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SOAH DOCKET NO. 473-08-3681
PUC DOCKET NO. 35717

APPLICATION OF ONCOR ELECTRIC DELIVERY COMPANY, LLC FOR AUTHORITY TO CHANGE RATES	§ § §	BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS

INITIAL BRIEF

OF

THE ALLIANCE OF TXU/ONCOR CUSTOMERS

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March 4, 2009

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INITIAL BRIEF OF THE ALLIANCE OF TXU/ONCOR CUSTOMERS

TO THE HONORABLE ADMINISTRATIVE LAW JUDGES:

NOW COMES, the Alliance of TXU/Oncor Customers ("ATOC") who files this Initial Brief and shows the following:

I. INTRODUCTION

Oncor Electric Delivery Company, LLC ("Oncor" or "Company") seeks to increase its rates by $253,000,000 annually. It is remarkable that in these times of belt tightening, when everyone else is struggling to find ways to live within their means, Oncor instead seeks its own bailout from consumers.

ATOC presented two witnesses who thoroughly analyzed various components of the Company's application. Although ATOC did not submit a comprehensive revenue requirement recommendation, the issues it did focus on revealed a variety of excessive requests from Oncor.[1] In fact, ATOC's adjustments alone caused Oncor's revenue requirement to be reduced by approximately $200 million. ATOC's analysis when viewed in conjunction with the other interveners' and the Staff of the Public Utility Commission's ("Commission" or "Staff") case clearly points to the preponderance of the evidence supporting Oncor receiving a rate reduction,

[1] ATOC's decision not to address an issue in its Initial Brief should not be interpreted as acquiescence or agreement on any issue. ATOC reserves the right in its Reply Brief to address any and all issues submitted by other parties in their Initial Briefs.

not a $253 million increase. ATOC thus respectfully submits that after the Commission reviews Oncor's requested increase in rates, the Commission will reach the same conclusion: Oncor does not merit an increase in rates and it has not proven a need for an increase.

The results of this analysis is unsurprising since as recently as 2007, Staff required Oncor (then referred to as TXU Electric Delivery) to file a rate case because their review of Oncor's earnings indicated that Oncor was over-collecting $80 million or 4% higher than their reasonable revenue requirement based on Staff's estimates. As detailed under the procedural history section of this pleading, it was dismissed as a part of a settlement. However, it was never determined that Oncor was not indeed over-collecting. ATOC's testimony repeatedly reveals that a review of Oncor's filing, when subjected to clear Commission precedent and the standards of sound rate making policy shows that Oncor should not receive a rate increase.

II. JURISDICTION AND NOTICE

The Commission has exclusive jurisdiction over the rates, operations, and services of Oncor in areas outside municipalities pursuant to Public Utility Regulatory Act (PURA)[2] §32.001(a)(1) and for those municipalities that have ceded jurisdiction to the Commission pursuant to PURA § 33.002(b). The Commission also has jurisdiction over Oncor's transmission rates pursuant to PURA § 35.004(d). Oncor also filed its case with all of its original jurisdiction cities. Oncor appealed the actions of its original jurisdiction cities to the Commission and consolidated those appeals into Docket No. 35717.

Oncor complied with the Commission's notice requirements. Pursuant to P.U.C. PROC. R. 22.51(a)(1) notice was published in newspaper having a general circulation in each county of Oncor's service territory once a week for four consecutive weeks. Pursuant to P.U.C. PROC. R.

[2] Public Utility Regulatory Act, TEX. UTIL. CODE ANN. §§ 11.001-64.158 (Vernon 1998 & Supp. 2008).

22.51(a)(2) Oncor provided notice of its filing by mailing notice by first class mail to all retail electric providers serving customers in Oncor's service area and all entities listed in the Commission's transmission matrix in Docket No. 30511, *Commission Staff's Application to Set 2008 Wholesale Transmission Service Rates for the Electric Reliability Council of Texas.* [3] Oncor also provided a copy of its statement of intent to the appropriate office of each municipality in Oncor's service area and provided each with a summary package of information. Additionally, Oncor provided notice by first class mail to all parties in Docket Nos. 34040 and Docket 34077.

III. PROCEDURAL HISTORY

On March 21, 2007, Staff filed *Commission Staff's Petition for Review of the Rates of TXU Electric Delivery Company.*[4] The basis for the petition was Staff determined that TXU Electric Delivery (now Oncor Electric Delivery Company) was earning excessive revenues, on a company-wide basis, in the amount of $80 million, or 4% higher than the reasonable revenue requirement Staff estimated.[5] Staff's petition asked the Commission to require Oncor to file a rate-filing package using a calendar year 2006 test year.[6] On April 30, 2007, the Commission required TXU Electric to file a rate-filing package.[7] On October 10, 2007, multiple parties filed a joint motion to abate the proceeding and on October 18, 2007 an Order was issued to that effect.[8] The ALJ granted the parties request to abate the proceeding until a final order was issued

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3 *Commission Staff's Application to Set 2008 Wholesale Transmission Service Rates for the Electric Reliability Council of Texas*, Docket No. 35011 (Nov.14, 2007).

4 *Commission Staff's Petition for Review of the Rates of TXU Electric Delivery Company*, Docket No. 34040 (March 21, 2007).

5 *Id.* at 1.

6 *Id.* at 2.

7 Docket No. 34040, Order Requiring Rate Fling Package (April 30, 2007).

8 Docket No. 34040, Order No. 10 (Oct. 18, 2007).

in Docket No. 34077.

On April 2, 2007, Texas Energy Future Holdings, L.P. (TEF) and Oncor, filed a *Stipulation of Binding Commitments by Texas Energy Future Holdings Limited Partnership in PURA Section 14.101 and Request for Issuance of Interim Order* regarding the merger of TEF with Oncor's parent corporation, TXU Corporation.[9] PURA § 14.101 requires that a transaction involving the sale of more than 50% of the stock of a public utility be reported to the Commission within a reasonable time and the Commission shall determine whether the transaction is consistent with the standards set out therein.[10] The Applicants stated that although the proposed transaction did not involve the direct sale of public utility stock, they choose to seek a public interest determination pursuant to PURA § 14.101(b).[11] Ultimately the Commission approved a non-unanimous stipulation.[12] As part of the settlement the Commission approved the dismissal of Docket No. 34040 and required Oncor to file a rate case no later than July 1, 2008.[13]

On June 27, 2008, in compliance with its settlement agreement in Docket No. 34077, Oncor filed a *Petition and Statement of Intent of Oncor Electric Delivery Company, LLC.*[14] The Company's application was filed in accordance with the requirements of Chapter 36 of PURA and P.U.C. PROC. R. 22.243 governing a utility's request to change rates. In its application the Company sought to increase overall base rate revenues on a system-wide basis by approximately $275 million. On October 3, 2008, Oncor filed supplemental testimony that reduced their

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9 *Joint Report and Application of Oncor Electric Delivery Company and Texas Energy Future Holdings Limited Partnership Pursuant to PURA § 14.101*, Docket No. 34077 (April 2, 2007).

10 Docket No. 34077, Order No. 1 (April 27, 2007).

11 *Id.*

12 Docket No. 34077, Order on Rehearing (April 24, 2008).

13 *Id.* at 9.

14 *Application of Oncor Electric Delivery Company, LLC for Authority to Change Rates,* Docket No. 35717 (June 27, 2008).

request to $253 million.[15] A public hearing on Oncor's request to increase overall base rate began on January 13, 2009 and concluded on February 9, 2009.

IV. EXECUTIVE SUMMARY

Oncor has requested a $253 million revenue requirement increase over their current rates. This request is unsupported by the preponderance of the evidence and should be rejected. ATOC has reviewed Oncor's case and determined that a variety of requests are overstated or simply apply the incorrect principals, methodology or precedent to the facts in this case. ATOC's review, while not encompassing a comprehensive revenue assessment, revealed adjustments of approximately $200 million. These adjustments, taken in conjunction with additional adjustments espoused and supported by other parties, including ATOC, indicate that Oncor does not merit an increase in rates.

V. RATE BASE

A. T&D Capital Investment

ATOC reserves its right to address this issue in its Reply Brief.

B. ADFIT

ATOC reserves its right to address this issue in its Reply Brief.

1. AMT Credits

ATOC reserves its right to address this issue in its Reply Brief.

2. FIN 48

ATOC reserves its right to address this issue in its Reply Brief.

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[15] Docket No. 35717, Supplemental Direct Testimony of Dane A. Watson, R. Keith Pruett and John M. Casey (Oct. 3, 2008).

3. Pension Plan, OPEBs, and FAS 112 Asset

ATOC reserves its right to address this issue in its Reply Brief.

C. Cash Working Capital

ATOC reserves its right to address this issue in its Reply Brief.

1. Lead/Lad Study

ATOC reserves its right to address this issue in its Reply Brief.

2. Cessation of Sale of Accounts Receivable

ATOC reserves its right to address this issue in its Reply Brief.

