4. Unit Lives

See the discussion under section XII.C.1.c, regarding unit life assumptions in the context of calculating depreciation rates. The General Counsel agrees with the Judges that the unit lives used to calculate depreciation rates should be used to calculate ECOM in this docket.

5. Unit Production

See discussion in section XXIII.D.3, above.

I. Judges' ECOM Conclusions

CPL argues that any quantification of CPL's ECOM in this docket by the Commission would be premature. CPL Exceptions, at 99. The Commission should reject CPL's argument. Quantification of ECOM provides a foundation for the General Counsel's STP Performance Standard. In order to implement the General Counsel's STP Performance Standard, the Commission should adopt the General Counsel's expected value for CPL's ECOM. In addition, quantification of ECOM is necessary if the Commission decides to make findings on CPL's unbundled cost of service.[14]

CPL proposed a depreciation "reclassification" in this docket to enable it to accelerate depreciation of its investment in STP by $18 million a year. PFD, at 517. According to CPL in its exceptions, the basis for its reclassification proposal is "a general consensus among the parties who quantified estimates of ECOM that CPL has *some* level of costs that could be stranded *if* retail access was mandated". CPL Exceptions, at 102 (emphasis added). CPL would have the Commission adopt its proposal with virtually no foundation for its adoption. CPL argues that the

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14 Just like other factors that the Commission adopts in rate cases that may change with time (e.g., cost of capital and sales forecasts), the ECOM estimate that the Commission adopts for CPL in this docket can be revised in the future,.

probability of retail competition is nothing more than speculation at this point. CPL Exceptions, at 99. It performed no probability analysis for its numerous ECOM scenarios. Under one of CPL's scenarios, it estimated its ECOM to be *negative* $13 million. CPL Ex. 226, at 67. Under this scenario, there is clearly no need to for accelerated depreciation of its STP investment. CPL can not have it both ways; it is inappropriate for it to argue on one hand that retail competition is nothing more than speculation, while on the other hand argue that it should be allowed to accelerate recovery of its STP investment because of its ECOM exposure.

XXIV. ECOM RECOVERY AND MITIGATION

A. Legal Basis for ECOM Recovery

1. Appropriateness of Considering CPL's Legal Right to Recover ECOM

CPL takes the position that the Commission should not adopt in this docket findings and conclusions concerning CPL's legal right to recover ECOM. CPL Exceptions, at 100-101. The General Counsel agrees. As indicated in the General Counsel's exceptions, the Commission should refrain from issuing an advisory opinion in this docket on this momentous issue. Therefore, the Commission should not adopt proposed FOF 365-368 and COL 57 and 60-88 in the PFD.[15]

The General Counsel notes the irony of CPL's position. While it takes the position that the Commission should not adopt findings and conclusions on this issue, it was CPL that interjected this issue in this docket. Nowhere in the Commission's Preliminary Order did the Commission ask the parties to address the issue of CPL's legal right to recovery of ECOM. CPL

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15 The General Counsel incorrectly stated with respect to this issue on page 78 of its exceptions that "the Commission should not adopt proposed COL 57 and the discussion at pages 60-88 in the PFD".

witness Steinmeier, who is a lawyer, devoted 47 pages of direct testimony to a section entitled "Appropriateness of Full Recovery of Stranded Cost". CPL Ex. 188, at 42-88. In this section, Mr. Steinmeier provides extensive testimony/legal opinion in response to the question: "What reasons do you believe exist as a matter of law for stranded cost recovery?" CPL Ex. 188, at 66-71. Mr. Stenmeier also provides rebuttal testimony on the legal issue. CPL Ex. 222, at 26-40. In addition, Mr. Stenmeier was joined in rebuttal by CPL witness Sidak, who provided 145 pages of testimony on the legal issue.

The cost to CPL for this testimony and related hearing time was substantial. This is an example of why the Commission should approve the General Counsel's proposed sharing of CPL's rate case expenses between shareholders and customers. It is clear that CPL was undisciplined in its rate case expenditures.

2. Right to ECOM Recovery Under Current Law

OPC argues that the Commission should adopt Cities' proposal to amortize on an accelerated basis, an amount equal to CPL's ECOM assuming overnight retail access in 1998, without any return on the unamortized balance. OPC Exceptions at 57-58; Cities Post-Hearing Brief at 17-18. The Judges properly rejected this argument. While some parties raised concerns about the economic viability of STP, no party seriously pursued the argument that STP is uneconomic and should be shut down, and therefore is not used and useful. The Commission decided in a prior case the level of CPL's prudent investment in STP, and the doctrines of *res judicata* and collateral estoppel bar relitigation of this issue. *Coalition of Cities v. Pub. Util. Comm'n of Texas*, 798 S.W.2d 560 (Tex. 1990). One wonders whether OPC and Cities would be proposing to "write up" CPL's investment in generation facilities in this docket if their estimates

of CPL's ECOM had negative values instead of positive values. Such a proposal to "write-up" the value of CPL's investment would not only violate the doctrines of *res judicata* and collateral estoppel, but would also violate PURA §2.206, which requires that rates be based on the original cost of property.

B. ECOM Recovery and Mitigation Proposals

1. Depreciation Reclassification

a. Reasonableness of CPL's Proposal

CPL argues against the Judges' rejection of its proposal to artificially accelerate the depreciation of its investment in STP by $18 million per year and artificially decelerate the depreciation of its distribution facilities by the same amount. CPL Exceptions, at 102. The General Counsel urges the Commission to reject CPL's proposal and adopt the Judges' finding that CPL's proposal is inappropriate. CPL characterizes its proposal as a way to mitigate ECOM. *Id.* CPL is wrong. Instead, CPL's proposal is nothing more than a shell game whereby CPL seeks to hide some of its generation ECOM in its distribution plant in service balances. CPL admits that its proposal will have only a small impact on its ECOM exposure. CPL Exceptions, at 103. However, its proposal would create a number of problems, as the Judges explained in detail. PFD, at 518-519.

XXVI. RANGE OF RATE CHOICES

At page 109 of its exceptions, CPL indicates that COL 46 is inconsistent with the ALJs discussion of the filing of a report on the Laredo Project in the PFD. CPL Exceptions, at 109.

General Counsel agrees with CPL that the report should be filed by March 1998. This is consistent with the recommendation of the General Counsel and the ALJs. See PFD, at 535.

XXVII. PERFORMANCE BASED RATEMAKING

B. STP Performance Standards

Based upon its belief the General Counsel's STP performance standard is illegal, CPL takes exception to the ALJs' recommendations regarding the reasonableness of the General Counsel proposal. CPL Exceptions, at 109. For the reasons discussed in General Counsel's exceptions, the Commission currently possesses the authority to implement General Counsel's STP performance standard. GC Exceptions, at 90-97. Consequently, the ALJs' findings are a necessary component of the Commission's order.

Additionally, the Company makes specific criticisms of the ALJs' findings. Each of these criticisms were raised during the hearing and were appropriately rejected by the ALJs. However, some response is necessary. CPL indicates that '[t]he fatal flaw in the Judges' proposed findings lies in their assumption that 'STP can reasonably be expected to achieve an 83 percent target capacity factor, absent an unanticipated management failure.'" CPL Exceptions, at 110 (quoting PFD, at FOF 388). For the first time in this proceeding, the Company is affirmatively stating that STP can not be expected to achieve an 83 percent capacity factor. This is contrary to its business plan and the testimony of its own witnesses. HL&P, the operating partner at STP, has indicated in the STP Business Plan Guidelines that targets established for STP would place it in the top quartile of the nuclear industry. GC Ex. 37, at 6. Moreover, CPL's own witness Vaughn testified that it was his expectation that STP would operate between 85-87% over the next three years. Tr., at 9498. These expectations are consistent with the levels contained in the business plan.

