

Stand Down for Safety <sup>276</sup>	609
Intellectual Capital Management <sup>277</sup>	36
<u>Litigation<sup>278</sup></u>	<u>445</u>
HUMAN RESOURCES TOTAL	\$ 4,182,189

INFORMATION TECHNOLOGY:

General Information Technology <sup>279</sup>	1,507,966
General Information Technology <sup>280</sup>	5,256,846
Accounting System Support <sup>281</sup>	83,604
End User Support <sup>282</sup>	357,328
Applications Solutions <sup>283</sup>	2,851,246
Call Center Support <sup>284</sup>	10,110
Supply Chain System Support <sup>285</sup>	195,144
Customer Systems Support <sup>286</sup>	24,109
Materials Management System Support <sup>287</sup>	55,598
Transmission System Infrastructure Support <sup>288</sup>	324,623
Fleet Management System Support <sup>289</sup>	706

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<sup>276</sup> The allocation factor is Equal Share Ratio.

<sup>277</sup> The allocation factor is Total Assets.

<sup>278</sup> This category is used for ITS specific work orders for applications and related services. The allocation factor is Total Fixed Assets.

<sup>279</sup> This category is used for IT specific work orders for the provision of IT administration and related services. The allocation factor is Number of Electric Retail Customers.

<sup>280</sup> The allocation factor is Number of Employees.

<sup>281</sup> The allocation factor is Number of General Ledger Transactions.

<sup>282</sup> The allocation factor is Number of Help Desk Calls.

<sup>283</sup> The allocation factor is Number of Non-UMWA Employees.

<sup>284</sup> The allocation factor is Number of Phone Center Calls.

<sup>285</sup> The allocation factor is Number of Purchase Orders Written.

<sup>286</sup> The allocation factor is Number of Residential Customers.

<sup>287</sup> The allocation factor is Number of Stores Transactions.

<sup>288</sup> The allocation factor is Number of Pole Miles.

<sup>289</sup> The allocation factor is Number of Vehicles.

Accounts Payable System Support <sup>290</sup>	88,009
Project Circus <sup>291</sup>	37,794
Direct Charges for Information Technology <sup>292</sup>	11,729
Fieldnet Project <sup>293</sup>	842
General Information Technology <sup>294</sup>	518,474
Information Support Technology <sup>295</sup>	145,584
Leased Asset Account Support System <sup>296</sup>	17
Asset Management Support <sup>297</sup>	72,753
<u>Treasury Support<sup>298</sup></u>	<u>1,353</u>
INFORMATION TECHNOLOGY TOTAL	\$11,543,635

SUPPLY CHAIN:

Process Development <sup>299</sup>	22,756
Procurement Process <sup>300</sup>	298,869
Stores Management <sup>301</sup>	26,000
Direct Charges for Supply Chain <sup>302</sup>	2,933
<u>Lease and Rental Agreement Administration</u>	<u>881</u>
SUPPLY CHAIN TOTAL	\$ 351,439

<sup>290</sup> The allocation factor is Number of Vendor Invoice Payments.

<sup>291</sup> The allocation factor is Number of Workstations.

<sup>292</sup> These are direct billed charges.

<sup>293</sup> The allocation factor is KWH Sales.

<sup>294</sup> This category is used for specific IT work orders for IT services for IT support and development and related services. The allocation factor is Total Assets.

<sup>295</sup> The allocation factor is Total AEPSC Bill Dollars, Etc.

<sup>296</sup> The allocation factor is Total Fixed Assets.

<sup>297</sup> The allocation factor is Total Gross Utility Plant (Including CWIP).

<sup>298</sup> The allocation factor is Number of Banking Transactions.

<sup>299</sup> The allocation factor is Number of Non-UMWA Employees.

<sup>300</sup> The allocation factor is Number of Purchase Orders.

<sup>301</sup> The allocation factor is Number of Stores Transactions.

<sup>302</sup> These are direct billed charges.

TCC's witness on Shared Services was William D'Onofrio. The two primary aspects of his testimony are that his evidence focuses on the classes of items within Shared Services rather on individual expenses, and that his testimony relies more on the accuracy of the allocation of expenses by AEPSC to its affiliates and relatively on comparisons to nonaffiliates.<sup>303</sup>

In keeping with these themes, the intervenors' witnesses testified primarily about their concerns about the classes of Shared Services expenses and the absence of external comparative data. Dr. Thomas testified that Mr. D'Onofrio's testimony failed to provide external, third-party benchmarking or outsourcing evaluations and that it lacked cost comparisons to outsourcing alternatives.<sup>304</sup> Dr. Thomas observed that several of the cost classes, including Information Technology and Human Resources, were well-suited to external comparison and third-party analysis.<sup>305</sup> Cities expert witness Mr. Tucker concurred, asserting that while the use of these allocation factors may be appropriate, their use does not provide evidence that the total amount being allocated is reasonable.<sup>306</sup> The upshot of these witnesses' criticisms was that the allocation factors may appropriately distribute the various costs among the AEP related companies, but TCC did not show that the costs themselves were reasonable.

TCC's seventeen pages of rebuttal testimony also focused on classes of expenses and relied little on outside comparisons.<sup>307</sup> Mr. D'Onofrio points out that AEPSC evaluates and uses outsourcing as a means to promote more efficient operations.<sup>308</sup> He asserts that TCC's affiliate costs and services that are not related to governance or strategy are the outcome, in part, of outsourcing studies upon which TCC has relied.<sup>309</sup> Further, Mr. D'Onofrio claims that the goal of outsourcing

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<sup>303</sup> TCC Ex. 11 at 27-39. PURA § 36.058(c) requires the Commission to make findings "for each item or class of items as determined by the Commission."

<sup>304</sup> *Id.* The ALJs observe that Mr. D'Onofrio did present comparative historical information in his exhibit, Total Shared Services Budgeted Costs for the Year 2000 As Adjusted vs. 2003. TCC Ex. 11, Exh. WND-3.

<sup>305</sup> *Id.*

<sup>306</sup> Cities Ex. 4 at 46.

<sup>307</sup> TCC Ex. 80.

