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State Office of Administrative Hearings



Shelia Bailey Taylor
Chief Administrative Law Judge

November 16, 2004

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TO: Stephen Journeay, Director
Office of Policy Development
William B. Travis State Office Building
1701 N. Congress, 7th Floor
Austin, Texas 78701

RE: SOAH Docket No. 473-04-1033
PUC Docket No. 28840

Application of AEP Texas Central Company for Authority to Change Rates

Enclosed are two copies of the Proposal for Decision (PFD) on Remand in the above-referenced case. Please file-stamp and return a copy to the State Office of Administrative Hearings for our records. Also enclosed is a disk containing an electronic copy of the PFD on Remand. By copy of this letter, the parties to this proceeding are being served with the PFD on Remand.

AEP Texas Central Company (TCC or Applicant) has extended the effective date in this case to November 19, 2004. In Order No. 21 issued November 5, 2004, the Administrative Law Judges (ALJs) requested that TCC extend its effective date to January 20, 2005, to allow sufficient time to complete number running and for the Commission to consider the case. TCC is considering that request but has not filed a response. Commission Staff is still conducting number running; therefore, the ALJs will file the number running memos under separate cover (Attachment B to the PFD on Remand) when the memos are received.

Please place this case on an open meeting agenda for the Commissioners' consideration. It is our understanding that you will be notifying us and the parties of the open meeting date, as well as the deadlines for filing exceptions to the PFD on Remand, replies to the exceptions, and requests for oral argument.

Sincerely,

Handwritten signature of Katherine L. Smith in cursive.

Katherine L. Smith
Administrative Law Judge

Sincerely,

Handwritten signature of Paul D. Keeper in cursive.

Paul D. Keeper
Administrative Law Judge

Enclosure

xc: All Parties of Record (without disk)

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743

**SOAH DOCKET NO. 473-04-1033
PUC DOCKET NO. 28840**

APPLICATION OF AEP TEXAS	§	BEFORE THE STATE OFFICE
CENTRAL COMPANY FOR	§	OF
AUTHORITY TO CHANGE RATES	§	ADMINISTRATIVE HEARINGS

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SOAH DOCKET NO. 473-04-1033
PUC DOCKET NO. 28840

APPLICATION OF AEP TEXAS	§	BEFORE THE STATE OFFICE
CENTRAL COMPANY FOR	§	OF
AUTHORITY TO CHANGE RATES	§	ADMINISTRATIVE HEARINGS

PROPOSAL FOR DECISION ON REMAND

This Proposal for Decision (PFD) on Remand responds to the Public Utility of Commission of Texas' (Commission's) Order on Remand of July 28, 2004, and Second Order on Remand of August 25, 2004. The Commission issued its First Order on Remand to the State Office of Administrative Hearings (SOAH) to consider the issue of consolidated taxes. A hearing on the merits on this issue was held on September 3, 2004. Briefs were filed on September 10, 2004; reply briefs were filed September 17, 2004. The Second Order on Remand ordered further evaluation of the following issues: (1) affiliate costs; (2) distribution A&G expense adjustments; (3) depreciation expense; (4) net salvage; (5) special meter reading fee, connect fee, and service reconnect fee; and (6) priority disconnect fee.

At a prehearing conference held August 27, 2004, the Administrative Law Judges (ALJs) made several rulings and set a procedural schedule for the processing of the remanded issues. Regarding the Second Order on Remand issues, the ALJs adopted the parties' proposal that no additional evidence would be submitted; no additional hearings would be held; and no additional briefing would be filed. The parties were allowed until September 3, 2004, to submit a list of citations to the evidence supporting the proposed findings of fact or conclusions law on each of the issues listed in the Commission's Second Order on Remand. No replies or responses to the list were permitted.

The parties filed their list of citations to the record on September 3, 2004. On September 9, 2004, AEP Texas Central Company (TCC or the Applicant) filed a Motion to Strike CPL Retail's Proposed Supplemental Findings of Fact and Supporting Citations, arguing that CPL's filing had exceeded the limitations established by Order No. 20. On September 13, 2004, CPL Retail

filed its response to the motion to strike. Having considered the motion and the response to the motion, the ALJs grant the motion to strike.

I. CONSOLIDATED TAX SAVINGS ADJUSTMENT

In the PFD the ALJs determined that a consolidated tax savings (CTS) adjustment should be made based on the value of the tax shield the utility provides to the parent company and its non-regulated affiliates.¹ The ALJs were not able to recommend a specific dollar amount, however, and recommended a limited remand. The Commission remanded to SOAH “the determination of the appropriate amount for a consolidated tax savings adjustment.”² The ALJs do not waiver in their original recommendation that a consolidated tax savings adjustment be made. That decision is buttressed by the recent court of appeals decision in the Reliant Unbundled Cost of Service (UCOS) case.³

Two issues are to be resolved in this remand: (a) the appropriate method for functionally assigning the CTS and (b) whether the adjustment amount should be “grossed up” to account for the tax effects of the adjustment. The ALJs find that the CTS should be functionally assigned. The ALJs also find that the CTS adjustment should be grossed up because such treatment is consistent with the Reliant UCOS proceeding.

A. Functional Assignment

The ALJs are not swayed from their initial determination that the CTS should be proportionally assigned between the generation and the transmission and distribution (T&D) functions, despite Cities’ reiteration of their argument that the CTS should not be functionally

¹ Proposal for Decision (July 2, 2004) at 204, FoF No. 194.

² Order on Remand (July 28, 2004).

³ *Reliant Energy, Inc. v. Public Util. Comm’n of Texas*, No. 03-02-00246-CV, slip op. (Tex. App.—Austin, August 26, 2004).

assigned. The parties appear to agree that the most accurate way to assign the CTS adjustment to the two functions is according to the taxable income produced by each function.⁴ Unfortunately, functional-taxable-income information is unavailable for the years prior to 2002,⁵ and the parties have presented proxies. TCC proposes two alternatives, Cities one.

TCC's first method is a point estimate based on TCC's 2002 taxable income, the first year for which functional taxable information was available. In 2002, TCC's T&D function produced 4.43% of TCC's total taxable income, leading to an adjustment of \$397,413.⁶

Neither Staff nor the Intervenors support the 4.43% proxy. The Coalition of Commercial Ratepayers (CCR) contends that TCC's proposed 4.43% factor is unreasonable on its face because it is a snapshot that does not reflect the percentage of income for the test year period, much less during the entire fifteen year period over which the adjustment is calculated. Cities assert that using 2002 tax income results in a minimal allocation of 4.43% to the T&D functions, due in part to aberrant losses for the transmission function in that year and because of bonus depreciation that went into effect in 2002 due to the September 11, 2001, events.⁷ According to Cities, taxable income and losses change dramatically from year to year. Whereas the transmission function has a taxable loss of (\$30,317,000) in 2002, it had taxable income of \$2,351,000 in 2003. Cities also complain because 11.31% of the CTS adjustment is allocated to the "securitization" function, which they contend is inappropriate because securitization did not occur until after 2000.

Perhaps recognizing that its first proxy method produced an unreasonably low percentage, TCC presented a second proxy. The second proxy allocates the savings for the fifteen years in question based on rate base, because rate base bears a relationship to earned return, and earned return is a major factor in producing taxable income. Using the rate base on which rates were set by the

⁴ Cities Reply Brief on Remand at 8, n 20.

⁵ TCC Ex. 93, Remand Testimony of Jeffrey Bartsch at 7.

⁶ TCC Ex. 96, Remand Rebuttal Testimony of Bartsch at 7.

⁷ Cross examination of Bartsch, Tr. at 3211.

Commission in Docket Nos. 8646, 9561, and 14965, TCC developed a calculation of tax savings based on the relative level of T&D rate base produced by final Commission orders in those cases.⁸ The percentages for the T&D functions for each year produced an allocation of 23.1% to T&D, which results in an adjustment of \$1,509,656.⁹

Cities complain that the second proxy method is also not representational because it fails to take into account accelerated depreciation on generation assets, particularly the South Texas Nuclear Project. Cities complain that during the 15 years in question, the generation function generated huge taxable losses and the taxable income that was being generated was due to the customers' payment of rates based on the other functions.¹⁰ Cities assert that for the years showing taxable losses, the generation assets should not receive any of the consolidated-tax-savings benefit because they were not generating any taxable income.¹¹

Cities' proposed proxy, which Cities contend was recommended by Office of Public Utility Counsel (OPUC) witness Candice Romines and adopted by the Commission in the Reliant UCOS proceeding, allocates the tax savings based on the composition of rate base in the Central Power and Light Company UCOS proceeding.¹² According to Cities, its witness Michael Arndt attempted to follow the Reliant UCOS precedent by identifying the composition of TCC's rate base presented by Central Power and Light Company in Docket No. 22352.¹³ Cities note that the information upon which Mr. Arndt relied is Schedule II-B (revised), prepared by TCC in accordance with rate filing package requirements.¹⁴ Cities note that its method allocates 40.32% of the tax savings to T&D, which when compared to TCC's Federal Energy Regulatory Commission (FERC) form 1, showing

⁸ TCC Ex. 95, Remand Testimony of Donald Moncrief at 5.

⁹ TCC Ex. 96, Remand Rebuttal Testimony of Bartsch at 7.

¹⁰ Cross examination of Michael Arndt, Tr. at 3282; Cities Ex. 137.

¹¹ *Id.* at 3285; Cities Ex. 137.

¹² *Application of Central Power and Light Company for Approval of Unbundled Cost of Service Rate Pursuant to PURA § 39.201 and Public Utility Commission Substantive Rule § 25.344*, Docket No. 22352 (Oct. 5, 2001).

¹³ Cities Ex. 128, Remand Testimony of Arndt at 8.

¹⁴ TCC Ex. 101.

that T&D comprised 46% of TCC's net plant in 2002, illustrates the conservative nature of Cities' proposal.¹⁵

TCC contends that Cities' proxy is flawed because it is based on a single year's rate base, that is, its functional rate base amounts as of September 30, 1999, that it filed in its UCOS case.¹⁶ According to TCC, those 1999 historical numbers were not used by the Commission to set rates because the rates that went into effect were based on the forecasted calendar year 2002. TCC points out that because the Company's UCOS case settled, it is difficult to know what the ultimate functional rate base was and suggests that the Final Order provides no help. And in response to Cities' suggestion that its proposed proxy was used by the Commission in the Reliant UCOS case, TCC responds that while the Commission used "asset based" factors to assign the tax savings to the T&D function, there is no specific evidence of what was used by the Commission and its final order contains no explanation.¹⁷

Of the three proxy methods, TCC's second one would appear to be the most representative of the 15-year-tax savings, but the result is not satisfying. TCC told the FERC that T&D comprised 46% of TCC's net plant, yet it is saying in this case that T&D represents just 23% of rate base. That is disturbing. This percentage is also ironic because previously in this proceeding, TCC proposed to allocate none of the costs of debt refinancing due to business separation to generation.¹⁸ Using just a single year's worth of data, however, whether of rate base or taxable income, seems less appropriate. As Staff notes, an allocation based on actual functionalized income for each year of the fifteen-year period would be the most appropriate basis for functional assignment. Absent such information, the rate base percentage assignment that TCC proposes as its second alternative, resulting in 23.1% or \$1,509,656, is an acceptable allocation of the CTS to the T&D utility.¹⁹

¹⁵ Cities Ex. 128, Remand Testimony of Arndt at 8; Cities Exs. 129, 130.