Tr., at 9498. Mr. Vaughn is the very individual who supplied the capacity factor targets in the Business Plan. Tr., at 9485-9487. Finally, Mr. Vaughn testified that he is "50 percent or maybe more than 50 percent sure" that STP will actually reach the Business Plan capacity factor goals during the next three years. Tr., at 9499. Previously, CPL has claimed STP should exceed an 83% capacity factor but did not want to be held responsible if it failed to reach that level. Now, CPL claims that it is a "fatal flaw" to expect STP to achieve an 83 percent capacity factor. CPL Exceptions, at 110. CPL is willing to disavow its own witnesses and business plan to avoid taking responsibility. All of this, of course, argues for the General Counsel's STP performance standard. Use of an 83% capacity factor for STP is "not only a fair goal but achievable and maintainable." Tr., at 8283. Moreover, using an 83% capacity factor will not require CPL to exceed its previously stated expectations of STP performance.

CPL further argues that the "selection of [the] 83 percent [capacity factor] was arbitrary." CPL Exceptions, at 110. This is incorrect. Mr. Oberg accurately observed that in establishing a reasonable performance standard, "the question of reasonableness must be addressed not only in light of past performance but also taking into account future expectations as well." GC Ex. 37, at 6. Mr. Oberg selected 83% as a reasonable capacity factor for STP "based on the clear capability of STP to perform at or within the top quartile of all operating nuclear units in the United States." GC Ex. 37, at 36. Mr. Oberg set out the following factors which support his recommendation:

> 1. HL&P has an excellent, experienced management team operating STP. In addition, CPL has organized a team of experienced personnel, some on site, to monitor STP plant operations.
>
> 2. STP is a base-load plant and can be expected to be utilized in this way for the foreseeable future.

3. STP has a reasonable forced outage rate (exclusive of the extended shutdown period of 1993-1994) that has shown improvement during operations of 1995 and into 1996.

4. The length of STP refueling outages has decreased keeping pace with the industry, even setting new national records thereby increasing the capacity factor performance.

5. The plant has matured, while at the same time it is new enough not to require any significant downtime for routine matters. The extended outage of 1993-1994 was utilized to accomplish deferred maintenance. The gross heat rate for each unit and the plant exceeds the average of other pressurized water units.

6. STP management has established, through their Annual Business Plan, a system for reaching increasingly ambitious performance goals. These performance goals and objectives exceed that established by the recommended performance standard.

7. STP has already installed features that allow it to minimize outage down time. These include the rapid refueling capability and eventually the three train Emergency Core Cooling Systems.

8. There are no known impediments to prevent STP from reaching the recommended capacity factor goal. There are no significant LERs that require resolution. Neither are there any major known operational restrictions that require immediate attention.

9. The proposed performance standard eliminates the Nuclear Regulatory Commission (NRC) safety considerations in that it eliminates "sharp thresholds" and short time periods."

10. Force majeure provisions protect CPL from extreme adverse events beyond the control of the STP owners.

See GC Ex. 37, at 36-37. These ten objective criteria discredit CPL's claim that the selection of an 83% capacity factor was arbitrary.

Irrespective of the other aspects of the General Counsel's plan, so long as STP operates at the reasonable level proposed by General Counsel, CPL will recover all of its test-year level costs. In fact, if future STP costs go down, CPL could receive a benefit even if generation falls below an

83% capacity factor. The 83% capacity factor level is below CPL's expected performance of the plant and below the performance of one third of the nuclear units in the United States. The record evidence including the testimony of CPL's own witness demonstrate that Mr. Oberg's recommended use of an 83% capacity factor is both reasonable, if not conservative given expectations, and appropriate.

Each year, *Nuclear News* magazine reports the capacity factor performance of all of the nuclear units in the United States. GC Ex. 37, at 23. The most recent numbers indicate that 36 of the 108 operating nuclear units had a capacity factor over the past three years of 83% or better. GC Ex. 37, at Sch. 14-A. Since the extended outage at STP, the plant has operated at almost a 90% capacity factor. Tr., at 8280. This recent performance proves that STP can perform in excess of the 83% capacity factor proposed by General Counsel. Implementation of the General Counsel's proposal will provide an incentive for continued reasonable performance.

In addition to these criticisms, CPL maintains that the General Counsel's STP performance standard does not provide adequate force majeure provisions nor does it provide CPL with relief from large penalties which it believes are unwarranted. CPL Exceptions, at 111. Initially, in a competitive world, CPL would not be protected by force majeure provisions. It would bear the risks of unforeseen outages. Moreover, CPL is not precluded from filing a proceeding with the Commission if some catastrophic event occurs which causes STP to fall below the required performance level.

CPL also criticized the General Counsel for proposing a performance standard for CPL rather than for all of the utilities within the Commission's jurisdiction. In its PO, the Commission specifically requested the parties consider appropriate performance standards for CPL.

Moreover, during the transition to competition, it is appropriate to provide CPL with a greater incentive to maximize performance. Insofar as CPL is before the Commission in this rate case, the Commission should not forego the opportunity to more closely replicate a competitive market with regard to the recovery of costs. That is, the more CPL produces, the more revenues it will earn. Given the small number of utilities owning nuclear units, it is appropriate to impose performance standards on an ad hoc basis rather than through a rulemaking.

In asserting that the use of the 83 percent capacity factor is defective, CPL misinterprets the record by suggesting that "STP could operate at the proposed average target capacity factor of 83 percent for the three-year period, and yet CPL could still incur net penalties under the Staff's proposal." CPL Exceptions, at 111. This is incorrect. Moreover, it is not, as CPL states, supported by the transcript. CPL Exceptions, at 111. At pages 8420-8421 of the transcript, the pages cited by CPL, General Counsel witness Ghosh was asked about the effects of the plan on two three year periods. In one three-year period the average capacity factor was assumed to be 84 percent. Tr., at 8419. In the other three-year period, Dr. Ghosh was asked to assume STP operated at an 82 percent capacity factor. Tr., at 8419. Dr. Ghosh was never asked about a situation where in a *three-year period* STP operated at an 83 percent capacity factor and there was a penalty. This is because there would not be a penalty in such a situation. Only when one nets the results of multiple three-year time frames could there be such a result.

Given CPL's mischaraterization of the General Counsel's STP Performance Standard, further explanation of the plan is in order. Under the plan, a nuclear cost factor is established for CPL by dividing the non-ECOM portion of CPL's STP test-year revenue requirement (adjusted for known and measurable changes and net of decommissioning cost) by CPL's share of STP

generation at the targeted capacity factor standard of 83%. When STP's actual capacity factor is less than or equal to the set capacity factor standard, revenue recovery of CPL's non-ECOM nuclear cost is determined by the nuclear cost factor multiplied by CPL's share of actual STP generation. Thus, the cost recovery is linked to STP performance and CPL is afforded with a reasonable opportunity to recover the entirety of its non-ECOM STP costs as long as it meets the minimum capacity factor of 83% included within the proposal. GC Ex. 37, at 4. Under the plan, if CPL exceeds the minimum performance standard, the Company will recover the incremental nuclear fuel cost plus any fuel savings resulting from the displacement of high fuel cost energy with low fuel cost nuclear energy resulting from excess STP generation. Any revenues in excess of replacement fuel costs should be applied toward reducing CPL's ECOM. Due to safety and financial concerns, Mr. Oberg recommended that decommissioning funds not be included in the establishment of a performance standard for STP. GC Ex. 37, at 4.

Finally, CPL again misinterprets the transcript in stating that 'in light of the Staff witnesses' admission that their proposal could benefit from further examination and refinement, it is inappropriate for the Judges to make any recommendation or specific findings of fact based on Staff's proposal." CPL Exceptions, at 111. CPL has again selectively highlighted portions of the evidence while conveniently ignoring others which disprove their allegations. Mr. Oberg did state that although his force majuere provision was "an excellent starting point" that 'it would profit by additional work." Tr., at 8366-8367. However, when asked whether the General Counsel's STP 'performance standard proposal is really more a work in progress and not ready for adoption," Mr. Oberg responded '[n]o, I wouldn't agree to that." Tr., at 8367. As discussed in the PFD, he

General Counsel's STP performance standard does not need additional examination and refinement.

