Alex Bauhan of Iowa State University:

CI	Value
Over 75	Excellent
50 to 75	Good
25 to 50	Fair
Under 25	Poor

SOURCE: DAW -2, p. 13 – 14

Bauhan also proposed a scale for measuring the "Retirement Experience Index." The "REI" shows of the degree to which the Iowa Curve is used in calculating the data.[182] The scale for the REI is:

REI	Value
Over 75	Excellent
50 to 75	Good
33 to 50	Fair
17 to 33	Poor
Under 17	Valueless

SOURCE: DAW – 2 at 14

Thus, for Account 364, page 745 of ATOC Exh. 40 shows that, for 5 test points, the "R0.5" with an average service life of 46.7 had a Conformance Index of 188.14 and a REI of 91.76, which would constitute "excellent" results for both. However, the analysis does not end with the calculation of the highest CI or REI. According to Mr. Watson, a SPR analysis "requires a little more judgment" than an actuarial analysis:

> So you certainly want to look at ones that are ranked better or higher, but you don't necessarily pick the -- the highest or one that is on the extreme of the lives that are shown. You want to look at one that's -- that's ranked well. And if the Conformance Index is low, you want to take special care to make sure to factor in

[182] *Id.* at 500.

other factors to help you understand which one makes the most sense.[183]

This is as good a point as any to recognize that the Company and the Staff have significant dispute over the results of the Staff's analysis. ATOC is confident that the ALJs will be able to sort out the merits of the arguments. ATOC would note, however, that Oncor uses a proprietary software program, while the Staff uses a program that can be examined by outsiders. The Commission has rejected the use of proprietary models in the past where the results were unverifiable.[184] The Austin Court of Appeals upheld that determination.[185] If given a choice between a proprietary model and an open model, ATOC would urge the Commission to use the open model.

Turning to Account No. 364 – the Company proposes a 38-year ASL with a R1 dispersion pattern.[186] The Company recognizes that the CI values were in the "fair" to "poor" range for all but the shortest bands (e.g., 5, 10 and 15 years).[187] Furthermore, the SPR results were "too poor to rank."[188] Mr. Pous pointed out that this is a very large account, with approximately $1.2 billion dollars at the end of 2007.[189] Thus, even a small change in the ASL can have a dramatic impact.[190] Mr. Pous testified that the Company did not choose the best fitting pattern or recognize trends.[191] ATOC's witness thus recommended a 41-year ASL with a corresponding R0.5 dispersion pattern, while acknowledging that the 45-year ASL could be

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183 *Id.*

184 *In re Southwestern Public Service Co.*, PUCT Docket No. 14174, 21 Tex. P.U.C. Bull. 924, FOFs 66(a) – 66(e) (Tex. P.U.C. Mar 14, 1996)

185 *Southwestern Pub. Serv. Co. v. Public Util. Comm'n*, 962 S.W.2d 207, 219 (Tex. App.-Austin 1998, pet. denied).

186 ATOC Exh. 2 at 27.

187 *Id.*

188 *Id.*

189 *Id.*

190 *Id.*

191 *Id.* at 28.

"reasonable" and "appropriate."[192]

This is an instance where it is clear that Mr. Watson's proposal is not well supported by whatever portion of his wide range of analyses he chose to rely upon. Mr. Watson's rebuttal is no clearer than was his direct. In rebuttal, Mr. Watson claims that there is very little difference between the matches for Mr. Pous and the Company, but fails to provide any support or evidence for such claim.[193]

What is clear from Mr. Watson's rebuttal was that he did not refute the fact that Mr. Pous' recommendation was a better fitting result "in every single analysis performed."[194] Moreover, Mr. Watson's rebuttal disingenuously attempts to portray that even the "excellent" and "good" results referenced by Mr. Pous in his testimony as those which "an analyst should not place significant weight on".[195] First, one must wonder why an analyst would consistently run analyses that he would not place significant weight on and fail to explain such actions even when requested to do so in requests for information.

Next, keeping with his what appears to be his practice; Mr. Watson failed to present evidence to support his claim, undoubtedly because none exists. Mr. Watson continued his unsupported attack on Mr. Pous' recommendation by claiming that it was "one of the most extreme lives from the analysis."[196] This unsupported attack can easily be put into proper perspective by noting that Staff recommended an ASL only 1-year shorter than Mr. Pous' recommendation.

Finally, it is important to simply state what Mr. Watson position is: the results of the data

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[192] *Id.* at 29.

[193] Oncor Exh. 42 at 72.

[194] *Id.* and ATOC Exh. 2 at 28.

[195] Oncor Exh. 42 at 72.

[196] *Id.*

for this account do not match the actual experience well, but even though Mr. Pous' recommendation is based on better graphical and statistical results the Commission should adopt the Company's request based on unsupported claims.