D. Self-Insurance Reserve

ATOC recommends the Company better coordinate the proposed amortization periods for investments in Account 303-Intangible plant with the rate base recovery mechanism.[16] The Company requested $14,634,315 associated with annual amortization of intangible plant. The Company at the end of the test year already had $3.3 million of intangible plant that was fully amortized.[17] Additionally the Company will have more intangible plant become fully accrued before these rates go into effect. The amortization periods the Company has offered range from 12 to 96 months for plant as of the end of the test year and the vast majority is under 60 months.[18] While it is not ATOC's goal to deny the Company's recovery of investment, it is also "not appropriate to have short amortization periods which will result in full amortization of investment prior to the next change in base rates."[19]

It is inappropriate to allow shorter amortization periods that will expire before the next

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[16] Direct Testimony of Jack Pous, ATOC Exh. 2 at 102:7-10.

[17] *Id.* at 102:18-21.

[18] *Id.* at 103:5-10.

[19] *Id.* at 103:14-16.

rate case because "to the extent any of the 100 plus items reflected in Account 303 become fully amortized prior to the effective date of the next base rate case, the Company will still continue to collect the annual amortization amounts in base rates charge to customers."[20] This would allow the Company to over recover costs and violate the ratemaking principal that they are only allowed to recover 100% of costs as reflected in rate base and no more. It appears that it would be almost impossible for the company to file another rate case and get new rates into effect before 2010. As such, nearly $5 million of annual amortization expenses will be completely amortized by the end of 2010.[21] Under this likely scenario customers will be paying $5 million of amortization expense for plant that is already fully accrued and for which the Company's accounting recognizes no benefit on behalf of customers.

ATOC recommends the Commission "adopt a recalculation of amortization expense based on a concept that no plant will become fully amortized within 60 months of the end of the test year."[22] Since the Company's rates will not go into effect until about the second half of 2009, Mr. Pous' recommendation only extends the shorter amortizations periods for two months to 48 months beyond the periods proposed by the Company. As an alternative, Mr. Pous' suggests that the Commission could "order to Company to continue booking amortization expense for each plant item reflected in the rate proceeding until the base rates from the next rate proceeding go into effect."[23] This would be an equitable resolution to the issue because it would capture for the benefit of the customers the amounts that will be charged thorough base rates after the item has fully accrued and the amount could be applied to any unamortized amount in the next rate proceeding.

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[20] *Id.* at 103:20-22.

[21] *Id.* at 104:10-20.

[22] *Id.* at 105:1-4.

[23] *Id.* at 105:10-12.

E. Existing Meters

ATOC reserves its right to address this issue in its Reply Brief.

F. Plant Held for Future Use

Oncor has requested to include $17,110,015 of plant held for future use (PHFU) in rate base. Mr. Pous recommends removing a large share of this amount from base rates. Oncor contends the amount spent is necessary to ensure that certain properties are available when the Company needs them and the cost associated with holding on to them are both reasonable and necessary.[24] However Oncor failed to present a definitive plan for these investments. The Commission's rules require that a utility have a definitive plan for the use of PHFU within a 10-year period before it can include PHFU in rate base.[25] In fact his rule has been previously applied to the Company.[26] After taking this rule into consideration Mr. Pous eliminated 9 different locations set forth by the Company that did not comply with the 10-year requirement.[27] Mr. Pous recommends removing $12,639,442 in PHFU.

G. Regulatory Assets

1. 2004 and 2006 Business Restructurings

Oncor inappropriately included $20,274,840 in rate base related to 2004 and 2006 restructuring efforts. The Company also requested an amortization of costs over a 5-year period that results in an annual amortization expense of $4,054,968. Oncor alleges both of these efforts were linked to cost saving programs. Oncor next contends that it is entitled to recovery of these costs because "the Commission has ruled equity in allowing customers to realize the cost of

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[24] ATOC Exh. 2 at 106:6-12.

[25] *Id.* at 106:20-22.

[26] *Application of Texas Utilities Electric Utility for Authority to Change Rates,* Docket No. 11735, Second Order on Rehearing (May 27, 1994).

[27] *Id.* at 108:1-10.

savings, while reimbursing the Company's investors for the costs necessary to extract savings," even though these costs were not incurred during the test year.[28] The Company cited Docket No. 11735 as an example of the Commission allowing for such a recovery.[29] However, the situation in Docket No. 11735 is nothing like the one presented in this case. In Docket No. 11735 the costs were projected and not already incurred.[30] In that situation the Company had not already recovered its restructuring costs through cost savings related to the reorganization. The "arrangement [in Docket No. 11735] was equitable in that the projected savings were provided to customers without any period where the Company shareholders had the opportunity to retain such savings."[31] To allow the Company to recover restructuring costs incurred in 2004 and 2006 now would allow the Company to double recover. The Company already recovered its costs the first time by retaining the cost savings prior to the rates in this case going into effect and if its request were to be adopted, the Company would be allowed to recover the costs again. ATOC recommends that the entire rate base amount of $20,274,840 and the corresponding $4,054,968 amortized amount be denied.

2. Pensions and OPEBs

ATOC reserves its right to address this issue in its Reply Brief.

H. Materials and Supplies

ATOC reserves its right to address this issue in its Reply Brief.

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[28] Direct Testimony of Keith R. Pruett, Oncor Exh. 29 at 48:15-17.

[29] *Application of Texas Utilities Electric Utility for Authority to Change Rates,* Docket No. 11735 (January 22, 1993).

[30] ATOC Exh. 2 at 99:12-16.

[31] *Id.* at 99:16-100:2.

I. Prepayments

ATOC reserves its right to address this issue in its Reply Brief.

VI. RATE OF RETURN

Based upon the capital structure and cost of debt calculated by ATOC witness David Parcell, ATOC recommends that the Commission set a rate of return for Oncor operations of 7.98%. The overall rate of return, as reflected in the table below, addresses the two main concerns of the statue: it is sufficient to attract investors and capital while not awarding Oncor shareholders more than a fair rate of return on the adjusted value of the invested capital.[32]

ATOC's Proposed Overall Cost of Capital[33]

	Percent	Cost	Return
Long-Term Debt	60.00%	6.97%	4.18%
Common Equity	40.00%	9.0-10.0%	3.60-4.00%
Total	100.00%		7.78-8.18%
			7.98% Mid-Point

ATOC's proposed 7.98% cost of capital is more than reasonable to ensure Oncor's financial position. It affords the Company an opportunity to achieve a pre-tax coverage level of 2.70 times ("x").[34] ATOC's recommendation realistically reflects the current economic turmoil, as well as the expectations of investor returns on utility stocks.

A. Return on Equity

ATOC witness Mr. Parcell's analysis indicates that a 9.5% return on equity (ROE) is appropriate. There are three primary steps Mr. Parcell used to analyze Oncor's total cost of

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32 PURA § 36.0551.

33 Direct Testimony of David C. Parcell, ATOC Exh. 1 at 2:11-14.

34 *Id.* at 82 (Attachment DCP-12).

capital. The first step was to develop the appropriate capital structure.[35] Mr. Parcell used the capital structure proposed by Oncor and established by the Commission in Docket No. 22350.[36] It is compromised of 40 percent common equity and 60 percent long-term debt.[37] Next Mr. Parcell needed to determine the embedded cost of debt. Mr. Parcell used a rate of 6.97%, which is the same rate proposed by the Company.[38] The third step was to estimate the cost of common equity. Mr. Parcell utilized three recognized methodologies to estimate the cost of equity for Oncor.[39] The following chart summarized Mr. Parcell's findings:[40]

Methodology	Range
Discounted Cash Flow	9.5-9.8%
Capital Asset Pricing Model	9.2%
Comparable Earnings	9.0-10.0%

Mr. Parcell concluded that the cost of common equity for Oncor is within a range of 9.0% to 10%.[41] Mr. Parcell review showed that by "combining these three steps into a weighted cost of capital results in an overall rate of return range of 7.78 percent to 8.18 percent."[42] Mr. Parcell's recommended 9.5 percent cost of equity results in an overall cost of capital of 7.98 percent. [43]

Since Oncor is not a publicly traded company, in order to develop ATOC's ROE recommendation, Mr. Parcell needed to "analyze groups of comparison or "proxy" companies as

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35 *Id.* at 2:21-23.

36 *Application of TXU Electric Company for Approval of Unbundled Cost of Service Rate Pursuant to PURA § 39.201 and Public Utility Commission Substantive Rule § 25.344*, Docket No. 22350, Order (October 4, 2001).

37 ATOC Exh. 1 at 2:23-26.

38 *Id.* at 3:1-4.

39 *Id.* at 3:5-8.

40 *Id.* at 3:9-11.

41 *Id.* at 3:12-15.

42 *Id.* at 3:16-17.

