing from rate base approximately $40 million of assets currently serving CPL's customers;
7. concluding that CPL has no need to insure itself against a major hurricane; and
8. disallowing over $4 million in costs for necessary services provided to CPL by Central and South West Services, Inc. (CSWS).

CPL Exceptions, at 3. CPL's criticisms are little more than a masking of its own shortcomings. Although the General Counsel sided with CPL on several of these issues, it would be inappropriate to suggest, as CPL has, "that the only way the Judges reach[ed] their result" was by resorting to "unconventional approaches." Regarding point one, the cost of equity, the ALJs' recommendation is equal to that of the General Counsel and higher than any other party in the case except for CPL. Notably, CPL's recommendation is 135 basis points higher than any other party in this case. PFD, at 50. CPL's depreciation proposals were reduced, primarily, due to the Company's inappropriate inclusion of future interim additions, future retirements, and future net salvage. In fact, the ALJs' treatment of these issues is consistent with Commission precedent. CPL is inconsistent in points three and four in complaining that the ALJs' refusal to alter the amortization of its STP deferred accounting asset is different from the treatment afforded other utilities while at the same time criticizing the Judges for changing their depreciation methodology to make it consistent with the vast majority of utilities in Texas.

Points five and six both relate to CPL's post test year adjustments (PTYA). Although the General Counsel has some concerns with the ALJs' application of the PTYA rule, the ALJs' determination that CPL failed to adequately account for all attendant impacts related to its requests is "unconventional." See General Counsel Exceptions, at 9-10.

Furthermore, CPL is incorrect in point seven in asserting that the ALJs "conclu[de] that CPL has no need to insure itself against a major hurricane." CPL Exceptions, at 3. The ALJs rejected CPL's request to increase its catastrophe reserve through an annual $3.6 million accrual. However, the ALJs concluded that "CPL's current catastrophe reserve of $5.4 million is adequate to cover the damages that CPL is likely to encounter from a typical hurricane that strikes its service area." PFD, at 258. Moreover, the ALJs concluded that if a major hurricane created a deficit, "CPL would [not] be unacceptably harmed if it had to file a rate case to recover such a reserve deficit." PFD, at 258.

In regard to affiliate expenses, the ALJs have been anything but "unconventional" towards CPL considering the Company's efforts. Considering CPL provided almost no support for its $46 million request, the ALJs should have disallowed far more than they did. In fact, the ALJs' disallowance ($4 million) is generous compared to the disallowances of the Cities ($30 million), OPC ($15 million), and General Counsel ($15 million).

Curiously, CPL states that the ALJs disallowed "necessary" affiliate costs. CPL Exceptions, at 3. At the hearing and in its brief, CPL incorrectly equated the terms "necessary" and "reasonable." For example, CPL complained that General Counsel witness Herndon rejected work orders even though he indicated that the task involved was necessary. CPL Brief, at 86. Mr. Herndon admitted that many of the tasks performed by CSWS were necessary expenses. Tr., at 3557. This does not mean, however, that the amount requested is reasonable. Mr. Herndon testified that "the fact that certain costs are necessary is not determinative of the reasonableness. I think that you need to evaluate the expenses and make a separate determination of reasonableness, in addition to whether they are necessary." Tr., at 3608. In fact, PURA provides that no expense associated with an affiliate transaction is allowable unless the Commission makes "specific findings of the reasonableness and necessity of each item or class of items allowed and a finding that the price to the utility is no higher than prices charged by the supplying affiliate to its other affiliates or divisions for the same item or class of items, or to unaffiliated persons or corporations." PURA Section 2.208(b). Admittedly, it would be appropriate to allow the reasonable portion of the request where the task is necessary rather than disallow the entire amount. However, this was not possible in this case. As discussed, Mr. Herndon disallowed the entire amount, despite the necessity of the task, because the Company provided no information from which such a reasonableness determination could be made. Given its' choice of words, CPL apparently now recognizes this distinction.

It is clear from the foregoing discussion that CPL's claim that reversal of the PFD "is warranted, if CPL is to have any kind of opportunity to recover its legitimately incurred costs, and earn a minimally reasonable return on its investment" is without merit and should be rejected.

One additional issue in CPL's introduction should be clarified. In footnote 3 on page 3 of its exceptions CPL indicates:

> The Judges erroneously state they are proposing a base rate revenue decrease of $10,324,566. In fact, the Judges actually recommend a non-fuel retail revenue increase of $12.2 million, as shown on Appendix A.

CPL Exceptions, at 3. Although the Company is understandably concerned primarily with total revenue, CPL's assertions are somewhat misleading. In order to arrive at its $12.2 increase, CPL has included miscellaneous revenues in its total retail *base* revenues. This is incorrect. The increase to miscellaneous revenues is not part of base rates. Secondly, the Company has included the rate case expense surcharge and the DSM surcharge in its calculation. CPL erroneously refers to their total as "retail base revenues including proposed surcharges". CPL Exceptions, at Appendix A. The proposed surcharges are not included in retail base revenues. They are charges which will cease once the specific costs for which they were created are collected.

Finally, CPL has included its full requested revenue increase for the interruptible service base revenues. However, it is not clear from the Proposal for Decision (PFD) if this is what the ALJs' intended. See e.g. TIEC Exceptions, at 17-18. Although the ALJs adopted CPL's proposed interruptible rates, the PFD failed to recognize that CPL's proposed rate increase for interruptible customers assumed that CPL's full requested revenue increase would be granted. Clarification of this issue could further reduce the Company's revenues. Assuming, however, no changes are made to interruptible revenues, the $4.8 million non-firm off-system capacity revenue credit is removed, the transmission adder credit is included, and non-firm base revenues are considered, the PFD proposes a total retail base revenue of $811,595,625. This is a base rate decrease of $3,737,049.

V. COMPLIANCE WITH PREVIOUS RATE CASE STIPULATIONS

A. Docket Nos. 8646 and 9561 Stipulations

3. Post Rate Freeze Revenue Restrictions

General Counsel is in agreement with CPL that finding of fact (FOF) number 14 is inconsistent with the terms of the Docket Nos. 8646 and 9561 stipulations. CPL Exceptions, at 4-5. Moreover, it is inconsistent with the text of the PFD and FOF 124. PFD, at 10.

6. Excess Unprotected Deferred Taxes

At page 5 of its exceptions, CPL excepts to the ALJs' recommendation that the balance of excess unprotected deferred income taxes be stated as of test-year end for purposes of implementing CPL's obligations under the stipulations. CPL Exceptions, at 5. CPL argues that the May 1996 balance is more appropriate. CPL Exceptions, at 5. CPL's argument is meritless. Initially, CPL is incorrect in suggesting that there is an inconsistency between sections IX.D and V.A.6. of the PFD. CPL Exceptions, at 5. At page 13 (section V.A.6.) of the PFD, the ALJs indicate that the May 1996 unamortized unprotected excess deferred income tax balance should be amortized over two years. PFD, at 13. This recommendation relates to the amortization treatment. At page 40 (section IX.D.) of the PFD, the ALJs agree that for rate base purposes 'the end of the test year is appropriate". PFD, at 40. This is consistent with the General Counsel's recommendation, the Commission's decision in Docket No. 11735 and their recommendation at page 13.

In addition, it should be noted out that CPL initially urged that the October, 1996 balance was most appropriate. However, according to CPL, it has now abandoned that position. See

CPL Exceptions, at 11 (footnote 11). Apparently, CPL no longer contests the General Counsel's position that the rate year commences with the bonding date.

B. Docket No. 12820 Stipulation

4. Reorganization Costs

In exception number three, CPL indicates that the ALJs have incorrectly stated CPL's requested amortization amount for its share of costs associated with the 1994 CSW reorganization. CPL Exceptions, at 5. The General Counsel agrees with the Company's exception. The parties agreed in Docket No. 12820 that CPL's share ($20.7 million) would be amortized over six years at the rate of $3,442,058. *See Petition of the General Counsel for an Inquiry into the Reasonableness of the Rates and Services of Central Power and Light Company,* Docket No. 12820, 21 P.U.C. BULL. 384 (Oct. 4, 1995), at Attachment B (Stipulation and Agreement), Article XVI, page 41. Notwithstanding the inconsistent language, it should be noted that the ALJs' amortization expense of $57,032,695 includes the correct $3,442,058 amount.