Mr. Pous' recommendation is superior, as demonstrated by the Company's own computer runs and should be adopted.

h) Account 365 – Distribution Overhead Conductors

The Company proposes to extend the ASL of this asset from 34 to a 37-year level, as well as changing the dispersion pattern from a R.1 to a R1.5.[197] The justification for this particular pattern was that the CI was fair for all but the shortest bands and a low modal R curve was the best fit.[198] However, Mr. Pous examined the data and determined that a 40-year ASL with a R.1 pattern was "a better fitting statistical results for all analyses performed by the Company."[199] Mr. Pous also noted that Mr. Watson was recommending a 40-year life for this asset in the SPS proceeding.[200]

ATOC Exh. 41 provides all the data that are necessary to resolve this dispute. Starting at page 809, the results of the various runs are presented. For short periods (the 5- and 10-year runs) the R0.5 and the L0 in the 45- to 51-year range are ranked higher than the R.1. Thereafter, the R.1 is the second highest result for all runs and consistently has a higher CI than the Company's recommended R1.5. The ASL for the R.1 is also consistent – from 40.7 years for the 15-year run (page 811) to 39.5 years for 58 year run (page 819). The REI for all of the longer runs is 100, and never falls below the "excellent" range. Thus, the Company's own documents show that Mr. Pous has made a recommendation that is more supported than that of Mr. Watson,

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197 ATOC Exh. 2 at 29.

198 *Id.*

199 *Id.* at 30. Emphasis in original.

200 *Id.*

and the Commission should adopt a 40 year ASL with a R.1 dispersion pattern for this account.

2. Net Salvage

The calculation of net salvage amounts has been one of the more contentious sub-issues within the general depreciation issue. This is not surprising given that there are millions of dollars at stake for virtually every account. "Net salvage" is computed by first determining the value received for the sale, reuse or reimbursement of retired property – in other words, finding the "gross salvage value." The amount that is deducted from that amount is the cost of retiring such property, whether that retirement reflects demolition of the item or the accounting transaction for retiring the item in place (abandonment).[201] The Company proposes to divide the current cost of removal by the original installed cost of the asset.[202] The Company also says that inflation from the time of installation of the asset to the time of removal must be taken into account.[203] ATOC acknowledges that TIEC and the Steering Committee of Cities have questioned these practices. ATOC has not taken a position on these issues.

Mr. Watson calculated his net salvage values by taking retirement data from 1995 forward, calculating the net salvage for each year and also calculated the averages for two, three, four, and five years. Because historic costs are being divided in to the current cost of removal, some results have very large negative net salvage amounts. The chart for Account 356 is representative:

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[201] ATOC Exh. 2 at 33.

[202] DAW – 2 at 51.

[203] *Id.*

Year	Retirements (Dollars)	Gross Salvage	Removal Cost	Net Salvage	Percent Salvage	2-yr Net Salv. %	3-yr Net Salv. %	4-yr Net Salv. %	5-yr Net Salv. %
Account 356									
1995	7,290	57,208	63,321	(6,113)	-83.86%				
1996	52,149	67,521	113,527	(46,006)	-88.22%	-87.68%			
1997	87,526	0	85,123	(85,123)	-97.25%	-93.88%	-93.38%		
1998	169,749	0	74,601	(74,601)	-43.95%	-62.08%	-66.49%	-66.89%	
1999	515,130	0	562,102	(562,102)	-109.12%	-92.97%	-93.45%	-93.12%	-93.04%
2000	831,899	0	982,922	(982,922)	-118.15%	-114.70%	-106.78%	-106.26%	-105.69%
2001	1,055,244	0	503,567	(503,567)	-47.72%	-78.77%	-85.28%	-82.55%	-83.03%
2002	948,568	3,875	750,864	(746,990)	-78.75%	-62.41%	-78.76%	-83.43%	-81.53%
2003	1,332,528	36,492	2,572,789	(2,536,297)	-190.34%	-143.93%	-113.50%	-114.43%	-113.85%
2004	283,152	126,519	5,904,934	(5,778,415)	-2040.75%	-514.63%	-353.39%	-264.27%	-236.96%
2005	5,069,942	136,029	3,565,586	(3,429,557)	-67.64%	-172.01%	-175.66%	-163.62%	-149.55%
2006	1,953,534	38,800	2,637,206	(2,598,406)	-133.01%	-85.83%	-161.58%	-166.02%	-157.39%
2007	2,053,314	600,473	2,776,428	(2,175,955)	-105.97%	-119.16%	-90.38%	-149.38%	-154.49%

SOURCE: DAW – 2 at 58.

Thus, this chart demonstrates that in 1995, the Company retired assets with original book value of $7,290. It recovered $57,208 from that asset, but the cost of removal was $63,321. The net salvage was a negative number ($57,208 – $63, 321 = -$6,113). The net salvage (-$6,113) is divided by the original cost of the asset ($7,290) for a salvage value of a negative 83.86%. In some years, the costs and assets may be exceptionally atypical, which can result in the -2,040.75% value shown for 2004. As indicated earlier in this Brief, Mr. Watson looked at this display of numbers, applied his "judgment" and came up with a recommendation of negative 65%. The negative net salvage number is applied to all of the investment in an account, so the larger a negative net salvage number, the more that is charged to depreciation expense. Note that it is also possible to have "positive" net salvage if the amount for gross salvage exceeds removal costs. For each account in dispute in this proceeding, however, Oncor proposes a negative net salvage value.