¹⁶ TCC Ex. 101.

¹⁷ TCC Ex. 94, Remand Testimony of James Warren at 11.

¹⁸ See Proposal for Decision at 72.

¹⁹ TCC Ex. 95, Remand Testimony of Donald R. Moncrief at 5.

B. Gross up

Cities, Staff, and CCR contend that the CTS adjustment should be grossed up. TCC does not.

TCC contends that the CTS adjustment should not be grossed up because the methodology being proposed in this proceeding is the “interest credit” methodology that was developed in Docket No. 14965. In that case the CTS adjustment was not grossed up. TCC asserts that the very name of the methodology, interest credit, indicates that it is really an adjustment to interest expense, and not federal income tax expense. According to TCC, the Commission in Docket No. 14965 calculated the consolidated tax benefit in terms of the time value of money that the use of the allocated affiliate tax losses provides by offsetting the utility’s taxable income. Because the interest credit methodology measures the amount of interest expense that the utility purportedly incurred in providing a tax shield to its affiliated companies over an applicable 15-year period and because interest expense is deductible for federal income tax purposes, the adjustment should not be grossed up.²⁰

According to TCC, the only rate case adjustments that require gross up are those items that have no federal income tax consequences, such as equity return amounts, federal taxes, and other items that are not deductible for tax purposes.²¹ An adjustment to any item that produces a tax deduction, such as interest expense, does not need to be grossed up. TCC argues that the outcome of the Reliant UCOS proceeding is not relevant because the Commission did not employ the interest credit methodology, but made the CTS adjustment to the federal income tax expense.

In response, Cities assert that the Commission never claimed that it was adjusting interest expense in Docket No. 14965. Although the CTS adjustment reflects cost-free capital, that does not

²⁰ TCC Ex. 94, Remand Testimony of Warren at 13-14.

²¹ *Id.*

mean that the Commission applied the savings to interest expense. Cities claim that the adjustment has always been an adjustment to the utility's federal income tax expense and not to interest expense. According to Cities and CCR, AEP is confusing nomenclature and the theory justifying the adjustment with the application of the adjustment. According to Staff, the debt rate multiplier is simply a proxy for the cost-of-capital rate to apply to the appropriate adjustment.²² Staff notes further that TCC has not incurred any actual interest expense by virtue of filing a consolidated tax return.

Cities reiterate that the Commission adopted the interest credit methodology to measure the CTS adjustment based on the value of the tax shield the utility provided to the parent company and its non-regulated affiliates over the last 15 years. That tax shield is a competitive advantage the affiliates gained by using the regulated utility's income to obtain cost-free capital.²³ Tax losses over the last 15 years are multiplied times the federal income tax rate and then multiplied times a tax shield rate, that is, the time value of money based on the cost of long term debt, for the adjustment to federal income taxes. According to Staff, the value of the CTS to the parent and affiliates is in the "tax shield" effect of the consolidated tax return; not merely the time value of savings, as TCC contends. Because the adjustment is a direct adjustment to federal income taxes and because it is thus not deductible for tax purposes, it must be grossed up. Because the CTS adjustment reduces the federal income tax expense, which is a part of revenue requirement, that decrease must also be deducted from the part of return that is taxed. According to Staff, the tax factor for the taxable component of return is 0.53846; therefore, the combined effect of the CTS adjustment and the associated gross-up is $(1.53846 * \text{CTS adjustment})$.

Although TCC urges that the Commission follow Docket No. 14965 and decline to gross up the CTS adjustment, the Commission has twice grossed up its CTS adjustment since Docket

²² Cross-examination of Arndt, Tr. at 3279-80.

²³ *Central Power and Light Company/Cities of Alice v. Public Util. Comm'n of Texas*, 36 S.W.3d 547, 555; (Tex. App.-Austin 2000, pet. denied).

No. 14965. In Docket No. 16705, the Commission applied a CTS adjustment and grossed it up for taxes.²⁴ In Docket No. 22355, the Reliant UCOS case, the Commission grossed up the CTS adjustment.²⁵ It appears to the ALJs that the CTS adjustment methodology has largely evolved through the expertise of Candice Romines, the former staff expert on federal income taxes, who testified in Docket No. 16705 why the adjustment should be grossed up and whose recommendation to gross up the adjustment was adopted by the Commission in the Reliant UCOS proceeding.²⁶ TCC points out that in the Reliant UCOS case, tax savings amounts were multiplied by the utility's long-term cost of debt.²⁷ That is what occurred in Docket No. 14965.²⁸ The CTS adjustment, which results in a reduction to revenue requirement, should fully reflect the ultimate revenue requirement impact of the adjustment. A gross up must be made to reflect the proper revenue requirement of the adjustment.

As noted previously, the recommended consolidated tax savings adjustment in this case is \$1,509,656. Consistent with the methodology adopted by the Commission in the Reliant UCOS proceeding, the income tax effect of the CTS adjustment needs to be grossed-up when computing the revenue requirement impact. The combined effect of the CTS adjustment and the associated gross-up is 1.53846 times the adjustment, for the amount of \$2,322,545 to be deducted from the federal income tax expense.

²⁴ *Application of Entergy Texas for Approval of its Transition to Competition Plan and the Tariffs Implementing the Plan, and for the Authority to Reconcile Fuel Costs, to Set Revised Fuel Factors, and to Recover a Surcharge for Under-recovered Fuel Costs*, Second Order on Rehearing (Oct. 14, 1998) at 93-94, FoF Nos. 96-98, at 144, CoL No. 31, and Schedule V.

²⁵ *Reliant Energy, Inc. v. Public Util. Comm'n of Texas*, No. 03-02-00246-CV (Aug. 26, 2004).

²⁶ Cross examination of Arndt, Tr. at 3317-18.

²⁷ TCC Reply Brief on Remand at 16.

²⁸ *Central Power and Light Co.*, 36 S.W.3d at 556.

II. COST OF SERVICE: AFFILIATE COSTS

A. Page 45

The text in the paragraph at the top of page 45 is withdrawn and replaced with the following:

The ALJs' analysis of this section is divided into four subsections: (1) a review of the controlling law and policy, (2) a review of the Applicant's affiliate cost billing system, (3) a review of the arguments of each of the three intervenors' expert witnesses, and (4) the ALJs' recommendations.

B. Pages 53-72

The text in pages 53-72, Sections VI.A.3 and 4, is withdrawn and replaced with the following:

1. Intervenors' Challenges to Affiliate Expenses

OPC's witness, Dr. Carol Szerszen,²⁹ reviewed TCC's proposed \$60,362,087 in affiliate costs and recommended the disallowance of \$13,402,570.³⁰ Her analysis is based on a review of individual expense items or classes of items. Dr. Szerszen's decision not to disallow the other \$46.9 million in affiliate costs was not due to her agreement with those costs. Instead, Dr. Szerszen asserted that time considerations prevented her from fully evaluating the rest of TCC's proposed affiliate expenses.

²⁹ Dr. Szerszen holds a Ph.D. in economics from the University of Illinois and has served as economist to the OPC since 1984. She has presented testimony in a number of cases before the PUC, including many of the dockets decided by the Commission and by the Texas courts.

³⁰ OPC Ex. 1A at 63.

In contrast to Dr. Szerszen's approach, the analysis of Mr. Tucker,³¹ Cities' expert on affiliate costs, involved a series of more general criticisms, including the complaint that TCC's evidence did not prove that its affiliate expenses were reasonable. Specifically, Mr. Tucker complained that TCC had not used outside benchmarks from the competitive marketplace to prove reasonableness.³² He objected to TCC's assertion that its lowered cost margins gained through its membership in the AEP family of companies was sufficient to prove reasonableness. Missing from TCC's proof, according to Mr. Tucker, was a showing that the Applicant's cost of obtaining these same services from third-party vendors was lower than any other means of obtaining these services.³³ Mr. Tucker recommended that the Commission disapprove \$16,572,333 in affiliate costs.³⁴

CPL's expert on affiliate cost issues was Dr. Dennis Thomas.³⁵ Dr. Thomas' criticisms were similar in nature to Mr. Tucker's. Dr. Thomas observed that: (1) except for two affiliate expenses,³⁶ TCC provided no external cost references to show that the level of expenses was reasonable,³⁷ and (2) TCC presented no historical pattern of expense levels to show how the cost of affiliate expenses developed over time.³⁸ Dr. Thomas suggested that the Commission postpone a decision on this issue³⁹ (a suggestion that we reject), recognize TCC's current level of affiliate expenses (resulting in a \$10.3 million disallowance),⁴⁰ or disallow all affiliate costs other than the two expenses that

³¹ Mr. Tucker's credentials include his service as an employee of SWEPCO, an AEP company, between 1974 and 1986, during which time he worked on regulatory matters. From 1986 to 1990, Mr. Tucker served as the controller for CPL, the predecessor company to the Applicant. In 1995, Mr. Tucker also was engaged by CSW Services (one of the companies merged into AEP) to provide support to Ms. Bennett in the development and preparation of her direct testimony regarding affiliate costs in Docket No. 14965. Cities Ex. 4 at 56; Tr. at 1456; Tr. at 1457.

³² The statute requires the Commission to make "a specific finding of the reasonableness and necessity of each item or class of items [of affiliate expenses] allowed." PURA § 36.058(c)(1).

³³ Cities Ex. 4 at 45.

³⁴ *Id.* at 51.

³⁵ Dr. Thomas's credentials include his prior service as a member and chairman of the Commission, his obtaining a Ph.D. in Management and Energy Policy from the University of Texas, and his prior service as the director of the Governor's Office of Management and Budget. CPL Ex. 1 at 4.

³⁶ According to Dr. Thomas, these included telecommunications (\$2,073,488) and customer choice operations (\$7,758,151 of which \$4,938,271 was for LogicaCMG). CPL Ex. 1 at 44.

³⁷ *Id.* at 18.

³⁸ *Id.*

³⁹ OPC Ex. 1A at 47.

⁴⁰ *Id.* at 48.

Dr. Thomas asserted had met the standard of proof (resulting in a \$53,438,109 million disallowance).⁴¹

2. Recommendation

TCC's proof of its affiliate expenses in this case is tied to two legal arguments: (1) the law requires no more than TCC has offered, and (2) there is no other information available. The first argument relies on a faulty analysis of the provisions of PURA § 36.058(d). The statute requires the Commission to determine the extent to which the conditions and circumstances of the transactions that underlie the affiliate expenses "are reasonably comparable relative to quantity, terms, date of contract, and place of delivery, and allow for appropriate differences based on that determination."⁴² TCC's proof under this portion of the law relates to the not-higher-than standard expressed in PURA § 36.058(c)(2). Using this approach, TCC witnesses testified that TCC's many affiliate expenses are not higher than those incurred by its other affiliated companies because the allocation factors are fairly applied. In other words, TCC argues, the allocation factors properly account for comparisons "with the prices charged by the supplying affiliate to its other affiliates," based on the elements of PURA § 36.058(d).