<sup>308</sup> TCC Ex. 80 at 5.

<sup>309</sup> *Id.* at 5-6.

is not to determine the lowest price but to make determinations based on issues of quality, contractual responsiveness, and other non-cost related matters.<sup>310</sup> He rejects cost trends (Dr. Thomas' "time series information") as conclusive proof of reasonableness in that too many variables can affect the meaning of the trend.<sup>311</sup> Among the most significant of these variables for Mr. D'Onofrio were the merger of AEP and CSW and the restructuring of the Texas market to provide for customer choice.<sup>312</sup>

With respect to benchmarking, Mr. D'Onofrio expressed similar concerns: "benchmarking has a very limited value in its use as a test of reasonableness."<sup>313</sup> He points out that benchmarking may fail to take into account service territory differences, operating characteristics, and other intrinsic differences between companies.<sup>314</sup> Mr. D'Onofrio cited his concern that a company's failure to rank best in its class in a benchmarked analysis should not be taken as a measure of the lack of reasonableness of the company's decisions.<sup>315</sup>

In making our findings on the Shared Services expenses, we have taken care to follow the courts' requirement that the two legal standards, not-higher-than and reasonable and necessary, must be separately met.<sup>316</sup> In doing so, we have chosen to consider TCC's evidence based on the individual items of Shared Services expenses. We make that choice because the evidence on individual expenses, while relatively sparse, is of qualitatively better value than the evidence on

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<sup>310</sup> *Id.* at 7.

<sup>311</sup> *Id.* at 8-9.

<sup>312</sup> *Id.* at 9.

<sup>313</sup> *Id.* at 10.

<sup>314</sup> *Id.*

<sup>315</sup> *Id.* at 10-11. The provisions of PURA require the Commission to take into account "appropriate differences" in making a finding regarding an affiliate transaction. PURA 36.058(d)(2). To take those differences into account, the Commission must have evidence in the record about "the conditions and circumstances of that transaction, [including the] reasonable comparab[ility] relative to quantity, terms, date or contract, and place of delivery. PURA 36.058(d)(1). Since the burden of proof is upon the applicant, the applicant bears the burden of introducing into the administrative record evidence about these details.

<sup>316</sup> *Railroad Commission of Texas v. Rio Grande Valley Gas*, 683 S.W.2d at 786.

classes of expenses. Also, in some cases, the evidence did not support the same findings about all of the individual expenses within a class of expense.

We also paid close attention to the types of allocation factors that the Commission has rejected in the past. Those rejections have been based on allocation factors that are arbitrary, fail to reliably measure the benefits received, lack a reasonable relation to the level of service provided, and over- or under-allocate affiliate charges.<sup>317</sup> For those expenses that we felt did not meet these tests, we found that they did not satisfy one or both of the standards.

In this case, TCC's argument was three-fold: (1) the amount of its Shared Services expenses were reasonable because they were allocated fairly, (2) the types of the expenses were reasonable because TCC has no incentive to unnecessarily incur cost,<sup>318</sup> and (3) the expenses were not higher than other affiliates' expenses for the same items since the same allocation factor was used for all affiliates. However, in many cases what was missing from the proof was a more complete description of what the expenses actually represented.

We find the Shared Services expenses for General Services, Human Resources, Information Technology, Supply Chain, and Shared Services Strategy departments meet the reasonable and necessary standard, with the following exceptions because insufficient information exists to determine reasonableness or necessity:

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<sup>317</sup> *Central Power and Light Co.*, 36 S.W.3d at 567. In this regard the court specifically recognized that "the Commission retains the right to review the *application* of those allocation factors to charges submitted by the utility for inclusion in the rate base." [Emphasis in original.] *Id.* at 565.

<sup>318</sup> "AEPSC operates at cost and does not earn a profit on the services it provides. Thus, incurring unnecessary expenses would be foolhardy since doing so entails significant downside monetary risk with absolutely no upside potential." TCC Ex. 80 at 13.

<u>Work Order or Activity</u>	<u>Allocation Factor</u>	<u>Expense</u>
Appliance Saturation Survey	Number of Residential Customers	\$ 122
Stand Down for Safety	Equal Share Ratio	\$ 609
Applications Solutions	Number of Non-UMWA Employees	\$ 2,851,246
Project Circus	Number of Workstations	\$ 37,794
Fieldnet Project	KWH Sales	\$ 842
Process Development	Number of Purchase Orders	\$ 22,756
Information Technology Support	Total AEPSC Bill Dollars, Etc.	\$ 145,584
TOTAL		\$ 3,058,953

We find that the Shared Services classes of expenses for General Services, Human Resources, Information Technology, Supply Chain, and Shared Services Strategy departments meet the not-higher-than standard, with the following exceptions because the allocation factor is arbitrary, fails to reliably measure the benefits received, lacks a reasonable relation to the level of service provided, and fails to provide comparative data as prescribed by the Commission in Outline Item 3.05:

<u>Work Order or Activity</u>	<u>Allocation Factor</u>	<u>Expense</u>
Records Management	Total Assets	\$386,277
General Human Resources	Number of Employees	3,508,840

<u>Work Order or Activity</u>	<u>Allocation Factor</u>	<u>Expense</u>
General Information Technology	Number of Electric Retail Customers	1,507,966
General Information Technology	Number of Employees	5,256,846
General Information Technology	Total Assets	518,474
<b>TOTAL</b>		<b>\$11,178,403</b>

We recommend that the Commission find that the remaining Shared Services expenses are reasonable, necessary, and not higher than charged to others.

### III. COST OF SERVICE: DISTRIBUTION A&G EXPENSE ADJUSTMENTS

The text in Section O, at pages 107 through 111, is replaced with the following text:

“The components of the A&G expense are:<sup>319</sup>

FERC Acct No.	Category	Company Total Electric	Distribution Amount
920	Administrative and general salaries	\$35,434,932	\$27,507,569
921	Office supplies and expenses	7,055,617	4,194,681
922	Administrative expense transfer	(1,054,888)	(705,234)
923	Outside services employed	11,216,923	6,505,697
924	Property insurance	173,348	104,906
925	Injuries and damages	4,018,325	2,133,083
926	Employee pensions and benefits	18,625,337	10,312,689

<sup>319</sup> TCC Ex. 2.1, Sched. II-D-2 at 1 & 2.