The Company makes much of the fact that Mr. Watson uses Company-specific data and that data has been verified through "one of . . . the most thorough and comprehensive

examinations that I have seen in my over 24 years of experience."[204] The value of that "thorough and comprehensive examination" is greatly diluted first by the fact that the Company had to file an errata to recognize missed data, and more importantly by the fact that Mr. Watson looks at the data and then frequently applies his unquantifiable "judgment" to make a recommendation that cannot be replicated by any other observer.

a) Reliance on Averages

One of the flaws in Mr. Watson's depreciation study is that he generally relies on the raw averages of the data, without looking into the *underlying* data to see if the trends represented by the averages are representative of future trends. As Mr. Pous testified, "Mr. Watson has failed to reasonably explain what is reflected in historical data in order to establish the reasonableness of relying on such historical data as the basis for his proposals."[205] For the sum of money that is involved in depreciation (in excess of $400 million annually), the Commission should require the Company to examine and fully explain the nature of the historical data in detail.

As an example of what Mr. Watson and the Company *should* have done, Mr. Pous points to Account 366 – Distribution Underground Conduit. Mr. Watson takes the averages produced over the years at face value.[206] However, his *notes* show that the Company does not generally remove conduit when it is retired.[207] Mr. Watson apparently did not think this fact was significant, as he did not refer to it in his study or his proposal.[208] If Mr. Watson had investigated further, he would have found that the Company's investment in conduit constituted 46% of the investment in this account, while the data shows that only 14% of the historical

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[204] Oncor Exh. 42 at 9.

[205] ATOC Exh. 2 at 38.

[206] *Id.*

[207] ATOC Exh. 12.

[208] ATOC Exh. 2 at 39.

retirement activity in his study was associated with conduit.[209] As Mr. Pous reviewed these data, he concluded that "a well analyzed depreciation study would have concluded that the historical database significantly overstated negative net salvage due to the mismatch between the type of historical retirements versus the type of investment remaining in service."[210] As is noted in later sections of this brief, this flaw did not simply occur in Account 366 – it infected multiple accounts.

b) Guidance from Other Utility's Experience

Because of his experience in over 120 cases, Mr. Pous is aware of the depreciation practices of numerous utilities around the country. In preparing his testimony, he drew upon that experience. At several points in his testimony, he challenges Mr. Watson's conclusions because they are out of line with the conclusions contained in Mr. Watson's testimony regarding identical accounts in the SPS case. Mr. Pous also uses a publication produced by the American Gas Association ("AGA") and Edison Electric Institute ("EEI") titled "A Survey of Depreciation Statistics" as a check on the reasonableness of the net salvage rates recommended by Mr. Watson.

The Commission should expect experts to know what is happening in their field and to explain why their recommendations may exceed industry norms. In return on equity testimony, for example, it is common for experts of all stripes to note the allowed rates of returns for other utilities around the country. However, in this case, Company witness Watson has (a) claimed that the use of such comparisons are "simply not appropriate,"[211] but (b) has identified other

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[209] *Id.* at 40.

[210] *Id.* (emphasis in original).

[211] Oncor Exh. 42 at 34.

utilities that he thinks are more comparable to Oncor[212] and achieved a comfort level with higher net salvage values for Oncor on the basis that those companies had higher net salvage rates.

Mr. Watson's testimony in this case does not match what he has said and done through the rest of his career. For example, he was the author of the depreciation study used by Texas Utilities Electric Company (a predecessor to Oncor) in 1991.[213] In that study, he determined life characteristics for two different accounts based "on the range of industry experience for these accounts."[214]

In March of 2008, he filed testimony in New Mexico and cited the "industry average net salvage" using industry average information filed in a Public Service Company of Colorado case.[215]

In the SPS case, he agreed that he "referred" to the AGA/EEI survey to show "what was being suggested there was somewhere in the range" of that survey.[216]

Even in the case now before the Commission, he agreed he "reviewed" the AGA/EEI depreciation study because "it helps me in my familiarity with what's going -- going on across the industry."[217] This is borne out by ATOC Exh. 16, wherein Mr. Watson, the sponsoring witness of Oncor's response to ATOC RFI No. 3-07, stated, "Mr. Watson also reviewed the AGA-EEI Depreciation Accounting Survey. That item is a proprietary product of AGA-EEI that is not subject to disclosure."[218] In fact, industry survey data are also contained in the first attachment to ATOC Exh. 16, pages 3093 – 3096 that shows account-by-account data for several

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212 *Id.* at 36.

213 ATOC Exh. 7; Tr. 524 – 525.

214 ATOC Exh. 7 at 18 and 19; Tr. 526 and 527.

215 ATOC Exh. 6 at 26; *see also* Footnote 9 and "Attachment DAW-R2."

216 Tr. 516 (Watson Cross).

217 Tr. 520 (Watson Cross).

218 ATOC Exh. 16.

utilities. This was material that Mr. Watson apparently helped prepare. "[A]t the bottom, I note the source of the information that I used -- that was used to fill this out."[219] It is also worth noting that the utilities that Mr. Watson presented for comparative purposes in rebuttal are not in the utilities he reviewed when developing his proposals.

In short, the record shows that Mr. Watson uses, refers to, reviews and prepares materials that contain comparative industry data. It is not a "new factor" to be considered, as Mr. Watson would have the Commission believe.[220] It is a rational way to determine if the Company is outside of the range of the majority of its peers. If the Company *is* on the high end of its peers, or completely outside the norm, it is reasonable for this Commission to inquire into the reasons for that performance. Despite the Company's rhetoric to the contrary, this is all ATOC is trying to do when it notes the results for other utilities.[221]

c) Reimbursed Retirements

From time to time, the Company is paid to retire a plant in advance of the end of its useful life. This is known as a "reimbursed retirement." The Company does not treat such reimbursed retirements as reductions to net salvage for the retired plant, but "counts" the reimbursement as a contribution in aid of construction for new plant.[222] This is contrary to NARUC Instruction 67[223] and PUC Docket No. 11735.[224] The proper treatment of reimbursed

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219 Tr. 521 (Watson Cross).