The historically unreliable performance, excessive costs, and continued cost increases at STP along with the transition to competition and the questionable benefits of other performance standards requires a new approach to performance standards for STP. In light of this, General Counsel recommends the Commission adopt the performance standard for CPL's share of the STP as detailed in "A Special Report on Performance Standards for the South Texas Project Nuclear Units". GC Ex. 37.

3. Legal Authority to Implement Performance Standards

c. Purchased Power Disallowance for Poor Generation Performance

At page 112 of its exceptions, CPL disputes the Commission's authority to implement any performance standard which would disallow costs in the absence of a finding of management imprudence. CPL Exceptions, at 112. CPL claims that "the Commission may not disallow costs in the absence of a finding of management imprudence." CPL Exceptions, at 112. This assertion is not supported by the law. The courts have already concluded that the Commission can establish performance standards which deny recovery of replacement fuel costs if the unit does not perform at the level required by the standard without a finding of management imprudence. *City of Alvin vs. Public Utility Commission of Texas*, 876 S.W.2d 346, 361 (Tex.App.--Austin 1993); 893 S.W.2d 450 (dismissed). In this case, the Court ruled that the Commission has authority to implement performance standards based on the broad grant of authority in PURA section 1.101(a). This is the only court case in Texas dealing directly with the issue of performance

standards. Nothing in the case suggests that the Court was approving a specific type of performance standard. Moreover, nothing in the case suggests that other types of performance standards would not be equally permissible. In fact, the case suggests just the opposite. Further discussion of the legality of the General Counsel's STP performance standard is contained at pages 90-95 of General Counsel's exceptions.

XXVIII. FUEL ISSUES

A. Alternatives to the Fuel Reconciliation Process

3. System Generation Efficiency Incentives

CPL objects to being required to file a report related to alternatives to the current fuel reconciliation process within 180 days of the final order in this case. CPL Exceptions, at 113. The Company's exception should be rejected. The ALJs correctly concluded that a fuel bandwidth system as proposed by General Counsel witness Adib might be "an appropriate alternative to the current fuel reconciliation process for policy makers to consider." PFD, at 560. Moreover, the ALJs concluded that it is reasonable to require CPL to prepare a report which would give the Commission and ultimately the Legislature sufficient information to consider moving to alternatives to the current fuel reconciliation process that would be more appropriate in a more competitive environment. PFD, at 560. Similar to its positions in the Competitive Issues Phase throughout the case, CPL urges the Commission to wait before taking action. However, contrary to CPL's position, it is not premature to provide such information.

General Counsel is sympathetic to CPL's need to maintain confidentiality regarding certain information. However, appropriate mechanisms are available to ensure the Commission and the

General Counsel are able to conduct an adequate review while protecting the proprietary interests of the Company.

At page 560 of the PFD, the ALJs find that a fuel bandwidth system might be an appropriate alternative to the current fuel reconciliation process. PFD, at 560. Consequently, the ALJs require CPL to prepare a report providing sufficient information for the Commission to consider moving to alternatives to the current fuel reconciliation process. PFD, at 560. The parameters of the report were recommended by the General Counsel. However, the ALJs failed to include four other related recommendations which detailed what should be done with the reported information. Specifically, the General Counsel recommends that the Commission:

1. Establish a project number for the informational filing.

2. Establish a procedural schedule to evaluate the informational filing.

3. Use the informational filing and testimony of other parties to determine if an alternative fuel reconciliation process for CPL is appropriate, and if so to develop an appropriate alternative fuel reconciliation process for CPL.

4. Finalize any new alternative fuel reconciliation process for CPL within twelve months from the date of the final order in this docket.

GC Ex. 49, at 63. The General Counsel urges the Commission to include these recommendations as a part of its order.

B. New Pricing Structures for Transmission and Ancillary Transmission Services

CPL excepts to the Judges' recommendation to treat its transmission equalization payments, to, from and over (TFO) charges, third party, and Oklaunion wheeling charges as non-reconcilable. CPL Exceptions, at 116. CPL's arguments should be rejected.

General Counsel recommends that transmission equalization payments and TFO charges be treated consistent with FERC Order No. 888. See FERC Order 888, "*Promoting Wholesale Competition through Open Access Non-Discriminatory Transmission Services by Public Utilities*," (April 26, 1996), at 182-184. Specifically, in Order No. 888 the FERC recognized that the transmission equalization payments violated FERC's comparability standard. GC Ex. 40, at 8. Therefore, FERC directed the CSW Companies to consult with the PUC and "file not later than December 31, 1996 a system tariff that will provide comparable service to all wholesale users on the CSW system." GC Ex. 40, at 8. Ultimately, these payments will become a FERC approved tariff for the entire CSW system which each of the companies will have to pay. These payments will be replaced by an access tariff which will probably be included in base rates. Therefore, these payments will not be reconcilable in the future. GC Ex. 40, at 8. In regard to the TFO charges, the Commission has not determined whether these costs should be included within a utilities' transmission cost of service. If consistent treatment is not required, it is possible that CSW could be paying TFO charges to Texas Utilities and Houston Lighting and Power while receiving revenues through its transmission cost of service.

General Counsel further recommends that third party and Oklaunion wheeling charges be eliminated pursuant to P.U.C. Substantive Rules 23.66 and 23.67. General Counsel witness Neeley testified that under the new transmission pricing structures "the third party and Oklaunion wheeling charges will be renegotiated and disappear." GC Ex. 40, at 10. As a result, they will not be reconcilable in the future. GC Ex. 40, at 10. The ALJs correctly determined that there is "no reason to ignore the change that is obviously coming." PFD, at 563. For these reasons, CPL's arguments should be rejected.

XXX. MISCELLANEOUS ITEMS

Item No. 1 : CPL excepts to the Judges' recommendation that CPL file interim tariffs within 20 days from the date of the final order. CPL Exceptions, at 116-117. General Counsel does not object to CPL filing the tariffs 30 days after the date of the final order.

Item No. 2 : At pages 82-84 of its exceptions, CPL excepts to the procedure set forth in Paragraph No. 24 of the Proposed Order for refund of bonded rates. CPL Exceptions, at 82. In addition, CPL set out an alternative proposal which is consistent with the approach the Commission relied upon in Docket No. 11735. General Counsel has met with CPL and discussed this proposal. The General Counsel has no objection to the Company's proposal.

For the reasons discussed, General Counsel requests that the Commissioners adopt its positions as detailed in the General Counsel's testimony, briefs, exceptions and this reply to exceptions.

Respectfully Submitted,

Bret J. Slocum
Director - Legal Division

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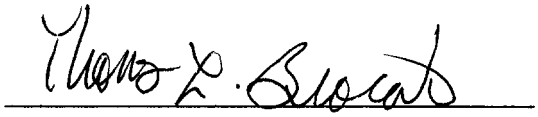
Assistant Director - Legal Division



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ATTACHMENT A

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	§	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

GENERAL COUNSEL'S INITIAL BRIEF

(Revenue Requirements Phase)

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April 29, 1996

balance of $4,561,193,103. General Counsel is not opining as to the reasonableness or appropriateness of these PTYAs. GC Ex. 15, at 3.

Non-Plant in Service Adjustments

CPL has requested non-plant in service PTYAs to mirror construction work in progress (CWIP) and the STP deferred accounting asset. General Counsel witness Coleman recommends that the Company's requested PTYAs to its mirror CWIP balances and STP deferred accounting asset be rejected. General Counsel urges that the mirror CWIP asset balance at test year end adjusted by the Settlement Agreement of the parties in Docket No. 12820 of $286,814,526 and the test year end level of mirror CWIP liability of ($20,499,998) be included in the Company's invested capital. GC Ex. 15, at 14, 32.

CPL has requested three adjustments to its mirror CWIP asset, two of which are PTYAs. The first adjustment to the mirror CWIP asset is a $30,000,000 reduction that resulted from the settlement in Docket No. 12820. This is not a PTYA and should be adopted.