We reach a different conclusion about the law and its meaning. The provisions of PURA § 36.058(b) permit the Commission to allow an affiliate expense only if the Commission finds the expense to be reasonable and necessary. To make that determination, the Commission has the duty to make "a specific finding of the reasonableness and necessity of each item or class of items"⁴³ and "a finding that the price . . . is not higher than the prices charged to its other affiliates . . . or nonaffiliated persons."⁴⁴ We conclude that the provisions of PURA 36.058(d) relate to *each* of the two findings required in PURA § 36.058(c). Thus, the Commission must take into account

⁴¹ Id. at 49.

⁴² PURA § 36.058(d).

⁴³ PURA § 36.058(c)(1).

⁴⁴ PURA § 36.058(c)(2).

quantity, terms, date of contract, place of delivery, and allow for appropriate differences in making *each* of those findings.⁴⁵ Thus, the legislature requires evidence of comparability as an element of not only the not-higher-than requirement but also of the reasonableness and necessity requirements.

Using this analysis, TCC is required to satisfy at least one element of the comparability provisions of PURA § 36.058(d) in proving reasonableness. The Commission's Guiding Principles provide applicants a range of choices of type of evidence in making that proof. An applicant is required only to select its evidence in a way that reasonably relates to the type of expense proposed.

The second part of TCC's argument, "there is no other information available" reflects TCC's own conclusion that there is no other valid evidence to prove its case. Thus, with few exceptions, TCC argues that benchmarking and outsourcing studies cannot be used "due to high variations between companies and industries,"⁴⁶ that TCC cannot make comparisons of its affiliate expenses with the expenses incurred by nonaffiliated persons because AEPSC does not deal with nonaffiliated persons,⁴⁷ and that historical data is either legally unavailable or unusable because of interfering business activities.⁴⁸ With these sources of data eliminated, TCC argues, the best evidence of reasonableness is by showing that the affiliate expenses were allocated fairly.

⁴⁵ The Commission adopted the Guiding Principles for the purpose of providing applicants a clear set of alternatives by which applicants could make proof of this element of the law.

⁴⁶ TCC Ex. 68 (Bennett rebuttal) at 62. See also Mr. Bailey's explanation that although TCC used benchmarking studies in the past, "we've learned [that] we can do these things internally and still glean the type of information we need to manage." Tr. at 2653-54. Also see Mr. Gordon's testimony that it would be virtually impossible to benchmark TCC's distribution affiliate costs against either FERC 1 data or other companies' data. Tr. at 2649.

⁴⁷ See, TCC Ex. 11(D'Onofrio direct) at 38:

Q. Does AEPSC provide these shared services [an affiliate expense] to non-affiliates?

A. No. Any services to non-affiliates are provide[d] not by AEPSC, but instead by AEP operating companies.

⁴⁸ The "black box" agreement in TCC's UCOS case prevented the Commission from receiving potentially valuable comparative data from that period. *Application of Central Power and Light Company for Approval of Unbundled Cost of Service Rate Pursuant to PURA § 39.201 and Public Utility Commission Substantive Rule § 25.344*, Docket No. 22352 (Oct. 5, 2001). TCC's data drawn from the eve of the merger was unusable because TCC's business activities had been affected for months in anticipation of the coming merger. According to TCC, the outcome of those pre-merger business practices was the corruption of the data for purposes of comparability. TCC Ex. 81 at 6-7; Tr. at 338-340.

In the absence of comparative data, the Commission has only TCC's legal arguments upon which to rely in making a finding as to reasonableness. As one example, we refer the Commission to TCC's request for \$324,623 for Transmission System Infrastructure Support, a Shared Services affiliate expense. TCC discloses that the allocation factor is Number of Pole Miles, that the expense is part of the Information Technology class of expenses, and that the expense involves "specific IT work orders for IT services for the Transmission function cutting across a wide range of application services, infrastructure, and other IT support services, where the use of number of pole miles is the main cost driver and thus provides the most appropriate method for allocating these costs."⁴⁹ Other than the detail in workpapers, TCC provided no other information on this expense. According to TCC, the Transmission System Infrastructure Support affiliate expense is reasonable because the allocation factor reasonably allocates the expense and because the efficiencies gained by the merger inure to the ratepayers' best interest.

That argument provides the Commission with little factual evidence upon which to base its findings. We ask: How does the \$324,623 proposed cost compares to the same type of costs borne by other utilities for similar functions? How does the expense compare with the expense incurred by TCC or its predecessor over the last several years? Is it reasonable to disaggregate Information Technology expenses into categories as narrow as this? Using what criteria should the Commission judge the reasonableness of the amount of the expense? Is \$324,623 more reasonable than \$324,624, or would TCC have served the public interest better by spending \$1,324,623? Not only do we not have the answers to these questions, but we cannot know them if the Commission adopts TCC's argument that the law requires nothing more or that there is no other information available.

We find TCC's theory of the case for proof of its affiliate expenses fundamentally unacceptable, and we reject this attempt to prove cost of service based on a reduction of the standards required by the provisions of PURA. If the ALJs are to make specific findings, supported

⁴⁹ TCC Ex. 11, Exh. WND-5 at 10.

by the evidentiary record, that the individual costs are reasonable and necessary for each item of expense or class of expenses, then we must have a context against which to make comparisons. TCC's context is based solely on its conclusions about the reasonableness of the expenses, and those conclusions are based primarily on TCC's allegedly having met the not-higher-than standard. We recommend that the Commission adopt Dr. Thomas' proposal to make a \$53,438,109 million disallowance in TCC's affiliate costs.

We recognize that the Commission may not concur with our analysis. To minimize the need for additional remands, and if the Commission is prepared to accept TCC's fundamental assumption that the reasonableness standard may be met by TCC's proof, then we provide the following contingent discussion (with contingent findings of fact and conclusions of law at Attachment A) based on an item-by-item or class-by-class review of each of TCC's proposed affiliate costs.

a. Regulatory, Legal, and Public Policy Expenses

TCC sought approval for \$5,263,768 in affiliate costs⁵⁰ for:

Texas demand side management	\$ 109,458
Code of conduct investigations	56,568
Non-rate case filings	957,739
Pricing analyses	231,732
Manage and participate in regulatory affairs	1,473,374
Manage and participate in legislative affairs	537,638
Manage and participate in public policy issues	138,761
Corporate existence and separation	1,074,020
Provide support to the board of directors	28,217

⁵⁰ TCC Ex. 7, Exh. SSB-2.

Rate case filings	261,319
"Various activities"	394,942

i. Texas Demand Side Management (DSM)

Texas DSM expenses are those associated with the programming and planning to meet statutory efficiency goals. The allocation factor is Number of Retail Electric Customers. The expense meets the necessary and reasonable standard since the function is mandated as a legal obligation of the utility.⁵¹ The service is billed at cost,⁵² such that TCC incurs only its proportionate share of affiliate charges on the same basis as all other AEP affiliates. The allocation formulas ensure proportionality by allocating costs based on reasonable attribution bases that reflect appropriate principles of cost causation.⁵³ For these reasons, the expense meets the not-higher-than standard. This proposed affiliate expense was not specifically opposed by Dr. Szerszen⁵⁴ or Dr. Thomas.⁵⁵ Mr. Tucker opposed the entirety of the affiliate expenses with some allowances for other expenses, none of which related to the issues associated with this proposed expense.⁵⁶ Based on this absence and lack of dispute, the ALJs find the DSM expense is a reasonable affiliate expense.

ii. Code of Conduct Investigations

TCC conducts and documents internal and code of conduct investigations. As part of this process, TCC incurs expenses for training software, educational brochures, and an employee concerns hotline. The main cost driver is the scope of the investigations, the detail required for the

⁵¹ TCC Ex. 2.2, Sched. V-K-7a at 44.

⁵² A portion of DSM expenses were direct charged, as were some of the other regulatory, legal, and public policy affiliate expenses. The expenses that were direct charged are collectively described by TCC in "Various Charges," and that item is discussed separately in this section.

⁵³ *Id.* at 45.

⁵⁴ OPC Ex. 1A at 45.

⁵⁵ CPL Ex. 1 at 33.

⁵⁶ Cities Ex. 4 at 49-50.

investigations, and the impact of the policies on the benefiting locations. The allocation factor used is Number of Employees since the function is driven by the size of the workforce.⁵⁷

TCC offered little testimony on this issue other than the comment on cross-examination that the Code of Conduct investigation expense was a “new factor that we’re using.”⁵⁸ In context, the statement referred to the fact that these investigations and the costs associated with them were being tracked for the first time since the merger as a separate affiliate cost. The non-testimonial evidence was in the form of supporting data about T&D functions. The schedule in which this information appears includes a brief discussion of this item’s necessity and reasonableness: “these activities [are] essential to TCC’s legal obligation to respond to and comply with all local, federal and state regulations.”⁵⁹ We adopt that position.

Dr. Szerszen did not oppose this proposed affiliate expense.⁶⁰ Dr. Thomas acknowledged that some of the activities are required by regulatory authorities, although he did not list this proposed expense as one. TCC’s unchallenged evidence reflects that the expense is reasonable and necessary and meets the not-higher-than standard for the same reasons expressed with regard to the DSM proposed expense.

iii. Non-Rate Case Filings

TCC prepares service quality reports, energy efficiency plans, construction reports, affiliate transaction reports, financial and operating reports, and SEC-, FERC-, and Commission-mandated reports.⁶¹ These expenses are allocated using Total Assets.⁶² In support of this proposed expense,

⁵⁷ TCC Ex. 4, Exh. DGC-5 at 1.

⁵⁸ Tr. at 2418.

⁵⁹ TCC Ex. 2.2, Sched. V-K-7a at 43 and Sched. V-K-7b at 37.

⁶⁰ OPC Ex. 1A at 45.

⁶¹ TCC Ex. 4 at 50 and Exh. DGC-5 at 2.

⁶² *Id.*

TCC produced a complete list of the reports and filings that were T&D-related.⁶³ That list contained more than three dozen Commission docket filings, as well as nine non-Commission docketed reports.

In her prefiled testimony, Dr. Szerszen asserted that the majority of the non-rate-case filings were not related to Texas T&D operations. On cross-examination, Dr. Szerszen asserted that TCC's workpapers failed to provide sufficient detail to determine whether the expenses associated with each of the dockets were related to Texas T&D expenses,⁶⁴ that these costs may be duplicated elsewhere in TCC's application,⁶⁵ and that AEP's generation and retail companies should absorb more of these expenses.⁶⁶

In debating the amount of detail necessary for TCC to sustain its obligation to show that each of these charges is reasonable and necessary, Dr. Szerszen asserted that "a line-by-line analysis may not be necessary, but [that she] would certainly expect a little bit more information than a one-line charge."⁶⁷ TCC's counsel raised the question, "So you would ask for some kind of work order for every single one of these [charges] so that [TCC] could keep track of them separately?" Dr. Szerszen reasserted, "We need some kind of breakdown -- possibly not a case by case, but we need more information than one line."⁶⁸

On rebuttal, Mr. Carpenter attempted to address Dr. Szerszen's issues.⁶⁹ However, Mr. Carpenter's testimony did not provide the costs associated with each of the docket items,⁷⁰ failed

⁶³ Cities Ex. 56.