220 Oncor Exh. 42 at 33.

221 In his rebuttal testimony, Mr. Watson attempted to draw comparisons between Oncor and two utilities in California and one in New York. As the record in this case showed there were major differences between those other companies and Oncor.

222 ATOC Exh. 2 at 42.

223 *Id.* at 43.

224 *Id. See Application of Texas Utilities Electric Company for Authority to Change Rates and Investigation of the General Counsel into the Accounting Practices of Texas Utilities Electric Company*, PUC Docket No. 11735, 20 Tex. PUC Bulletin 1029 (January 28, 1994) ("Docket No. 11735").

retirements is to classify it as gross salvage.[225]

There appears to be some dispute over the Commission's determination in Docket No. 11735. In that docket, Cities Witness Arndt testified that reimbursements should be included in the calculation of net salvage (thus leading to no salvage value), and General Counsel Witness Mr. Van Sickle agreed. Mr. Watson testified that there should be a negative 5% net salvage value. The PFD in that case ruled in favor of the Company's position on reimbursements. However, the Commission overturned the PFD and found in Finding of Fact 129B, "General Counsel and Cities' proposed salvage value of zero percent for TU Electric's transmission plant is reasonable."[226] In other words, the Commission considered the proper treatment of retirement reimbursements and adopted a position that such reimbursements *should* be considered as part of gross salvage, a position consistent with NARUC.

d) Overall Reasonableness of Results

In establishing the rates of a utility, this Commission is commanded to establish the utility's "*overall* revenues" at a level that will allow for a reasonable opportunity to recover reasonable and necessary operating expenses and earn a reasonable return.[227] It is therefore reasonable to look at the *overall* impact of a Company's request. In the case now before the Commission, the Company's net salvage proposals "produce annual revenue requirements as much as 6 times the highest reported historical amount and more than 10 times the historical average."[228] As Mr. Pous explained:

> For example, if Mr. Watson proposes a negative net salvage value for an account that is 5 to 10 times greater than the Company's highest level experienced, and is significantly more negative than what Mr. Watson is proposing for SPS for the

[225] ATOC Exh. 2 at 43.

[226] Docket No. 11735, FOF 129B.

[227] PURA § 36.051 (emphasis added).

[228] ATOC Exh. 2 at 37.

same investment, I believed the Commission and the customers are entitled to a detailed explanation and reconciliation. Again, simply stating that comparison between companies is not appropriate is not a valid answer.[229]

As this Commission considers each account listed below, it should note that Mr. Pous has consistently recommended amounts that *exceed the historical average* for almost all such accounts.[230] In other words, if predictions are made based on history, Mr. Pous has built in *more* than what a strictly historical review would warrant. The Company should not be heard to complain when it is recovering all of its historical average – and then some.

e) Staff Recommendations

Finally, there is one element that Mr. Pous could not capture in his testimony, as his testimony was filed prior to that of Staff. In several instances, Staff also agrees with Mr. Pous that the negative net salvage value proposed by the Company is too large. Staff's recommendations can provide another data point by which the overall reasonableness of the Company's net salvage number can be judged.

If the Commission recognizes that each of these concepts is reasonable – that historical averages must be tempered with a review of the true underlying data; that the amount of other utility's net salvage can be a useful check on excessive claims; that reimbursed retirements must be applied to net salvage; that a recovery that far exceeds historical averages is more than reasonable; and that the Staff analysis can provide additional guidance as to the reasonableness of the Company's claim – then it will be a fairly simple process to continue through each individual account and determine that Mr. Pous has the superior recommendation. Even if the Commission is skeptical as to one or more of these concepts, it must recognize that the Company has the burden to overcome *all* of the challenges to its proposal. ATOC is confident that the

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[229] *Id.* at 46.

[230] The exceptions involve historical data that may have an exceptional year.

Commission will find that the Company did not meet this burden.

With this background in mind, we can now turn to individual accounts.

f) Account 352 – Transmission Substation Structure and Improvements

The Company combines this account with Account 361 – Distribution Substation Structure and Improvements – and seeks an overall 50% net salvage value.[231] The Company bases this claim on the fact that the 13-year average yielded a negative 67% net salvage and the shorter-year results were even more negative.[232] Because the last several years have "some variability," Mr. Watson applies his judgment and recommends 50%.