The second and third requested adjustments to the mirror CWIP asset balance at test year end represent improper PTYAs and should be rejected. The second adjustment, a reduction of $12,525,375, is the Company's selective attempt to restate one component of invested capital to the beginning of the Company's "pro-forma rate year." The third adjustment, a reduction of $2,625,000, reflects the effects of the margins on the factoring of accounts receivable of Houston Lighting & Power Company (HL&P), beginning January 1, 1996.

Similarly, the Company has requested improper PTYAs to its mirror CWIP liability of $20,499,998 and to its STP deferred accounting asset of ($1,299,134) to reflect the balances that will exist at the beginning of the Company's "pro forma rate year," October 1, 1996. The mirror CWIP liability was fully amortized as of December 31, 1995. CPL Ex. 5, at 55. Therefore, the

Company requested zero be include in its rate base related to the mirror CWIP liability. The October 1, 1996, projected deferred accounting asset balance requested by the Company was $487,245,253. GC Ex. 15, at 26, Schedule IV. These types of PTYAs are not consistent with the Commission's application of P.U.C. SUBST. R. 23.21(b) and should likewise be rejected. However, if the Commission determines that these types of PTYAs are appropriate under the PTYA rule, then the Commission should reflect the deferred accounting asset balance as of May 9, 1996, the date that rates will be implemented under bond and consequently the first day of the rate year. GC Ex. 15, at 28.

CPL's PTYAs to mirror CWIP should be rejected because:

1. the Company's adjustments are not consistent with this Commission's application of the current PTYA rule, and

2. the Company has applied the PTYA rule inconsistently in its requested rate base.

P.U.C. SUBST. R. 23.21(b) provides:

> Post test year adjustments for known and measurable changes to historical test year data (including, but not limited to revenue, expenses, and invested capital) will be considered only where the attendant impacts on all aspects of a utility's operations can be with reasonable certainty identified, quantified, and matched.

The invested capital or "rate base" portion of this rule has become known as the "post test year adjustment rule". The PTYA rule was adopted by the Commission in June 1989. 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). The "Big Cajun" rule prohibited a utility from adjusting its invested capital for any event that

occurred subsequent to the test year. GC Ex. 15, at 16. The application of the "Big Cajun" rule resulted in significant lag between the time when production facilities were placed in service and when the costs of the facilities were reflected in rates. GC Ex. 15, at 16. To alleviate the financial strain that such delay caused utilities, the Commission began permitting the use of accounting order deferrals, i.e., utilities were allowed to defer or capitalize costs that would otherwise have been expensed and never recovered in rates. As accounting deferral orders multiplied, the Commission sought an alternative solution to the problem and adopted the current PTYA rule. The PTYA rule was intended to allow utilities to time their rate filings in such a manner as to obtain rate relief reflecting significant plant additions at the same time the facility was placed in service. GC Ex. 15, at 16-17.

During the "Big Cajun" era, the Commission routinely made PTYAs in determining the appropriate level of a utility's cost of service. For example, in calculating payroll expense, the Commission considered pay increases and changes in the number of utility personnel that occurred subsequent to test year end. The "Big Cajun" rule did not modify the Commission's treatment of known and measurable changes to a utility's cost of service. It should be apparent that 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.

An example of the proper application of the PTYA occurred in Docket No. 9300 wherein Texas Utilities Electric Company sought, and the Commission approved, the inclusion of Unit 1 of Comanche Peak in rate base as a PTYA. . See *Application of Texas Utilities Company for Authority to Change Rates*, Docket No. 9300, 17 P.U.C. BULL. 2057, (Sept. 27, 1991). Consistent with the PTYA rule, the rate application was filed and processed in a manner that allowed rates from the docket to take effect at or about the date that Unit 1 was placed in service, thus eliminating the need for accounting order deferrals. Similarly, TUEC again sought to properly apply the PYTA rule in Docket No. 11735 when it sought to include Comanche Peak Unit 2 in rates as a PTYA. As in Docket No. 9300, the Commission also approved this proper application of the PTYA. See *Application of Texas Utilities Company for Authority to Change Rates and Investigation of the General Counsel into the Accounting Principles of Texas Utilities Electric Company*, Docket No. 11735, 20 P.U.C. BULL. 1029, (Second Order on Rehearing), (May 27, 1994).

Moreover, 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 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.

CPL has applied the PTYA rule on a piecemeal basis. The Company has requested that only some of the components of rate base which existed at the end of the test year be adjusted. The Company has requested that its mirror CWIP asset, mirror CWIP liability and the STP deferred accounting asset be restated to reflect the balances that will exist as of the beginning of the Company's "pro-forma rate year", October 1, 1996. But, the Company did not request that all of the other components of invested capital in existence at the end of the test year likewise be restated to October 1, 1996. GC Ex. 15, at 15. Even assuming that it is appropriate, which it is not, to restate components of rate base already in existence at the end of the test year to the beginning of the expected rate year, it would still be inconsistent and consequently contrary to sound ratemaking principles not to restate all components of rate base, such as accumulated depreciation,[3] in existence at the end of the test year to the same point in time. Invested capital reflects a snapshot in time. In order to have an accurate picture, it is necessary that each component be reflected as of one point in time.[4] In the view of the General Counsel, the most reasonable point in time is at the test year end.

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

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[3] If the Company's interpretation of the PTYA rule was applied only to accumulated depreciation, then invested capital would be lowered by approximately $169,966,436. The Company requested an annual depreciation expense amount of $135,973,149. The adjustment described above is based on the Company's requested depreciation expense that would accumulate from June 30, 1995 through October 1, 1996, the date the Company uses for its non-plant in service post test year adjustments.

[4] However, the Commission will allow an adjustment to reflect a proper PTYA such as procudtion plant placed in service after the test year end.

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 to the beginning of the Company's "pro-forma rate year". 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 cannot 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. In contrast, General Counsel recommends that 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 likewise should be restated to the same point in time consistent with sound regulatory principles as well as the PTYA rule itself.

CPL's witness on this issue, Mr. Felber, is simply not as credible as General Counsel witness Coleman. In support of the Company's position, Mr. Felber made several statements which are misleading and inaccurate. First, Mr. Felber discussed the precedence of Docket Nos. 8646 and 9561 related to PTYAs. CPL Ex. 94, at 14. However, as Mr. Felber admitted during cross examination, Docket Nos. 8646 and 9561 were settled cases and are not precedential in nature. Tr., at 4421. . See *Application of Central Power and Light Company for Rate Changes and Inquiry Into the Company's Prudence with Respect to South Texas Project Unit 2*, Docket No. 9561, 17 P.U.C. BULL. 349 (December 19, 1990), *Application of Central Power and Light*

Company for Authority to Change Rates, Docket No. 8646, 16 P.U.C. BULL. 1388 (October 19, 1990).

Second, in support of the proposed PTYAs, Mr. Felber erroneously asserted that the Company made a PTYA in Docket No. 8646 to include STP deferrals in rate base. CPL Ex. 94, at 14. Schedules from CPL's application in Docket No 8646, demonstrate that the STP deferrals were not a component of CPL's rate base in Docket No. 8646. GC Ex. 22.

Third, Mr. Felber asserted that a PTYA was made in Docket No. 8646 to remove units from rate base that were placed in cold storage. CPL Ex. 94, at 18. However, this adjustment does not represent a PTYA. The direct testimony in Docket No. 8646 of CPL witness Graf states the Company's long-term storage plans evolved from the analysis and assessment of a task force appointed in 1986. Cities Ex. 177, at 27. The evidence in Docket No. 8646 shows that several gas units were placed in cold storage because of new generation capacity and load growth that did not meet previous expectations. GC Exs. 20, 22-24. Obviously, these events did not all transpire subsequent to the test year end in Docket No. 8646. The Company's removal of the long term storage units represented the removal of excess capacity that existed as of the test year end in that proceeding.

In conclusion, 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.