FERC Acct No.	Category	Company Total Electric	Distribution Amount
928	Regulatory commission expenses	9,049	14
930	Advertising and miscellaneous general expense	4,092,318	2,597,195
931	Rents	1,738,658	1,056,014
935	Maintenance of general plant	5,476,805	4,306,157
	Total	\$86,786,424	\$58,012,771

Affiliate costs include numerous A&G expenses, but few, if any witnesses segregated their testimony into categories of A&G or other accounts. As a result, most witnesses' testimony on affiliate costs include A&G expenses as well as other expenses.<sup>320</sup> Some of the affiliate expenses have been disallowed in this PFD as not having met the standards imposed under PURA § 36.058(c). The ALJs have not been provided a citation to a table that segregates all of the A&G components of the individual affiliate expenses accounts according to the distribution function.

However, the foregoing list of distribution A&G expenses was admitted without objection,<sup>321</sup> as was the list of Total Company A&G expenses.<sup>322</sup> TCC introduced testimony about many of these individual categories (albeit in few cases, if any, by individual transmission or distribution function),<sup>323</sup> and the intervenors introduced their own testimony and evidence in which TCC's

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<sup>320</sup> A&G expenses for this purpose are defined as all costs charged to FERC account numbers 920-935. Docket No. 28840, Letter from Philip F. Ricketts (for TCC) to ALJs (Sept. 3, 2004).

<sup>321</sup> Tr. at 85.

<sup>322</sup> TCC Ex. 2.1, Sched. II-D-2 at 1.

<sup>323</sup> TCC Ex. 4 at 6, 11, 2-34, 38-53, Exh. DGC-5 (Affiliates); TCC Ex. 5 at 11-13 (Affiliates), 36-50, 36-50 (A&G Expenses), Exh. RWH-8 and -9; Ex. 2.1, Sched. II-D-2, including Attachments, II-D-2.1, II-D-2.4, II-D2.6a-c, II-D-2.7, II-D-3, II-D-3.1, II-D-3.7, II-D-3.8, II-D-3.9, II-D-3.11, II-E-4.4; TCC Ex. 7 at 31-52 (Affiliates), Exh. SSB-2, SSB-3; TCC Ex. 2.2, Sched. V-K-1, V-K-1a, V-K-2, V-K-4, V-K-6, V-K-7; TCC Ex. 2.3, Sched. V-K-8 through V-K-11, V-K-12a; TCC Ex. 2.4, Sched. V-K-12b-d; TCC Ex. 8 at 6, 16-20, Exh. HRG-2 (Affiliates); TCC Ex. 9 at 6-7, 28-33, Exh. MAB-2 (Affiliates); TCC Ex. 10 at 21-25, Exh. DLH-1 (Affiliates); TCC Ex. 11 at 6-7, 26-39 (Affiliates), Exh. WND-3 through 5; TCC Ex. 12 at 5-41, Exh. JCC-1, JCC-2, JCC-4; TCC Ex. 13 at 5-6, 13-20 (Affiliates), Exh. DBT-3; TCC Ex. 14 at 7-20, Exh. JLL-1 (Affiliates); TCC Ex. 15 at 4-5, 21-30, Exh. PLS-5 (Affiliates); TCC Ex. 19 at 4-8; TCC 20 at 6-28 (Pension & Benefits), Exh. MJT-1.3; TCC Ex. 66 at 8-14, 55-75 (Affiliates); TCC Ex. 67 at 22-28



figures and assumptions were challenged.<sup>324</sup> Almost all of the testimony included cross examination on these issues.<sup>325</sup>

Based on this evidence, the ALJs find reasonable the Applicant's actual A&G expense (including that portion allocated to distribution), with two exceptions. The two exceptions are Adjustment No. 1, the pension expense increase of \$7,264,784, of which \$6,258,658 is allocated to distribution,<sup>326</sup> and Adjustment No. 16, the merger related revenue requirement credit of \$16,337,000 all of which is allocated to distribution.<sup>327</sup> The basis for the disallowance of these two amounts have been discussed in detail in previous sections of this PFD."

#### IV. COST OF SERVICE: DEPRECIATION EXPENSE

The text in Section P, at pages 111 through 115, is replaced with the following text:

As part of the Applicant's cost of service calculation, the Applicant proposes a recovery of its existing depreciation expenses of \$71,814,601.<sup>328</sup> This amount includes some revisions to the Applicant's originally proposed depreciation expenses based on suggestions by Cities' witness,

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(Payroll), 29-33 (Pension), 33-34 (OPEB), 35-36 (Group Insurance), 40-48 (A&G Expenses), Exh. RWH-4R; TCC Ex. 68 at 1-71, Exh. SSB-1R through 6R (Affiliates); TCC Ex. 68A, Exh. WP/SSB-R (Affiliates); TCC Ex. 70 at 36-43 (Affiliates); TCC Ex. 72 at 4-11 (Affiliates); TCC Ex. 73 at 4-15 (Affiliates); TCC Ex. 74 at 28-30 (Affiliates); TCC Ex. 75 4-12 (Affiliates); TCC Ex. 76 at 4-8 (Pensions), 8-10 (Compensation), 11-12 (Group Insurance); TCC Ex. 80 at 4-17 (Affiliates); TCC Ex. 82 at 4-5, 24-30 (Affiliates); and TCC Ex. 87 4-16 (Compensation).