IX. INVESTED CAPITAL

A. Post-test-year Adjustments

1. Standards for Adjustments

At pages 6-8 of its exceptions, CPL expresses concerns over the ALJs' application of the PTYA standard. CPL Exceptions, at 6-8. CPL asserts that the ALJs' standard of "account[ing] for all attendant impacts in the broadest sense" results in "arbitrary disallowances of PTYAs based on the fact that other changes, not causally related, are simply happening at the same time (i.e., temporally)." PFD, at 262. CPL Exceptions, at 7. General Counsel is in general agreement with the concerns expressed by CPL. CPL correctly points out in its exceptions that the only attendant impacts which should be reflected are those for which there is a causal relationship to the asset in question. CPL Exceptions, at 6-8. Specifically, General Counsel disagrees with the ALJs' application of the PTYA rule in rejecting CPL's request for recovery of the Coleto Creek Coal Blending Facility costs. As noted previously, load growth is not an attendant impact of the Coleto Creek facility. See GC Exceptions, at 9-10.

In contrast to CPL's argument that the ALJs have taken too broad an interpretation of the PTYA rule, OPC excepts to the ALJs' "extremely narrow" interpretation of the rule. OPC Exceptions, at 39-40. Specifically, OPC argues against the ALJs' rejection of its proposed adjustment to revenues for post-test year load growth. OPC Exceptions, at 39. OPC claims that it is unfair to make PTYAs without making post test year load growth adjustments. OPC Exceptions, at 39. OPC admits that no immediate causal connection exists between other post test year adjustments. The only connection is a temporal one. OPC Exceptions, at 39-40. The Cities make a similar argument at pages 6-7 of their exceptions. Cities Exceptions, at 6-7. Their logic is flawed.

Initially, the PTYA provisions of P.U.C. SUBST. R. 23.21(b) were only intended to apply to rate base. Consequently, whether a PTYA is appropriate depends in part on whether the adjustment is to a cost of service or a rate base item. If the item is in cost of service, the adjustment may be made if it represents a "known and measurable change" to the Company's reasonable and necessary expenses. However, if the PTYA is to a rate base item, then the adjustment may be made only if the attendant impacts on all aspects of the utility's operations can be identified, quantified, and matched with reasonable certainty. The load growth adjustments proposed by OPC and Cities are in response to cost of service adjustments (e.g. salary and wage increases beyond the test year). However, the projected load growth adjustments are neither known nor measurable. The Cities acknowledge the uncertainty of future revenue growth in stating that "CPL anticipates annual revenue growth of $27 million due to increased sales." Cities Exceptions, at 7. For these reasons, the Commission should adopt the ALJs' recommendations on this issue.

Secondly, the Commission has never allowed PTYAs to invested capital for intangible assets in a contested case. GC Ex. 15, at 16-17. PTYAs are intended to be made for tangible assets such as major plant additions. Since the adoption of the current PTYA rule, the Commission has, consistently rejected PTYAs for components of invested capital other than plant in service; e.g., accumulated depreciation and accumulated deferred income taxes (ADFIT). See e.g., *Application of Texas-New Mexico Power Company for Authority to Change Rates*, Docket No. 8928, 15 P.U.C. BULL. 2026 (Apr. 18, 1990), (rehearing denied), *Application of Texas Utilities Company for Authority to Change Rates*, Docket No. 9300, 17 P.U.C. BULL. 2057 (Sept. 27, 1991)., *Application of El Paso Electric Company for Authority to Change Rates*, Docket No. 9945, 18 P.U.C. BULL. 9 (Nov. 12, 1991), *Application of Texas - New Mexico Power Company for Authority to Change Rates*, Docket No. 10200, 19 P.U.C. BULL. 89 (Oct. 16, 1992). Given the Commission's consistent application of the PTYA rule, it is evident that the PTYA rule does not, and was not intended to, apply to the type of adjustment OPC and Cities have proposed.

At page 58 of its exceptions, the Cities argue that in rejecting the PTYAs for the Coleto Creek facility and the East Tie, the ALJs failed to exclude post-test year O&M, depreciation, ad valorem and other tax adjustments associated with the facilities. Cities Exceptions, at 58. The first time, the Cities argue for exclusion of these costs. See Cities Revenue Requirement Brief, at 8. The Cities are correct that depreciation should be adjusted. However, a comparison of the number running memoranda (section F) to Schedule C-1 of the rate filing package indicates that these amounts have already been removed. Specifically, the Coleto Creek facility was removed from Depreciation Account 312 and the East Tie was removed from Depreciation Account 353. In regards to the other items, the Cities are effectively requesting a new standard in the treatment of PTYAs. The Commission should decline to adopt such a standard. In Docket No. 5560 the Commission was confronted with this same issue. The Commission disallowed the requested PTYA. However, the Commission also indicated that:

> The known, measurable and reasonable operating expenses attributable to Big Cajun 2, Unit 3 should be included in GSU's revenue requirement despite the fact that this plant, which went into commercial operation on September 1, 1983, is not considered to be plant in service for this docket.

See *Application of Gulf States Utilities Company For A Rate Increase,* 10 P.U.C. Bull. 405, Docket No. 5560 (July 13, 1984), FOF 56. Thus, the Commission clearly distinguished between rate base and cost of service. Subsequent to this docket, the Commission adopted P.U.C. SUBST. R. 23.21(b). The invested capital or "rate base" portion of this rule has become known as the "post test year adjustment rule". As the preamble to the rule stated: "[t]he amendment is intended and does explicitly overrule the Commission precedent established, known as the Big Cajun rule, that disallowed known and measurable changes to historical test year invested capital." 14 Tex. Reg. 2951 (June 13, 1989). However, the PTYA did not overrule the "cost of service" portion of Docket No. 5560. For a further discussion of this Big Cajun rule and P.U.C. SUBST. R. 23.21(b), please refer to General Counsel's initial brief in the Revenue Requirements Phase pages 8-12.

CPL should be allowed to recover its reasonable and necessary costs. Given the Commission's holding in Docket No. 5560 and the fact that the Cities have not disputed the reasonableness of the costs, General Counsel urges the Commission to reject the Cities argument.

5. Coleto Creek Coal Blending Facility

Although the General Counsel did not take a position on the reasonableness of the PTYA for the cost of the Coleto Creek Coal Blending Facility, the General Counsel did except to the ALJs' reasoning that load growth is an attendant impact of the construction of the facility. GC Exceptions, at 9. However, the General Counsel does not support CPL's argument that if the Commission decides to disallow the PTYA treatment for the coal blending facility the Commission should "permit the costs of the facility to be recovered through reconcilable fuel under P.U.C. SUBST. R. 23.23(b)(2)(B)(v)." CPL Exceptions, at 9. CPL goes on to state that the "special circumstances supporting such treatment are the lower fuel expenses which result." CPL Exceptions, at 9. There is no evidence to support CPL's claim. In fact, CPL raises this alternative for the first time in its exceptions. CPL can not, at this late date alter its request without any party being allowed to challenge it.

B. Original Cost of Plant in Service

2. Transmission Projects Since Last Rate Case

b. High Voltage Direct Current (HVDC) Project

i. South HVDC Tie

As discussed in exceptions, the General Counsel supports the Company's comments regarding reliance on a financial integrity standard as the basis for inclusion of abandoned plant. GC Exceptions, at 10-11. CPL Exceptions, at 12-13. Financial integrity is not an appropriate standard for determining whether abandoned plant costs should be recovered. However, there are other reasons why the Commission should disallow the South HVDC Tie costs.

At page 13 of its exceptions, the Company maintains the fiction that the South Tie was abandoned only after construction of the East Tie was completed. CPL Exceptions, at 13. However, the ALJs correctly recognized that this is not the case. As page 34 of the PFD, they indicate:

> A review of the FERC East Tie order and the entire history of the CSW interconnection matter, however, indicates CPL's obligation to build the South DC Tie disappeared long ago. The FERC sought the construction of the interconnection between the CSW utilities on both sides of the ERCOT/SPP boundary, not the specific building of the South Tie. CPL witness Bruggeman acknowledged as much.