It should be noted a new PTYA rule is pending at the Commission. In the event the new PTYA rule is adopted by the Commission prior to either the final order or before the beginning of

the Company's rate year, General Counsel recommends that the requirements of the new PTYA rule be reflected in the Company's request.

General Counsel witness Coleman agrees with CPL's $30,000,000 reduction resulting from the Non-Unanimous Agreement (NUA) in Docket No. 12820. *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, __ P.U.C. BULL __, (Order on Rehearing) (November 9, 1995). However, General Counsel does not agree with the other two PTYAs that the Company has requested and urges that the mirror CWIP asset balance of $286,814,526, mirror CWIP liability balance of ($20,499,998) and STP deferral balance of $488,544,387 be included in the Company's invested capital, as recommended by General Counsel witness Coleman. GC Ex. 15, at 14.

B. Original Cost of Plant in Service

1. Generating Units

Not addressed.

2. Transmission Projects Since End of Test Year in CPL's Last Base Rate Case, Docket No. 12820

a. Lon Hill - Coleto Creek

Not addressed.

b. Cross Valley Tie

Not addressed.

ATTACHMENT B

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	§	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

GENERAL COUNSEL'S INITIAL BRIEF

(Revenue Requirements Phase)

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April 29, 1996

3. Franchise Taxes

Not addressed.

4. Ad Valorem Taxes

The discussion of this issue is contained in Section VIII.D.1. "Non-Revenue Related Taxes" of this brief.

E. Federal Income Taxes

The Commission should allow $79,087,818 for federal income taxes for CPL. This calculation results from the application of the stand-alone approach and is supported by the testimony of General Counsel witness Candice Romines. GC Ex. 19, Ex. 19A.

1. Method for Calculating Federal Income Taxes

Ms. Romines' recommendation reflects the stand-alone approach, as ordered in GTE-SW, Docket No. 5610, which was upheld in *Public Util. Comm'n. v. GTE Southwest, Inc.*, 901 S.W.2d 401 (Tex. 1995). GC Ex. 19, at 5. Ms. Romines presented her recommended FIT adjustments, which are illustrated in General Counsel Schedule V, using Tax Method 1. GC Ex. 19, at 5. Although General Counsel witnesses have filed Tax Method 2 calculations in previous cases, Ms. Romines determined that a Tax Method 2 calculation was not needed. GC Ex. 19, at 5.

2. Current Tax

Interest

Ms. Romines' calculation of interest expense of $119,235,977 should be adopted. GC Ex. 19, at 11. GC Ex. 19A, at 1. Applying the General Counsel's recommended weighted cost of

debt to the recommended invested capital, Ms. Romines' recommendation reflects synchronized interest and should be adopted for that reason. GC Ex. 19, at 11. Synchronized interest is the portion of return that is not taxable and effectively normalizes tax benefits. It may be less than or greater than the actual interest deducted for tax return purposes. GC Ex. 19, at 1.

Consolidated Tax Savings

The Stand-Alone Approach

The parties have recommended various methods of allocating the tax savings resulting from the filing of a consolidated tax return by Central and South West Corporation on behalf of the CSW member companies and subsidiaries, including CPL. General Counsel recommends using the stand-alone approach. GC Ex. 19, at 14 and 21-25. Using that approach, results in no additional adjustment for consolidated tax savings to the company's request.[14] The use of the stand-alone approach is consistent with the ruling in *GTE Southwest,* 901 S.W.2d 401. Under the stand-alone approach, consolidated tax savings relating to the provision of service by the utility are reflected in rates. Ms. Romines determined that the revenue requirement effect of consolidated tax savings already reflected in CPL's request is approximately ($5,674,459). GC Ex. 19, at 2. GC Ex. 19A. General Counsel recommends that only these savings relating to costs that CPL generates in providing utility service be allocated to CPL's ratepayers. General Counsel recommends that no adjustment be made to include additional savings generated by the other CSW members and affiliates. GC Ex. 19, at 21. This recommendation is consistent with the benefits/burdens standard outlined in FERC Order 173. GC Ex. 19, at 8. According to FERC Order 173:

[14] Other than the adjustment recommended by Ms. Romines in General Counsel Exhibit 19A, at 2, no.9 and CR-21, for ($80,151).

> [The] stand-alone policy in effect looks beneath the single consolidated tax liability and analyzes each of the deductions used to reduce the group's tax liability to determine the deductions for which each service is responsible. It then allocates to the jurisdictional service those deductions which were generated by expenses incurred in providing that service....[T]he test is whether the expenses that generate the deduction are used to determine the jurisdictional service's rates. Put more simply the test is whether the expenses are included in the relevant cost of service.

23 FERC ¶61,396 at 61,852-3 (June 22, 1983).

Use of the benefits/burdens standard has been upheld by the federal courts. *City of Charlottesville, Virginia v. Federal Energy Regulatory Comm'n.*, 774 F.2d 1205 (D.C. Cir. 1985), *cert. denied* 106 S.Ct. 151, 475 U.S. 1108, __ L.Ed.2d __ (1986). Use of the benefits/burdens standard results in CPL's ratepayers receiving their fair share of the CSW group's consolidated tax savings, which is consistent with PURA section 2.208(c). GC Ex. 19, at 18-19.

Although the Commission has discretion regarding the treatment of a group's consolidated tax savings, there is no rational difference between consolidated tax savings that are unrelated to utility operations and a utility's below-the-line tax benefits over which the Commission has no discretion. *See GTE Southwest*, 901 S.W.2d 401. Both are associated with costs borne by the shareholder, and neither are related to the provision of service. GC Ex. 19, at 22. If the parent company were to reorganize so that all of the functions performed by the non-regulated affiliates were performed by the utility companies, consolidated tax savings that are unrelated to the rendition of electric service would become below-the-line tax benefits that could not be used to reduce CPL's revenue requirement. GC Ex. 19, at 22. If ratepayers cannot receive the tax benefits associated with these activities under one type of organizational structure, then it should not receive the tax benefits indirectly through a consolidated tax savings adjustment.

General Counsel recommends that consolidated tax savings relating to affiliate activities that are unrelated to CPL's rendition of service be excluded from the revenue requirement. Ms. Romines determined that CPL has derived a benefit from its affiliation with the CSW group and that its cost of capital has not been adversely affected by the affiliation. GC Ex. 19, at 24. Advocates of "consolidated tax savings adjustments" unrelated to the rendition of service have argued that the utility and its captive ratepayers should derive tax benefits from affiliates because the utility acts as a shield for non-regulated affiliates. They rationalize that the utility acts as a shield that encourages investment in companies that might not otherwise attract investors. This argument assumes, without support, that affiliates with tax losses are chronic loss companies and that the utility's affiliation with companies with tax losses is harmful to the ratepayer. GC Ex. 19, at 22. This argument fails to consider that shareholders bear the risk of investment in such affiliates. GC Ex. 19, at 22. Finally, this position also fails to recognize that the affiliates are not conversely entitled to benefit from consolidated tax savings relating to the provision of utility service. GC Ex. 19, at 22. Principles of equity do not favor such a "one-way street."

Advocates of consolidated tax savings adjustments unrelated to the rendition of service also argue that the utility and its ratepayers should derive tax benefits from non-regulated affiliates because of economies of scale enjoyed by the non-regulated affiliates. OPUC argues that non-utility affiliates benefit significantly from the existence of large public utility operations that provide financial stability and less costly service arrangements that would otherwise be unavailable to non-utility affiliates on a stand-alone basis. See OPUC's Second Brief to the Commission on Threshold Issues, at 5-6. Ms. Romines analyzed OPUC's equity argument relating to economies of scale. GC Ex. 19, at 35. Although the non-regulated affiliates may derive benefits from being able to do business with the large public utility companies, there is no correlation between

economies of scale and consolidated tax savings. GC Ex. 19, at 36. Additionally, the alleged economies of scale have not been quantified. There is no justification for allocating consolidated tax savings to ratepayers as a surrogate for unquantifiable cost benefits derived from economies of scale. The burdens that ratepayers *allegedly* bear are too far removed from the non-regulated affiliate tax benefits to justify allocating the benefits to ratepayers. See FERC Opinion 173 at 61,861. Furthermore, the benefits derived from economies of scale would actually increase an affiliate's tax expense because the affiliate's net income would presumably be higher than it otherwise would be absent its affiliation with the utility. Intervenors' attempts to use consolidated tax savings as a means of reducing CPL's rates for non-regulated affiliates' profits resulting from economies of scale should not be entertained. Intervenors are trying to accomplish indirectly through consolidated tax savings adjustments what they are prohibited from doing directly by PURA, that is, using the profits of affiliates to reduce a utility's rates. GC Ex. 19, at 37.