43 *Id.* at 3:16-17.

a substitute for Oncor to determine its cost of common equity."[44] Mr. Parcell would normally select a group of publicly-traded proxy companies, but selecting such a sample proved "problematic since the Company's parent and risk perception (i.e. bond ratings) are dominated by the LBO (leveraged buyout)."[45] Mr. Parcell therefore chose to conduct studies on the proxy group selected by Oncor's witness Dr. Hadaway.

As Mr. Parcell points out "neither the courts nor economic/financial theory have developed exact and mechanical procedures for precisely determining the cost of capital."[46] The reason for this is because cost of capital is an opportunity cost and looking towards the future, so it can only be estimated.[47] There are several models available to estimate the cost of equity capital. Mr. Parcell utilized three methodologies quite familiar to the Commission for his analysis. He used the Discounted Cash Flow (DCF), Capital Asset Pricing Model (CAPM) and the Comparable Earnings (CE) methods.

The DCF is based on the theory that maintains that the value of any security or commodity is the discounted present value of all future cash flows. For common equity cash flows come in the form of dividends and increases in share prices. The most common DCF model assumes that dividends will grow at a constant rate. The growth-dividend component tends to be the most crucial and controversial element in this methodology. It is difficult to assess an investor's expectations, a challenge evidenced by the acts of various investors making a decision to buy or sell the same stock at the same time. Because no single indicator of growth is always used by all investors it is necessary to consider a variety of dividend growth indicators when deriving the growth component of the DCF model. Mr. Parcell considered a multitude of

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[44] *Id.* at 21:25-22:2.

[45] *Id.* at 22:3-6.

[46] *Id.* at 6:5-6.

[47] *Id.* at 6:6-8.

indicators and sources of growth in his DCF analysis, such as earnings retention, historic and projected earnings, projections of growth and book value for the proxy group of companies.[48] Mr. Parcell used this information to determine that the proper DCF range for the proxy group is 9.5 percent to 9.8 percent.

Mr. Parcell also performed a CAPM analysis. The CAPM "is a version of the risk premium method" and it "describes and measures the relationship between a security's investment risk and its market rate of return."[49] Mr. Parcell performed his CAPM analyses on the same group of proxy companies that he utilized in his DCF model. His CAPM resulted in a cost of equity for Oncor of 9.2%.

Mr. Parcell also performed a CE analysis. This "method is designed to measure the returns expected to be earned on the original cost book value of similar risk enterprises. Thus, this method provides a direct measure of the fair return, because the CE method translates into practice the competitive principle upon which regulation is based."[50] Mr. Parcell's analysis considered the equity returns of the proxy group of utilities for the period 1992-2007. In estimating a fair level of return for a future period it is important to examine a diverse period of time to avoid unusual circumstances that may be present over a relatively short period of time. Mr. Parcell's CE results were in the 9% to 10% percent range.

Oncor's primary objection to Mr. Parcell's ROE calculation seems to be that the results are lower than Oncor believes are appropriate. Dr. Hadaway suggests that Mr. Parcell's analysis is flawed and that if he "realistically evaluated his results" he would have arrived at a different number. However, a review of Dr. Hadaway's testimony and studies indicates that Dr. Hadaway

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48 *Id.* at 24:9-19.

49 *Id.* at 25:24-26.

50 *Id.* at 28:17-20.

has not realistically reviewed the current economic situation and adjusted his results accordingly.

Dr. Hadaway's first DCF model combines a yield "with the average of four growth rates – all of which are projections of earnings per share (EPS) growth.[51] The problem with this approach is it relies on a single measure of growth: analysts' forecasts of EPS. Dr. Hadaway's use of this one growth measurement would indicate that investor's rely on only one source of information for their investment decisions. This is an unlikely claim and one for which Dr. Hadaway offers no support in his testimony.[52]

Dr. Hadaway's second DCF model's major flaw is it relies on a constant 6.5 percent Gross Domestic Product (GDP) growth rate.[53] This is based exclusively on historic growth and in stark contrast to the U.S. government estimates for long-term growth that are significantly lower.[54]

The third DCF model Dr. Hadaway used is structured as a '"two-stage growth' model that uses five years of 'cash flows' (i.e., dividends) plus years 5-150 years of dividend growth (as measured by GDP at 6.50 percent)."[55] Dr. Hadaway's third model created two problems. The first is that by estimating growth 150 years into the future the model incorporates questionable growth rates. And the second problem remains the use of a constant 6.5 GDP growth rate despite all evidence to the contrary that it is not in keeping with actual projections or realistic expectations.[56]

Oncor's repeated misuse of data and projections has skewed the results of his ROE analysis. ATOC's concern with Dr. Hadaway's analysis is validated when the various parties'

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51 ATOC Exh. 1 at 33:20-26.

52 *Id.* at 34:6-14.

53 ATOC Exh. 1 at 37:24-25.

54 *Id.* at 37:25-28.

55 *Id.* at 36:28-37:1.

56 *Id.* at 37:6-15.

testimony regarding ROE is reviewed. The following summary of the ROE as determined by various parties demonstrates that Dr. Hadaway's results are the outlier among the parties:

Party	ROE
Staff	10.25%
OPC	9.30%
Cities	9.75%
ATOC	9.50%
Oncor Direct	10.75%
Oncor Rebuttal	11.50%

In fact, Dr. Hadaway's rebuttal ROE became an even more extreme outlier than the one presented in his originally filed testimony. It appears that Dr. Hadaway's repeated use of overly optimistic, unrealistic growth rates and a miscalculation of investor expectations has resulted in an ROE estimate that is not in keeping with the actual marketplace. Dr. Hadaway's recommendation should be rejected. On the other hand, Mr. Parcell's conclusion that a 9.5% ROE is supported by the weight of the evidence, is most aligned with the analysis of the other parties and should be adopted.

B. Cost of Debt

As stated in the Section VI, A., Mr. Parcell accepted the Company's proposed cost of debt for the purpose of calculating an overall rate of return.

C. Capital Structure

As stated in Section VI, A., Mr. Parcell accepted the Company's proposed capital structure, which was approved by the Commission in Docket No. 22350.

D. Overall Rate of Return

ATOC's recommendation is a return on common equity of 9.5% and an overall rate of return of 7.98%. As shown in Mr. Parcell's attachment DCP-13 his recommendation would still allow the Company to meet its benchmark for a BBB (investment grade) rated utility.[57] Additionally, the debt ratio is within the benchmark for a BBB rated utility.[58] This would allow Oncor to have a sufficient level of earnings to maintain its financial integrity.

VII. COST OF SERVICE

A. Labor Expenses

ATOC Witness Jack Pous recommends two adjustments to labor expenses. Mr. Pous adjusts both Oncor's overtime and incentive compensation amounts. Mr. Pous' recommendation results in a $17,389,606 reduction to payroll expense and an additional payroll cost of $6,532,625 to be capitalized.[59]

1. Incentive Compensation

Oncor included $21,991,882 in its revenue requirements for incentive compensation. This number is composed of $15,459,257 for payroll expense and the remaining amount of $6,532,625 as capitalized costs.[60] Mr. Pous recommends disallowing Oncor's entire request. ATOC has two primary objections to Oncor's inclusion of incentive compensation in base rates. First, incentive compensation does not meet the known and reasonable criteria for inclusion in base rates. According to Oncor the incentive compensation may not actually get paid out.[61] Additionally, "according to Oncor incentives are paid to the employees to 'align the interests of

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[57] *Id.* at 33:5-7.

[58] *Id.* at 33:7-8.

[59] ATOC Exh. 2 at 84:4-7.

[60] *Id.* at 85:5-8.

[61] *Id.* at 85:15-86:2.

Participants, Participating Employers and Company shareholders by rewarding performances that satisfied performance goals."'[62] This indicates the compensation is tied to financial performance and not to improvements in service to rate payers.

Lest the Commission reach the erroneous conclusion that Mr. Pous believes that incentive compensation should never be offered, such is not the case. He instead suggests that the type of incentive compensation Oncor seeks to recover from ratepayers, is more properly paid for by those that benefit from those goals: shareholders. As Mr. Pous' testimony points out in detail, various utilities have repeatedly asked for incentive compensation to be included in base rates. However, the Texas Commission, as well as other jurisdictions, has repeatedly refused to allow incentive compensation to be included in base rates.[63] Mr. Pous' adjustment results in a reduction of $15,459,257 in O&M expenses and an additional $6,532,625 to be removed from capitalized costs. In addition, as a function of reducing payroll expense, Mr. Pous had to make three other flow-through adjustments that effected: payroll taxes, depreciation, and property taxes. Mr. Pous made these adjustments to comply with the matching principal. As shown in his Schedule JP-3 they add up to an additional $2,223,981 of flow-through adjustments, for a total reduction of $26 million to the revenue requirement.