<sup>324</sup> Cities Ex. 4 at 6, 19-51, Exh. GWT-11 & -12 (Affiliates); Cities Ex. 6 at 20-25 (A&G Expenses); Cities Exs. 49-51 (Affiliates); Cities Ex. 111 (Affiliates); Cities Ex. 113 (Affiliates); OPC Ex. 1A at 38-64 (Affiliates); TIEC Ex. 7; TIEC 16 (Pension); CPL Ex. 1 at 13-53 (Affiliates); CPL Ex. 1A (Affiliates); CPL Ex. 9 (Affiliates); CPL Ex. 15 (Affiliates); Staff Ex. 2 at 7 (Outside Services), 8 (Advertising, Contributions, and Dues), 9-10 (Legislative Monitoring), 14-15 (Group Insurance), 15-17 (Pensions/OPEB); and CCR Ex. 1 at 13-16 (Salaries & Wages), 16-17 (Pensions), 20-23 (Affiliates).

<sup>325</sup> Tr at 138, 251-311, 354, 375-476, 495-503, 538-564 707-734, 748-749, 870-898, 1456-1513, 1580-1601, 1929-1931, 2020-2078, 2183-2216, 2376-2377, 2408-2416, 2511-2626, 2473-2475, 2648-2649, 2691, 2714, 2720, and 2848-2861.

<sup>326</sup> TCC Ex. 5 at 36-37; TCC Ex. 2.1, Sched. II-D-2, Attachment at 1-3.

<sup>327</sup> TCC Ex. 5 at 42-43; TCC Ex. 2.1, Sched. II-D-2, Attachment at 7-9.

<sup>328</sup> TCC Ex. 85, Exh. JEH-1R at 2.

Ms. Hughes. Included in that list of accepted revisions was a proposal to establish a depreciation reserve by plant account and to maintain the reserve by plant account.<sup>329</sup> We concur with the parties' agreement, finding that the proposal is reasonable, and we recommend the Commission's adoption of the agreement as part of the Final Order. Based on the evidence presented and discussed in the paragraphs that follow, the ALJs recommend that the Commission adopt a depreciation expense of \$64,182,475.

The areas of disagreement between the Applicant and Cities concern: (1) the average service lives of TCC's transmission and distribution assets, and (2) the net salvage value for two distribution accounts. Each of these is discussed briefly.

#### **A. Average Service Lives**

The average service life of an asset is a measure of the length of time that a particular asset will remain in service before the asset is replaced due to failure or removal. All other things being equal, the longer the average service life of an asset, the more years there are in which to depreciate the asset. Thus, the more years of depreciation that are available, the lower the depreciation rate and expense per year.

The length of the lives of utility assets may be established two different ways: (1) by examining the utility's actuarial analyses of its equipment, or (2) by examining the average life of similar utility assets held by other utilities. The most commonly used study of average lives of utility assets is conducted by the Edison Electric Institute (EEI). The EEI compiles a survey of utility assets from a group of approximately 100 investor-owned utilities in the United States and Canada.<sup>330</sup> The EEI data was used by TCC and by Cities in reviewing TCC's service life estimates.

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<sup>329</sup> TCC Ex. 85 at 13.

<sup>330</sup> Cities Ex. 5 at 18.

Using either method of establishing an asset's service life, the data may be graphed to examine trends in service life. The graphs produce a variety of statistical prediction formulas, the most well-known of which are the Iowa survivor curves. Iowa survivor curves vary by the number of years and the slope of the curve, and more than one curve may be appropriate for a given asset. To fit the appropriate curve to a data set, an analyst may rely upon visual or mathematical matching. Visual matching relies upon the analyst's subjective determination of the "goodness-of-fit," and mathematical matching relies upon a mathematical calculation that compares the data to the proposed curve. Mr. Henderson and Ms. Hughes relied upon these methods and prediction tools.

The scope of the disagreement on Average Service Lives involved only eight accounts within TCC's depreciation data system:<sup>331</sup>

<u>Account</u>	<u>Current TCC (years)</u>	<u>TCC Proposed (years)</u>	<u>Cities Proposed (years)</u>	<u>TCC Proposed Accrual</u>	<u>Cities Proposed Accrual</u>
353 Station Equipment	45	58	62	\$4,843,036	\$4,346,517
354 Towers & Fixtures	50	60	71	740,845	530,192
355 Poles & Fixtures	46	50	65	3,982,072	3,118,753
356 OH Conductor	42	50	65	3,428,824	2,536,719
362 Station Equipment	38	47	60	2,071,344	1,445,011
364 Poles & Fixtures	39	39	43	13,187,583	10,870,953
365 OH Conductor	40	42	48	9,604,095	8,131,396
367 UG Conductor	35	40	50	3,680,398	2,926,530
Total Proposed Accrual	--	--	--	\$41,538,197	\$33,906,071
Average	41.9	48.3	58	--	--

<sup>331</sup> TCC Ex. 85 at 9; Cities Ex. 5, Exh. NHH-3.

<u>Account</u>	<u>Current</u> <u>TCC</u> (years)	<u>TCC</u> <u>Proposed</u> (years)	<u>Cities</u> <u>Proposed</u> (years)	<u>TCC</u> <u>Proposed</u> <u>Accrual</u>	<u>Cities</u> <u>Proposed</u> <u>Accrual</u>
Percentage increase from current	--	15.3	38.4	--	--

For each account number, Ms. Hughes reviewed her reasons for selecting a service life based upon visual or mathematical matching. In rebuttal and briefs, TCC argued that Cities' selection of length of service life was unreasonably long, that Ms. Hughes overemphasized goodness-of-fit statistics, and that Ms. Hughes' average service life recommendation was based on industry statistics that were improperly selected.

The ALJs are not persuaded by TCC's criticisms. Ms. Hughes presented the historical data upon which she relied, and she convincingly explained the specifics of her reasons by which she projected the service lives. With regard to the allegation that some of her predictions exceed the highest service lives shown on the EEI survey,<sup>332</sup> Ms. Hughes was able to show that TCC's assets' service lives were exceeding the survey's historical experience. Where TCC's historical data is available and shown to be reliable, the ALJs find that TCC's own actuarial experience should override aggregated survey data. We find that the average service lives as presented by TCC, with the exception of account numbers 353, 354, 355, 356, 362, 264, 365, and 367, are just and reasonable. The ALJs recommend that Cities' recommended service lives be used for each of the eight accounts to calculate TCC's depreciation expense.