Advocates of the economies of scale argument also fail to take into account the benefits that CPL and its ratepayers derive from the affiliation. For example, economies of scale enjoyed by the affiliate may allow CPL to continue to enjoy consolidated tax savings related to CPL's rendition of service. As affiliate taxable income increases, CPL is able to accelerate its use of alternative minimum tax credits, thereby accelerating reductions to its rate base. GC Ex. 19, at 37.

Ms. Romines also considered the equity principles cited in *Public Util. Comm'n. v. Gulf States Utilities Co.*, 809 S.W.2d 201, 211-212, (Tex. 1991) and referred to in the First Supplementary Preliminary Order. These principles include: 1) that gain should follow risk of loss; 2) whether the asset sold has been included in rate base over the years; 3) whether the asset was depreciable property, nondepreciable property or a combination of the two types; 4) the impact

of the allocation on the financial strength of the utility; 5) the reason for any appreciation in the asset's value (e.g., inflation, a general increase in property values in the area; 6) any advantages enjoyed by the shareholders because of favored treatment accorded the asset; 7) the dividends paid out to the shareholders over the years; and 8) any extraordinary burdens borne by the ratepayers in connection with that asset. The issue in the Gulf States Utilities (GSU) case was how to allocate between shareholders and ratepayers the proceeds from GSU's sale of an operating plant to a joint venture formed with two of GSU's industrial customers. GC Ex. 19, at 26. The allocation question in the GSU case addressed the allocation of proceeds from the sale of utility property not the allocation of FIT. The issue in this case is the allocation of non-utility tax attributes. Ms. Romines concluded overall that the equity principles presented in the First Supplementary Preliminary Order, when adapted to the issue at hand, did not create a ratepayer entitlement to the CSW group's tax benefits generated by affiliates and unrelated to CPL's rendition of utility service. GC Ex. 19, at 25-35.

In adapting these principles Ms. Romines recognized that CPL's taxable income may reduce non-regulated affiliates' risk that net operating loss carry forwards will expire unused. However, any tax shield provided by CPL does not produce an additional burden on the ratepayer. Tr., at 4229. Furthermore, any tax shield provided by CPL cannot be determined today because any perceived shield could actually be reduced, or even erased, by future changes in tax rates. GC Ex. 19, at 30.

Prospective Rate Base Approach

Although General Counsel believes that its stand-alone approach with regard to consolidated tax savings is the approach that should be adopted, General Counsel is offering a secondary recommendation. Should the Commission determine that equity considerations favor

the ratepayer in the allocation of consolidated tax benefits unrelated to CPL's rendition of service, General Counsel believes that this secondary prospective rate base approach is the most equitable alternative to the benefits/burdens approach. GC Ex. 19, at 14.

The prospective rate base approach results in no adjustment in this case. If consolidated tax savings are recognized prospectively, the savings realized while Docket 14965 rates are in effect would be recognized in CPL's next rate case, and CPL's share of those savings would be treated as cost free capital in that docket. The prospective rate base treatment has the following advantages: (1) it more accurately and fairly reflects consolidated tax savings than the historical cost of service adjustment, (2) it recognizes that consolidated tax savings in prior rate cases have already been allocated and flowed through and are not available as cost free capital in this proceeding, and (3) it subjects future consolidated tax savings to allocation and ratemaking treatment. GC Ex. 19, at 39.

General Counsel recommends that a prospective rate base approach be used to quantify consolidated tax savings during the period that rates set in this docket are in effect. Consolidated tax savings are not necessarily permanent. Savings realized in one year may be reversed in a subsequent year. The rate base approach recognizes the possible temporary nature of consolidated savings and provides ratepayers with the utility's share of the cost free capital provided to the consolidated group until the savings are repaid. Additionally, the prospective rate base approach does not preclude the flow-through of savings to ratepayers if permanence is established. GC Ex. 19, at 53-54.

Both General Counsel and CPL agree that if the stand-alone approach is not adopted the prospective rate base approach should be. The rate base method accumulates losses and taxable income of the non-regulated affiliates. The prospective rate base adjustment would begin

accumulating these losses and taxable income on the first day of CPL's rate year in this case and would continue accumulating losses and taxable income through the test year used in CPL's next rate case.

General Counsel and CPL disagree on the appropriate prospective rate base methodology. However, the disagreement is a narrow one. It concerns the taxable income that may be reported in the prospective period by non-regulated affiliates. Ms. Romines recommends that taxable income which would offset historical period losses, be eliminated before the rate base adjustment is calculated. To the extent of the net operating loss carryforward balance on the first day of CPL's rate year, the taxable income reported in the prospective period is the reversal of the prior losses already considered. GC Ex. 19, at 52, 53. In other words, there are two categories of net operating losses, historical and prospective, and prospective taxable income. The question is how to apply that prospective taxable income. CPL would ignore the historical net operating losses and match the prospective taxable income with prospective net operating losses. General Counsel would first match the taxable income with the historical net operating losses because prudent tax management would require the utilization of the net operating losses in the order in which they are incurred.

This disagreement between General Counsel and CPL is highlighted by Mr. Jeter's erroneous assumption about Ms. Romines' recommendation in General Counsel Exhibit 19 at 52-53 and Attachment 12A. Mr. Jeter assumes that the ($10) rate base adjustment loss, recognized in Ms. Romines' example for the prospective period (Years 2 and 3), is a double-counting of the historical Year 1 loss. CPL Ex. 99, at 37. Mr. Jeter does not understand that the loss that Ms. Romines would recognize in the prospective rate base adjustment is the prospective Year 2 loss and not the Year 1 loss. GC Ex. 19, at 53, CR-12A. The year 1 loss and the offsetting $10

income in Year 3 should not be considered in the prospective rate base adjustment. However, if the Commission decides to adopt the prospective rate base approach, it can reserve the question of the recognition of taxable income to when the prospective rate base adjustment is actually calculated.

Ms. Romines recommends that the consolidated tax savings be allocated using the net allocation method which was used by FERC prior to Order 173. *Federal Power Comm'n. v. United Gas Pipeline Co.*, 386 U.S. 237, 87 S.Ct. 1003, (1967). When non-regulated affiliate tax losses are allocated using the net allocation method, the taxable income and losses of non-regulated affiliates are first combined, and then only the net loss is allocated to the regulated members. GC Ex. 19, at 40. The following example illustrates the different allocation methods proposed.[15]

Assumptions:

		Taxable Income	General Counsel % of Tax Inc. With Netting	Cities % of Tax Inc. Net of Subs.	OPUC % of Tax Inc. No Netting.
Utility U		$500	100%	74%	72%
Affiliate A		$100		15%	14%
Affiliate B	$100				14%
Subsidiary Bs	$(25)				
Net Affiliate B		$75		11%	
Affiliate C		$(200)			

[15] This illustration does not address other differences between the parties' positions.