2. Overtime Expense

Oncor revenue requirement for overtime included $21,980,303.[64] Overtime is an expense that can vary year to year and it is therefore necessary to normalize any unusual results for ratemaking purposes. Because rates are set for future implementation, it is necessary to ensure that the level of expenses in a given year are what can be normally expected to occur – and hence

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[62] *Id.* at 86:3-5.

[63] *Id.* at 86:11-89:15.

[64] *Id.* at 84:10.

recovered through rates – that that the utility is less likely to either over-revere or under-recover its expenses going forward. For example, the utility may have experienced a catastrophic event in the test year, but which represents an event not likely to be repeated year-in and year-out. To ensure that any such aberrations are not included in base rates as a continuing expenses, those abnormal expenses are "normalized" to a level more reflective of a more usual level of expenses. Oncor's test year overtime expense was significantly higher than recent years. For ratemaking purposes it is better to assess the last three years of overtime expenses. Averaging the last three years produces a number that is more likely to be in keeping with Oncor's overtime expense going forward. Based on this assessment, Mr. Pous recommends an overtime expense of $20,049,954, or a $1,930,349 reduction to Oncor's request.

B. Pension and OPEB Expense

ATOC reserves its right to address this issue in its Reply Brief.

C. Self-Insurance Reserve

An electric utility can submit a self-insurance plan to the Commission for approval, who then determines if the plan is in the public interest. In order to establish that the plan is in the public interest the "utility must present a cost benefit analysis performed by an independent insurance consultant who demonstrates that, with consideration of all costs, self-insurance is a lower cost alternative than commercial insurance and the ratepayers will receive the benefits of the self insurance plan."[65] In particular, the cost benefit analysis must consist of three components. It needs to "present a detailed analysis of the appropriate limits of self insurance, an analysis of the appropriate annual accruals to build a reserve account for self insurance, and

[65] PURA § 25.231(G).

the level at which further accruals should be decreased or terminated."[66]

Oncor's self-insurance plan proposes to dramatically increase the annual self-insurance accrual by $51,832,590 to $57,107,000 from the $5,274,410 approved in 2001.[67] Oncor's justification for this enormous increase is presented in the cost-benefit analysis testimony provided by two Company witnesses, Robert N. Hughes and Jeanne H. Camp. Although ATOC does not contest the merits of having a self-insurance plan (or support it), ATOC does believe that Oncor's level of annual self-insurance accrual is excessive, unreasonable and should be rejected. A more appropriate level of $14,500,000 as proposed by ATOC witness Jack Pous should be approved. Mr. Pous' number is based on Oncor's actual historical needs. Mr. Pous took all the data provided by the Company, normalized it by removing some of the most extreme events, which are unlikely to be repeated, and came away with an appropriate funding level. Mr. Pous' number allows the company to triple their catastrophic reserve, but does not unnecessarily burden ratepayers with an unsupportable accrual amount.

Additionally, Oncor has acquired a self-insurance deficit balance over the past 13 years of $146,172,428 and wants to amortize the balance over five years. Company witness Mr. R. Keith Pruett's proposed amortization, results in an additional $28,834,485 in revenue requirements annually. Mr. Pruett's proposed amortization period is too short and should be increased to 10 years to better match the period over which the amortized amount will be recovered through rate, to the length of time it took Oncor to arrive at this balance. When combined, Oncor's proposed annual accrual amount and the amortization of the deficit, account for $85,941,485 in revenue requirements. This increase is not supported by the preponderance of the evidence and should be rejected.

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[66] *Id.*

[67] *Application of TXU Electric Company for Approval of Unbundled Cost of Service Rate Pursuant to PURA § 39.201 and Public Utility Commission Substantive Rule § 25.344*, Docket No. 22350 (March 31, 2000).

1. Recovery of Test-Year-End Deficit

a) Liability Charges

ATOC reserves its right to address this issue in its Reply Brief.

b) Amortization Period

Oncor's suggested amortization period of 5 years for recovery of its self-insurance deficit is improperly short and should be increased to 10 years. As pointed out by Company witnesses Ms. Camp and Mr. Pruett, Oncor built up its self-insurance balance over the period of 13 years. If Oncor were allowed to amortize its deficit over only five years it would contravene the ratemaking principle of reasonableness by burdening ratepayers at a much greater rate and over a shorter time than the deficit was acquired.[68]

When analyzing self-insurance accrual and in particular amortization of self-insurance deficits, it is important to think about the relative impact on particular ratepayers versus the Company. Under ATOC's proposal Oncor will still be allowed to recover the over $140 million dollar deficit. The only modification ATOC recommends, as well as several parties, is that the recovery period be spread out on a timeline more in keeping with how the deficit balance actually grew. Oncor will still recover the entirety of its balance. Ratepayers on the other hand may have to share a larger or smaller share of the burden based on a variety of factors beyond their control. A defined pool of ratepayers (some for the entire time period and others partially) over the last 13 years leading up to the test year "ran-up" the self-insurance balance. Going forward this balance must be paid for by another set of ratepayers. Although there will obviously be some overlap in the two distinct groups of ratepayers, there will be many ratepayers who were not responsible for any of the deficit and some that were only partially responsible. Nevertheless the balance has to be paid, but there is flexibility over the time frame of payment.

[68] ATOC Exh. 2 at 83.

When Oncor shortens the recovery period to only five years it is artificially and unnecessarily placing a much higher burden on a smaller pool of ratepayers. If instead Oncor lengthens it to a minimum of ten years Oncor will allow a larger group of ratepayers to more equitably shoulder the burden of the 13-year deficit. The ten- year timeframe from a ratemaking perspective better achieves the balance of interests between the ratepayers and Oncor's shareholders and is therefore more reasonable and should be approved.

2. Threshold Level for Charges to the Self-Insurance Reserve

ATOC reserves its right to address this issue in its Reply Brief.

3. Annual Accruals for Future Losses

Oncor's self-insurance plan improperly proposes to increase the annual self-insurance accrual to $57,107,000 from the $5,274,410 approved in 2001. This unjustified increase should be rejected and Mr. Pous' recommendation of $14,500,000 should be approved. As pointed out in Mr. Pous' testimony Oncor's "request is based on a limited database that contains an unreasonable level of severe storms."[69] Additionally, the study endorsed by Mr. Hughes and Ms. Camp relies "on a value much higher than the expected mean loss level" which "produces unrealistic level of revenue requirements."[70] In fact, Oncor's database only includes 15 years of data, 1993 thorough 2007.[71]

This timeframe is unusually short for assessing weather related events and does not give an accurate picture of long-term weather patterns, which Oncor relied on when determining its annual accrual number. A more common time period used for comparison purposes is 30-

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[69] ATOC Exh. 2 at 76.

[70] *Id.*

[71] *Id.*

years.[72] Besides using too small of a sample of years, Oncor also included storm events in its database that were compared to "100-year" and "500-year" events.[73] These highly unusual events combined with a limited database inappropriately skewed Oncor's analysis. As pointed out in Mr. Pous' testimony there are many potential problems if an inappropriate historical time frame is relied upon for statistical analysis. In Mr. Pous' analysis he posited that if an analysis was "performed to project the frequency and severity of hurricanes that might strike Florida in any given year, and 2004 were selected as the historical database, a false and excessive projection would be produced."[74] 2004 was the only time in recorded history that 4 major hurricanes impacted Florida.[75] Although Oncor used more than one year for its database it still inappropriately relies on unrealistic weather events to form the basis of its recommended annual accrual amount.

Despite stating that "three or four of the worst storms in the company's history [occurred] in the last three years" the company made no effort to normalize or modify its actuarial database to create more accurate and realistic results.[76] This might be understandable if Oncor did not normalize its actuarial database elsewhere in its filed rate case. However, in performing his depreciation analysis Oncor Witness Dane A. Watson eliminated "outliers and unusual historical occurrences prior to performing his actuarial or semi-actuarial analyses."[77] In fact, Oncor's self-insurance actuarial results are unreasonable on their face. Oncor's proposal "exceeds every single actual annual level experienced for the past 15 years" and that is even including "three or

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[72] *Id.* at77.

[73] ATOC Exh. 14 (Oncor's Response to ATOC 3-04).

[74] *Id.*

[75] *Id.*

[76] ATOC Exh. 11 (Oncor's Response to ATOC's 3-05).