## **B. Net Salvage**

Salvage value is a component in the calculation of depreciation and is used to offset the original cost of an asset in the determination of its service value.<sup>333</sup> Net salvage value is the salvage

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<sup>332</sup> TCC Ex. 85 at 11; Tr. 8 at 1522.

<sup>333</sup> TCC Ex. 17 at 7.

value of the asset at retirement less the cost of removal.<sup>334</sup> As with the service life component, the net salvage value testimony produced a relatively high degree of concurrence between the witnesses for TCC and Cities. On only two accounts did the witnesses' testimony differ. On each, the witnesses agreed that the net salvage rates would be a negative.

On Account 366, TCC recommends a net salvage value of -75%, based upon the actual salvage and removal history from 1984 through 2002. In contrast, Cities relied on industry data to formulate her recommendation.<sup>335</sup> Cities also note that Account 366 involves underground conduit, the salvage of which is negligible since that particular asset is retired in place instead of being removed on retirement.<sup>336</sup>

The ALJs recommend the position of TCC with regard to account 366, Underground Conduit (Distribution). As with the service life issue, the ALJs concur with TCC that general industry data should not be relied upon when actual company data are available and that the actual salvage value and removal history are known. TCC's recommended depreciation amount for this account is \$397,113.<sup>337</sup>

On Account 369, Services (Distribution), TCC proposes a -38% figure, and Cities proposes a -30% figure. The basis of their disagreement is whether three triple digit negative salvage values (-679%, -362%, and -193%) should have been excluded as "outliers" in the calculation of the salvage rate.<sup>338</sup> Again, the ALJs find no reason to dispute TCC's own historical data and recommend the adoption of TCC's position on the treatment of this estimate. TCC's recommended depreciation amount for this account is \$3,798,375.<sup>339</sup> We find that the salvage values as presented by TCC are just and reasonable.

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<sup>334</sup> Cities Ex. 5 at 26.

<sup>335</sup> *Id.* at 11-12.

<sup>336</sup> Cities Ex. 5 at 30.

<sup>337</sup> TCC Ex. 85, Exh. JEH-1R at 2.

<sup>338</sup> Cities Ex. 5 at 31.

<sup>339</sup> TCC Ex. 85, Exh. JEH-1R at 2.

### C. Summary of Recommendations

The ALJs' recommendation is the result of the combination of Ms. Hughes' figures for the eight disputed accounts' average services lives,<sup>340</sup> and the revised figures from Mr. Henderson's rebuttal testimony.<sup>341</sup> The combination of those two sets of data are:

<u>Account</u>	<u>Selection of Depreciation Amount Based On:</u>	
	<u>Cities' Average Service Life</u>	<u>TCC's Salvage Value</u>
353 Station Equipment	\$4,346,517	--
354 Towers & Fixtures	530,192	--
355 Poles & Fixtures	3,118,753	--
356 OH Conductor	2,536,719	--
362 Station Equipment	1,445,011	--
364 Poles & Fixtures	10,870,953	--
365 OH Conductor	8,131,396	--
366 Underground Conduit	--	397,113
367 UG Conductor	2,926,530	--
369 Services	--	3,798,375
Total Proposed Accrual	\$33,906,071	\$4,195,488

Because we adopt the change in depreciation in the eight accounts based on Cities' average service life, the total amount is \$7,632,126 less than the \$41,538,197 proposed by TCC. Thus, TCC's cost of service is diminished by \$7,632,126. Because we adopt depreciation in the two

<sup>340</sup> Cities Ex. 5, Exh. NHH-1.

<sup>341</sup> TCC Ex. 85, Exh. JEH-1R at 2.

accounts based on TCC's salvage value, the amount does not involve a change in TCC's proposed figure."

## **V. NET SALVAGE**

In its Second Order on Remand, the Commission remanded the issue of Net Salvage, a component of Subsection P. (Depreciation) in Section VI. (Cost of Service). The Commission directed that the ALJs address the Applicant's agreement to track accumulated depreciation expense by individual account rather than by financial function. The parties have agreed to establish a depreciation reserve by plant account and to maintain the reserve by plant account.<sup>342</sup> The ALJs neglected to address the issue in the original PFD, and we have recommended that the Commission include this agreement between the parties as part of its Final Order. The language of our recommendation is included in the last sentence of the first paragraph of the revised section on Depreciation in this Revised PFD.

## **VI. SPECIAL METER READING FEE, CONNECT FEE, AND SERVICE RECONNECT FEE**

The text at pages 171-72 of section VIII.F.2.b., beginning with the second full paragraph on page 171 is withdrawn and replaced with the following:

The Commission in its Second Order on Remand notes that the PFD, when considering the Special Meter Reading Fee, Connect Fee, and Service Reconnection fee, did not adequately discuss whether the Applicant provided sufficient evidence for its labor charges and for its loading factor. The Commission remanded this issue for an analysis based on the reasonableness of the Applicant's actual cost to provide those services, as well as a justification for the Applicant's proposed labor charge and loading factor.

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<sup>342</sup> TCC Ex. 85 at 13.

The primary explanation for the fees is in Schedule IV-J-2. At page 27 of the schedule, the Applicant sets out the salaries per hour, adds a 60.18% loading factor, and then adds a 2.5% labor rate increase. According to the schedule, 48.14% of the 60.18% loading factor consists of taxes, including FICA and unemployment, workers' compensation and public liability insurance, pensions, savings, and other fringe costs. The remaining 12.04% is a non-productive fringe rate, which consists of vacation and sick pay.<sup>343</sup> According to TCC witness Donald Moncrief, much of the difference between what was charged in prior rate cases is the 60.18% loading factor. Mr. Moncrief did not know why that had substantially changed.<sup>344</sup>

With regard to the loading factor, the ALJs believe that they can take judicial notice that all employers pay, with rare exception, 7.65% for social security and medicare taxes.<sup>345</sup> Based on that notice, the ALJs conclude 7.65% of the loading factor is reasonable. With the cost of health insurance and workers' compensation insurance being what it is today, the remainder of the 48.14% may not be an unreasonable overhead loading rate, but no evidence was provided supporting that rate. Hence, the ALJs cannot find the remaining 40.52% is reasonable.