Consolidated Tax Savings Loss Allocation

Party	Utility U		
	Percentage	Total Affiliate Loss to be Allocated	Allocation of Loss
General Counsel Alternative Net Allocation Method	100%	($25)	($25)
Cities Partial Net Allocation Method (Net of Subsidiaries)	74%	($200)	($148)
OPUC No Net Allocation Method	72%	($225)	($162)

In the example above, General Counsel would combine the losses and income of affiliates A, B, and C ($100+$75-$200) to arrive at a net loss of ($25) and then allocate 100% of the ($25) net loss to the Utility. Cities would allocate 74% of Affiliate C's loss of ($200), or ($148) to the Utility.[16] The only basis for Cities' allocation is that it is consistent with the Docket No. 11735 method. Tr., at 2406. OPUC would recognize losses at the subsidiary level to produce the greatest allocation of affiliate losses to the utility. OPUC Ex. 18, REN-5A. In the example, Affiliate B has a subsidiary company, Subsidiary Bs. OPUC would allocate Subsidiary Bs' loss to the Utility even though Affiliate B has taxable income against which the subsidiary loss could be offset. OPUC would combine Subsidiary Bs' loss of ($25) and Affiliate C's loss of ($200) and then allocate 72% of the ($225) combined loss, or ($162) to the Utility.[17] OPUC's method by its nature results in the greatest allocation of losses to the utility.

Most arguments for consolidated tax savings adjustments center around a shield provided by the utility. The net allocation method is the only method that achieves the goal of reflecting

[16] This percentage is Utility U's portion of the combined Taxable Income of Utility U, Affiliate A, and Net Affiliate B, (net of Subsidiatry Bs).

[17] This percentage is Utility U's portion of the combined Taxable Income of Utility U, Affiliate A, Affiliate B.

the tax shield that the utilities actually provide the non-regulated affiliates. Cities' and OPUC's methods allocate a benefit to the utility and its ratepayers even when the utility's taxable income is of no use to the affiliates. GC Ex. 19, at 40. To recognize more than the actual tax shield provided by the utility is not appropriate under any principle of equity.

Ms. Romines also recommends in the prospective rate base approach that 50% of the cumulative net savings realized by non-regulated members' activities unrelated to the regulated members' rendition of service be allocated to the CSW utility companies. GC Ex. 19, at 39. This 50% percent allocation recognizes the synergistic relationship between the utility companies and non-regulated affiliates, whereby taxable income is provided by the utility and the loss is generated by the non-regulated affiliate.

TUEC 11735 Cost of Service Approach

The Cities' approach, based on the recommendation of Mr. Arndt, includes additional consolidated tax savings of the CSW group in the amount of $4,062,311. His consolidated tax savings adjustment is calculated using the actual tax approach and results in a revenue requirement effect of approximately ($6,249,703).

The major concerns with Mr. Arndt's recommendation are that he continues to advocate the actual tax approach, and he misapplies the benefits/burdens standard. Tr., at 2410. Other experts have recognized this flaw and have recommended rate base adjustments. GC Ex. 19, at 44-45.

If the Commission chooses to reduce CPL's rates with consolidated tax savings relating to non-regulated affiliate losses, Cities' position should be rejected because Mr. Arndt's recommendation fails to reflect the true nature of consolidated tax savings. Cities' position fails to recognize that a non-regulated affiliate's use of a net operating loss on a consolidated return

may only be an acceleration of the use. Cities' method treats losses as though they could never be used on a separate return basis and assigns them permanently to the regulated utility companies. GC Ex. 19, at 56.

Mr. Arndt's recommendation reflects a lack of understanding of consolidated tax savings. He was unable to explain the difference between his recommendation and the rate base adjustment. Tr., at 2407-8. His denial that his cost of service method is an allocation of affiliate losses indicates either that he has only an elementary understanding of the issue or that he is unwilling to admit the obvious. Tr., at 2311, 2410.

Mr. Arndt also indicated that he is unfamiliar with PURA and more specifically, the requirement in Section 2.203, which provides that, "the regulatory authority shall fix its overall revenues at a level which will permit such utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in *rendering* service to the public over and above its reasonable and necessary operating expenses." (emphasis added) See generally Tr., at 2305-2311. Mr. Arndt also failed to consider the total tax liability of the affiliates. Tr., at 2417-2419. This disregard for deferred taxes is inconsistent with his treatment of federal income taxes relating to CPL's rendition of service. Cities Ex. 101, at MLA-1, Schedule 5, p. 1.

Mr. Arndt testified that his recognition of consolidated tax savings allows CPL to recover its share of federal income tax expense to the extent possible under the normalization requirements of the Internal Revenue Code. Cities Ex. 101, at 9. This statement is inconsistent with his later testimony that the IRS places no ceiling on FIT. Tr., at 2426-2427. If Mr. Arndt's adjustment is rejected, the resulting increase to FIT does not violate the normalization provisions of the Internal Revenue Code.

Mr. Arndt's bias or lack of understanding is also reflected in his testimony where he broadly states that "tax losses only have value because of the existence of CPL's taxable income." Cities Ex. 101, at 8. Tax losses also have value if they are carried forward on a separate return basis in a future year.

Historical Rate Base Approach

If the Commission chooses to reduce CPL's rates with consolidated tax savings related to non-regulated affiliate losses, OPUC's recommendation should be rejected because it: 1) reflects historical savings already allocated and flowed through 2) recognizes no sharing between ratepayer and shareholder 3) inappropriately allocates losses on an annual basis and thus does not account for the reversal of savings and 4) overstates the shield provided by utility income in that it fails to net affiliate losses with affiliate income.

One reason that OPUC's recommendation is flawed is because it is based on the erroneous argument that ratepayers have supplied cost-free capital in prior years. OPUC Ex. 18, at 44. OPUC's witness' assertions to the contrary not withstanding, it is the federal government that provides this cost-free capital by allowing the consolidated group to defer payment of taxes. GC Ex. 19, at 45-48, Attachment CR-5. Tr., at 3040, 3049. Temporary consolidated tax savings are like accelerated depreciation. When a company claims accelerated tax depreciation on its tax return, the company receives the use of the funds provided until the future payment. This is similar to an interest free loan. The "interest-free loan" related to consolidated tax savings is accomplished by treating the consolidated group as though it were required to pay to the Treasury each subsidiary's separate return tax, with the Treasury then lending back to the consolidated group without interest, the excess of this amount over the consolidated group's actual current tax liability resulting from the consolidated tax return. GC Ex. 19, at 46.

Mr. Needler testified that the Commission has consistently made consolidated tax savings adjustments for losses of non-regulated affiliates. Mr. Needler failed to recognize contrary positions in Docket Nos. 5610, 8585 and 9300. Tr., at 3055.

OPUC's recommendation treats prior consolidated tax savings unrelated to CPL's rendition of service that were not allocated to the ratepayers in prior cases as though they were savings held in abeyance for allocation in this rate case. This treatment is flawed: these savings were not held in abeyance any more than savings allocated to the ratepayer were. All consolidated tax savings unrelated to CPL's rendition of service have been allocated and flowed through to either ratepayers or the shareholders and are no longer available for consideration. GC Ex. 19 at 39,47-50,54.

OPUC's allocation of losses on an annual basis fails to correctly account for the reversal of savings over time, as the following example shows. OPUC Ex. 18, at REN-5A.

Member Company	Year 1 Taxable Income or (Loss)	Year 2 Taxable Income or (Loss)	Cumulative Two-Year Total
Utility U	$100	$100	$200
Affiliate A	($10)	$10	$ 0
OPUC's Allocation to Utility U	($10)	$0	($10)

OPUC's allocation of Affiliate A's losses to Utility U for this two-year historical period would equal ($10), which is 100% of the Year 1 loss, even though the $10 of taxable income in Year 2 reverses the Year 1 loss. This example illustrates that OPUC's method does not account for reversals. Mr. Needler believes that the loss affiliate would have already been compensated for the loss in the earlier year. Tr., at 3027. But, Mr. Needler fails to consider what occurs after the "earlier years." When Affiliate A pays tax on the $10 taxable income in Year 2, this payment

offsets any cost free capital received in Year 1. Consequently, Mr. Needler's adjustment to rate base does not reflect an end of period amount of cost free capital. Any rate base method, whether historical or prospective, must consider all years within the period considered. General Counsel recommends that any rate base adjustment be calculated so that the allocation is based on cumulative totals, and not on annual amounts.