⁶⁴ Tr. at 2195.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.* at 2196.

⁶⁸ *Id.*

⁶⁹ TCC Ex. 66 at 56-57.

⁷⁰ An applicant is required to provide sufficient information for other parties to review the transactions underlying the affiliate costs. Outline Item 2.05.

to demonstrate that the services were not duplicated,⁷¹ and did not show that there was a logical and consistent relationship between the asset allocator and the benefits received by TCC's T&D ratepayers for AEPSC's allocated non-rate case filing expenses.⁷² In the absence of these details, we conclude that TCC's evidence is not sufficient to meet PURA's reasonable-and-necessary standard and the not-higher-than standard required by the Commission.

iv. Pricing Analyses

Pricing analyses includes research, scenario analysis, and development of economic and other assumptions related to the pricing of the utility's services. TCC used Total Assets as an allocation factor because it reasonably approximates the costs of each benefiting location's proportionate share of the services, which vary based on size.⁷³ Dr. Szerszen did not propose disallowance of this affiliate expense item,⁷⁴ although Dr. Thomas expressed concern about affiliate costs that encompass a "clear discretionary element."⁷⁵

TCC's evidence for the item's satisfaction of the necessary-and-reasonable and the not-higher-than standard was the general language included in the underlying schedules.⁷⁶ The ALJs' concern with this proposed expense is that it is not clearly differentiated from other economic modeling expenses that TCC seeks to include in the cost of service. Specifically, TCC provides no description of how this expense differs from analyses used in rate case filings or in the management

⁷¹ A showing that services are not duplicated is one of the issues that the Commission has identified as relevant in proof of affiliate costs. Outline Item 3.05.

⁷² OPC Ex. 1A at 46-47. Dr. Szerszen's complaint was that "[b]ecause AEPSC allocates the vast majority of these expenses, it can be concluded that T&D operations issues may be only tangentially related to many of the non-rate case filings in the company's cost of service." *Id.* Also, Dr. Szerszen found it "questionable whether the allocation of 88% of non-rate case expenses to benefiting locations using an asset allocator has any relationship to the costs incurred and benefits received by the benefiting location." *Id.* The Commission has expressed its preference that an applicant should decrease its reliance on allocation factors in favor of direct billing. Outline Item 3.02.

⁷³ TCC Ex. 4, Exh. DGC-5 at 2.

⁷⁴ Tr. 2198-2200.

⁷⁵ CPL Ex. 1 at 33.

⁷⁶ TCC Ex. 2.2, Sched. V-K-7a at 44.

of regulatory affairs. For this item, TCC used none of the types of proof that the Commission has found acceptable for establishing the item as a reasonable or necessary expense.⁷⁷ Further, TCC did not show that affiliate expenses associated with “pricing analyses” did not duplicate other expenses within the application. Thus, the ALJs cannot find that this expense is reasonable and necessary or that the expense is not-higher-than other affiliated entities’ costs.

v. Manage and Participate in Regulatory Affairs, Legislative Affairs, and Public Policy Issues

TCC’s management and participation in regulatory and legislative affairs includes the company’s meetings and communications with government agencies and with federal, state, and local elected officials.⁷⁸ TCC’s management and participation in public policy issues involves TCC’s identification and development of policies and positions pertaining to complex industry issues.⁷⁹ For each of these expenses, the particular regulatory, legislative, or public policy requirement at issue serves as the main cost driver, and the costs are allocated using the Total Assets allocation factor.⁸⁰

OPC’s Dr. Szerszen recommended the disallowance of these affiliate costs on the grounds that TCC provided no evidence to prove that the amounts are associated with non-lobbying activities. “In other words,” stated Dr. Szerszen in her prepared testimony, “there is no evidence that the requested costs are separate and distinct activities from lobbying activities, which are not recoverable from ratepayers under PURA.”⁸¹ Dr. Szerszen’s reference is to the legislative prohibition against

⁷⁷ Outline Item 3.05.

⁷⁸ TCC Ex. 4, Exh. DGC-5 at 3.

⁷⁹ TCC Ex. 4, Exh. DCG-5 at 3. These include: oversight of the AEP state and Washington, D.C. offices, monitoring federal and state legislative activities, articulating AEP policy positions with the U.S. Congress and state legislatures, and representing AEP’s policy positions with the U.S. Congress and state legislatures, the Federal Energy Regulatory Commission (FERC), the Securities and Exchange Commission (SEC), the U.S. Environmental Protection Agency (EPA), and the Texas Commission on Environmental Quality (TCEQ). TCC Ex. 4 at 39-40.

⁸⁰ TCC Ex. 4, Exh. DCG-5 at 3. The factor approximates the costs of each benefiting location’s proportionate share of the services, which vary based on size.

⁸¹ OPC Ex. 1A at 45.

the Commission's consideration of an expenditure for ratemaking purposes "for legislative advocacy, made directly or indirectly, including legislative advocacy expenses in trade association dues."⁸² Thus, TCC has the burden of proving that none of the affiliate costs associated with regulatory affairs were used for legislative advocacy.

TCC addressed in detail its segregation of costs between legislative monitoring and legislative advocacy. Specifically, Ms. Bennett, the witness with responsibility for TCC's general accounting, testified that she had compiled the AEPSC billings and had "removed costs that are not allowed by Texas statute [including] legislative advocacy."⁸³ In performing this segregation of costs, Ms. Bennett testified, each witness reviewed the costs included in his or her area "to ensure that the costs were reasonable and necessary."⁸⁴ Finally, the specific amounts billed to TCC by benefiting location, including the adjustments to cost of service, are included in the evidence.⁸⁵ The ALJs conclude that TCC segregated and is not seeking to include its lobbying expenses in its cost of service.

As a separate but related criticism, Dr. Szerszen questioned whether TCC accurately allocated its non-lobbying governmental affairs expenses to T&D. She stated, "I don't believe that all these expenses should be charged totally to T&D. I think, possibly, the generation company and retail company should pick up some expenses."⁸⁶ Dr. Szerszen's concern was that TCC never provided the underlying detail for the expenses. As a consequence, she was unable to determine to her satisfaction whether the allocations were reasonable.⁸⁷

⁸² PURA § 36.062(1).

⁸³ TCC Ex. 7 at 33.

⁸⁴ *Id.*

⁸⁵ *Id.* at Exh. SSB-3 and SSB-10. With respect to the charges that were made for non-includible legislative advocacy costs, those amounts are described and identified in TCC's evidence. TCC Ex. 66 at 58-60.

⁸⁶ Tr. at 2195. In her direct testimony, Dr. Szerszen similarly testified, "Because AEPSC allocates the vast majority of these expenses, it can be concluded that T&D operations may be only tangentially related to many of the non-rate case filings included in the company's cost of service." OPC Ex. 1A at 46.

⁸⁷ *Id.*

Dr. Szerszen described the type of information that she would require to perform this level of analysis. As with her criticism of other proposed TCC affiliate costs, she explained that she would require something more than the one line summary charge that TCC listed in its filings.⁸⁸ Her complaint was that expenses were not available in the workpaper schedules.⁸⁹

On cross-examination, Dr. Szerszen testified that OPC had issued no RFIs during discovery seeking details about any of the particular classes of affiliate costs, about the TCC allocation system, or about the manner in which TCC fits into AEP's benefiting locations.⁹⁰ In addition, Dr. Szerszen had testified in a previous Commission matter that "the information required [to be filed by an applicant in a rate case] is minimal"⁹¹ and that obtaining this detailed level of information would be difficult because an applicant is "not required to file that kind of detailed information on affiliate transactions."⁹² Given this prior testimony, Dr. Szerszen's level of detail criticism in this case is less credible than it otherwise would be. Finally, Dr. Szerszen testified that OPC simply didn't have "the time or resources" to track each of these data items to its source.⁹³

Although OPC raises legitimate concerns about its ability to determine the reasonableness of these costs, TCC's evidence reflects that it properly distinguished between includible and non-includible costs.⁹⁴ The ALJs find that TCC's proof met the standards established by the legislature and by the Commission. OPC may have been able to examine that proof more carefully for the purpose of challenging its sufficiency if OPC had had the resources. However, based on the evidence presented in this hearing, TCC's proposed affiliate cost for regulatory, legislative, and public policy expenses were reasonable and necessary.

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ Tr. at 2184.

⁹¹ Tr. at 2187.

⁹² Tr. at 2188-89.

⁹³ Tr. at 2188.

⁹⁴ TCC Ex. 2.1, Sched. II-D-2.6.

With respect to the not-higher-than standard, Dr. Thomas criticizes TCC's evidence as containing "little external verification, [providing] no references for comparison," and lacking time series data, information about which expenses are currently included in rates, or the amount of the increase that is requested.⁹⁵

On rebuttal, TCC witness David Carpenter responded that no benchmarking studies are available and that no utilities have comparable characteristics that would render a valid comparison.⁹⁶ Mr. Carpenter contended that the "black box" settlement of TCC's UCOS case precluded use of specific amounts as affiliate costs.⁹⁷ Finally, Mr. Carpenter argued, two additional events since the settlement of the UCOS case have precluded the use of TCC's own prior data: the initiation of the competitive utility market in ERCOT and the AEP merger.⁹⁸

Mr. Carpenter's testimony about TCC's decision not to use benchmarking studies was repeated by other TCC witnesses. For example, Mr. Bailey explained that although TCC used benchmarking studies in the past, "we've learned [that] we can do these things internally and still glean the type of information we need to manage."⁹⁹ Mr. Gordon testified that it would be virtually impossible to benchmark TCC's distribution affiliate costs against either FERC form 1 data or other companies' data.¹⁰⁰

Although the Commission's guiding principles do not require the use of benchmarking, the Commission encourages benchmarking wherever possible as a reality check for reasonableness of the expense.¹⁰¹ If benchmarking is not appropriate or possible, then the Commission allows the use

⁹⁵ CPL 1 at 34.

⁹⁶ TCC Ex. 66 at 71.

⁹⁷ *Id.* at 70.

⁹⁸ *Id.*

⁹⁹ Tr. at 2653-54.

¹⁰⁰ Tr. at 2649.

¹⁰¹ Outline Item 3.01.

of a variety of other types of evidence.¹⁰² With specific regard to the not-higher-than standard, the Commission has expressed its preference that an applicant should not rely upon allocation factors based on asset size.¹⁰³ Finally, as a corollary to these directives, the Commission encourages an applicant seeking approval for affiliate costs to decrease its reliance on allocation factors in favor of direct billing.

Instead of providing the Commission with the type of external verification evidence on these larger expense items, TCC treated the regulatory, legislative, and public policy expenses in the same manner as it treated the smaller proposed affiliate expenses. Although, as Mr. Hooper testified, TCC is able to glean the type of information that TCC needs to manage its affairs, the Commission has informed applicants that the Commission expects more. TCC's evidence did not include those other types, and primarily relied upon comparisons of information obtained internally. Despite the Commission's preference for the alternative, TCC used asset size as an allocation factor and relied little on direct billing.