As for the non-productive fringe rate, the ALJs question the need for this. The ALJs assume that Applicant pays each employee for 40 hours of work a week for 52 weeks, a full year's worth of work, which would include sick time and vacation leave. Applicant might argue that the non-productive fringe rate is needed to pay others to perform the work while the titled worker is out on vacation or sick leave, but there is no evidence that the company did that. Finally no evidence was submitted showing that the employees in question will receive a salary increase of 2.5%.

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<sup>343</sup> Tr. at 1169.

<sup>344</sup> *Id.* at 2945.

<sup>345</sup> <http://www.ssa.gov/pressoffice/2000colafact.htm>. Any party objecting to the official notice should file such an objection in its exception to this remand PFD.



Concerning more specifically the Connect Fee and Service Reconnection Fee, which Applicant has set at \$27 for each,<sup>346</sup> the ALJs make the following observations: figuring one-quarter of an hour for a customer service associate's time does not appear to be unreasonable, and the same can be said for a half-hour for a field operations specialist's time. Billing for an 0.08 of an hour for a supervisor's time is more questionable, however.

To illustrate how the Connect and Service Reconnection fees would be affected by the observations above, the ALJs present the following: (1) taking the \$15.75 per hour salary of the customer service associate,<sup>347</sup> which multiplied by a load factor of .0765 creates an hourly wage of \$16.95, which when divided by a fourth equals \$4.24; (2) then taking the \$15.57 per hour salary of the field operations specialist,<sup>348</sup> which multiplied by the same load factor creates an hourly wage of \$16.76, which when divided by half equals \$8.38; (3) adding those labor costs, which total \$12.62 to the \$3.30 transportation cost creates a cost of \$15.92 (or **\$16 fee**) rather than proposed \$27 fee. The ALJs find that a \$16 fee is reasonable, but that the \$27 fee that the Applicant seeks is not.

As for the Special Meter Reading Fee,<sup>349</sup> the ALJs do not question the time billed for the customer service associate and the meter reader, but do question the supervisor's time, as well as the 60.18% loading factor. Applying the reasoning of above creates a cost of \$8.53 (or **\$9 fee**) rather than proposed \$17 fee. The ALJs find that a \$9 fee is reasonable, but the \$17 fee that the Applicant seeks is not.

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<sup>346</sup> Schedule IV-J-2 at 1 and 3.

<sup>347</sup> *Id.* at 27.

<sup>348</sup> *Id.*

<sup>349</sup> *Id.* at 16.

## VII. PRIORITY DISCONNECT FEE

The text at page 173 of section VIII.F.2.d. which reads as follows: “ Because TCC failed to show a basis for the cost increase, the ALJs find that the Priority Disconnect Fee should be \$34.00,” is withdrawn and replaced with the following:

The ALJs note that the components that make up the charge<sup>350</sup> are identical to the components that make up the \$34 Priority Connect Fee,<sup>351</sup> except that Applicant estimates an hour’s worth of a field operations specialist’s time versus the half-hour of a field operations specialist’s time for the Priority Connect Fee, as well as an hour for the truck’s time. Applicant provided no basis for the difference, and the ALJs cannot find such a basis in other evidence. Therefore, the Priority Disconnect Fee should be no greater than the Priority Connect Fee, which in turn should be reduced because of the unsupported 60.18% loading factor. However, the Priority Connect Fee charges time and a-half for the field operations specialist’s time, while the Priority Disconnect Fee only charges the field operations specialist’s basic hourly rate. Applying the above reasoning, including using a loading factor of 7.65% and allowing TCC to charge time and a-half for one-half hour of the field operations specialists’ time produces a fee of approximately \$20 for the Priority Connect Fee and the Priority Disconnect Fee. The ALJs find that a \$20 fee for each service is reasonable, and that the \$43 and \$34 that the Applicant seeks is not.

## VIII. REMAND FINDINGS OF FACT AND CONCLUSIONS OF LAW

### A. Findings of Fact

1. The Commission issued Orders on July 28 and August 25, 2004, remanding portions of the case to the State Office of Administrative Hearings.

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<sup>350</sup> *Id.* at 2.

<sup>351</sup> *Id.* at 1.

2. A hearing on the remanded consolidated tax savings issue was held on September 3, 2004. The record closed on September 17, 2004.

**Cost of Service: Consolidated Income Tax Savings**

Findings of Fact numbers 195 and 196 are withdrawn from the original Findings of Fact proposed in the PFD. The following Remand Findings of Fact replace them:

3. It is reasonable to use the interest credit methodology to calculate TCC's consolidated federal income tax savings adjustment.
4. An additional adjustment should be made to reflect the savings due to generation assets that are no longer part of the transmission and distribution (T&D) utility.
5. Using the rate base percentage assigned to the T&D functions in effect for each of the 15 years prior to 2002 is an appropriate method for functionally assigning consolidated tax savings.
6. The percentages of the T&D functions for each of the 15 years prior to 2002 produces an allocation of 23.1% to T&D, resulting in an adjustment of \$1,509,656.
7. Because the adjustment is a direct adjustment to federal income taxes, it must be grossed up to reflect the full effect on revenue requirement of the adjustment.
8. The combined effect of the consolidated tax savings adjustment and the associated gross-up is 1.53846 times the \$1,509,656 adjustment for an amount of \$2,322,545 to be deducted from federal income tax expense.

**Cost of Service: Affiliate Expenses**

Findings of Fact numbers 73-158 are withdrawn from the original Findings of Fact proposed in the PFD. The following Remand Findings of Fact replace them:

9. TCC's theory of the case for proof of its affiliate expenses fundamentally unacceptable.

10. With two exceptions, TCC failed to present evidence to show how the proposed 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.
11. TCC's proposed affiliate expense of \$2,073,488 for Telecommunications is reasonable and necessary and not higher than other affiliates' costs.
12. TCC's proposed affiliate expense of \$7,758,151 for Customer Choice Operations is reasonable and necessary and not higher than other affiliates' costs.
13. TCC's other proposed affiliate expenses are because TCC failed to prove that the expense is reasonable.