3. Provision for Deferred Taxes

Not addressed because Ms. Romines determined that a Tax Method 2 calculation was not needed.

4. Investment Tax Credits

The calculation of investment tax credits set forth in Ms. Romines' testimony should be adopted. GC Ex. 19, at 12. GC Ex. 19A, Schedule V, Attachment CR-3. This results in ($5,479,687) for amortization of ITC. Ms. Romines' recommendation is based on a remaining life calculation using rates recommended by General Counsel witness Reed. The investment tax credits relating to "mothballed units," which are not being depreciated, have been removed from the calculation to prevent a normalization violation and to match benefits with burdens. GC Ex. 19, at 8, 12.

5. Other Federal Income Tax Issues

Additional Depreciation

The Commission should adopt the additional depreciation of $18,723,911, as set forth in Ms. Romines' testimony. GC Ex. 19, at 13. GC Ex. 19A, at Attachment CR-4. This recommendation is based on the removal of the depreciation add-back related to the South HVDC Tie and reflects depreciation rates recommended by General Counsel witness Larry Reed.

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	§ § § § § §	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

GENERAL COUNSEL'S REPLY BRIEF

(Revenue Requirements Phase)

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May 20, 1996

General Counsel recommends that the ALJ adopt Mr. McEnaney's recommended ad valorem tax of $48,706,890.

E. Federal Income Taxes

2. Current Tax

Consolidated Tax Savings

Although General Counsel is recommending the stand-alone approach with regard to consolidated tax savings along with CPL, General Counsel does not agree with CPL's claim that CPL and its customers benefit from early utilization of ITCs and net operating losses (NOLs). CPL Brief, at 144. The evidence in this case does not show that CPL realized any of these benefits. Tr., at 605-606. The evidence in this case does show, however, that CPL and its customers benefit from consolidated tax savings related to AMT and capital losses. Tr., at 603, 4239-40.

Some assertions made by Cities in their brief are unsubstantiated and should be rejected. First, Cities assert without support that "some parties oppose ratemaking recognition of any [consolidated] taxes saved...." Cities Brief, at 118. This statement is not accurate. All parties have proposed some level of rate recognition of taxes saved as a result of the filing of a consolidated tax return. However, Cities continue to ignore evidence that consolidated tax savings are already reflected in the Company's request. The revenue requirement effect of consolidated tax savings already reflected in CPL's request is approximately ($5,674,459). GC Ex. 19, at 23. GC Ex. 19A, at 1. As discussed in the brief, General Counsel recommends that those savings related to costs that CPL generates in providing utility service be allocated to CPL's ratepayers.

Cities also claim that "Cities are the only parties which have reflected Commission precedent on consolidated tax savings." Cities Brief, at 118. Cities seem to place a great deal of significance on General Counsel witness Romines taking a contrary position in this case from the Commission's reasoning in Docket No. 11735. Cities Brief, at 120. The quotes from Ms. Romines' prior testimony which the Cities cite concerning a utility's fair share of consolidated tax savings reflect the Commission's reasoning at the time Docket No. 11735 was adjudicated. Cities Brief, at 120. They don't necessarily reflect Ms. Romines' expert opinion. Ms. Romines' position in this case is based on her professional opinion derived from many years of service at the Commission. GC Ex. 19A, Attachment CR-1. Although she considers recent precedent when making a recommendation, recent precedent may not be controlling, especially when there is contrary precedent. See *Application of General Telephone Company of the Southwest for a Rate Increase,* Docket No 5610, *Application of Texas Utilities Company for Authority to Change Rates,* Docket No 9300, and *Inquiry of the General Counsel into the Reasonableness of the Rates and Services of Southwestern Bell,* Docket No. 9300. While the Commission may have been persuaded at one time that regulation creates captive revenues that provide the financial support for loss affiliates, the argument is based on the assumption that affiliates with tax losses are chronic loss affiliates. Cities Ex. 139, at 1024. However, there is no evidence in this case that CSW subsidiaries are chronic loss companies.

Cities argue that General Counsel and CPL would have the Commission ignore the fact that CSW files a consolidated tax return. In support of this assertion, Cities allege that CPL and GC "quibble over terminology," wherein General Counsel uses the term "stand-alone" and CPL supposedly uses the term "separate return". Cities' citation to page 6 of Mr. Williams testimony does not support Cities' assertion that CPL recommends that FIT expense be calculated on a

separate return basis. Cities Brief, at 121. Mr. Williams testimony refers to one column on Schedule G-7.3, a required rate filing comparison of separate return tax and consolidated tax, not to the Company's request.

The terms separate return and stand-alone are not synonymous. Cities' continued failure to acknowledge the difference between the stand-alone approach and the separate return approach is perplexing. As was discussed in Ms. Romines' testimony and General Counsel's brief, FERC Order 173 explains that "[The]stand-alone method is different. It does not ignore the consolidated return or the tax reducing benefits the group realizes by filing such a return. Unlike a separate return policy, our stand-alone policy in effect looks beneath the single consolidated tax liability...." The stand-alone approach does not reflect the tax that CPL would pay if it had filed a separate return. The stand-alone approach recognizes consolidated tax savings related to costs generated by CPL and related to CPL's rendition of utility service. GC Ex. 19, at 14.

Cities' argument on this point is much like the argument that unless consolidated tax savings adjustments are made, the utility's "fair share" of consolidated tax savings would be zero. Cities Brief, at 120. But when the stand-alone approach as defined by FERC is used, CPL's "fair share" of consolidated tax savings is not zero. GC Ex. 19, at 21-24. GC Ex. 19A. While, it may appear that the "fair share" of consolidated tax savings would always be zero if non-regulated affiliate losses are not considered and reflected in a consolidated tax savings adjustment, this is not the case. When all consolidated tax savings are considered, particularly those generated by CPL and reflected in CPL's requested revenue requirement, the exclusion of a consolidated tax savings adjustment does not result in the utility's "fair share" being zero. Nor does it result in an unreasonable or unlawful allocation of the consolidated tax savings. GC. Ex. 19, at 18-19.

In its brief, OPC, in its transparent attempt to allocate as much consolidated tax savings as possible to CPL, states that it is willing to accept the expense (cost of service) method, which is based on a totally different assumption than the rate base approach recommended by its own witness. OPC Brief, at 52. OPC reasons that CPL should receive a greater share of the consolidated tax savings because CSW's overall tax expense is lowered by the filing of a consolidated tax return, because PURA mandates it, and because of precedent. OPC Brief, at 53. General Counsel disagrees with OPC's reasoning. It does not necessarily follow that any lowering of CSW's overall tax expense results in a lowering of CPL's tax expense. CPL's share of the overall tax expense is an allocation issue, not a fact. Although PURA mandates that the utility recognize its fair share of consolidated tax savings, it does not mandate that the fair share include tax benefits related to non-regulated affiliate losses. *Public Util. Comm'n. v. GTE-SW*, 901 S.W. 2d 401 (Tex. 1995). Furthermore, OPC fails to consider the evidence which demonstrates that consolidated tax savings related to the utility's rendition of service are reflected in CPL's request. As a result, its fair share is already reflected and no adjustment is necessary. GC Ex. 19. at 14.

Cities also complain that CPL was permitted to retain $34.3 million of unamortized excess unprotected deferred income taxes for the benefit of its shareholders instead of flowing those funds to ratepayers in 1995. Cities Brief, at 124. Cities incorrectly assert that these unprotected deferred taxes were supplied by the ratepayers. This argument is similar to OPC's argument that consolidated tax savings represent cost free capital provided to CPL by ratepayers. OPC Ex. 18, at 44. It should go without saying that the federal tax laws are drafted and administered by the federal government. Therefore, it is the federal government that supplies the cost free capital by allowing the consolidated group to defer payment of taxes, not the ratepayers. GC Ex. 19, at 45-48, Attachment CR-5. Tr., at 3140, 3049.