[77] ATOC Exh. 2 at 78.

four of the worst storm in Company history and 2 different 100 years storms."[78] If these extreme weather events still did not reach the proposed level of self-insurance, then Company's request necessarily has to be excessive. It also has to be taken into consideration that this is an annual accrual amount. As explained in the following chart from Mr. Pous' testimony "if the Company's request had been discounted at its proposed 3.5% trend factor back to 1993, the Company's request would have resulted in a $383 million surplus.[79]

Table 4

Resulting Balance In Self-Insurance Fund With Oncor's Proposal

Year	Oncor Proposal	Discounted Proposal	Storm Charges	Reserve Balance
2007	$57,107,000	$53,309,996	$53,865,856	($555,860)
2006	$57,107,000	$51,507,242	$32,611,865	$18,895,377
2005	$57,107,000	$49,765,451	$24,277,977	$25,487,474
2004	$57,107,000	$48,082,562	$50,352,621	($2,270,059)
2003	$57,107,000	$46,456,581	$10,799,231	$35,657,350
2002	$57,107,000	$44,885,586	$13,606,642	$31,278,944
2001	$57,107,000	$43,367,716	$18,687,279	$24,680,437
2000	$57,107,000	$41,901,175	$3,790,857	$38,110,318
1999	$57,107,000	$40,484,227	$11,045,425	$29,438,802
1998	$57,107,000	$39,115,195	$7,709,998	$31,405,197
1997	$57,107,000	$37,792,459	$5,984,529	$31,807,930
1996	$57,107,000	$36,514,453	$8,907,849	$27,606,604
1995	$57,107,000	$35,279,665	$6,920,033	$28,359,632
1994	$57,107,000	$34,086,633	$1,849,141	$32,237,492
1993	$57,107,000	$32,933,945	$1,653,662	$31,280,283
Total			$252,062,965	$383,419,918

Mr. Pous recommends a more appropriate and reasonable $14.5 million dollar annual accrual level. Mr. Pous arrived at this figure by "summing the actual claimed expenses the Company incurred over the past 15 years."[80] He then normalized those results by removing two highly unusual and unlikely to be repeated storm events. Even with removing these two events,

[78] *Id.* at 79.

[79] *Id.* at 80.

[80] *Id.* at 81.

Mr. Pous left in a second "100 year storm and possibly one of the 'three or four worst storms' in the Company's history." By leaving these highly unusual storms in the database Mr. Pous' numbers are actually very generous towards the Company. He continued his conservative analysis by utilizing the Company's proposed 3.5% loss trend rate even though he believed it to be excessive.[81] He limited the escalation period to the test year, 2007, and as shown in his schedule, JP-2, the annual self-insurance number he arrived at was $14,437,333, which he rounded up to $14.5 million.[82]

Mr. Pous' results and technique are more in keeping with the most recent Commission precedent on self-insurance than Oncor's testimony. Despite that, Mr. Hughes and Ms. Camp both take issue with Mr. Pous' averaging of past losses and normalization of the database. They argue that Mr. Pous' analysis is not consistent with actuarial science principles. Whether or not that claim is true, is not nearly as important as what the Commission has determined is most appropriate in the past. The last fully litigated rate case to deal with this is was Docket No. 33309.[83] In that docket AEP Texas Central Company (AEP TCC) was the only party that presented an actuarial analysis to determine the appropriate level of annual self-insurance accrual. Despite being the only party to submit an actuarial analysis of the database, the Commission did not endorse the numbers or technique offered by AEP TCC. The Commission instead chose a number that was in keeping with AEP TCC's historic losses over the previous ten years and greatly reduced AEP TCC's request.[84] In fact the numbers that Mr. Pous arrives at are more in keeping with the most recent Commission precedent on self-insurance than Oncor's

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81 *Id.* at 82.

82 *Id.*

83 *Application of AEP Texas Central Company for Authority to Change Rate*, Docket No. 33309, Order on Rehearing (March 4, 2008).

84 *Id.* at 23.

testimony.

Whatever the merits of actuarial science in deciding on an appropriate level of annual accrual amounts, it should never trump the need for a reasonable ratemaking policy. By limiting their data pool and failing to normalize unusual occurrences Oncor's witnesses have arrived at a figure that is clearly inappropriate and inconsistent with Commission precedent. That is why when asked about Docket No. 33309, Mr. Hughes affirmed that he had not reviewed it when preparing this study or his testimony.[85]

ATOC recommends that the Commission use the modified average of the actual storm data that is presented in Mr. Pous' testimony. This would result in a $14.5 million annual accrual, which is nearly triple the amount Oncor is currently collecting. This allows Oncor a reasonable increase, in keeping with the available data, without allowing a smaller data pool and extreme weather events to unnecessarily skew the results.

4. Target Reserve Cap Amount

Traditionally the Company offers and ultimately the Commission approves a target reserve cap amount.[86] It is important to have a cap amount because if the estimates of future self-insurance needs are wildly off, it would be possible that year after year the Company would be building up a large, unnecessary surplus. However, in this case Oncor in its original filed case did not suggest a cap amount. Not until Mr. Hughes' rebuttal testimony did he even concede that a cap amount was acceptable and Ms. Camp never mentions it anywhere in her direct or rebuttal testimony.[87] Mr. Hughes stated that $90 million would be an acceptable cap

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85 Tr. at 2030:25-2031:4.

86 *See*, Docket No. 33309 (October 4, 2006) and *Application of Entergy Gulf States, Inc. for Authority to Change Rates and to Reconcile Fuel Cost*, Docket Bi. 34800 (September 9, 2006).

87 Direct Testimony of Robert N. Hughes, Oncor Exh. 46 at 7:21-24.

amount.[88] However, he fails to address where the number came from or how he arrived at that figure or why that number does not appear anywhere in Ms. Camp's testimony. Only upon cross-examination did he present any sort of rationalization for the figure, but he still conceded that there is no schedule that would show that figure, he did not perform an actuarial study to reach that number and nowhere in the record does it appear, other than that one line in his rebuttal testimony.[89]

He defended his lack of a cap amount by stating the proposed annual accrual amount acts as a natural cap. Even though he believes that Oncor "will not have a substantially positive or negative reserve balance from year-to-year" he still suggests a cap amount that is over $30 million more than Oncor's proposed annual accrual amount.[90] This amount does not hold up to scrutiny. If Mr. Hughes indeed believes that $57 million acts as a natural cap then it begs the question: Why is it not his actual cap amount? Instead he has offered a number that is substantially over his annual accrual amount, which indicates either a lack of faith regarding the accuracy of his natural cap number or an unsupportable arbitrariness in his figure. In either event, Oncor's cap amount of $90 million should be rejected.

D. Affiliate Transaction – EFH Corporate Services

ATOC reserves its right to address this issue in its Reply Brief.

E. Outsourced Business Processes (CGE Charges)

ATOC reserves its right to address this issue in its Reply Brief.

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[88] *Id.*

[89] Tr. at 2028:1-23.

[90] Oncor Exh. at 7:16-17.

1. CGE Relationship to Oncor

ATOC reserves its right to address this issue in its Reply Brief.

2. CGE Charges to Oncor

ATOC reserves its right to address this issue in its Reply Brief.

F. Energy Efficiency Expenses and Programs

ATOC reserves its right to address this issue in its Reply Brief.

1. Low-Income Weatherization

ATOC reserves its right to address this issue in its Reply Brief.

2. REAP

ATOC reserves its right to address this issue in its Reply Brief.

G. Depreciation Expense

As the ALJs heard throughout the hearing, this is one of the largest areas of expense in this case. The Company is seeking an adjusted level of depreciation expense of $411,307,796, which is an increase of $87,166,065 over existing rates.[91] Just to place that number in perspective, it exceeds the *entire* rate increase recently awarded by this Commission to Southwestern Public Service Company, ($23 million),[92] AEP Texas Central Company, ($29 million),[93] and AEP Texas North Company ($13.7 million)[94] ***combined.***

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91 ATOC Exh. 2 at 3.

92 *Application of Southwestern Public Service Company for Authority to Change Rates, Reconciliation of its Fuel Costs for 2004 and 2005; Authority to Revise the Semi Annual Formulae Originally Approved in Docket No. 27751 Used to Adjust its Fuel Factors; and Related Relief,* PUCT Docket No. 32766, Order, FOF 10 (July 27, 2007).

93 *Application of AEP Texas Central Company for Authority to Change Rates,* PUCT Docket No. 33309, Order on Rehearing at p. 2 (March 4, 2008).

94 *Application of AEP Texas North Company for Authority to Change Rates,* PUCT Docket No. 33310, Order, FOF 14 (May 29, 2007).

The late scientist Carl Sagan is frequently credited with the statement "Extraordinary claims require extraordinary proof."[95] And the rate cases listed above had volumes of testimony and exhibits to justify the amount of increase. This Commission may logically impose a significant burden of proof on a company that is seeking a significant level of recovery. With regard to depreciation, Oncor has not met its burden of proof, much less a significant burden; in fact, its basic case regarding depreciation is lacking in justification and support.

Depreciation is based on estimates of the future. "[T]he purpose of depreciation is to project or estimate the future retirement periods when assets are going to retire in the future."[96] However, "it's very hard to estimate the future."[97] As ATOC witness Pous summarized it, "There are very few things that we know with certainty in the future other than death and taxes."[98]

Because depreciation expense is built on estimates, as Oncor witness Watson put it, "the practice here is to be conservative. When a trend in net salvage is toward more negative removal costs, which would mean more expense, I'll moderate that trend. When the trend is toward lower removal costs, I'll extend the trend."[99] Thus, in this case, it is appropriate for the Commission to pick the conservative result, which translates into utilizing the longer average service lives supported by the record and lesser negative net salvage values.