TCC has not provided the types of comparative data sought by the Commission to verify the reasonableness of these proposed affiliate expenses, and the proposed expenses should be disallowed.

vi. Corporate Existence and Separation Expenses

The Applicant proposed an affiliate cost of \$1,074,020 for amounts associated with the maintenance of the corporate existence of the Applicant's portion of the AEP system companies as legal entities. The amounts also reflect work related to corporate separation required by federal or state laws and regulations. The main cost drivers for this expense are compliance with legislative

¹⁰² Outline Item 3.05.

¹⁰³ Outline Item 3.04. In addition, of the total proposed affiliate cost supported by Mr. Carpenter's testimony, 92.5% is allocated rather than direct billed. CPL Ex. 1 at 35.

and regulatory restructuring requirements and the complexity of the regulatory process required to achieve separation. The Applicant's portion was allocated based on Total Assets.¹⁰⁴

One of the primary criticisms of including this cost was its alleged non-recurring nature. Dr. Szerszen asserted the concern that once TCC undergoes legal separation, this corporate separation expense should not be incurred again.¹⁰⁵ TCC reasonably demonstrated, however, that TCC will continue to incur expenses for SEC filings related to corporate existence and separation.¹⁰⁶

Dr. Szerszen objected to TCC's including an expense for "corporation separation-general."¹⁰⁷ She asserted that the term is too non-specific to permit the intervenors to review the transactions underlying the affiliate costs. The ALJs agree that the lack of specificity renders the evidence less than convincing. The application reflects that \$126,159 has been allocated to "corporation separation-general" for transmission¹⁰⁸ and \$545,277 for distribution.¹⁰⁹ Mr. Carpenter attempted to explain these amounts as the expenses for "the two SRE work orders." Although the statement may be accurate, how or why the two SRE work orders should be allowed as affiliate costs for corporate separation was not addressed. We find that the affiliate expense is reasonable and necessary, other than the two amounts for "corporation separation-general," \$126,159 and \$545,277.

With respect to the not-higher-than standard, Dr. Szerszen criticized the use of Total Assets as an allocation factor.¹¹⁰ Her objection was that there is no logical relationship between TCC's T&D corporate existence/separation and the utility's asset base. Dr. Szerszen suggested that costs would more directly depend on the complexity of the corporate existence/separation issues facing

¹⁰⁴ TCC Ex. 4, Ex. DGC-5 at 5.

¹⁰⁵ OPC Ex. 1A at 47-49.

¹⁰⁶ TCC Ex. 66 at 62-63.

¹⁰⁷ OPC Ex. 1A at 48.

¹⁰⁸ TCC Ex. 7, Ex. SSB-3 at 38 (Work Order SRE0118101).

¹⁰⁹ *Id.* at 18 (Work Order SRE0118101).

¹¹⁰ OPC 1A at 48.

each benefiting location rather than the location's asset size.¹¹¹ Although the ALJs concur with Dr. Szerszen that complexity of legal issues is a legitimate cost driver, we do not concur that complexity could serve as a practical allocator of these expenses. We find that the not-higher-than standard is reasonably met by the use of Total Assets as the allocation factor.

vii. Provide Support to the Board of Directors

TCC sought to include \$28,217 for support for the board of directors in the form of a corporate secretary. The allocation factor is Total Assets. The amount is reasonable and necessary in that these expenses are incurred to permit TCC to comply with governmental responsibilities.¹¹² TCC met the not-higher-than standard based on appropriate principles of cost causation.¹¹³

viii. Rate Case Filings

TCC sought to include \$261,319 for preparation and filing of rate cases, including participating in the presentation of the cases. The main cost driver is the regulatory requirements of the jurisdiction in which the case is filed, and the allocation factor is Total Fixed Assets.¹¹⁴

Dr. Szerszen objected to the inclusion of the entire amount since TCC filed no rate cases during the test year.¹¹⁵ Additionally, with respect to this rate case, Dr. Szerszen asserted that TCC should be required to itemize the expenses to demonstrate that the charges are reasonable and that the cost components are comparable to those incurred by other parties in this docket.¹¹⁶ Finally, Dr. Szerszen asked the Commission to review the rate case expenses to assure that they do not

¹¹¹ *Id.* at 48-49.

¹¹² TCC Ex. 2.2, Sched. V-K-7a.

¹¹³ *Id.* at 45.

¹¹⁴ TCC Ex. 4, Exh. DGC-5 at 7.

¹¹⁵ OPC Ex. 1A at 47.

¹¹⁶ *Id.*

duplicate the \$1.656 million that TCC has sought in consulting and legal fees, as well as to require that "AEPSC's portion of rate case expenses . . . be amortized."¹¹⁷

On rebuttal, Mr. Carpenter concurred that TCC had filed no major rate cases during the test year and pointed out that other AEPSC charges "can be allocated using [the same] activity code and allocation factor."¹¹⁸ As examples, Mr. Carpenter listed open access tariffs and pulse metering tariffs.¹¹⁹ If these expenses were incurred, TCC did not list them as open access tariffs, pulse metering tariffs, or other types of filings. In the absence of supporting documentation or further explanation, the ALJs recommend disallowance of the entire amount. We cannot find that the amount was either reasonable or necessary.¹²⁰

ix. "Various Activities"

TCC sought to include \$394,942 for "various activities." The expense describes the total amount of direct charges made to TCC for each of the foregoing functions for which allocated expenses were sought. These charges are listed in the testimony of Ms. Bennett, as follows:¹²¹

<u>Expense</u>	<u>Transmission</u>	<u>Distribution</u>
Rate case filings	\$0	\$723
Prepare fuel filings	13,265	0
Respond to fuel filing requests	2,723	0
Perform price analyses	0	24,832

¹¹⁷ *Id.*

¹¹⁸ TCC Ex. 66 at 61.

¹¹⁹ *Id.*

¹²⁰ Mr. Carpenter addressed the issue of potential duplication of expenses. He asserted that no duplication had been made of the expenses in this docket. However, he agreed that \$48,760 had been included as an affiliate expense in Docket No. 22352 and that the amount should be disallowed from this request. *Id.*

¹²¹ TCC Ex. 7, SSB-3.

<u>Expense</u>	<u>Transmission</u>	<u>Distribution</u>
Non-rate case filings	83,459	29,217
Manage/participate in regulatory affairs	89,037	121,237
Manage/participate in DSM	0	30,448
Total	\$188,484	\$206,457

Dr. Szerszen stated that TCC provided no evidence or testimony describing these activities or their purpose.¹²² TCC's inclusion of "fuel filings" and "responses to fuel filings" is not reflected elsewhere in TCC's regulatory, legislative, or public policy affiliate expenses. The amounts associated with these items are disallowed. The amounts for rate filings and non-rate case filings are disallowed for the same reasons expressed in those sections in which the rate filings and non-rate case filings are found not to be reasonable or necessary. The amounts for managing and participating in regulatory affairs are disallowed for the same reasons expressed in the section in which the TCC was found not to have met the not-higher-than standard. The remaining amount in management and participation in DSM is allowed for the same reasons expressed in that section.

b. Corporate Communications

TCC sought to include \$1,126,972 in the cost of service for the following items:

Employee communications ¹²³	\$385,007
Educational services ¹²⁴	\$131,262

¹²² OPC Ex. 1A at 49.

¹²³ Employee communications includes the performance and management of the various forms of communications with employees. The major tasks include researching, developing and delivering internal communications on such topics as safety and industry issues, and monitoring news coverage and circulating news articles. TCC Ex.12 at 17.

¹²⁴ TCC Ex.12, Exh. JCC-2 at 1.

Video, photo, & desktop services ¹²⁵	\$ 95,367
Media relations ¹²⁶	\$128,904
Community relations ¹²⁷	\$251,324
Customer communications ¹²⁸	\$ 52,183
"Various activities" ¹²⁹	\$ 82,925

Dr. Szerszen objected to the last four items in the list. Her complaint was that these items are not reasonable or necessary expenses of providing services in that they are incurred primarily to enhance the utility's corporate image.¹³⁰ The TCC witness that addressed these issues was Calvin Crowder. On rebuttal, Mr. Crowder asserted that, although the expense does include costs of advertising, the expense also includes support of required functions, including assisting communities in performing infrastructure planning, ensuring public safety, and providing outage management.¹³¹

Dr. Thomas objected to the costs associated with media relations, community relations, educational services, and employee communications on the grounds that they are similar to "governmental affairs and regulatory services."¹³² Dr. Thomas pointed out that while these services

¹²⁵ *Id.*

¹²⁶ Media relations are for tasks associated with news releases, communicating positions and views to the public, providing media tours and open houses, offering technical support, and conducting public opinion research. *Id.* at 15.

¹²⁷ Community relations includes the time spent by employees to support community organizations, cost of memberships and time spent in participating in various local organizations, meetings with civic officials, coordinating tours and open houses, coordinating public opinion research, developing and placing advertising, and coordinating employee volunteer programs. *Id.* at 16.

¹²⁸ Customer communications expenses include the costs associated with advertising and interfacing with advertising agencies. The Commission has a rule that limits a utility's expenditures for advertising, contributions, and donations as part of the cost of service to 0.3% of the utility's gross receipts. P.U.C. SUBST. R. 25.231(b)(1)(E). TCC's figures come well within that limitation. In addition, customer communications expenses include the cost of maintaining an Internet site for customer services. *Id.* at 15-17.

¹²⁹ The name describes direct charges made to TCC for each of the other functions in this section for which allocated expenses were sought. TCC Ex.12, Exh. JCC-2 at 1.

¹³⁰ OPC Ex. 1A at 50.

¹³¹ TCC Ex. 73 at 7.

¹³² CPL Ex. 1 at 43.

are common for any large corporate entity, they are discretionary in nature and “may not be necessary for AEP to provide monopoly T&D services in a regulated setting.”¹³³

The ALJs have no difficulty in finding that these services are reasonable and necessary. However, the absence of comparative data against which to apply the not-higher-than standard is a problem. The Commission has expressed a preference for obtaining comparative historical data,¹³⁴ and Mr. Crowder explains that: (1) these services are provided at cost by AEPSC to TCC, (2) the costs are allocated in a manner that assures reasonable accuracy,¹³⁵ and (3) the merger of AEP resulted in the elimination of redundant employee positions and the realization of savings.¹³⁶ However, the record does not quantify those savings claimed or include information on pre-test year annual expenses to allow such a comparison. We recommend that this amount be denied.

3. Economic Development

TCC seeks approval of this proposed affiliate expense of \$457,174, composed of \$51,707 for development of targeted commercial/industrial recruitment, \$126,652 for development and implementation of community economic development partnerships and programs, and \$278,815 for “various activities.”¹³⁷ Mr. Crowder explained that this affiliate expense involves the implementation of a targeted approach to commercial/industrial recruitment, which matches potential prospects against specific available sites and buildings.¹³⁸ TCC claims that these activities assist in stimulating the local economy and increasing the electric load in the area.¹³⁹

¹³³ *Id.*

¹³⁴ Outline Item 3.05.

¹³⁵ TCC Ex. 12 at 23.

¹³⁶ *Id.* at 19.

¹³⁷ TCC Ex. 12, Exh. JCC-1. As in previous sections, these “various activities” are the other functions contained in the list but that use direct billing to TCC as their allocation factor.

¹³⁸ *Id.* at 8.

¹³⁹ *Id.* at 10.