The Company's statement that this account has "some variability" is a significant understatement. The underlying data can be found in the Depreciation Study:

Year	Retirements (Dollars)	Gross Salvage	Removal Cost	Net Salvage	Percent Salvage	2-yr Net Salv. %	3-yr Net Salv. %	4-yr Net Salv. %	5-yr Net Salv. %
Account 352 and 361									
1995	3,810	0	0	-	0.00%				
1996	82,394	0	0	-	0.00%	0.00%			
1997	15,391	0	1,068	(1,068)	-6.94%	-1.09%	-1.05%		
1998	0	0	449	(449)	NA	-9.86%	-1.55%	-1.49%	
1999	55,725	123	8,032	(2,909)	-5.22%	-6.03%	-6.22%	-2.88%	-2.81%
2000	23,455	0	1,189	(1,189)	-5.07%	-5.18%	-5.74%	-5.94%	-3.17%
2001	654	0	1,553	(1,553)	-237.46%	-11.37%	-7.08%	-7.64%	-7.53%
2002	1,195	0	2,658	(2,658)	-222.50%	-227.79%	-21.34%	-10.25%	-10.81%
2003	46,483	0	170	(170)	-0.37%	-5.93%	-9.06%	-7.76%	-6.65%
2004	231,188	0	110,491	(110,491)	-47.79%	-39.85%	-40.64%	-41.10%	-38.31%
2005	68,335	0	139,636	(139,636)	-204.34%	-83.51%	-72.34%	-72.86%	-73.16%
2006	300,793	0	193,545	(193,545)	-64.34%	-90.26%	-73.91%	-68.62%	-68.90%
2007	10,266	0	109,955	(109,955)	-1071.03%	-97.57%	-116.80%	-90.67%	-84.28%

SOURCE: DAW-2 at 54.

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[231] ATOC Exh. 2 at 47.

[232] *Id.* at 48.

Notice should be taken of the percentages under the "Percent Salvage" column. They range from -.37% to -1,071.03%. This is "some variability" indeed.

Mr. Pous criticizes the Company's negative 50% as "the most negative net salvage" of any utility with which he is familiar.[233] He notes that Mr. Watson is proposing a negative 20% for transmission and a negative 15% for distribution in the SPS case.[234] The AGA/EEI survey has results in the negative 5% range for both transmission and distribution.[235] Furthermore, an examination of the underlying data for this account shows significant levels of negative net salvage associated with yard improvements and surfaces.[236] This history is not indicative of the future, where the final retirements of such improvements and services is abandonment in place.[237] Because this account has more than "some" variability – in fact, the variability is "dramatic" - Mr. Pous questions Mr. Watson's reliance on this database.[238]

Based on these data points, Mr. Pous recommends a negative 10% for this account.[239] He notes that this result would leave the Company with over $200,000 a year – higher than any level experienced by the Company in the historical database.[240] The Commission can judge the reasonableness of this recommendation by looking at the chart reproduced above. A comparison of the numbers under the "Net Salvage" column with $200,000 Mr. Pous recommends quickly shows that Mr. Pous' recommendation would significantly exceed any single year's historical number. By contrast, Mr. Watson's recommendation would result in a number that is

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233 *Id.*
234 *Id.*
235 *Id.*
236 *Id.*
237 *Id.*
238 *Id.* at 49.
239 *Id.*
240 *Id.*

approximately ten times the highest level experienced in the identifiable database.[241] Taken in conjunction with Staff's recommendation of a negative 33% net salvage, it is clear that the Company's excessive proposal should be rejected.

g) Account 353 – Transmission Substation Equipment

The Company seeks a negative 15% net salvage for this account, based solely on the fact that the 10-year band yielded 15% while the 13-year band was only slightly less negative.[242] Mr. Pous criticizes the Company for relying on the "simple arithmetic average" without examining the underlying data.[243] When that data is examined, it becomes clear that the historical data is "skewed" because it understates the retirement activity of transformers and overstates the retirement activity of circuit breakers.[244]

Transformers can have low levels of net salvage or even positive salvage, depending on the market price of copper.[245] Circuit breakers, on the other hand, have little to no salvage value.[246] In the historic database examined by the Company, transformers only accounted for 14% of the retirement activity.[247] Thus, this history understates their importance, as they are 25% of the investment.[248] By contrast, circuit breakers represent 38% of the historic retirement but only 18% of the investment.[249] Mr. Pous also questioned whether the use of contract labor overstates the cost of removal.[250]

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241 *Id.*
242 *Id.* at 50.
243 *Id.*
244 *Id.*
245 *Id.*
246 *Id.*
247 *Id.*
248 *Id. See also* ATOC Exh. 6 and Exh. 7.
249 *Id.*
250 *Id.* at 50 – 51.

Mr. Pous recommends a negative 5% salvage.[251] This recommendation recognizes that in the future, the Company will reflect a higher level of retirement for transformers. The AGA/EEI survey average ranges between zero and a negative 5%.[252] Mr. Watson has recommended a negative 10% in the SPS case.[253] Recent historical data also includes electromechanical equipment (with high negative net salvage numbers), while the future will include the retirement of more transformers (which will yield lesser negative net salvage values or even possibly positive net salvage values).[254]

Mr. Pous' recommendation will result in the Company recovering approximately $1.6 million for this account each year, which is higher than the Company has experienced in the last five or ten years.[255] By contrast, the Company proposal would result in approximately 3.7 times the annual level of negative net salvage over the last ten years. When coupled with the fact that the Staff recommended a negative 13% net salvage value for this account, it is clear that the Commission should reject the Company's proposal.

h) Account 354 – Transmission Towers and Fixtures

This is one of the Accounts where Mr. Watson has applied his "judgment" to reach a result that cannot be reproduced. The data for this account show:

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[251] *Id.* at 51.