A key factor that affects all of the Company's depreciation study is the use of "judgment." The Company itself recognized that judgment is "inextricably bound" in reaching

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95 http://www.quotedb.com/quotes/2789.

96 Tr. 490 (Watson cross).

97 Tr. 558 (Watson re-cross).

98 Tr. 890. (Pous cross).

99 Tr. 551 (Watson cross).

the results of a depreciation study.[100] There does not appear to be any dispute that each depreciation expert brings his or her own judgment to the process.

The concern that ATOC has in this case with Oncor's requested depreciation rates and with Mr. Watson's testimony, is the fact that the judgment exercised by Mr. Watson in reaching his recommendations cannot be rationally quantified or reproduced. Oncor claims that Mr. Watson's experience and interviews with Company employees provides him with insights that are "not reproducible or quantifiable on paper."[101] This was demonstrated at the hearing.

ATOC counsel attempted to have Mr. Watson explain how he calculated a negative net salvage value of 65% for account 356. The five-year average was negative 154%; the 13-year band was negative 136%.[102] According to Mr. Watson, he looked at the data and found the "floor,"[103] even though he did not reveal in his testimony that he was using this "floor" methodology.[104] There was little rationale as to which number was picked. The estimate could have been 75%.[105] On the stand, Mr. Watson pointed to a 62% result from a two-year band.[106] When asked if someone else could calculate the 65% number, he finally conceded, "Not specifically, I guess."[107] Mr. Watson's approach to selecting asset lives and net salvage values for Oncor's assets is riddled with the very element he contends to eschew. Mr. Watson went on at length on all the factors necessary to support an informed judgment:

> The first factor is looking at the historical data and understanding what's happening within the history. To develop an informed judgment, to make a selection from that historical information, I would interview company officials,

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100 ATOC Exh. 15 at 2.

101 *Id.* at 3.

102 Oncor Exh. 16, Exhibit DAW-2 at 58.

103 Tr. 508 (Watson Cross).

104 Tr. 509 (Watson Cross).

105 *Id.*

106 Tr. 511 (Watson Cross).

107 Tr. 515 (Watson Cross).

> validate what they're saying against my own experience and understanding and then use that to validate either what's happening in the historical data or to understand they're not matching and more examination needs to be made of the data in order to make an informed judgment on the future expectations for that account. ...
>
> The Company experts provided information to me. Generally it was of a factual nature, and ... I would not use that information without validating it against both the historical data that's in the Company and my judgment and experience from using – doing depreciation studies for 24 years. ...
>
> All depreciation text (*sic*) require [some measure of reliance on Company input in order to develop] to be part of a study in order to accurately project what's in the future. ***Because otherwise you get a black box concept where you feed stuff in and you get something out, and you don't really know if it's right or not or representative of the future.***[108]

In the end, however, Mr. Watson presents what is in effect a "black box" of how he exercised his judgment. That this is the case is borne out by ATOC Exhibits 30 through 47, where Oncor's responses to requests for information (RFIs) requesting details to support Mr. Watson's proposals, are but cross-references to Mr. Watson's pre-filed direct testimony – the very testimony that prompted the RFI.

As will be developed later in this Brief, Mr. Watson's use of unexplained and unquantifiable "judgment" did not just occur in account 356. The problem this poses the Commission is that it must take Mr. Watson's conclusions on faith. This is not an appropriate way to use judgment in a depreciation study. As Mr. Pous explained on the stand:

> Okay. Judgment by itself can mean anything. You have to have some kind of boundaries, explanations, details, something to define what the judgment is and what -- how it was used and what result transpired. Just simply saying, "It's my judgment that a net salvage amount of X is appropriate" without basing it on the facts or giving some indication is inappropriate, especially if in data requests the company was asked to provide a step-by-step basis of how they use that judgment to get to their final result, and that information was not provided.[109]

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[108] Tr. at 2546-2547 (Watson Cross on Rebuttal).

[109] Tr. 988 (Pous Redirect).

This statement on the stand is reflective of Mr. Pous' general position with regard to the use of unexplained "judgment:"

> This is again precisely why generalized statements claiming judgment and experience, or information provided by Company personnel, or other unsubstantiated statements, should not be given credence automatically. The Commission and customers deserve an explanation as to why Mr. Watson is proposing a negative 10% for investment in Account 366 for SPS while he is proposing a negative 50% in this proceeding. Granted each Company is different; however, simply stating that a Company is different and that comparisons are inappropriate negates any claim by Mr. Watson for his ability to rely on experience and judgment if such experience is not somewhat indicative of the industry.[110]

In evaluating the judgment applied by a depreciation expert, it is also necessary to take into account his experience and his biases. Company witness Watson is a consummate Company man. He graduated college in 1985[111] and went immediately to work for Texas Utilities,[112] the predecessor of Oncor. He stayed at TXU until 2004,[113] when he opened his own consulting shop. He has been producing depreciation studies for the Company since 1991.[114] He has prepared testimony for "eight or ten" other electric utilities.[115] It does not appear that he has ever been a witness for anyone *other* than a utility.

ATOC witness Pous also started with a utility – Kansas City Power and Light Co. – after his graduation from college.[116] In 1976, he joined R.W. Beck and Associates and performed "predominantly utility work."[117] In 1986, he co-founded Diversified Utility Consultants, Inc.[118] He is registered to practice as a professional engineer in Florida, Texas, Mississippi, North

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110 ATOC Exh. 2 at 41.

111 Oncor Exh. 15 at 2.

112 *Id.* at 3.

113 *Id.*

114 ATOC Exh. 7.

115 Tr. 477 (Watson Cross).

116 ATOC Exh. 2, Appendix A at 1.

117 *Id.*

118 *Id.*

Carolina, Arizona, New Mexico, Arkansas and Oklahoma.[119] He has been involved in over 300 utility rate proceedings, with depreciation being the subject of at least part of his testimony in approximately 120 of those cases.[120] He has testified on behalf of the Staff of five different regulatory Commissions.[121] In other words, he has presented testimony on behalf of utilities, intervenors and Staff.

Staff witness Nara V. Srinivasa has been with the Commission since 1990.[122] He is a registered professional engineer in Texas and has 30 plus years experience in various aspects of engineering and management.[123] He has filed direct testimony regarding the depreciation of electric utility assets in three cases (counting this case) and has worked on depreciation related issues in several other cases.[124] As a member of the Staff, Mr. Srinivasa had the opportunity to review both the intervenor testimony and the Company testimony before filing his own. Traditionally, Staff witnesses provide their independent analysis of the facts without representing any particular stakeholder bias and have therefore been given great credibility by ALJs and Commissioners.

This case also raised issues regarding the use of depreciation statistics from other utilities, how much reliance to place on utility average numbers, the appropriate treatment of reimbursed retirements and the overall reasonableness of results of the expert's depreciation. Those issues apply predominantly to the issues relating to net salvage, and will be discussed in that section of this brief.

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[119] *Id.*

[120] *See* ATOC Exh. 2, Appendix A, at 2- 11.

[121] ATOC Exh. 2 at 2.

[122] Direct Testimony of Nara V. Srinivasa, PUCT Staff Exh. 8 at 1.

[123] *Id.* at 2.

[124] *Id.* at 2 – 3.

1. Service Lives

At issue in this case are the Service Lives of various accounts and the Net Salvage level of certain accounts. With regard to Service Lives, the objective is to determine the Average Service Life, the dispersion pattern and the remaining life for each account or subaccount.[125] The Average Service Life can be determined through an "actuarial" analysis, which uses aged data of actual property whose retirement age is known,[126] or "semi-actuarial" analysis, which is used when the age of the plant that is being retired is not known.[127] Oncor used the actuarial analysis method for transmission plant and one distribution plant.[128] As Oncor witness Watson explained, the actuarial method "has a lot more information. It's a lot more able to delve into the individual pieces of the history."[129]

For accounts where such data was not available, the Company used the Simulated Plant Records ("SPR") method for determining the remaining distribution plant.[130] The Company used a proprietary model to generate survivor curve shapes for each account from 1950 to 2007.[131] After the shapes were computed, Mr. Watson visually examined the curve fit and used his judgment to determine the proposed life parameter.[132]

ATOC is recommending adjustments to ten specific accounts:

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[125] ATOC Exh. 2 at 11.

[126] *Id.*

[127] *Id.* at 11 – 12.

[128] *Id.* at 12.

[129] Tr. 483 (Watson Cross).

[130] ATOC Exh. 2 at 12.

[131] Staff Exh. 8 at 24 – 25.

[132] *Id.* at 25.