**Cost of Service: Distribution A&G Expense Adjustments**

The following Remand Findings of Fact are added:

14. The A&G Expense associated with the distribution function is \$58,012,772, including twenty categories of adjustments.
15. TCC's evidence supports the foregoing proposed A&G expenses, including the adjustments, as just and reasonable, with two exceptions.
16. The two exceptions are Adjustment No. 1, the pension expense increase of \$6,258,658, and Adjustment No. 16, the merger related revenue requirement credit of \$16,337,000.

**Cost of Service: Depreciation Expense**

Finding of Fact number 56 is withdrawn from the original Findings of Fact proposed in the PFD. The following Remand Finding of Fact replaces it:

17. TCC's adjusted end of test year accumulated depreciation was \$64,182,475.

The following Remand Finding of Fact should be added:

18. TCC has agreed to and will establish a depreciation reserve by plant account and maintain the reserve by plant account.

**Rate Design: Discretionary Service Charges**

Findings of Fact numbers 266, 267, and 268 are withdrawn from the original Findings of Fact proposed in the PFD. The following Remand Findings of Fact replace them:


19. TCC provided insufficient evidence for its loading factor of 60.18%.
20. TCC provided insufficient evidence for its supervisor labor charges.
21. TCC provided insufficient evidence showing that the employees in question will receive a salary increase of 2.5%.
22. The Connect Fee and Service Reconnection Fee are reasonably \$16.
23. The Meter Reading Fee is reasonably \$9.
24. The Priority Connect Fee and Priority Disconnect Fee are reasonably \$20.

**B. Conclusions of Law**

Conclusion of Law number 53 is withdrawn from the original Conclusions of Law, and the following are added.

1. TCC's federal income tax expense in cost of service should be reduced by \$2,322,545 to reflect TCC's share of AEP's consolidated tax savings.

**SIGNED on November 16, 2004.**



**KATHERINE L. SMITH  
ADMINISTRATIVE LAW JUDGE  
STATE OFFICE OF ADMINISTRATIVE HEARINGS**



**PAUL D. KEEPER  
ADMINISTRATIVE LAW JUDGE  
STATE OFFICE OF ADMINISTRATIVE HEARINGS**

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

**CONTINGENT FINDINGS OF FACT:**

*Regulatory, Legal, and Public Policy Expenses*

1. TCC sought approval for \$5,263,768 in proposed affiliate costs for Regulatory, Legal, and Public Policy Expenses.
2. Texas DSM expenses are those associated with the programming and planning to meet statutory efficiency goals.
3. The allocation factor for DSM expenses is Number of Retail Electric Customers.
4. The DSM expense w-as necessary and reasonable to provide service since the function is mandated as a legal obligation of the utility, TCC was not charged a higher rate for the DSM expense than others.
5. TCC conducts and documents internal and code of conduct investigations.
6. As part of this process, TCC incurs expenses related to training software, educational brochures, and an employee concerns hotline.
7. The main cost driver for code of conduct investigations is the scope of the investigations, the detail required for the investigations, and the impact of the policies on the benefiting locations.
8. The allocation factor for code of conduct violations used is Number of Employees since the function is driven by the size of the workforce.
9. Code of conduct investigations are essential to TCC's legal obligation to respond to and comply with all local, federal and state regulations.
10. The code of conduct of conduct investigations expense was reasonable and necessary to provide service and TCC was not charged a higher rate for the expense than others.
11. TCC prepares service quality reports, energy efficiency plans, construction reports, affiliate transaction reports, financial and operating reports, and SEC-, FERC-, and Commission-mandated reports.
12. These expenses are allocated using Total Assets based on the benefiting location's size.

13. There is not 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.
14. The evidence does not show that the non-rate case filing expense was reasonable or necessary standard or or that TCC was charged a higher rate for the DSM expense than others.
15. Pricing analyses includes research, scenario analysis, and development of economic and other assumptions related to the pricing of the utility's services.
16. TCC proposes to allocate the pricing analyses expense based on Total Assets because it reasonably approximates the costs of each benefiting location's proportionate share of the services, each of which vary based on size.
17. The pricing analyses proposed expense is not clearly differentiated from other economic modeling expenses that TCC seeks to include in the cost of service.
18. The pricing analyses proposed expense does not clearly differ from analyses used in rate case filings or in the management of regulatory affairs.
19. The evidence does not show that the pricing analyses expense was reasonable or necessary to provide service or that TCC was not charged a higher rate for the expense than others.
20. TCC's management and participation in regulatory and legislative affairs includes: (1) the company's meetings and communications with government agencies and with federal, state, and local elected officials, and (2) TCC's identification and development of policies and positions pertaining to complex industry issues.
21. For each of these expenses, the particular regulatory, legislative, or public policy requirements of the specific jurisdiction serve as the main cost driver, and the costs are allocated using the Total Assets allocation factor.
22. TCC properly distinguished between includible and non-includible costs related to the conducting of regulatory and legislative affairs.
23. TCC's proposed affiliate cost for managing and participating in regulatory, legislative, and public policy expenses are reasonable and necessary.
24. The "black box" settlement of TCC's UCOS case<sup>1</sup> precluded use of specific amounts as affiliate costs.

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<sup>1</sup> *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).*



25. Instead of providing the Commission with external verification evidence on this expense, TCC treated the management and participation in the regulatory, legislative, and public policy processes in the same manner as TCC treated the smaller proposed affiliate expenses.
26. TCC's evidence relied primarily upon comparisons of information obtained internally.
27. TCC used an asset size allocation factor asset size for the above expenses and relied little on direct billing.
28. TCC has not provided the types of comparative data sought by the Commission for these proposed affiliate expenses.
29. The evidence does not show that TCC was not charged a higher rate for the above-described expense than others.
30. TCC's proposed affiliate cost for maintenance of the corporate existence related to TCC's portion of the AEP system companies and to work required by federal or state laws and regulations.
31. The main cost drivers for this expense are compliance with legislative and regulatory restructuring requirements and the complexity of the regulatory process required to achieve separation.
32. The Applicant's portion of the above-listed expense was allocated based on Total Assets.
33. TCC will continue to incur expenses for SEC filings related to corporate existence and separation.
34. One of the components of corporate existence and separation is an expense for "corporation separation-general."
35. The evidence does not show that the "corporation separation-general" expense was either reasonable or necessary for TCC to provide service.
36. The portion of the affiliate expense for corporate existence and separation is reasonable and necessary, other than the amounts for "corporation separation-general."
37. The use of Total Assets as an allocation factor bears a logical relationship TCC's T&D corporate existence and separation.
38. TCC was not charged a higher rate for the reasonable and necessary corporate existence and separation expense since it was allocated based on Total Assets.