Dr. Thomas described this area as “one of the classic gray areas for regulatory consideration of utility activities” and as “discretionary in nature.”¹⁴⁰ The ALJs concur. To prove an expense as reasonable and necessary, an applicant must overcome a presumption to the contrary.¹⁴¹ Although providing load growth to an area may be to the advantage of all ratepayers, expenditures for the matching of individual businesses with sites is not.

The ALJs do not find that this proposed affiliate expense is a reasonable or necessary cost of service.

a. Customer Choice Service Expenses

Customer Choice Operations is a department within the Customer Operations business unit of AEPSC. It is responsible for ensuring that all the required policies, systems, procedures, and processes are in place to facilitate end-use customers’ ability to select competitive providers where authorized across the eleven-state AEP system. Customer Choice Operations also works with ERCOT and other market participants on IT issues.¹⁴² The Applicant sought to include in the cost of service two affiliate expense amounts: \$2,819,880 (allocated from AEPSC) and \$4,938,271 (allocated from AEPSC for the LogicaCMG expense.) Of these, only the first was at issue. We find that the \$4,938,271 expense was both reasonable and necessary and that the evidence in support of the expense meets the not-higher-than standard.

The \$2,819,880 is the sum of three charges: \$2,559,197 for activities related to the development and execution of business processes to comply with Commission rules,¹⁴³ \$160,761 for development and implementation of AEP IT systems for processing and participating in national

¹⁴⁰ CPL Ex. 1 at 43.

¹⁴¹ Outline Item 1.01.

¹⁴² TCC Ex. 14 at 7. TCC outsources some of its IT functions to Market Data Clearinghouse (LogicaCMG).

¹⁴³ TCC Ex. 14, Ex. JLL-1 at 1.

business standards groups,¹⁴⁴ and \$99,921 for the development and tracking of business processes to comply with Commission rules.¹⁴⁵ The allocation factor used for the first two of these components is the Number of Retail Electric Customers, and the allocation factor used for the last component is the Number of Industrial Electric Customers.¹⁴⁶ These allocation factors demonstrate compliance with the not-higher-than standard.

Dr. Szerszen complained that the request was excessive because the company has not provided any evidence that the charges are a reasonable approximation of future costs of the implementation process.¹⁴⁷ TCC's witness on this issue, Mr. Laine, testified that TCC may reasonably expect these costs to continue because of the uncertain nature of the new retail electric market and the continuing development of the Commission's rules in response to the market.¹⁴⁸ We agree with Mr. Laine.

Dr. Szerszen also asserted that T&D ratepayers should not be charged for any costs necessary to implement a competitive retail provider market. By rule, the Commission has required utilities in Texas to maintain a cost-accounting and records system based on the FERC chart of accounts system to ensure that the costs associated with T&D services are accurately and separately identified.¹⁴⁹ A utility's compliance with this mandate is a recoverable cost of service.

Dr. Szerszen complains that the three different work orders for this item do not contain a sufficient amount of detail to determine the reasonableness and necessity of this expense. On this point, we agree. In reviewing the work papers for Ms. Bennett,¹⁵⁰ TCC's financial witness, we found little more than the single lines of text about which Dr. Szerszen complains. In the absence of

¹⁴⁴ *Id.*

¹⁴⁵ *Id.* at 2.

¹⁴⁶ *Id.*

¹⁴⁷ Mr. Tucker expresses this same concern. Cities Ex. 4 at 47.

¹⁴⁸ TCC Ex. 14 at 9-10; .

¹⁴⁹ P.U.C. SUBST. R. 25.221(d).

¹⁵⁰ TCC Ex. 7, Exh. SSB-3 at 18; TCC Ex. 2.1, Sched. V-K-7a at 47.

information about these work orders, we are unable to agree with Mr. Laine's position that this expense was reasonable and necessary.

Dr. Thomas, CPL's expert witness, found that Mr. Laine provided sufficient comparative support for these costs.¹⁵¹ We find that TCC's evidence provides sufficient support for a finding of having met the not-higher-than standard. Because we are unable to make a recommendation on the entirety of the proof of the reasonableness and necessity standard, we recommend that this affiliated expense be denied.

b. Customer Service Operations

TCC proposed \$5,669,855 in expenses associated with Customer Service Operations:¹⁵²

Call center customer operations ¹⁵³	\$2,814,138
Call center management ¹⁵⁴	47,473
Meter services ¹⁵⁵	147,455
Manage unauthorized use of energy ¹⁵⁶	98,756
Manage and resolve account exceptions ¹⁵⁷	351,243

¹⁵¹ CPL Ex. 1 at 45-46.

¹⁵² AEPSC Customer Service Operations include five separate functions: field revenue operations (meter-related activities), customer services (services relating to the resolution of customer complaints, competitive retailer relations, and account management issues), customer operations billing and support (usage history requests and billing review adjustments), customer solutions centers (call center services), and customer choice operations ("choice policy," "choice processes," and "market transaction interface"). TCC Ex. 10 at 8-13.

¹⁵³ Answering and responding to customer telephone inquiries and service requests. *Id.* at Exh. DLH-1 at 1.

¹⁵⁴ Predicting call center volume and scheduling the call center workforce to enable call demand to be handled in a cost effective manner. *Id.*

¹⁵⁵ Reading end-use customer meters, connecting and disconnecting meters, and installing/removing meters. *Id.* at Exh. DLH-1 at 2.

¹⁵⁶ Investigating and resolving unauthorized use of energy and meter tampering cases. *Id.*

¹⁵⁷ Maintenance activities for correct end-use customer billing and account information. *Id.* at Exh. DLH-1 at 3.

Respond to Commission and legislative service complaints ¹⁵⁸	9,829
Plan and develop regulated products and services ¹⁵⁹	163,010
Manage end-use customer issue resolution ¹⁶⁰	249,504
Process customer payments ¹⁶¹	2,909
"Various activities" ¹⁶²	1,785,538

Dr. Szerszen recommended that the Commission not allow TCC's T&D ratepayers to be charged for costs incurred in promoting the sale of regulated products and services, an apparent reference to the \$163,010 component of this expense.¹⁶³ Mr. Hooper explained on rebuttal that none of these costs are for marketing and promotion expenses. Instead, these functions involve charges to create and develop new ways of providing services and information to end-use customers. Examples include the development of an Internet-based information system to allow customers to obtain outage restoration information online.¹⁶⁴ The ALJs find that these are reasonable and necessary functions of the utility.

¹⁵⁸ *Id.*

¹⁵⁹ Create new programs and functions for providing services and information to end-use customers. *Id.* at Exh. DLH-1 at 4.

¹⁶⁰ Respond to end-use customer issues including new construction, complaint resolution, TDU billing, power quality, and reliability concerns. *Id.* at Exh. DLH-1 at 5.

¹⁶¹ Process end-use customer payments for discretionary fees billed per competitive retailer selection. *Id.*

¹⁶² Direct charges to TCC for the foregoing expense items. *Id.* at Exh. DLH-1 at 6.

¹⁶³ Dr. Szerszen's testimony refers to the total amount of marketing and promotional expenses incurred by AEP for the test year as some \$607,458. OPC Ex. 1A at 55. Dr. Szerszen does not provide the source for that number. The amount is not part of the allocated expenses or for the direct billed charges (the "Various Activities" component) for Activity Codes 617 or 618, the codes for promotion, planning, and development of regulated product services. TCC Ex. 7, Exh. SSB-3 at 2-3.

¹⁶⁴ TCC Ex. 74 at 24-25.

Additionally, Dr. Szerszen proposes disallowing costs incurred by TCC to resolve account exceptions.¹⁶⁵ Account exceptions include resolving billing disputes, making billing adjustments, adjusting discretionary fee disputes, and the like.¹⁶⁶ These functions are unlikely to cease, and a portion of the workaround spreadsheet process is now formalized in the Commission's Customer Protection rules.¹⁶⁷ These functions are reasonable and necessary for the performance of the utility's customer service obligations and should be included in the cost of service.

With respect to the not-higher-than standard, 31.5% of the charges are direct billed. With respect to allocation factors, TCC primarily uses number of retail electric customers and number of phone center calls. These affiliate costs meet the not-higher-than standard and should be approved.

c. Financial Services; Risk Management Services; Research, Development, and Trade Organization Support; and Fringe Benefits Adjustment

The Applicant sought a total of \$16,048,592¹⁶⁸ for the following affiliate expenses:

Perform strategic planning and analysis ¹⁶⁹	\$1,692,895 ¹⁷⁰
Develop and administer long-range business plans ¹⁷¹	491,909

¹⁶⁵ OPC Ex. 1A at 55-56.

¹⁶⁶ TCC Ex. 74 at 26.

¹⁶⁷ P.U.C. SUBST. R. 25.487(d)(1). These functions were impacted by the imposition of Customer Choice, primarily with regard to problems associated with establishing and re-establishing service and relating that service to a REP. This process is known as "safety net spreadsheet." Customer service operations deal with a number of other related matters, known as "workarounds," including street light outages and emergency reconnection requests. TCC Ex. 10 at 14-17.

¹⁶⁸ TCC Ex. 7, Exh. SSB-2 at 1.

¹⁶⁹ All tasks involved in developing and articulating AEP's overall financial and operational objectives and monitoring progress toward achieving them. The activity involves formulating the corporation's mission statement and developing strategic plans for the entire organization, including time spent in meetings and doing pre- and post-meeting preparation and follow-up work. It also includes efforts devoted to studies that support strategic decision-making. The allocation factor is Total Assets. TCC Ex. 7, Exh. SSB-6 at 8.

¹⁷⁰ TCC Ex. 68 at 49.

¹⁷¹ All work creating business plans, including time spent in meetings and doing pre- and post-meeting preparation and follow-up work. Also includes efforts devoted to studies that support the business planning process. The allocation factor is Total Assets. *Id.* at 9.

Evaluate investment/diversification opportunities ¹⁷²	11,482
Prepare long term financial plans ¹⁷³	172,517
Conduct research and development ¹⁷⁴	199,150
Provide technical and economic evaluation ¹⁷⁵	176,126
Trade association dues ¹⁷⁶	495,599
Business continuity planning ¹⁷⁷	21,693
Manage operational risk ¹⁷⁸	257,310
Distribution labor accruals-SCD work orders ¹⁷⁹	(17,864)
Process payroll ¹⁸⁰	(589,450)
Maintain general ledger ¹⁸¹	1,225,782
SRE work orders related to unbundling ledgers ¹⁸²	48,053

¹⁷² Tasks associated with analyzing opportunities for investment into service/product line ventures or business diversification outside of the traditional regulated utility sector, including the analysis of the financial and business impact of the investment or opportunity. The allocation factor is Total Assets. *Id.* at 10.

¹⁷³ All efforts to forecast the long-term results of operations from an O&M, capital, revenue, or financial statement perspective. Research, sensitivity analysis, and communication with the budget preparers is included in this activity. The allocation factor is Total Assets. *Id.* at 13.

¹⁷⁴ All tasks associated with planning, supervising, designing, performing, and evaluating both basic and applied research activities. The allocation factor is Total Assets. *Id.* at 18.

¹⁷⁵ All tasks associated with the technical or economic analysis and investigation necessary to resolve a problem or determine the feasibility of the most appropriate alternative for non-power related projects. The allocation factor is Total Assets. *Id.* at 13.