PFD, at 34. The Company effectively abandoned the South Tie in 1987, or nearly ten years ago. PFD, at 34. To ask ratepayers to bear the costs of a project abandoned nearly ten years ago is unreasonable and not in the public interest. Regardless of whether a financial integrity showing has been made, CPL's proposal is contrary to sound ratemaking principles and should be denied.

For the first time, in its exceptions, CPL indicates that it "no longer requests the rate base treatment [for the South Tie] that would enable it to earn a return on its abandoned plant." CPL Exceptions, at 15. CPL now "requests a ten-year straight-line amortization of the costs." CPL Exceptions, at 15. This recommendation should be denied. As noted, CPL abandoned the South Tie in 1987. CPL has had three rate cases since the plant was abandoned in which they could have requested amortization of the South Tie but chose not to do so. They can not now at this late date request amortization of the expense. In addition, unlike other abandoned plant where the Commission has allowed amortization of the costs, CPL never obtained a CCN for the South Tie from the Commission. For these reasons, CPL's request to amortize the costs associated with the South Tie should be rejected.

ii. East HVDC Tie

CPL also takes exception to the ALJs' disallowance of its costs associated with the East Tie. CPL Exceptions, at 10. Primarily, CPL argues that "the evidence does not support the Judges' finding that load has grown as a result of the East Tie." CPL Exceptions, at 9. Consequently, CPL asserts the ALJs have erred in requiring CPL to account for load growth as an attendant impact. However, at the end of its discussion, CPL states that even if the Commission were to find a load growth adjustment appropriate for either the Coleto Creek Coal Blending Facility or the East Tie, the "proper approach would be to reduce operating expenses and rate base associated with the PTYAs by a percentage representing load growth." CPL Exceptions, at 10. This argument is incorrect for several reasons. First, the Commission is well within its authority to deny inclusion of any costs where the Company fails to meet its burden of accounting for the attendant impacts of the PTYA. Second, it would not be appropriate to reduce operating expenses and rate base by a percentage representing load growth. Load growth is reflected in billing determinants. Therefore, the appropriate relief would be to increase billing determinants by the amount of load growth.

E. Plant Held for Future Use

At pages 16-17 of its exceptions, CPL excepts to the ALJs' recommendation that the four generating units in long-term storage should not be included in rate base as plant held for future use (PHFU). CPL Exceptions, at 16-17. Apparently, CPL is no longer requesting inclusion of the Walker Grimes Lignite Reserves ($10,710,930). The four generating units are Nueces Bay No. 5, La Palma Nos. 4 and 5, and Victoria No 4. CPL's arguments should be rejected.

As set forth in the Commission's Preliminary Order and verified by the record evidence, the four generating units do not meet the requirements of the Commission's well established PHFU rule.[1] In addition, the four generating units do not meet other considerations set forth in the Preliminary Order. Specifically, the Commission's December 21, 1995, Preliminary Order, found that the generating units "should not be included in rate base in this docket prior to consideration of CPL's generation planning in a docket addressing the IRP process, or process which may replace IRP in the future." Therefore, General Counsel witness Coleman, in accordance with the Commission's Preliminary Order, disallowed the Company's request. The ALJs were correct in disallowing the $19,871,821 for the four generating units.

At page 18 of its exceptions, the Company alleges that "in the event the Commission adopts the Judges' recommendation, an adjustment must be made to accumulated depreciation.."

1 The Commission issued a Preliminary Order in this docket on December 21, 1995. During January 1996, the Commission issued First and Second Supplemental Preliminary Orders. The Supplemental Orders did not reverse the Commission's determination that the Walker-Grimes lignite reserves and the generating units should not be included in rate base.

CPL Exceptions, at 18. Generally, CPL is correct that any associated accumulated depreciation related to the disallowed items should also be disallowed. However, CPL never raised this issue in its rebuttal testimony, at the hearing, or in its briefs. Consequently, it is unclear what the appropriate amount of accumulated depreciation, if any, would be. Without any citation to the evidence, CPL asserts that the correct amount is $14,339,235. However, without providing the parties an opportunity to review this information, CPL's assertion can not be verified. Consequently, the Commission should reject the Company's request.

F. Working Capital

In its exceptions, CPL argues that the FIT lead days used in the cash working capital calculation should be calculated using an average based on data from 1991, 1992, 1993, and 1994. CPL Exceptions, at 18-20 An average calculation is adopted in situations where it produces a more representative result than does a single year's information. The very nature of the reason for using an average requires that all anomalous items be identified and eliminated from the calculation. A review of the information for the four years in CPL's average calculation, reveals that the 1993 data is anomalous. The Company did not meet its burden of proof regarding the reasonableness of the 1993 information or the reasonableness of the use of the average calculation as opposed to the use of the most recent information. The ALJs correctly adopted the General Counsel's recommended lead days for FIT based upon the 1994 information.

H. Mirror Construction Work in Progress (CWIP)

At pages 10-12 of its exceptions, CPL continues to demonstrate its failure to comprehend the purpose and intent of the PTYA rule. General Counsel discussed the history of this rule at length in its initial brief. See Attachment A. In summary, the PTYA rule is intended for plant in service components of invested capital not intangible assets. Given the Commission's consistent application of the PTYA rule, it is evident that the PTYA rule does not, and was not intended to, apply to non-plant in service items as CPL has proposed. However, even if one accepts the Company's erroneous interpretation of the PTYA rule, CPL has still applied it inconsistently.

Not only has the Company selectively applied the PTYA rule to certain components of the Company's invested capital, but it has failed to match the attendant impacts of the adjustments that it has requested, as required by P.U.C. SUBST. R. 23.21(b). CPL witness Felber stated in his rebuttal testimony that the mirror CWIP and STP deferred accounting asset are related to plant in service. CPL Ex. 94, at 15. Therefore, if the Company desired to request a PTYA related to mirror CWIP, it also should have requested to adjust the associated balances of STP plant in service, STP accumulated depreciation and the ADFIT associated with STP. All of these components existed as of June 30, 1995 as did the mirror CWIP and STP deferred accounting asset. GC Ex. 15, at Schedule IV. The Company can not simply pick and choose which components it will restate to a future date. The PTYA rule clearly requires that all attendant impacts be reasonably identified, quantified, and matched. General Counsel does not advocate an interpretation of the PTYA rule which would permit the selective restatement of the components of invested capital that were in existence at the end of the test year to the beginning of the expected "pro forma rate year" as proposed by CPL. However, if an adjustment is to be made, all the corresponding components of invested capital such as STP plant in service, accumulated depreciation, and ADFIT associated with STP should likewise be restated to the same point in time consistent with sound regulatory principles, as well as, the PTYA rule itself.

CPL's rate base adjustments to mirror CWIP are not based on sound regulatory policy. The Company has applied its interpretation of the PTYA rule inconsistently and made several erroneous statements regarding its PTYAs. General Counsel recommends that the Company's PTYAs to mirror CWIP be rejected.

The Company also argues that its proposed PTYA are attendant impacts of cost of service adjustments related to these items. CPL Exceptions, at 11. The Company's argument should be rejected because the cost of service is based on a utility's reasonable and necessary test year costs adjusted for known and measurable changes. See Section IX.A.1. above.

The General Counsel supports the ALJs' determination that CPL's requested mirror CWIP asset and liability balance PTYAs should be denied. However, as discussed above, the General Counsel disagrees with the ALJs' standard for making such adjustments. Specifically, General Counsel excepts to the ALJs conclusion that 'PTYAs are permissible for such [intangible] assets if all attendant impacts are identified and accounted for." PFD, at 47. The Commission has never allowed PTYAs to invested capital for intangible assets such as mirror CWIP in a contested case. GC Ex. 15, at 16-17. For this reason, the Commissioners should reject the ALJs' reasoning and adopt the General Counsel's position on this issue. However, if the Commission concurs with the ALJs' recommendation that PYTAs may be made for intangible assets, the General Counsel agrees with the ALJs that CPL has failed to reasonably identify, quantify and match all attendant impacts.