Table 2

ACCOUNT DESCRIPTION	Oncor CURVE	Oncor LIFE	ATOC CURVE	ATOC LIFE
350 Transmission Land Rights	R3	70	R3	100
353 Transmission Substation Equipment	L0.5	46	L0.5	53
354 Transmission Towers & Fixtures	R3	60	R3	70
355 Transmission Poles, Towers & Fixtures	R2	50	R2.5	54
356 Transmission Overhead Conductor	R2	50	R2.5	56
362 Distribution Substations	R1	48	L1	54
364 Distribution Poles, Towers & Fixtures	R1	38	R0.5	41
365 Distribution Overhead Conductor	R1.5	37	R1	40
367 Distribution Underground Conductor	R1.5	34	R1	37
370 Distribution Conventional Meters	Amortz.	11	R5	38
370 Distribution BPL/PLC	Amortz.	11	R2	20

Source: ATOC Exh. 2 at 13.

Staff's revised testimony also proposed adjustments to Accounts 353, 354, 355 and 356, with 60 years supported for each account.[133]

a) Account 350 – Transmission Land Rights

The investment in this account represents land rights and easements associated with transmission line and transmission substations.[134] The notes taken by Mr. Watson for his study indicate that "The chance of getting more transmission corridors in the metroplex is very small."[135] Later, the same set of notes quotes Transmission engineers as saying "The primary way to get new capacity into the metroplex is to re-build existing lines."[136] As Mr. Pous explained, "Given the difficulty in obtaining new transmission right of ways, the existing land rights and easements will be used and reused in association with upgraded or replacement

[133] Staff Exh. 8 at 35.

[134] ATOC Exh. 2 at 14.

[135] ATOC Exh. 11 at 6.

[136] *Id.* at 20.

facilities."[137] Furthermore, the Company's response to an ATOC RFI acknowledges that "none of the Oncor transmission easements have an expiration date with the exception of easements from the University of Texas, the General Land Office and perhaps a few other isolated easements executed over decades of time."[138]

The Company is proposing to retain the 70 year life of this account because there is "insufficient data" to justify a change.[139] This is inconsistent with the Company's treatment of other transmission assets, where the Company has recognized much longer lives than in the past.[140] It is illogical to assume that equipment will last longer than the easements on which the equipment sits. The survivor curves for several assets will extend for more than 100 years.[141] Therefore, it is logical and conservative to adopt a 100-year ASL, while retaining the R3 dispersion pattern.[142]

As discussed more below (with regard to calculation of net salvage), Oncor vigorously opposes the use of data from other utilities as a means of comparing Oncor's depreciation results with other industry participants.[143] However, for *this* account, Mr. Watson claims it is unfair to establish a longer life for this account than is approved for AEP or Entergy.[144] Mr. Watson also points out that Southern California Edison has a 60-year life for this account,[145] and Mr. Pous recommended a 70-year life for SPS.[146]

What is most interesting about the Mr. Watson's arguments regarding this account is

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137 ATOC Exh. 2 at 14.

138 ATOC Exh. 33.

139 Oncor Exh.16, Exhibit DAW – 2 at 22.

140 ATOC Exh. 2 at 15.

141 *Id.*

142 *Id.*

143 Oncor Exh. 42 at 33 – 37.

144 *Id.* at 45.

145 *Id.*

146 *Id.* at 45 – 46.

what they do *not* say. They do not say they will not use the rights of way for up to 100 years. They do not dispute the fact that some transmission equipment has lives that extend well beyond a 100 years. It is reasonable for the Commission to find, therefore, that for this particular utility, this particular account justifies a 100-year life.

In this particular instance, appeals to the results for other utilities should be unavailing. As Mr. Watson urges, "Each utility is unique."[147] There is no indication in this record as to the service lives of the transmission assets for those other utilities. It may well be that the assets of those companies will not last for over 100 years. It may well be that they operate in areas where there are alternative transmission corridors and some easements will not need to be used. They may have transmission easements that have expiration dates. However, for Texas, for Oncor, the evidence in this case is that such equipment will be used and there will be strong reasons to keep the existing rights of way as long as possible and most easements will not expire. Therefore, this Commission should adopt the 100-year ASL advocated by Mr. Pous.

b) Account 353 – Transmission Substation Equipment

In order to calculate average service lives, depreciation experts use survivor curves, with the Iowa survivor curves (developed at Iowa State University) being the curves most used in utility depreciation.[148] Account 353 is one of the accounts for which the Company used an actuarial analysis, so the primary question is which Iowa curves "fit" the data better. The first step is the creation of curves showing actual data, which some analysts ignore portions of the results.[149] As Mr. Watson testified, picking the appropriate Iowa curve involves the judgment of

[147] Oncor Exh. 42 at 34.

[148] Staff Exh. 8 at 17.

[149] Tr. 2461 (Watson Cross).

the expert.[150] As the record shows, experts also disagree as to the weight to be given to different bands.

Account 353 deals with transmission equipment.[151] With regard to Account 353, Mr. Pous examined the bands presented by the Company and determined that average service lives in the 53 to 55 year range with L0.5 Iowa Survivor Curves are a "better fit" than the Company's proposed 46-year life.[152] Based on this and other information, he recommended a 53-year life. He presented a chart that showed perfect coincidence of projected life and actual data to about the 40 percent level, with the rest of the proposed curve being very close to the actual data.[153] He also noted that the Company expects transformers – the largest component of this account – to last for more than 50 years.[154] Finally, he noted that Mr. Watson was proposing a 55-year life for this account in the Southwestern Public Service Company case, Docket No. 35763.[155]

On the stand, Mr. Watson agreed that if Mr. Pous plotted the same data in the same way as Mr. Watson, the charts should look the same.[156] He also acknowledged that looking at the longest bands supported a 50-year life,[157] and those bands contain "every available exposure and retirement."[158] Alternatively, Mr. Watson speculates, without support, that shorter experience bands are more representative.[159] Indeed, Mr. Watson would have the Commission believe that assets with proposed ASLs ranging from 46 to 60 years are better represented when only 5 years

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150 Tr. 2454 (Watson Cross).

151 ATOC Exh. 34.

152 ATOC Exh. 2 at 17.

153 *Id.*

154 *Id.*

155 *Id.* at 18.

156 Tr. 2479 (Watson Cross).

157 Tr. 2480 (Watson Cross).

158 Tr. 2479 (Watson Cross).

159 Oncor Exh. 42 at 49.

of activity is analyzed versus an analysis of the full data.[160] There is no evidence that the limited activity during 2002 through 2007, only 5 years, is more representative than the mortality characteristics exhibited over a more extended period. In fact, the ASL for the plant in this account is much shorter that the average life expectancy for humans in the United States, yet it would be illogical to assume that life insurance companies base their premiums on the mortality characteristics experienced by humans during a period as short as 5-years. Long periods or more robust data, produce more reliable Service Life results and are less likely to be artificially skewed by non-representative activity that can materialize in short time frames.

With regard to the types of transmission equipment that are used in the field, Mr. Watson agreed that SPS used the same type of equipment "to some degree."[161] Given these facts, the Commission could and should find that the appropriate life for this account is Mr. Pous' recommended 53 years, with a L0.5 Iowa Survivor Curve.

c) Account 354 – Transmission Towers and Fixtures

The Company's depreciation study (DAW-2, p. 25) describes the subject of this account as steel transmission towers for voltages of 69 kV and above. The Company recommends a 60-year life with a R3 survivor curve. Mr. Pous finds that life to be "inadequate."[162] Looking at a placement band of 1900 to 2007 and an experience band of 1990 to 2007, Mr. Pous presents a graph that shows his recommended 70 years to be much closer to actual results than the Company's 60-year proposal.[163] Furthermore, Mr. Watson recommended a 75-year life for the same account in the SPS case.[164] There is therefore substantial evidence to support a

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[160] *Id.* at 50.

[161] Tr. 2480 (Watson Cross).

[162] *Id.*

[163] *Id.* at 19.

[164] *Id.*

Commission finding of 70 years with an R3 curve.

d) Account 355 – Transmission Poles, Towers and Fixtures

The Company is proposing a 50-year ASL with a corresponding R2 Iowa survivor curve. Mr. Pous describes such a life as "artificially short" and recommends a 54-year ASL with a R2.5 survivor curve.[165] Mr. Pous included a graph that showed his recommended 54-year life as being much closer to the actual Oncor experience than the Company's 50-year proposal.[166]

It is difficult for laymen to judge the "fit" of various survivor curves. However, an examination of the curves presented in ATOC Exh. 38 for this account can be instructive. Pages 349 through 355 compare various curves to the actual data for vintage 1900 – 2007, and activity years 2002 - 2007. The first chart, on page 349, shows a R2 45.00. The two curves mirror each other down to about the 60% surviving level and the 40-year level, but then diverge. Just looking at this chart, it would be hard for a layman to agree to a R2 45.00, unless all of the other charts showed greater divergence. Looking through these charts showing 1900 – 2007, and activity 2002 - 2007, the largest mirroring of Iowa curve and actual data appears to be the S1 50.00 chart on page 355. Looking at the vintage 1900 – 2007, activity years 1990 – 2007 (pages 356 – 363), the longest mirroring appears to be the S1 60.00 on page 363. As we look through vintage 1900 – 2007, activity years 1998 – 2007, (pages 364 – 370), the R2 53.00 (page 366) and R2 55.00 appear to show the longest period of mirroring. Similar convergence shows up on the vintage 1955-2007, activity years 1990-2007 for the R2 55.00 (page 382) and the S1 57.00 (page 383). Shorter vintages/activity years show convergence between a number of Iowa curves and the actual data.