[252] *Id.*

[253] *Id.*

[254] *Id.*

[255] *Id.*

Year	Retirements (Dollars)	Gross Salvage	Removal Cost	Net Salvage	Percent Salvage	2- yr Net Salv. %	3- yr Net Salv. %	4- yr Net Salv. %	5- yr Net Salv. %
Account 354									
1995	136,509	33,812	72,435	(38,623)	-28.29%				
1996	16,247	8,636	36,750	(28,114)	-173.04%	-43.69%			
1997	2,845	0	2,260	(2,260)	-79.42%	-159.09%	-44.34%		
1998	272,328	0	27,011	(27,011)	-9.92%	-10.64%	-19.69%	-22.44%	
1999	148,294	0	256,565	(256,565)	-173.01%	-67.42%	-67.50%	-71.40%	-61.19%
2000	168,917	0	321,684	(321,684)	-190.44%	-182.29%	-102.67%	-102.56%	-104.44%
2001	541,450	0	319,815	(319,815)	-59.07%	-90.31%	-104.59%	-81.79%	-81.79%
2002	197,054	0	267,623	(267,623)	-135.81%	-79.54%	-100.19%	-110.42%	-89.81%
2003	825,904	0	499,708	(499,708)	-60.50%	-75.01%	-69.49%	-81.28%	-88.51%
2004	657,515	0	309,161	(309,161)	-47.02%	-54.53%	-64.06%	-62.84%	-71.86%
2005	1,035,029	0	513,783	(513,783)	-49.64%	-48.62%	-52.52%	-58.56%	-58.65%
2006	1,702,620	0	304,100	(304,100)	-17.86%	-29.88%	-33.20%	-38.54%	-42.88%
2007	589,631	139,476	432,919	(293,442)	-49.77%	-26.07%	-33.40%	-35.65%	-39.92%

SOURCE: DAW- 2 at 56

The Company statistics show a five-year band of about 40% and a 13-year band of about 50%, but because of "potential moderating of the net salvage," the Company seeks 35%.[256]

Mr. Pous recommends a negative net salvage of 20%.[257] He bases this recommendation on the fact that the historical data "reflects less than robust levels of retirements and less than planned replacement activity."[258] In the SPS case, Mr. Watson is recommending a zero level of net salvage for this account.[259] The AGA/EEI survey yields an approximate negative 20% net salvage averages.[260] Adoption of Mr. Watson's recommendation would produce more than 10 times the annual expense for this account for the last 10 years and would be 6.5 times higher than the highest value the Company has experienced.[261] Mr. Watson's proposal must be rejected.

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256 *Id.* at 52.

257 *Id.*

258 *Id.* at 53.

259 *Id.*

260 *Id.*

261 *Id.*

i) Account 355 – Transmission Poles and Fixtures

The Company seeks a negative 100% net salvage for this account, based on historic averages that range from negative 190% to 230%.[262] However, due to "variability" and "potential moderating," Mr. Watson applied his judgment and arrived at a negative net salvage value of 100%.[263] This number stands in contrast to his recommendation in the SPS case of 60%.[264] This recommendation would be the most negative net salvage value in the industry according to the AGA/EEI survey.[265]

Mr. Pous recommends a negative 60% for this account.[266] This would produce a level of revenue requirement equal to the Company's highest level of negative net salvage in its recorded history and would be three times the annual average in the historical database.[267] The 60% matches Mr. Watson's recommendation in the SPS case and is on the high end of the AGA/EEI data.[268] It is also consistent with the Staff recommendation of 65% for this account. When coupled with Mr. Pous' recommendation for a new, "detailed and thorough depreciation analysis,"[269] the Commission should adopt Mr. Pous' recommended 60%.

j) Account 356 – Transmission Overhead Conductors

This brief has already discussed Account 356, in the section that discusses the complete inability to quantify or replicate the "judgment" that went into the Company's recommendation of 65%. ATOC will not repeat that argument here, but would ask the Commission to consider it as if set forth here.

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262 *Id.* at 54.
263 *Id.*
264 *Id.*
265 *Id.*
266 *Id.* at 55.
267 *Id.*
268 *Id.*
269 *Id.*

The Company's recommendation suffers when compared with other industry data. It is higher than any of the other companies in the AGA/EEI survey.[270] It is much higher than the negative 10% that Mr. Watson is sponsoring in the SPS case.[271]

Mr. Pous recommends a negative 25% net salvage.[272] Because the Company's recommendation is "above the high end of the industry," he calls into question the Company's accounting treatment for net salvage.[273] Mr. Pous also notes that the underlying data has significant variability, ranging from negative 48% to negative 2,041%.[274] Even with the Company's practice of smoothing out aberrations over several years, "it is hard to smooth out aberrations that reflect over 2,000% negative net salvage values in a given year."[275] Mr. Pous' recommendation would provide the Company with approximately $4.8 million of annual revenue– an amount that has only been exceeded once in 13 years and that would provide over three times the average annual level of net salvage.[276] It is "more than equitable" to provide the Company with over three times its average annual net salvage experience.[277] Staff also agrees that the Company's request is excessive, and recommends a negative 49% net salvage. The Commission should apply its "judgment" to this account, and rule in favor of ATOC.

k) Account 361 – Distribution Substations and Improvements

This account has already been discussed in conjunction with Account 352, Transmission Substations and Improvements. The same recommendations apply for both the Company and ATOC. The Commission should rule in a consistent manner for both accounts.