X. COST OF CAPITAL

B. Cost of Equity

CPL begins its cost of equity discussion by asserting that the ALJs' 10.9 percent recommendation "may be the lowest return on equity ever allowed an investor owned utility at this Commission." CPL Exceptions, at 20. What CPL fails to note is that interest rates are near the lowest level they have been in the 20 year life of the Commission. The ALJs' recommendation is a direct consequence of this fact. It is telling that, in its 20 pages of discussion, CPL never alleges that the ALJs' recommendation will deny them a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public. This is because the ALJs' recommended 10.9 percent cost of equity is reasonable.

CPL presented the testimony of Dr. Hadaway in support of its 12.25 percent request. This is a full 135 basis points higher than any other parties' recommendation in this proceeding. The ALJs' correctly noted that "high grade junk bonds were yielding 12.0 percent during the hearing." PFD, at 50. The ALJs then noted that "[n]othing indicates that CPL is in dire financial straights, which would make its equity worth no more than a junk bond." PFD, at 50. Despite its criticisms that such comments are "unusual", CPL later admits that this did not have an effect on the Judges' ultimate decision. CPL Exceptions, at 22, 38. Furthermore, the ALJs recognized that "CPL is in very good financial shape and expects its financial statistics to improve even without a rate increase." Tr., at 1088-99.

Although the General Counsel disagrees with the ALJs' rejection of the General Counsel's DCF analysis and use of the constant growth DCF methodology, the General Counsel supports the ALJs' recommended cost of equity for CPL of 10.9 percent. CPL presented no credible evidence indicating that such a recommendation is unreasonable. Moreover, CPL's claims that the Judges relied upon "unorthodox principles of finance and economics" are unsupported by the evidence. Consequently, the Commission should deny CPL's exception.

Before discussing the specific factors in this proceeding, CPL discusses other recent cases in which higher rates of return were authorized by the regulatory body. CPL Exceptions, at 21-22. According to CPL, these cases demonstrate that "there is a growing consensus that competitive risks are driving up the cost of equity for utilities and that investor uncertainty is a significant factor to be taken into account." CPL Exceptions, at 22. General Counsel does not disagree with these comments. In fact, it is for this very reason that the General Counsel relies on a multi-stage DCF analysis. General Counsel witness Tietjen testified that "[b]ecause of the uncertainty surrounding the changing nature of the industry and the concomitant impact on dividend streams, the use of a single-stage discount model is clearly not appropriate." GC Ex. 11, at 33. For these reasons, Mr. Tietjen applied a multi-stage DCF model that incorporates the various growth rates expected over time.

The Company next alleges that the ALJs' have relied upon "an unusual method of determining CPL's cost of equity." CPL Exceptions, at 22-23. In many respects, the ALJs' recommendation is similar to each of the witnesses in the case. The ALJs have relied upon comparisons of DCF and risk premium analyses to arrive at their result. The primary difference between the individual witnesses' approach and the ALJs' approach is that the ALJs relied on the analysis of more than one witness to get a reasonable range from which they ultimately made their determination. The Company's real complaint is that the ALJs determined that its witness, Dr. Hadaway, lacked credibility and therefore did not include his recommendation in their analysis.

At page 2 of its exceptions, OPC indicates that no party except CPL agreed to a return on equity higher than 10.6%. OPC Exceptions, at 2. OPC goes on to state that the General Counsel's recommended 10.9% recommendation is based upon a flawed risk premium analysis. OPC Exceptions, at 3. OPC's statement are incorrect. The General Counsel recommends CPL's return on equity be set at 10.9%. This is consistent with the ALJs' recommendation.

Initially, OPC claims that there was a "computation error" in General Counsel's "risk premium study". OPC Exceptions, at 3. In truth, General Counsel relied upon inaccurate information in conducting it's DCF analysis. Next, OPC claims that because of this "General Counsel changed the initial cost of equity recommendation of Mr. Tietjen to 10.9%." OPC Exceptions, at 3. This is also incorrect. General Counsel merely indicated, based upon Mr. Tietjen's testimony, that its DCF cost of equity would have changed from 11.52 percent to 10.58 percent if the inaccurate information had been discovered and that as a result of Mr. Tietjen's weighted recommendation would be 10.9 percent[2] OPC correctly notes this in its exceptions. OPC Exceptions, at 3. However, OPC then states that the General Counsel's recommendation is "based on a flawed risk premium study." OPC Exceptions, at 3. This is also incorrect. As noted, the error related to the DCF analysis, not the risk premium analysis.

2. Risk Premium Analysis

In evaluating the risk premium recommendations presented by the parties the ALJs' correctly rejected Dr. Hadaway's study because it calculated risk premiums for a 40-year period. PFD, at 53. Instead, the ALJs' find that use of the most recent 15 years of data is "far more

2 Mr. Tietjen's return on equity recommendation is based on an averaging of his DCF analysis and risk premium analysis.

reasonable." PFD, at 53. CPL excepts to this conclusion on the basis that the ALJs do not explain their recommendation. CPL Exceptions, at 24.

Contrary to CPL's claim, there is adequate evidence supporting the ALJs' conclusions. CPL Exceptions, at 25. For example, General Counsel witness Tietjen's risk premium analysis starts with the first quarter of 1980 and continues through the first quarter of 1995. The first quarter of 1980 was chosen as a starting point of the risk premium analysis because it was approximately at that time, that a fundamental change took place in investor perceptions of the risk associated with bonds. Specifically, action by the Federal Reserve Board sent interest rates soaring and ushered in an unprecedented era of volatility and risk in bond prices and yields. Risk premium data before 1980 do not capture this fundamental shift in risk that occurred in investor perceptions of long-term bonds. GC Ex. 11, at 49. The first quarter of 1995 was used as the ending point because it was the last quarter for which return on equity data and bond yield data were available. GC Ex. 11, at 50. General Counsel, TIEC, and OPC all relied upon 15 years of data. In addition, CPL's own witness has used 15 years of data in previous cases and testified that data before 1958 was unduly affected by World War II and the Korean conflict. PFD, at 52. Moreover, the years from 1955 to 1961 contain five of the highest-risk premiums. PFD, at 53. CPL own witness' previous testimony further supports the use of a risk premium analysis which relies on 15 years of data.

At page 25 of its exceptions, CPL makes specific criticisms regarding Mr. Tietjen's risk premium analysis. None of these are credible. CPL Exceptions, at 25. Mr. Tietjen made adjustments to his risk premium analysis which dispute each of CPL's claims. For example, before the calculations were made in Mr. Tietjen's risk premium model, the five negative equity risk premiums observed in the second quarter of 1981 through the second quarter of 1982 were removed from the data. GC Ex. 11, at 50. This was done because it would not be reasonable to assume that investors would ever consciously make an equity investment with the *expectation* of earning less than the corresponding bond yield. Also, so as not to bias the average risk premium or the slope of the regression analysis, the five outliers (i.e., the five highest equity risk premiums observed in the data) in the other direction were also removed. These outliers occurred in the first through the fourth quarters of 1986 and in the third quarter of 1993. GC Ex. 11, at 50. In addition, Mr. Tietjen testified that "the allowed cost of equity, as opposed to the earned cost of equity, is the appropriate measure because it is a reasonable approximation of investors' expectations." GC Ex. 11, at 48. Because both the average utility bond yield and the allowed rate of return on equity are *prospective* measures of risk and because the cost of equity is a forward-looking concept, the risk premium model used by General Counsel is an appropriate methodology for estimating CPL's cost of equity.

3. Discounted Cash Flow (DCF) Analysis

CPL admits that the ALJs' DCF analysis has "little impact on the final result." CPL Exceptions, at 29. Nevertheless, CPL excepts to the PFD on the grounds that the ALJs' reasoning is "riddled with errors." CPL Exceptions, at 29. General Counsel filed exceptions to the ALJs' rejection of its DCF analysis. However, even if the Commission does not grant the General Counsel's exception, it should not rely on the DCF analysis of CPL witness Hadaway.

The return on equity recommendation of CPL witness Hadaway is clearly inflated. The primary shortcoming of his recommendation is that it is based upon an average of only three of the seven models he presented. Tr., at 1599. These consists of the three-year horizon non-constant growth terminal value, the ten-year transition multi-stage growth value, and the five-year transition multi-stage growth values discussed at page 34 of CPL's exceptions. Not surprisingly, the three models relied upon by Mr. Hadaway are those which produced the highest returns. The ALJs rejected Dr. Hadaway's three- year terminal value model because it assumes that investors have three-year investment horizon, which the ALJs concluded is unreasonable. PFD, at 57. Even if the ALJs are incorrect in stating that Dr. Hadaway conceded that it is improper to assume that investors have a three-year investment horizon as CPL claims, it does not mean that the ALJs' determination is incorrect. CPL Exceptions, at 35.