¹⁷⁶ Preparing for, attending, and supporting industry, professional, and trade association meetings, conferences, and special functions, including AEIC, APC, CIGRE, Edison Electric Institute, EUCG, INPO, and NEI. The allocation factor is Total Assets. *Id.* at 20.

¹⁷⁷ Develop and maintain business resumption plans for the enterprise in the event of a disaster. The allocation factor is Number of Employees. *Id.* at 1.

¹⁷⁸ All tasks associated with identifying, measuring, and managing operational risks associated with business operations. The allocation factor is Total Fixed Assets and Direct. *Id.* at 28.

¹⁷⁹ "Payroll Accrual Work Orders. Automatic reversing entries." The allocation factor is number of electric retail customers. *Id.* at 1

¹⁸⁰ All tasks associated with processing active and retiree payroll and compensation adjustments for employees. The allocation factor is Number of Employees. *Id.*

¹⁸¹ Includes reconciling and balancing all ledgers, including labor and system costs for ledger maintenance. The allocation factor is Number of GL Transactions. *Id.* at 2.

¹⁸² Time and expenses to unbundle the companies' financial ledgers. The allocation factor is Number of GL Transactions. *Id.*

Capital software amortization-SW work orders ¹⁸³	1,300,895
Transmission labor accruals-SCT work orders ¹⁸⁴	(1,751)
Process invoices ¹⁸⁵	303,580
Perform fuel accounting ¹⁸⁶	406
Compile, verify, and enter time sheets ¹⁸⁷	5,972
Develop, update, and administer accounting policies ¹⁸⁸	410,114
Prepare internal financial reports and studies ¹⁸⁹	215,326
Prepare and file external and regulatory reports ¹⁹⁰	244,596
Sarbanes-Oxley internal controls ¹⁹¹	72,941
Participate in process improvement efforts ¹⁹²	825,654
Develop measures & analyze organizational performance ¹⁹³	839,196

¹⁸³ "These Project IDs are used to amortize capitalized software for benefiting location 1060--All Companies with an Attribution Basis of 15." The allocation factor is Number of Non-UMWA Employees. *Id.* at 3.

¹⁸⁴ "Payroll Accrual Work Orders. Automatic reversing entries." The allocation factor is Number of Transmission Pole Miles. *Id.*

¹⁸⁵ Tasks performed to process invoices relating to purchase order and/or non-purchase order transactions for payment, including preparation of account/work order classification, verification, and release of disbursement checks. The allocation factor is Number of Vendor Invoice Payments. *Id.*

¹⁸⁶ The pricing of fuel consumed and establishing the value of fuel inventory, including verification of invoices and vouchers prior to payment distribution., all tasks associated with recording and monitoring accounting records for fuel purchased and fuel consumed. This is a direct billing. *Id.* at 4.

¹⁸⁷ All tasks associated with the preparation and approval of employee time sheets. The expense is direct billed to TCC. *Id.* at 5.

¹⁸⁸ Tasks performed to develop and maintain AEP's accounting procedures, including formal documentation of changes and notification to affected parties. The allocation factor is Total Assets. *Id.*

¹⁸⁹ Tasks performed to develop and maintain AEP's accounting procedures, including research, evaluation of alternatives, determination of action, and communication of decisions. The allocation factor is Total Assets. *Id.* at 6.

¹⁹⁰ All efforts to comply with SEC, PSC, and FERC reporting requirements, including review, research of issues, preparation, and filing of reports. The allocation factor is Total Assets. *Id.* at 7.

¹⁹¹ Accumulate costs incurred to document and test financial controls as required by the SEC rules and implementing the Sarbanes-Oxley Act. The allocation factor is Total Assets. *Id.* at 8.

¹⁹² All tasks involved with the development and/or participation in formal efforts to support improvements in AEP business processes, including Continuous Improvement and Business Process Re-engineering. The allocation factor is Total Assets. *Id.* at 11.

¹⁹³ All tasks associated with the development of organizational performance measures and the subsequent analysis of organizational performance, including "internal/external benchmarking of organizational performance and review and analysis of management reports and results of operations" The allocation factor is Total Assets. *Id.* at 12.

Develop, monitor, and analyze budgets ¹⁹⁴	594,715
Provide continuity planning ¹⁹⁵	6,977
Perform internal audits ¹⁹⁶	436,964
Perform and coordinate external audits ¹⁹⁷	13,279
Communicate and transfer technologies ¹⁹⁸	11,886
Evaluate & prioritize research & development needs ¹⁹⁹	3,125
Coordinate tax compliance ²⁰⁰	440,491
Coordinate tax accounting & regulatory services ²⁰¹	110,789
Coordinate tax planning & analysis ²⁰²	117,314
Manage financial risk ²⁰³	252,894
SP work orders relating to AEPSC payroll, interest, and income tax ²⁰⁴	214,239

¹⁹⁴ Tasks performed to develop, coordinate, review, and revise all versions of short-term (one year or less) budgets. The allocation factor is Total Assets. *Id.* at 14.

¹⁹⁵ All tasks associated with identifying, measuring, and managing financial and operational losses associated with service interruptions and the importance of maintaining viable emergency response and business resumption plans. The allocation factor is Total Assets. *Id.* at 15.

¹⁹⁶ All efforts associated with performing and supporting the management audit process. The allocation factor is Total Assets. *Id.* at 16.

¹⁹⁷ Tasks associated with support of external audits, including audits by IRS, SEC, state and local officials, independent auditing entities, and FERC. The allocation factor is Total Assets. *Id.* at 17.

¹⁹⁸ All work associated with the identification, investigation, development, and communication of new technologies, including the translation of research findings into usable tools, techniques, or products and the possible commercialization of the technology. The allocation factor is Total Assets. *Id.* at 19.

¹⁹⁹ All tasks related to the identification of technology needs and opportunities, prioritization of those that cannot be filled with existing technology, and securing funding for those high priority needs where a technology gap exists. The allocation factor is Total Assets. *Id.* at 21.

²⁰⁰ All record keeping and filing as well as time spent preparing returns for federal, state, and local taxes. The allocation factor is Total Assets. *Id.*

²⁰¹ All record keeping and filing as well as time spent performing tax accounting and regulatory support services. The allocation factor is Total Assets. *Id.* at 22.

²⁰² All record keeping and filing as well as time spent performing tax planning and analysis. The allocation factor is Total Assets. *Id.* at 23.

²⁰³ All tasks associated with identifying, measuring, managing, and reporting risk exposures and evaluating the process for managing financial risk. The allocation factor is Total Assets. *Id.* at 24.

²⁰⁴ "Wages/expenses associated with the month end accrued for all AEPSC employees. The charges to this project will be reversed in the subsequent month by the ADS. Interest and financing costs associated with working capital and short-term borrowings or investments. Income tax and credits." The allocation factor is AEPSC Bill less Indirect and Interest. *Id.* at 24.

Labor accruals—all other functions—SCA work orders ²⁰⁵	90,719
Manage property risk ²⁰⁶	28,522
Manage liability risk ²⁰⁷	59,447
Perform owned asset accounting ²⁰⁸	120,546
Process other accounts receivable ²⁰⁹	56,374
Manage liability claims ²¹⁰	308,374
Internal support ²¹¹	3,026,020 ²¹²
Depreciation, amortization, and interest expense ²¹³	1,349,859
Fringe benefit adjustment ²¹⁴	1,225,304 ²¹⁵

²⁰⁵ “Payroll accrual work orders. Automatic reversing entries.” The allocation factor is AEPSC Bill less Indirect and Interest. *Id.* at 25.

²⁰⁶ The evaluation and implementation of AEP’s property insurance program, including identifying exposures, insuring properties and determining property value, as well as management of any retained risk. The allocation factor is Total Fixed Assets. *Id.*

²⁰⁷ The evaluation and implementation of AEP’s liability insurance program, including evaluating risk, determining level of protection required, implementing a risk plan via insurance, and supporting any documentation requirements of insurers. The allocation factor is Total Fixed Assets. *Id.* at 26.

²⁰⁸ Tasks associated with maintaining the proper classification of utility plant capital assets. The allocation factor is Total Gross Utility Plant. *Id.*

²⁰⁹ “All work associated with processing ‘Other Accounts Receivable’ for both associated companies and outside parties.” The allocation factor is Number of Nonelectric OAR Invoices. *Id.* at 27.

²¹⁰ All activities involved with disposition of liability claims. The allocation factor is Total Fixed Assets and Direct. *Id.* at 28.

²¹¹ These are the costs that are incurred by AEPSC to provide services to affiliates within the AEP system. These are both direct billed and allocated costs that are then re-allocated by AEPSC to the various related corporate entities, including TCC. The amounts include maintaining the AEPSC ledger and billing system; expenses related compiling, verifying, and entering timesheets of AEPSC employees, and expenses incurred during the preparation and analysis of AEPSC budgets; payroll processing; accounts payable voucher processing; and the coordination of tax planning and analysis. All of these allocated amounts are billed at cost to AEPSC, such that no net income to AEPSC results from the process. The goal of the centralization of this function is to take advantage of the economies of scale. TCC Ex. 7 at 48-51.

²¹² *Id.* at 50. This figure is slightly different from the total reflected in TCC Ex. 7, SSB-6 at 28.

²¹³ This amount represents “certain capital and working capital costs,” capitalized software (specifically, the AEPSC billing system), and interest incurred by AEPSC for borrowing funds for working capital. The allocation factor is total billing by AEPSC for each affiliate. *Id.* at 51.

²¹⁴ Fringe benefits are applied to payroll charges as a loading percentage, calculated by dividing the total expected fringe benefits cost by the total expected base payroll for a given year. *Id.* at 51-52.

²¹⁵ *Id.* at 52.

Dr. Szerszen proposes the disallowance of the first nine items, a total of \$3.52 million in affiliate expenses. In tabular form, her objections are:

Proposed Expense	Excessive Amounts	No Logic for Allocation vs. Direct Billing	No Benefit to Ratepayers	Allocator Has No Relation to Benefits	Not Essential for T&D Operations	Insufficient Detail
Strategic Planning and Analysis ²¹⁶	•	•	•	•		
Developing and Administering Long Range Business Plans ²¹⁷	•	•	•	•		
Preparing Long Term Financial Plans ²¹⁸	•	•	•	•		
Business Continuity Planning ²¹⁹			•		•	
Evaluation of Diversification Opportunities			•		•	
Research and Development ²²⁰			•	•		

²¹⁶ OPC Ex. 1A at 58-59.

²¹⁷ *Id.*

²¹⁸ *Id.*

²¹⁹ *Id.* at 59.