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[270] *Id.* at 56.
[271] *Id.*
[272] *Id.*
[273] *Id.*
[274] *Id.* at 57.
[275] *Id.*
[276] *Id.*
[277] *Id.*

l) Account 362 – Distribution Substation Equipment

This Account involves somewhat less dispute than some of the other accounts, as the Company is seeking a negative 15% net salvage value and Mr. Pous is recommending a negative 10%.[278] Staff comes in at 11%.

Both the Company and Mr. Pous recognize that the trend is downward (that is, less negative).[279] Mr. Pous, however, took a closer look at the historical data and noted that the historical data is "inappropriately skewed" to excessive negative levels.[280] This is caused by supervising control and data acquisition ("SCADA") equipment being 12% of the historic retirements but only 3% of the investment.[281] SCADA equipment is unlikely to have any gross salvage value.[282]

However, approximately 38% of the investment is in transformers, which only represented 30% of the historic retirement activity.[283] As already discussed in this brief, transformers can have low negative net salvage values, depending on the price of copper.[284] This account also involves contractor expense for historic work, which is normally higher than in-house costs. Mr. Pous finds that the Company has not demonstrated that such costs will reoccur in the future. Finally, he notes that Mr. Watson recommends a negative 10% net salvage value in the SPS case. Under the circumstances of this Account, Mr. Watson's -15% is too high. Mr. Pous has correctly moderated it to -10%, and that is the number the Commission should adopt.

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278 *Id.* at 59.

279 *Id.*

280 *Id.*

281 *Id.*

282 *Id.*

283 *Id.* at 59 – 60.

284 *Id.* at 60.

m) Account 364 – Distribution Poles, Towers and Fixtures

For this Account, the Company seeks a negative 65% net salvage value, based upon a thirteen-year average of negative 72%.[285] Mr. Pous finds such a recommendation to be 2.6 times higher than Mr. Watson's recommendation in the SPS case and approximately double the AGA/EEI average results of negative 30% to negative 40%.[286] Mr. Pous recommends a negative 45% net salvage value.[287] He points to the fact that the historical averages for this account were impacted by three or four of the worst storms of the Company's history.[288] Furthermore, vegetation management costs were charged to cost of removal in 2005.[289] This could explain why 2005 was the most negative in the Company's recorded history.[290] The Commission should also consider the fact that the Company began leaving retired poles in place in 2004.[291] Such a practice would mean less cost of removal being incurred.[292]

Another factor that may be affecting this account is that the historic period had traffic exposure increasing the cost of removal.[293] Replacement of one or two poles due to traffic accidents will not allow for any economies of scale.[294] As larger numbers of poles are removed on a planned basis, and more poles are removed in a given area at the same time, economies of scale will result.[295]

Furthermore, this is an account where Mr. Watson specifically notes the Company's

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285 *Id.* at 60 - 61.
286 *Id.* at 61.
287 *Id.*
288 *Id.*
289 *Id.*
290 *Id.* at 61-62.
291 *Id.* at 62.
292 *Id.*
293 *Id.*
294 *Id.*
295 *Id.*

policy on reimbursed retirements.[296] As discussed earlier in this Brief, the Commission rejected an earlier attempt to treat reimbursed retirements in the manner Mr. Watson proposes. Mr. Watson's proposal also violates NARUC's position on this matter. The Commission should rule in a consistent manner in this case.

When viewed on an overall recovery basis, the Company's proposal is excessive. Mr. Watson's recommendation of $29 million a year would amount to a sum that is over three times the highest level of annual negative net salvage as reflected in the Company's historical database.[297] It would be over five times the average annual cost of removal experienced over the last ten years.[298] The nearly $30 million annually for this one account would equal or exceed the *entire* rate increase recently awarded by this Commission to Southwestern Public Service Company, ($23 million),[299] AEP Texas Central Company, ($29 million),[300] and AEP Texas North Company ($13.7 million).[301] As Mr. Pous put it:

> Request for almost $30 million of annual revenue requirements must require some reasonable level of documentation, justification, and support rather than simple historical averages based on questionable accounting practices.[302]

Mr. Pous' recommendation will not leave the Company bereft. His recommendation will provide the Company with more than two times its highest level net salvage experienced in the

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296 *Id.*

297 *Id.* at 63.

298 *Id.*

299 *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).

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

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

302 ATOC Exh. 2 at 63.

last ten years and approximately three times the average level.[303]

n) Account 365 – Distribution Overhead Conductors and Devices

The Company proposes a negative 55% net salvage value for this account, based only on a 10-year simple average of negative 54%.[304] In contrast, Mr. Pous is recommending a negative 40% net salvage.[305] He is bolstered in this recommendation by the fact that Mr. Watson is testifying to a negative 20% in the SPS case; and the AGA/EEI survey indicates that a negative 10% to negative 20% is a reasonable expectation.