The five-year multi-stage model was rejected by the ALJs because it assumed the dividends will grow at the same rate as earnings, that competition will come in five years, and that each of his 27 comparable single-A utilities will obtain the same growth rate and experience the same competitive impact for five years. PFD, at 57. The arguments presented at pages 35-37 of CPL's exceptions simply do not eliminate these flaws. CPL Exceptions, at 35-37. There is no basis to support Mr. Hadaway's reliance on these three models alone. Based upon these facts, the ALJs were correct in rejecting CPL's proposed return on equity.

a. Constant and Non-Constant Growth Models

The General Counsel is in agreement with CPL that it is inappropriate to rely upon a constant growth DCF methodology. Further discussion is contained at pages 13-14 of General Counsel's Exceptions. GC Exceptions, at 13-14.

c. Model Assumptions

ii. Staff's Assumptions

CPL spends considerable effort in its exceptions responding to the General Counsel's DCF analysis. CPL Exceptions, at 38-41. Although erroneous, it should be noted that the ALJs did not rely on the General Counsel's DCF analysis in making their recommendation. PFD, at 59. Consequently, CPL discussion is not an actual exception but, rather, a continuation of their reply brief. Notwithstanding the fact that the ALJs did not rely on General Counsel's DCF analysis, the General Counsel offers the following comments in response to CPL's statements.

Initially, CPL notes that it does agree that "the mathematical calculation of a DCF cost of equity using the 3.4 percent growth rate with the Staff's previous method would be 10.58 percent." CPL Exceptions, at 39 (footnote 24). Additionally, CPL agrees that Mr. Tietjen testified that if the information he relied upon was discarded and he relied on the correct utility growth rate information that he would have utilized a prior Staff method. CPL Exceptions, at 39.

In its exceptions, CPL expresses four remaining concerns with regard to the General Counsel's DCF analysis. According to CPL: (1) there was no indication whether the actual Zacks growth rate is 4.7 percent or 3.4 percent, (2) Mr. Tietjen did not agree that the 3.4 percent growth rate should be substituted for the 6.7 percent growth rate, (3) there was no explanation for why 3.4 percent growth rate should be used instead of the 4.7 percent growth rate, and (4) because of the "unfairness of applying a mechanical calculation of return on equity after the hearing had closed, thus denying [CPL] the right to cross-examine on the question of whether a cost of equity of 10.58 percent is reasonable." CPL Exceptions, at 39-40. None of CPL's concerns are meritorious.

First, Cities Exhibit No. 132 contains a listing of all of the domestic utilities used to derive Zacks long-term growth rate for December 30, 1995. Cities Ex. 132. Averaging the expected growth rates for the domestic utilities produces a long-term industry growth rate of 3.4%. Cities Ex. 132. The accuracy of this information was verified by Mr. Tietjen subsequent to its being admitted into the record. Tr., at 3960-3964, 3981-3982. CPL had an opportunity to verify this information or object to its inclusion in the record but chose not to do so. If foreign utilities were also included in the calculation, the resulting growth rate would be 4.7%. Cities Ex. 131. This explains the difference between the 4.7 percent and 3.4 percent figures which CPL raises as its first concern.

Secondly, CPL is correct that Mr. Tietjen did not state on the record that the 3.4 percent growth rate should be substituted for the 6.7 percent growth rate. This is because at the time Mr. Tietjen was testifying, it was not verified that the information he relied upon was incorrect. However, Mr. Tietjen testified that in the event the Zacks number reported to Bloomberg had been 4.7 percent or less he would have used the approach used by General Counsel in recent proceedings. Tr., at 3927. Mr. Tietjen indicated that this approach would have been appropriate since the effects of competition would not have been incorporated into the Zacks figures. Tr., at 3927. Once it was verified that the 6.7 percent information relied upon by Mr. Tietjen was erroneously reported by Zacks to Bloomberg, the only alternative was to rely on the correct information.

As noted by Mr. Tietjen, use of the correct information would have resulted in his using the approach taken by General Counsel witnesses in recent cases because the effects of competitions would not have been accounted for in the Zacks information. Tr., at 3927. Those recent cases referred to by Mr. Tietjen are Docket Nos. 12700, 12820, and 13369, where the General Counsel witnesses estimated the long-term growth rate using "a simple average of the projected growth rate for the overall electric utility industry and the projected growth rate of the Standard & Poor's 500 index." GC Ex. 11, at 41. The Standard & Poor's 500 index is composed of a broad group of 500 stocks that are often used as a general barometer of the market as a whole. GC Ex. 11, at 42. This approach is based on the assumption that the asset structure of utilities would eventually consist of approximately 50 percent generation assets and 50 percent transmission and distribution assets. Further, this approach assumes that the generation side of the industry, being subject to competitive markets, would eventually grow at the overall market growth rate projected for in the S & P 500 index, while the remaining assets, still subject to some form of traditional regulation, would grow at the rate projected for the overall utility industry. GC Ex. 11, at 42.

For example, in CPL's last rate case, Docket No. 12820, the Staff calculated its long-term growth rate based upon an average of the then-projected utility industry growth rate and the S&P 500 growth rate. GC Ex. 11, at 42. The averaging of the industry growth rate and the market growth rate is, in effect, an attempt to properly capture the effects of the emergence of competition into the generating side of the industry.

Cities' Exhibit No. 131 consists of pages from the January 7, 1996 copy *Credit Analyst Watch* containing the S&P 500 long-term industry growth rate of 7.5% for December 30, 1995. An average of the S&P 500 long-term industry growth rate of 7.5% and the Zacks utility industry long-term growth rate for the same period of 3.4% results in a recommended long-term growth rate of 5.45%. Inclusion of the 5.45% long term growth rate in Mr. Tietjen's comparable company DCF analysis changes his DCF point estimate from 11.52% to 10.58%. When this figure is averaged with Mr. Tietjen's risk premium analysis recommendation of 11.2%, the resulting cost of equity recommendation is 10.9%.

CPL's third criticism is that there was no explanation for why a 3.4 percent growth rate should be used instead of the 4.7 percent growth rate. CPL Exceptions, at 40. This is incorrect. As noted, the difference between the 3.4 percent growth rate figure and the 4.7 percent growth rate figure is that the 3.4 percent number is an average of the expected long-term industry growth rates for the domestic utilities. Cities Ex. 132. If foreign utilities were also included in the calculation, the resulting growth rate would be 4.7 percent. Cities Ex. 131. Mr. Tietjen was asked during cross examination the following by the Cities' attorney:

> Q. ...So in your view, would it be more reasonable to exclude the growth rates of the foreign companies and focus on the growth rates for American companies?
>
> A. I think generally speaking, that's probably the reasonable thing to do.

Tr., at 3697. In addition, TIEC asked Mr. Tietjen about the appropriateness of including foreign utilities in the analysis. Tr., at 3909. Again, Mr. Tietjen indicated that "certainly the inclusion of foreign utilities in such an average would raise some concerns." Tr., at 3909. Although Mr. Tietjen expressed some concerns about which foreign utilities were included in the Zacks information, he was able to verify the contents and accuracy. Tr., at 3909-3911. As noted, CPL did not object to the verification of the Zacks' information contained in Cities Exhibit 132.

CPL's final concern is that they were precluded from conducting cross-examination on the "question of whether a cost of equity of 10.58 percent is reasonable." CPL Exceptions, at 40. This is incorrect, the Cities, TIEC and OPC all presented witnesses who recommended DCF results which were below 10.58 percent. PFD, at 54. In addition, CPL questioned Mr. Tietjen at length about the consequences of the errors in the Zacks information. Tr., at 3883-3894. Finally, it is ironic that CPL complains about the inclusion of "a mechanical calculation of return on equity." CPL Exceptions, at 40. CPL agreed with the accuracy of the calculation. CPL Exceptions, at 39 (footnote 24). Moreover, CPL offered at extra-record calculations itself in its exceptions which, in contrast to General Counsel's DCF recommendation, are not supported by the evidence. See CPL Exceptions, at 18, Appendix D.