Looking at these various bands, it is possible for a layman to conclude the answer is

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[165] ATOC Exh. 2 at 20.

[166] *Id.* at 21.

somewhere *around* 50 to 60 years, with some convergence around 53 to 55 years and somewhere *around* R2 or S1. Moreover, the same discussion regarding Mr. Watson's unsupported reliance on shorter bands noted for Account 353 is equally applicable here. Mr. Pous, with his experience in over 120 cases relating to depreciation, has justified 54 years and an R 2.5 survivor curve. Such a recommendation is certainly justified by the curves presented in ATOC Exh. 38 and should be adopted by the Commission.

e) Account 356 – Transmission Overhead Conductors

The Company proposes a 50-year life with a R2 curve for this account, while Mr. Pous recommends a 56-year ASL with an R 2.5 curve.[167] Mr. Pous presents a chart showing his recommendation being much closer to the actual data than the curve recommended by the Company.[168] He also stated that his recommendation was based on actuarial results for the 5-, 10- and 18-year experience bands, which not only coincide with the Company's testimony that the more recent bands should be used for this account, but also coincide with longer experience-band results.[169]

This account was the subject of cross for Mr. Watson. At issue was the chart in his rebuttal testimony for this account:

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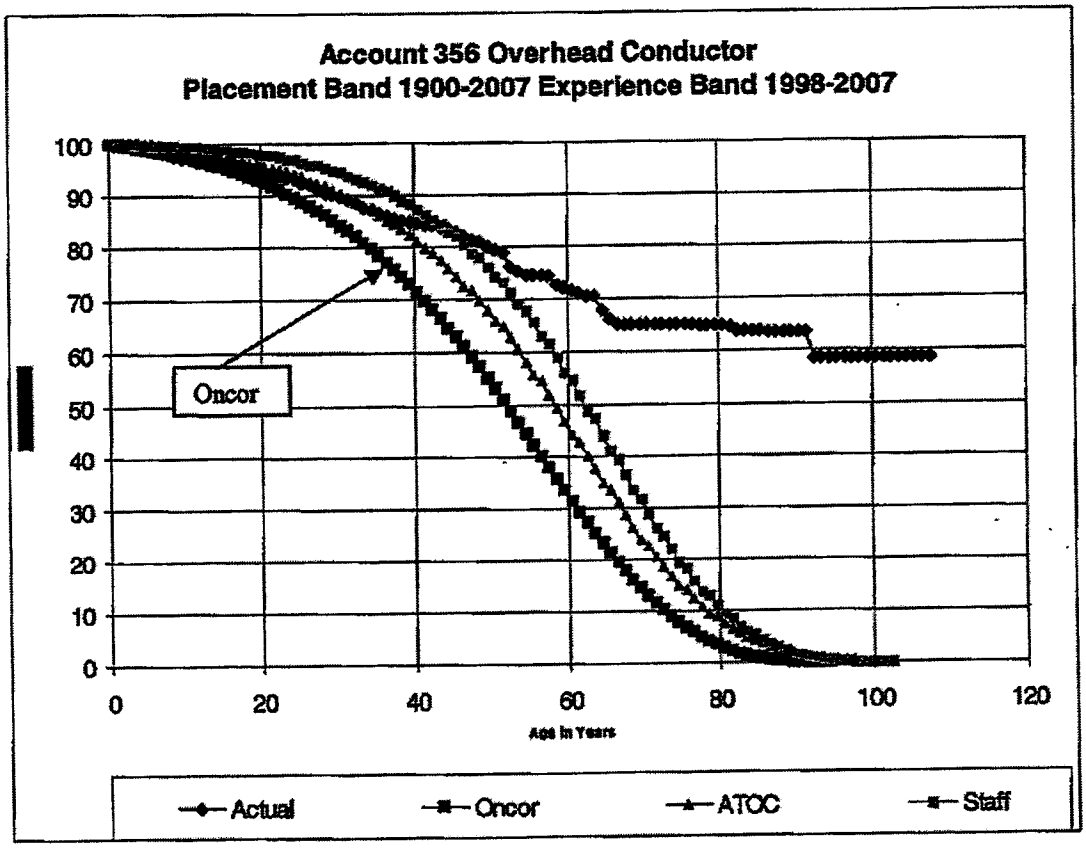
[167] ATOC Exh. 2 at 22.

[168] *Id.* at 23.

[169] *Id.* at 22.



SOURCE: Oncor Exh. 42 at 61

As Mr. Watson testified (with some understatement), the actual data is the line "that doesn't look like the other three."[170] The point of divergence is "the beginning of the stub of the curve of the observed life table."[171] What *can* be said about this table is that the ATOC recommendation (shown as a line of triangles) has the closest correspondence for the longest period of time. Mr. Watson's rebuttal presents another chart that also has actual data that does not look like the other three curves.[172] In this chart, the "beginning of the stub" starts earlier and wanders through both the ATOC recommendation and the Staff recommendation. For a chart showing a shorter period (placement band 1955 – 2007, experience band 2002 – 2007), the

[170] Tr. 2458 (Watson Cross).

[171] *Id.*

[172] Oncor Exh. 42 at 62.

actual data weaves its way through all of the recommendations in a less dramatic fashion.[173]

Boiled to its essence, the Oncor case seems to be that there is some data that supports ATOC, some data that supports the Staff and some data that supports Oncor. Oncor would (of course) place the greatest weight upon the data that supports its conclusion, the short 5-year experience band. As previously noted, the shorter the experience bands, the greater tendency for skewed results. In fact, the Company provides no evidence of why it "expects" more recent data to be indicative of future mortality characteristics.[174]. It is possible to conclude from the charts that unruly actual data does not always "fit" the purity of Iowa curves, thus reinforcing the need to rely on a more robust or longer experience bands to help stabilize the data. Mr. Pous' recommendation of 56 years represents a middle ground between the Company's 50 years and the Staff's 60 years. It is supported by his decades of experience on behalf of utilities, intervenors and Commission staff. Under the circumstances, the Commission should adopt Mr. Pous' recommendation.

f) Account 362 – Distribution Substations

The Company seeks to extend the ASL on this account from 40 years to 48 years and change the dispersion pattern from R2 to R1.[175] Mr. Pous recommends an ASL of 54 years with a L1 curve. As his testimony demonstrates through charts, the 5-, 10- and 15-year experience bands show 54, 52 and 54 ASLs as being "excellent fitting depreciation patterns."[176] He also notes that other results indicate even longer ASLs in the 55- to 60-year range.[177] He notes that this recommendation matches the increase in Account 353 and that Mr. Watson is recommending

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[173] *Id.*

[174] Oncor Exh. 16 at 27. See also, ATOC Exhs. 30 through 47.

[175] ATOC Exh. 2 at 23.

[176] *Id.* at 24.

[177] *Id.*

a 54-year life in the SPS case.[178]

Even Mr. Watson had to concede that the ATOC recommendation does "match well for all the bands."[179] This fact is borne out by ATOC Exh. 39, which contains various Company-run charts for this account. Even a layman observer can recognize the close correlation shown on page 599 for the L1 55.00 curve for vintage 1900-2007, activity years 2002 – 2007. Similar close fits show up for 50 years on page 603, 65 years for page 607, 62 years for page 613, and the near-perfect convergence for 54 years on page 622. There is also an easily-seen convergence for the L1 65 on page 631 and the L1 60 on page 641.

Mr. Pous' recommendation does more than "match well" the evidence presented – it is clearly a *better* match than that proposed by the Company, across multiple vintages and multiple activity years. The Commission should adopt Mr. Pous' recommendation of 54 years with a L1 dispersion pattern.

g) Account 364 – Distribution Poles, Towers and Fixtures

This account is the first account discussed in this Brief that uses the Simulated Plant Records ("SPR") method for determining the appropriate average service life. As noted above, Oncor uses a proprietary program to compute the SPR. The program "calculates the best life for each of the 28 Iowa Curves for each of the bands."[180] The product is "a number of bands, a number of curves and lives that are fairly close in rank."[181] ATOC Exh. 40, page 745 shows the results of one such computer run. The different curves are ranked by "Conformance Index" and "Retirement Experience Index."

The ranking of the "Conformance Index" used by depreciation experts was devised by

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[178] *Id.*

[179] Oncor Exh. 42 at 67.

[180] Tr. 499 (Watson Cross).

[181] *Id.*