39. The allocation factor for the affiliate expense for support of the board of directors is Total Assets.
40. The amount is reasonable and necessary in that these expenses are incurred to permit TCC to comply with governmental responsibilities.
41. Allocating the above expense based on Total Assets ensured that TCC was not charged a greater rate for that expense than other affiliates.
42. The main cost driver for TCC's preparation and filing of rate cases is the regulatory requirements of the jurisdiction in which the case is filed, and the allocation factor is Total Fixed Assets.
43. TCC made no major rate filings during the test year.
44. The evidence does not show that the above-listed expense was either necessary or reasonable for TCC to provide service.
45. The "various activities" portion of the expense describes the total amount of direct charges made to TCC for the foregoing functions.
46. Of these, the portion of the expense related to managing and participating in DSM (\$30,448) is reasonable and necessary and meets the not-higher-than standard.

#### *Corporate Communications*

47. TCC sought to include \$1,126,972 in the cost of service for corporate communications.
48. These expenses are reasonable and necessary but the record does not show that TCC was not allocated this expense at a rate not higher than other affiliates were charged.

#### *Economic Development*

49. TCC seeks to include \$457,174 in affiliate expenses for economic development.
50. This proposed affiliate expense involves stimulating the local economy and providing load growth to the area.
51. The evidence does not show that this proposed affiliate expense was a reasonable or necessary cost of TCC's service.

### *Customer Choice Service Expenses*

52. TCC sought to include in the cost of service four affiliate expense amounts related to Customer Choice Service Expenses: an expense for LogicaCMG, development and execution of business processes to comply with Commission rules, development and implementation of AEP IT systems for processing and participating in national business standards groups, and development and tracking of business processes to comply with Commission rules.
53. The \$4,938,271 LogicaCMG expense was both reasonable and necessary, and the expense was not allocated to TCC at a higher rate than to other affiliates.
54. The evidence in support of these last three components of the Customer Choice Service Expenses does not contain a sufficient amount of detail to show that these expenses were either reasonable or necessary for TCC to provide service.

### *Customer Service Operations*

55. TCC proposed \$5,669,855 in affiliate expenses associated with Customer Service Operations.
56. 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.
57. Thirty-one point five percent (31.5%) of the charges are direct billed, and the allocation factors used are Number of Retail Electric Customers and Number of Phone Center Calls.
58. TCC was not allocated the above expenses at a higher rate than other affiliates.

### *Financial Services; Risk Management Services; Research, Development, and Trade Organization Support; and Fringe Benefits Adjustment*

59. The Applicant sought a total of \$16,048,592 for affiliate expenses related to Financial Services; Risk Management Services; Research, Development, and Trade Organization Support; and Fringe Benefits Adjustment.
60. TCC did not prove that the following were reasonable or necessary for it to provide service or that TCC was not allocated them at rates higher than other affiliates: perform strategic planning and analysis, develop and administer long-range business plans, evaluate investment/diversification opportunities, prepare long term financial plans, conduct research and development, provide technical and economic evaluation, trade association dues, business continuity planning, and manage operational risk.
61. With respect to the \$13,351,288 balance of the components, all were reasonable and necessary for TCC to provide service and were allocated to TCC at rates not higher than that to other affiliates.

### *Telecommunications*

- 62. TCC proposed an affiliate expense of \$2,073,488 in allocated telecommunications costs with external evidence of cost evaluation and reasonableness for the affiliate telecommunications costs.
- 63. 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.
- 64. The above-listed affiliate cost was reasonable and necessary to provide service, and TCC was allocated a share of the expense at a rate not higher than to other affiliates.

### *Distribution*

- 65. The affiliate distribution services cost charged to TCC Distribution by AEPSC during the test year was approximately \$5.1 million.
- 66. The above-listed expense was reasonable and necessary to provide service, and TCC was allocated a share of the expense at a rate not higher than allocated to other affiliates.

### *Transmission*

- 67. The affiliate transmission services cost charged to TCC by AEPSC during the test year was approximately \$3.76 million.
- 68. 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.
- 69. The proposed affiliate expense was reasonable and necessary to provide services , and the expense meets the not higher than standard.

### *Shared Services*

- 70. AEPSC billed TCC \$16.9 million during the test year for Shared Services.
- 71. Shared Services centralizes five functions of AEP's related corporate entities: General Services, Human Resources, Information Technology, Supply Chain, and Shared Services Strategy departments.
- 72. The Shared Services classes of expenses were reasonable and necessary to provide service, and TCC was not billed at a higher rate for them than other affiliates, with the following exceptions: Appliance Saturation Survey, Stand Down for Safety, Applications Solutions, Project Circus, Fieldnet Project, Process Development, and Information Technology Support.

73. The Shared Services classes of expenses were reasonable and necessary for TCC to provide service and TCC was not billed at a higher rate for them than other affiliates: with the following exceptions: Records Management, General Human Resources, General Information Technology (\$1,507,966), General Information Technology (\$5,256,846), and General Information Technology (\$518,474).

**CONTINGENT CONCLUSIONS OF LAW:**

1. 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 quantity, terms, date of contract, place of delivery, and allow for appropriate differences in making *each* of those findings.
2. PURA 36.058(d) requires evidence of comparability as an element of not only the not-higher-than requirement but also of the reasonableness and necessity requirements.
3. TCC is required to satisfy at least one element of the comparability provisions of PURA § 36.058(d) in proving reasonableness.
4. 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.