Based upon Mr. Tietjen's multi-stage DCF and risk premium analyses, General Counsel recommends a point estimate for CPL's cost of equity, of 10.9 percent. This number is the average of Mr. Tietjen's revised comparable companies' DCF costs of equity analysis and his risk premium analysis. GC Ex. 11, at Schedule DT-13. Moreover, this number was recommended by the ALJs based upon their independent analysis and conclusion that a 10.9 percent return on equity will afford CPL a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public. Consequently, the General Counsel urges the Commission to reject the Company's exceptions.

XII. COST OF SERVICE

A. Operations and Maintenance Expense

1. Salaries and Wages

At pages 6-7 of the Cities exceptions, they criticize the ALJs' adoption of the General Counsel's recommended salary expense. Cities Exceptions, at 6-7. This recommendation relies on a post test year November 18, 1995 payroll. Specifically, the Cities criticize General Counsel for not "annualiz[ing] revenues to November 1995." Cities Exceptions, at 6. Such an adjustment is inappropriate and should be rejected by the Commission. Further discussion of this issue is contained in Section IX.A.1 above.

2. Employee Pension and Benefits

At pages 41-42 of its exceptions, CPL excepts to the ALJs' recommended disallowance of $462,393 in employee pensions and benefits. The ALJ appropriately adopted $462,393 in General Counsel adjustments to various employee benefit categories[3]. While CPL's exceptions highlight the $462,393 amount, it mistakenly discusses the $462,393 as if it relates only to pension expense. Of the $462,393, only $231,755 relates to pension expense. The remaining adjustments, $230,638, apply to other employee benefit categories. CPL offers no exception to the $230,638.

CPL does, however, except to the ALJs' adoption of General Counsel's proposed treatment of pension expense. General Counsel's recommended pension expense is based on CPL's actual funding level for the 12 month period ending September 1995. Given the fact that General Counsel's recommendation is based on "actual" expense levels, it is clearly known and measurable. The Commission should adopt the ALJs' recommendation to disallow $231,755 in pension expense as well as the additional $230,638 in employee benefit adjustments to which CPL did not except.

5. Factoring Expense

Cities except to the ALJs' allowance of 100% of factoring expense on the grounds that the ratepayers only receive 61.45% of the benefits of factoring. Cities' argument that the ratepayers only receive 61.45% of the benefits of factoring confuses the factoring expense issue

3 See General Counsel Exhibit 17, Attachment DCM-3, for a detail of the various benefits.

with the cash working capital issue. Although Cities state "[t]he determination of reasonable factoring expense is not governed by the cash working capital rule. Factoring expense and cash working capital are two different issues," these statements are inconsistent with Cities' logic for adjusting factoring expense. Cities erroneously employ the cash working capital concept of "exclusion of non-cash items" and apply it to the factoring expense. The Commission's Substantive Rule 23.21(d)(2)(B)(iii) details the appropriate methodology for calculating cash working capital. This rule states that non-cash items will be excluded from the calculation of cash working capital, but makes no mention of applying this principle to factoring expense.

The ALJs' recommended factoring expense represents CPL's reasonable cost of this business transaction. If the Commission deems that the business practice of "factoring" is a reasonable one, then the true cost of the transaction (100%) should be allowed. For the above reasons, the Cities' exception should be denied.

6. Affiliated Transactions

a. Introduction

At pages 43-46 of its exceptions, CPL discusses affiliate expenses. CPL Exceptions, at 43-46. Initially, CPL observes that the ALJs failed to exclude some of the amounts that CPL had agreed to exclude subsequent to its initial filing. CPL Exceptions, at 43-44. Specifically, CPL claims the ALJs failed to disallow $1,017,964 in expenses which CPL agreed to exclude. This is offset by the Judges' including $119,609 of payroll taxes related to affiliate transactions, which was also separately disallowed as a payroll tax adjustment. CPL Exceptions, at 44. General Counsel agrees with CPL that the payroll tax adjustment should not be deducted twice. See CPL Exceptions, at 46. According to CPL, the result is to increase the ALJs' affiliate disallowance from $4,049,654 to $4,948,009.[4] However, these changes do effect the amount recommended to be included in CPL's cost of service by the ALJs. Specifically, the ALJs' recommendation that CPL be allowed to recover $41,852,634 for CSW Servicies remains unchanged. Compare PFD, at 74 to CPL Exceptions, at Appendix H. Based upon the direct testimony of the parties, CPL reduced its requested affiliate expenses. CPL now seeks to have this appear as a larger disallowance.

In addition, CPL indicates that its exceptions are limited to the Judges' recommended exclusions in two areas: economic development and marketing work orders in the amount of $1,480,805 and expenses associated with executive personnel in the amount of $1,307,445. CPL Exceptions, at 44. This amounts to CPL foregoing recovery of the remaining $1,261,404 of the ALJs' disallowance ($4,049,654 - $,1307,445 - $1,480,805 = $1,261,404).

Notwithstanding these concessions, General Counsel urges the Commission to reject the recommendations of the ALJs relating to affiliated expenses. In contrast, the Commission should adopt as CPL's reasonable and necessary cost of service for affiliate transactions $35,106,539 as recommended by General Counsel witness Herndon for the reasons set forth in General Counsel's exceptions.

In addition, CPL excepts to the ALJs requiring CPL file a study which updates the scope of services report and a study on corporate and executive management expenses. CPL Exceptions, at 42-43. These reports were recommended by General Counsel witness Herndon due to the fact that the existing information is outdated. In addition, there has been a substantial

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4 At page 44 of its exceptions, CPL indicated that after making these adjustments, the affiliate transaction disallowance would be $4,828,400. This appears to be an error. The correct number is contained in CPL Exceptions, Attachment H ($4,948,009).

increase in the amount of affiliate services since the preparation of the most recent study. These reports will assist CPL and the Commission in evaluating their affiliate expenses.

d. CSWS Transactions

i. Parties Positions

The General Counsel excepts to the Judges' recommended inclusion of $41,852,634 in cost of service for CSWS-related costs. PFD, at 95. General Counsel recommends including $31,002,458 of expenses from CSWS in CPL's cost-of-service. This represents a disallowance of $15,428,670 to the Company's request. At page 44 of its exceptions, CPL indicates that it has presented "extensive record evidence" in support of its affiliate expenses. CPL Exceptions, at 44. However, this "extensive" information was provided in rebuttal testimony after it was clear that CPL had failed to present adequate information in its application. Over the General Counsel's objections, this information was admitted, analyzed, and relied upon by the ALJs. See GC Exceptions, at 17-21.

vi. Challenges to Specific CSWS Work Orders

(D) General Corporate services

The Company excepts to the ALJs' disallowance of $1,307,445 in expenses associated with executive personnel. CPL Exceptions, 46. The ALJs rejected these work orders on the grounds that "the evidence introduced by CPL is too vague to conclude that this work was necessary to serve CPL's customers." PFD, at 100. As noted by the ALJs, the primary basis for the General Counsel's disallowances is that "CPL failed to provide enough information to prove that the allocated costs are reasonable." PFD, at 95. In other words, CPL failed to meet its burden of proof. Consequently, the General Counsel supports the ALJs disallowance of these expenses.

(E) Economic Development and Marketing

CPL also excepts to the ALJs' exclusion of $1,480,805 in affiliate expenses related to economic development and marketing. CPL Exceptions, at 44-45. This exception should be rejected. The general marketing and advertising expenses disallowed provided general corporate image promotion, which logically would benefit CSW and its affiliates than CPL. GC Ex. 10, at 15. Additionally, some of these expenses were non-recurring. GC Ex. 10, at 15. In regard to these expenses, the ALJs correctly noted that "the scope of the marketing activities is unclear, they were conducted centrally for all the CSW utilities, any benefit to CPL's ratepayers is indirect and speculative, and there has been no showing that they were necessary to provide service." PFD, at 109. For these reasons, the Commission should adopt the ALJs' recommendation.