²²⁰ *Id.* at 60-61

Proposed Expense	Excessive Amounts	No Logic for Allocation vs. Direct Billing	No Benefit to Ratepayers	Allocator Has No Relation to Benefits	Not Essential for T&D Operations	Insufficient Detail
Technical and Economic Evaluation ²²¹			•	•		•
Trade Association Memberships ²²²			•	•		•
Managing Operational Risk ²²³				•	•	

Finally, Dr. Szerszen questions that entire amount of the expenses that AEPSC allocated to TCC as being excessive since, she asserts, the merger of AEP was to have produced savings that have not materialized.²²⁴

On rebuttal, Ms. Bennett asserts that the AEPSC work order system was developed to ensure that each AEP affiliate is billed no more than any other affiliate for a particular service, based on the formula chosen.²²⁵ Since approximately 93% of the amount billed in affiliated costs were allocated rather than direct billed,²²⁶ allocation of these expenses is an integral part of the AEPSC process. With particular respect to the first three items, Ms. Bennett argues that Total Assets is an appropriate allocator because the expenses associated with a company's strategic, financial, and business planning are directly related to the "size of the organization."²²⁷ Ms. Bennett states her belief that

²²¹ *Id.* at 61.

²²² *Id.* at 61-62.

²²³ *Id.* at 62-63.

²²⁴ *Id.* at 63-64.

²²⁵ TCC Ex. 68 at 48.

²²⁶ *Id.* at 60. An additional 5.7% of the costs billed to TCC were billed using benefiting locations that included a combination of TCC companies, e.g., TCC Transmission, Distribution, and Generation.

²²⁷ *Id.* at 49.

the size of the organization is related to the total assets of the organization, such that the Total Assets allocation factor produces a close approximation of the benefit received by TCC for these services.²²⁸

The difficulty with this argument is that the Austin court of appeals has upheld the Commission's disallowance of affiliate costs that were allocated based on Total Assets.²²⁹ The action of the court was based in part upon Mr. Arndt's and Dr. Szerszen's testimony that "size-based allocation factors . . . "underallocat[e] costs to smaller, non-utility subsidiaries"²³⁰ and "overallocate[] charges to utility operations which are capital intensive."²³¹ The court concluded that this expert testimony "provides a reasonable basis for the Commission's decision to disallow the disputed charges for failing to satisfy the requirement of PURA section 36.058(c)(2)."²³²

Although the Commission has not adopted a general prohibition against the use of size-based allocation factors, it has asked applicants to provide, where possible, comparative data. The form of the evidence is left to the applicant, as appropriate to the type of expense. The types of evidence the Commission will accept are varied: historical cost trends, process improvements aimed at achieving efficiency, benchmark data, outsourcing results, proof of customer benefit, a showing that services are not duplicated, comparison of test year costs, cost control processes, and reviews by independent third parties are only a sample.²³³

Despite these developments, TCC not only continues to use Total Assets as an allocation factor,²³⁴ but TCC's supporting evidence is little more than an argument that the merged company

²²⁸ *Id.*

²²⁹ *Central Power and Light Co.*, 36 S.W.3d at 567.

²³⁰ *Id.*

²³¹ *Id.*

²³² *Id.*

²³³ Outline Item 3.05.

²³⁴ "The total asset formula is appropriate for allocating the expenses related to providing these services." TCC Ex. 68 at 50.

has gained efficiencies generally.²³⁵ The argument is that: (1) TCC has provided the Commission with more information than was presented in Docket No. 14965,²³⁶ and (2) the quality of this explanation of “size-based allocation factors” accounts more accurately for the affiliate expenses.²³⁷

Dr. Szerzen is not alone in her criticism of TCC’s evidentiary deficiencies regarding this group of proposed affiliate costs. CPL’s expert, Dr. Thomas, observes that TCC provides “no external, third-party, or extrinsic evidence that the Commission can use to gauge or determine reasonableness.”²³⁸ He suggests a series of types of evidence that might have been used to support this group of proposed expenses.²³⁹ Mr. Tucker, Cities’ expert, similarly points out that the majority of TCC’s evidence consists of “general statements that providing services on a centralized basis is cheaper than providing those services at each affiliate.”²⁴⁰

Dr. Szerszen challenges each of the nine expenses because she contends that the allocation factor is not related to the expense or that the expense provides no benefit to the rate payers or both.²⁴¹ The ALJs agree with her. The burden is upon TCC to overcome a presumption that these affiliate costs are not includible in the cost of service.²⁴² The evidence presented by TCC on these nine proposed expenses does not overcome the statutory presumption against inclusion in the cost of service.

²³⁵ “The centralized provision of these services by AEPSC is far more efficient than TCC[’s] performing these services itself, allowing the realization of cost savings to occur.” *Id.*

²³⁶ In Docket No. 14965, CPL provided 290 pages of information on affiliate expenses. In this docket, TCC has provided 4,111 pages of information on affiliate expenses. TCC Ex. 68 at 22.

²³⁷ *Id.* at 41.

²³⁸ CPL Ex. 1 at 37.

²³⁹ *Id.* at 37-38.

²⁴⁰ Cities Ex. 4 at 45.

²⁴¹ Dr. Szerszen testified that her proposed disallowance of only \$13.4 million in affiliate expenses should not be taken as her agreement with the balance of the affiliate expenses. She did not address the others, she explained, because the complexity and size of the case did not leave her with the time to fully evaluate all of TCC’s other affiliate expenses. OPC Ex. 1A at 63.

²⁴² *Central Power and Light Co.*, 36 S.W.3d at 568.

With respect to the balance of these cost of service items, which are not disputed, we find that all satisfy the reasonable and necessary standard. We also find that these components meet the not-higher-than standard based on the description of the expense components and their relation to the allocation factors.

d. Telecommunications

TCC witness David Trego's testimony supported \$2,073,488 in allocated affiliate telecommunications costs with external evidence of cost evaluation and reasonableness for the affiliate telecommunications costs. The external evidence included a competitive bid analysis of network services, a least cost optimization analysis of circuits and services provided by private versus common carriers, a benchmark study showing that the LAN/WAN services provided by AEPSC compared favorably to industry averages, and time series data showing a decline in both budgeted costs and personnel requirements.²⁴³ The allocation factors, Number of Radios, Number of Remote Terminal Units, and Number of Phone Lines, were reasonably related to the provision of the services. The affiliate cost was reasonable and necessary, and TCC met the not-higher-than standard through extrinsic proof.²⁴⁴

e. Distribution

The affiliate distribution services cost charged to TCC Distribution by AEPSC during the test year was approximately \$5.1 million, allocated as follows:²⁴⁵

²⁴³ *Id.* at 44-45.

²⁴⁴ TCC Ex. 13 at 13-20, Exh. DBT at 1-4.

²⁴⁵ TCC Ex. 8, Exh. HRG-2.

General services ²⁴⁶	\$2,982,397
Outage calls and Service Status ²⁴⁷	13,464
Plan, design, & engineer facilities ²⁴⁸	1,466,818
Construct facilities ²⁴⁹	507,693
Business unit support ²⁵⁰	107,634

The outsourced construction services are direct billed, accounting for about 28% of the total proposed amount. With respect to the other 72%, TCC's witness on the topic, Mr. Gordon, provided a comparison of costs using FERC Form 1 and compared the Applicant's rank in a group of other T&D utilities.²⁵¹ Although Dr. Thomas criticized this evidence as lacking in "fine-tun[ing],"²⁵² the ALJs conclude that TCC has met its burden of proof with respect to both the reasonable and necessary standard and the not-higher-than standard.

f. Transmission

The affiliate transmission services cost charged to TCC by AEPSC during the test year was approximately \$3.76 million, allocated as follows:²⁵³

General services ²⁵⁴	\$3,622,293
Evaluate equipment & material ²⁵⁵	103,155

²⁴⁶ The allocation factor is Number of Electric Retail Customers.

²⁴⁷ The allocation factor is Number of Phone Center Calls.

²⁴⁸ The expense is direct billed to TCC.

²⁴⁹ The allocation factor is Distribution Construction Expenditures.

²⁵⁰ The allocation factor is Total Assets.

²⁵¹ TCC Ex. 8 at 16, Exh. HRG-3.

²⁵² CPL Ex. 1 at 38.

²⁵³ TCC Ex. 9, Exh. MAB-2.

²⁵⁴ The allocation factor is Number of Transmission Pole Miles.

²⁵⁵ This expense is direct billed to TCC. Curiously, this component of the Transmission affiliate expense includes \$7,266 for Distribution allocated costs. The reason for Transmission's including a Distribution component (and on a direct billed basis) was not explained.

Perform spill clean-up & remediation ²⁵⁶	553
Engineer, design, & construct facilities ²⁵⁷	34,827

Approximately 3% of the transmission affiliate costs are directly billed.²⁵⁸ The allocated portion of this affiliate cost is so high because the Transmission Planning employees of AEPSC perform work within this region of AEP's service area, served by TCC and AEP TNC. About \$2 million of the total \$3.67 million in transmission affiliate costs are allocated between these two companies only,²⁵⁹ thereby eliminating many of the potential objections to the method of allocation. The use of Number of Transmission Pole Miles is an appropriate allocation factor in that it represents the underlying cost causation in an effective manner. The proposed affiliate expense is reasonable and necessary.

g. Shared Services

Shared Services was organized in 1999 to centralize five functions of AEP's related corporate entities: General Services, Human Resources, Information Technology, Supply Chain, and Shared Services Strategy departments.²⁶⁰ The \$16.9 million total is the largest group of affiliate expenses within the \$60 million total affiliate expense proposed by TCC.²⁶¹ The individual expenses and classes within Shared Services are:

²⁵⁶ The allocation factor is Total Fixed Assets.

²⁵⁷ The allocation factor is Transmission Construction Expenditures.

²⁵⁸ TCC Ex. 9 at 29.

²⁵⁹ *Id.*

²⁶⁰ TCC Ex. 11 at 8. Although Shared Services Strategy is a division of Shared Services, the expenses associated with this department are billed as general administrative costs through Financial and Accounting. *Id.* at 37.

²⁶¹ CPL Ex. 1 at 41.

GENERAL SERVICES:

Office and Facility Services ²⁶²	\$ 116,686
Office Services ²⁶³	109,606
Contractor and Consultant Evaluation ²⁶⁴	2,044
Materials and Supplies Services ²⁶⁵	5,628
Travel and Event Planning ²⁶⁶	(24,366)
Fleet management ²⁶⁷	19,974
Direct Charges for General Services ²⁶⁸	81,698
Records Management ²⁶⁹	386,277
Property Management ²⁷⁰	146,453
<u>Security Management²⁷¹</u>	<u>57,773</u>
GENERAL SERVICES TOTAL	\$ 901,773

HUMAN RESOURCES

Employee Education ²⁷²	181
General Human Resources ²⁷³	3,508,840
Appliance Saturation Survey ²⁷⁴	122
Direct Charges for Human Services ²⁷⁵	671,956

²⁶² The allocation factor is Number of Employees.

²⁶³ The allocation factor is Number of Non-UMWA Employees.

²⁶⁴ The allocation factor is Number of Purchase Orders Written.

²⁶⁵ The allocation factor is Number of Stores Transactions.

²⁶⁶ The allocation factor is Number of Travel Transactions.

²⁶⁷ The allocation factor is Number of Vehicles.

²⁶⁸ These are direct billed charges.

²⁶⁹ The allocation factor is Total Assets.

²⁷⁰ The allocation factor is Total Fixed Assets.

²⁷¹ The allocation factor is Total Gross Utility Plant.

²⁷² The allocation factor is Number of Electric Retail Customers.

²⁷³ The allocation factor is Number of Employees.

²⁷⁴ The allocation factor is Number of Residential Customers.

²⁷⁵ These are direct billed charges.