8. Rate Case Expense

At pages 68-69 of its exceptions, CPL proposes to include the surcharges for DSM cost recovery and rate case expenses in the cost recovery factor tariff as proposed in CPL's IRP filing. General Counsel strongly disagrees. A consolidated line item surcharge that includes such diverse costs as CPL proposes to include is not in the public interest. Customers are entitled to know what they are paying for, and they need that information so that they can make choices in a competitive environment. CPL argues that there is not sufficient space on a customer bill, or that its billing software would require a significant modification. CPL Exceptions, at 68. CPL's arguments are disingenuous. It may be appropriate to allow utilities some flexibility in the presentation of customer bills. This is because, in the future, utilities will be offering new and diverse services they have not offered in the past. However, they should not be permitted to bundle the costs of these services into one line item on the bill because in a more competitive environment, customers will need more information so that they can compare services and make intelligent choices. Consequently, the current trend is toward unbundling of costs, not more bundling.

To date, the Company has requested **$14,052,575** in rate case expenses for Docket No. 14965. This amount includes costs incurred through August, 1996. The total amount ultimately requested for expenses incurred in this case is likely to be far in excess of this amount. Of course, this is the real motivation behind the Company's proposal. CPL does not want ratepayers to be reminded each month that CPL spent over $14 million in rate case expenses in order to obtain a base rate decrease. Instead, they want to hide this amount while at the same time making it appear that they are spending more on DSM related projects. The Commission has previously used a separate line for rate case expense surcharges. If CPL can ask ratepayers to pay for its outrageous request, they should not be allowed to hide that fact from ratepayers. Consequently, CPL's proposal should be summarily rejected.

b. Docket No. 14965

The Cities except to the ALJs level of rate case expense included in amortization expense. Cities Exceptions, at 59. The Cities conclude that the sum of $1,552,922 for Docket No. 12820 and $4,725,818 for Docket No. 13126 when amortized over three years produces an annual amount of $2,092,913. Cities Exceptions, at 59. While the mathematical calculation is correct, the Cities' conclusion is based on incomplete information. Reference to Staff Number Running Memo No. 5 and the corresponding response in ALJ Number Running Memo No. 3 reveals an additional \$6,270,034[5] in Docket No. 12820 rate case expenses. The \$6,270,034 was approved for recovery in Docket No. 12820 and thus was not at issue in this case. Due to the stipulation in Docket No. 12820, the \$6,270,034 should be included in the amortization expense. Consequently, the Cities' conclusion that the ALJ 'inadvertently included rate case expenses of \$4,176,031[6] in amortization expense" is incorrect.

11. Other

At pages 26-28 of its exceptions, the Cities except to the ALJs' recommendation to include \$3,032,032 in cost of service related to expenses which were incorrectly booked in Account 912. Although General Counsel can understand CPL making a 'bookkeeping entry error", CPL has failed to demonstrate that these expenses were actually recoverable DSM expenses. Moreover, the ALJs do not specifically address the merits of the Cities claim in Section XII.H of the PFD, as they indicate. PFD, at 181. Consequently, the Commission might want to further evaluate this issue.

B. Decommissioning Expense

1. Overview

In its exceptions, CPL raises three issues relating to decommissioning expense: (1) the ALJs' exclusion of the cost of the spent-fuel dry-storage facility, (2) the ALJs' use of a 4.9% annual escalation rate, and (3) the ALJs' recommendation that CPL's STP decommissioning fund yield will be 7.0%. CPL Exceptions, at 48-52. The General Counsel will reply to CPL's second

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5 \$5,584,063 for CPL and \$685,971 for Cities.

6 The \$4,176,031 is the result of the following calculation [(\$1,532,239 + \$4,725,818 + \$6,270,034)/3]. The amount should actually be \$4,182,925 [(\$1,552,922 + \$4,725,818 + \$6,270,034)/3] to reflect \$140,063 in Cities expenses per the PFD instead of the \$119,379 noted in ALJ Number Running Memo No. 2. See related discussion at page 44 of General Counsel's Exceptions.

issue in Section XII.B.4.a below. In addition, General Counsel will reply to two issues raised by the Cities and OPC.

3. Methodology for Annual Accrual

In its exceptions, OPC recommends a levelized-real methodology (inflation adjusted) whereby the annual expense accruals for future years are equal in inflation-adjusted terms, but are initially lower, in nominal terms. OPC Exceptions, at 17. In contrast, the ALJs propose a straight-line methodology whereby the same amount is collected each year. PFD, at 196-197. The ALJs' treatment is consistent with the General Counsel's recommendation and should be adopted.

With the exception of El Paso Electric Company, the levelized-nominal methodology is used by all nuclear utilities in Texas. Significantly, HL&P, the operating partner at STP, uses the levelized-nominal methodology. Therefore, requiring CPL to use a levelized-real methodology would result in inequities and disparities in funding between the STP owners. In addition, under the levelized-real methodology there exists the risk that future ratepayers will be required to make up shortfalls that could occur.

In rejecting OPC's proposal the ALJs noted that "it would pass the risk of rises in decommissioning costs, which have moved steadily upward, to future ratepayers who would have to make up shortfalls." PFD, at 197. The ALJs also correctly note that OPC's proposal makes no allowances for increases in decommissioning costs. OPC responds to this argument by stating that it merely "accepted CPL's estimate of total decommissioning costs." OPC Exceptions, at 17. Therefore, OPC claims that CPL's estimate must be too low. This is criticism is misplaced. The fact that CPL's estimated total decommissioning cost may not be entirely accurate does not mean it is unreasonable.

Making precisely accurate forecasts of future decommissioning costs is, at best, a difficult task. Unanticipated cost increases could occur over the next twenty years. Consequently, it is not reasonable to adopt a methodology which can not account for such increases as OPC proposes.

Both the ALJs' and the General Counsel's recommendations are based on a future-value analysis that estimates future decommissioning costs and anticipated trust fund accumulations. They use a straight-line methodology wherein an equal amount is funded each year during the unit's operation. Mr. Tietjen's annual funding recommendation consists of twelve equal monthly contributions in the amount of $679,853 representing $287,976 for STP Unit 1 and $391,877 for STP Unit 2. This methodology is the most reasonable and should be adopted by the Commission.

4. Assumptions for Annual Accrual

a. Cost Escalation

As noted, CPL excepts to the ALJs' use of a 4.9% annual escalation rate. CPL Exceptions, at 50-51. The Company is concerned that the Judges' approach "lends credibility to Staff's recommended waste escalator" CPL Exceptions, at 50. Specifically, CPL argues that "neither Mr. Tietjen nor General Counsel have ever articulated how Mr. Tietjen arrived at his recommendation, or what adjustments were made to the data from the South Carolina site." CPL Exceptions, at 50. CPL's arguments are incorrect.

For the waste burial component of the overall escalation factor, Mr. Tietjen used a rate of 7.5%. GC Ex. 11, at 9. While acknowledging that there exists "great uncertainty" in determining an appropriate waste burial factor, Mr. Tietjen attempted to balance the "myriad of factors ... that may affect the determination of this rate in the future." GC Ex. 11, at 14. Mr. Tietjen based his recommendation upon a consideration of the historical rate increase, the most recent increase for the site available to CPL for disposal, and the most recent rate recommended by the General Counsel. This factor was adopted in the most recent contested rate case decided by the Commission. See *Inquiry into the Reasonableness of the Rates and Services of Gulf States Utilities, Company,* Docket No. 12852, __ P.U.C. BULL. __, (March 20, 1995). To derive his rate, Mr. Tietjen analyzed the historical cost information at the waste burial site in South Carolina, since "it is presently the only site that would be available to CPL" for waste burial. GC Ex. 11, at 13. Moreover, Mr. Tietjen's reliance on the South Carolina site information is consistent with the expected change in NRC policy. Mr. Tietjen testified that the NRC is adopting an exclusive site-specific waste burial escalation rate which would use only the site to which the material would be sent. GC Ex. 11, at 12. In determining an appropriate waste burial escalation rate, Mr. Tietjen also considered that the NRC expects that technological improvements in waste-compacting techniques will offset cost increases in the future. Additionally, Mr. Tietjen also considered that the NRC is expected to reduce the weighting of waste burial costs in determining the composite escalation rate. GC Ex. 11, at 12. Ultimately, Mr. Tietjen recommended a waste burial rate of 7.5%. This rate represents the approximate average of the nine-year compounded average increase for the South Carolina site and the rate most recently adopted by the Commission. Given the recent uncertainty associated with waste burial costs, Mr. Tietjen's recommendation is the most reasonable because of the weight he gives to cost information from the site which could actually receive waste burial materials from STP and because of the emphasis he places on the Commission's most recent finding on the escalation of waste burial costs.

At pages 31-33 of their exceptions, the Cities again raise their objection with the use of an adjusted NRC formula to derive projected STP decommissioning cost escalation rates. Cities Exceptions, at 31-33. They assert that "[t]he NRC's formula is for past inflation; not for forecasting future inflation." Cities Exceptions, at 32. This argument was appropriately rejected by the ALJs. General Counsel agrees that the NRC formula was not intended to be used to forecast inflation. Recognizing this fact, the General Counsel, TIEC, and CPL all modified the NRC formula to predict nuclear decommissioning inflation. Consequently, the ALJs correctly concluded "that the modified NRC formula is a reasonable method to determine nuclear-decommissioning cost inflation if correct inputs are used..." PFD, at 199.

C. Depreciation and Amortization

1. Depreciation Rates and Expenses

b. Support for Existing Rates

Primarily, CPL proposes to maintain its existing depreciation rates if the Commission approves the modified amortization schedule for recovery of the deferred accounting asset. CPL Exceptions, at 52. This proposal was rejected by the ALJs. Consequently, CPL proposes to increase its current annual depreciation expense by $15.6 million. CPL Exceptions, at 52. This request should also be rejected. The primary differences between CPL's request and the ALJs' recommendation are due to the ALJs' elimination of future interim activity and their rejection of substantial increases in negative net salvage. As mentioned previously, future interim additions should be eliminated because they do not comply with the Commission's known and measurable standard. Moreover, the validity of CPL's proposed increase in negative net salvage is questionable because it is based upon the inappropriate reliance on estimates. Consequently, the rates proposed by CPL should be rejected.

c. Service Life Assumptions

At pages 53-54 of its exceptions, CPL excepts to the ALJs' recommendation that the minimum service lives of all of CPL's non-nuclear steam production units be set at 40 years. CPL Exceptions, at 53-54. The General Counsel disagrees. As General Counsel witness Reed testified, different kinds of power plants have different expected life spans. The standard minimum for non-nuclear steam is 40 years. GC Ex. 8, at 7.

CPL provides little support for its argument. Mr. Roff employs life spans for depreciation purposes which are significantly shorter than the planned retirement date for numerous units. This implies that CPL anticipates operating the units subsequent to the end of their depreciable lives. In its rebuttal testimony, CPL asserts that the shorter dates will be used unless there is a decision to refurbish the units. CPL Ex. 92, at 19-22. This is inconsistent with CPL's expected life spans for the units. Moreover, it fails to take into consideration the possibility that certain units will be refurbished.

Despite CPL's criticisms that the 40-year life observed by the Commission in numerous cases is not applicable to them, CPL has failed to demonstrate that the Commission's precedent on this issue is unreasonable. CPL Exceptions, at 54. Cities witness Pous also supports the use of a 40-year life. Cities Ex. 106, at 12. In fact, Mr. Pous indicated that the trend in the electric industry has been to defer significant retirement costs by extending service lives in order to maximize the economic benefits of the units. Cities Ex. 102, at 12. Using a life span of less than 40 years could also result in intergenerational inequity if the units have service lives of 40 years or more because current ratepayers will have paid the depreciation associated with the use of the asset by a future generation of customers. Such as result is unreasonable and should be rejected. For these reasons, the Commission should adopt a minimum 40-year life-span for CPL's non-nuclear units.

d. Interim Additions and Retirements and Net Salvage

As discussed previously, CPL's proposed rates, as presented by Mr. Roff, erroneously include future interim additions and retirements. The Commission has consistently rejected including future interim additions and retirements on the basis that they violate the "known and measurable" requirements of P.U.C. SUBST. R. 23.21(b). See e.g., *Application of Central Power and Light Company for Authority to Change Rates*, Docket No. 8646, 16 P.U.C. BULL. 1388 (October 19, 1990), *Application of El Paso Electric Company for Authority to Change Rates*, Docket No. 8363, 14 P.U.C. BULL. 2834 (May 5, 1989). Recognizing this fact, the ALJs appropriately excluded these costs.

In their exceptions, CPL admits that these expenses are not known and measurable. CPL Exceptions, at 55. Notwithstanding this fact, CPL asserts that they should be allowed to recover such costs since "depreciation expense is clearly a recoverable expense." CPL Exceptions, at 55. This argument should be rejected. The fact that depreciation costs are recoverable does not relieve CPL of its obligation to demonstrate that changes to the test year level of expense are known and measurable. As noted by General Counsel witness Reed, future interim additions and retirements "are not appropriate for inclusion in depreciation rates." GC Ex. 8, at 3.

Additionally, Mr. Roff included future net salvage in determining depreciation rates. This proposal was also rejected by the ALJs. PFD, at 207. The Judges correctly concluded that future net salvage should be excluded from the determination of depreciation rates on the basis that they are not known and measurable expenses. PFD, at 209. There is no evidence that these changes will in fact be made at specific plants. PFD, at 209.

Furthermore, while Mr. Reed used existing net salvage composite rates, CPL included estimates of inflation in the net salvage determination. Also, CPL derived its estimates of salvage expense by comparisons with other utilities. This resulted in very significant increases in negative net salvage for the mass property accounts. Mr. Reed testified that the comparison of utilities did not constitute "a fair representation." GC Ex. 8, at 7. For example, all of CPL's comparison group were non-Texas utilities. GC Ex. 8, at 7. For this reason, Mr. Reed used the current net salvage composite rates. Although it is not clear in the PFD, it appears that the ALJs agreed with Mr. Reed's recommendations on this issue.

In summary, the calculation of the depreciation expense should <u>not</u> reflect future interim additions and retirements and future net salvage. General Counsel witness Reed testified that in order to include future interim additions and retirements and future net salvage, accurate forecasts of future events would be necessary. GC Ex. 8, at 11. Mr. Reed went on to note that "[f]orecasts of future events, especially long-term future events, seldom accurately reflect reality." GC Ex. 8, at 11. Additionally, Mr. Reed noted that inclusion of future interim additions and retirements and future net salvage is contrary to the known and measurable standard in P.U.C. SUBST. R. 23.21(b). Pursuant to this rule, only known and measurable changes will be reflected in a utility's allowable expenses. Future interim additions and retirements and future net salvage are neither known nor measurable. Both the General Counsel and the Commission have consistently rejected future interim additions and retirements and future net salvage on this basis.

For this reason, future interim additions and retirements and future net salvage should not be reflected in the calculation of depreciation rates.

At page 34 of the Cities' exceptions they identify an error in the number-running process. Specifically, the rates used by the ALJs in calculating depreciation expense incorporated the Company's recommended changes to existing net salvage values and average service lives for mass property accounts. See Cities Exceptions, at Attachment B. However, as pointed out by the Cities', the "ALJ did not rule that the net salvage values and average service lives proposed by CPL are reasonable." Cities Exceptions, at 34. Consequently, the Company's recommendations should not have been used. Moreover, the ALJs did not make a recommendation on what rates should be used. The General Counsel supports the Cities' exception on this issue.

The General Counsel recommends that the Commission reject the Company's proposed changes to the existing net salvage and average service lives for mass property accounts. In reviewing CPL's net salvage values, General Counsel witness Reed testified that:

> For mass property accounts, the Roff depreciation study resulted in very significant increases in negative net salvage. For these reasons, I did not utilize Roff's estimated net salvage rates, but instead I utilized the currently existing net salvage rates.

GC Ex. 8, at 7. Mr. Reed also recommended use of existing service lives for the mass property accounts. GC Ex. 8, at 8. Based upon Mr. Reed's testimony, General Counsel recommends the Commission adopt the existing net salvage rates and service lives for the mass property accounts.

Finally, the Cities correctly point out that depreciation rates for the mass property accounts with existing salvage values and service lives calculated using the ALG procedure are not in the record and would have to be calculated. Cities Exceptions, at 36 (footnote 28). This is because the General Counsel's recommendation was calculated using the ELG procedure which