Looking closely at the underlying historical data, Mr. Pous finds that it is not representative of the future. For example, almost 30% of the retirement activity was related to reclosures, while only 7% of the account is associated with such reclosures.[306] However, the vast majority of investment in this account is associated with conductors.[307] The cost to remove conductors can be expected to be less compared to the unit cost to remove reclosures.[308] As another example of why the history of this account may not tell an accurate story is the fact that the historical period contained three or four of the worst storms in the Company's history.[309] Emergency situations undoubtedly drive up costs.[310]

Furthermore, costs of future removal should be reduced by the Company's deployment of advanced metering operations.[311] Such operations should give the Company the ability to react

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303 *Id.* at 64.
304 *Id.* at 65.
305 *Id.*
306 *Id.*
307 *Id.* at 65 – 66.
308 *Id.* at 66.
309 *Id.*
310 *Id.*
311 *Id.*

in a defined or planned manner instead of on an emergency basis.[312]

Some of the Company's accounting practices may affect the historic numbers and make them not be representative of future outcomes. This is another account where reimbursed retirements may affect the historic net salvage value.[313] Mr. Watson's notes say the cost of removal is estimated, which may explain why the Company's books reflect costs of removal that are too high.[314] Furthermore, vegetation management costs are being included in replacement cost activity. This is "inappropriate accounting" and may explain why the Company's values are out of line with the industry.[315]

The *results* of the Company's recommendation are also out of line. A negative 55% produces values that are 2.6 times the highest value the Company has experienced in its database and almost five times the average cost experienced during the last ten years.[316] By contrast, Mr. Pous' recommendation will provide the Company with $13 million annually, which is "significantly greater" than the actual level of negative net salvage experienced historically.[317] For these reasons the Commission should adopt Mr. Pous' recommendation.

o) Account 366 – Distribution Underground Conduit

For this Account, the Company proposes a negative 50% net salvage, based on the average net salvage for the full database.[318] In contrast, Mr. Pous recommends a negative 20% net salvage.[319] Mr. Pous points to the fact that in the SPS case, Mr. Watson is recommending a

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312 *Id.*
313 *Id.*
314 *Id.*
315 *Id.*
316 *Id.*
317 *Id.* at 67.
318 *Id.*
319 *Id.* at 68.

negative 10% net salvage for this account.[320] The AGA/EEI survey shows industry averages in the negative 5% to negative 15% range.[321] Mr. Watson's negative 50% would be "the most negative value" in regards to that study.[322]

The difference between the Company's proposed net salvage values and the corresponding industry average values may be explained by the fact that investment in this account quite often is abandoned in place.[323] Mr. Watson's notes reflect that Oncor personnel told him that they "generally don't remove conduit."[324] This is important, as 46% of the investment in this Account is related to conduit.[325] In other words, future costs may not match historic expenses.

Mr. Watson's notes also reveal that the Company replaced a significant portion of underground conduit in the Las Colinas area in 2001 and 2002.[326] This period shows the highest level of retirement activity for this Account, but also showed a negative 28% net salvage value.[327] This supports the notion that there are economies of scale that are not reflected in other years in the Company's database.[328] It is also important to consider that conduits reflect 14% of the retirement activity, but constitute approximately 46% of the investment.[329] This means that investment that has one of the lowest costs of removal is "significantly underrepresented."[330]

When measured on an overall basis, Mr. Watson's proposal would give the Company

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320 *Id.*
321 *Id.*
322 *Id.*
323 *Id.*
324 *Id.*
325 *Id.*
326 *Id.*
327 *Id.*
328 *Id.*
329 *Id.* at 69.
330 *Id.*

over seven times the highest annual level experienced by the Company and over 13 times the average level for the last ten years.[331] This would be excessive and unjustified by the facts. The Commission should adopt Mr. Pous' recommendation.

p) Account 367 – Distribution Underground Conductor

Compared to other accounts, ATOC and the Company are not wildly far apart with regard to their recommendations regarding net salvage for this account. Mr. Watson sponsors a negative 10% net salvage,[332] while Mr. Pous recommends a negative 5%.[333] The historic statistics show a ten-year average of negative 15%, but Mr. Watson recognizes that the last few years have shown increasing gross salvage amounts.[334]

Mr. Pous justifies his 5% number by first noting that Mr. Watson testifies to the identical number in the SPS case.[335] He also recognizes a trend in data to less negative net salvage, which has averaged around negative 4%.[336] Looking at the retirement activity versus the investment mix reveals that switchgears represent 27% of the historic activity but only approximately 14% of the total investment.[337] Switchgears have a higher level of negative net salvage and net removal costs than underground conductor (which tends to be abandoned in place).[338] In light of the fact that the Staff also recommends negative 5% net salvage for this account, 5% is clearly supported by the substantial weight of the evidence and should be adopted by the Commission.

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331 *Id.*

332 *Id.*

333 *Id.* at 70.

334 *Id.* at 69 – 70.

335 *Id.* at 70.

336 *Id.*

337 *Id.*

338 *Id.*

q) Account 368 – Distribution Line Transformers

This is another account where Mr. Watson applies his "judgment," although in a narrower range. The historical statistics for this account show a negative 26% for the five-year band and a negative 23% for the 10-year band.[339] Based on those numbers, Mr. Watson recommends negative 20% net salvage value.[340] Mr. Pous believes his negative 15% is "more realistic."[341] One indicator he uses is Mr. Watson's recommendation in the SPS case, which is negative 5%.[342] Another indicator is the AGA/EEI Survey, which shows approximately a zero to negative 5% average for the industry.[343]

Mr. Pous also takes into consideration the installation of advance metering, which should lower emergency replacements.[344] He also notes that the historical information may include some level of Polychlorinated Biphenyls ("PCBs), which would result in "much higher costs of removal."[345] Future costs of removal should be lower to reflect the elimination of PCBs from the historical values.[346]

With regard to the overall recovery, the Company's proposal would result in annual levels of net salvage values approximately equal to two times the highest value experienced by the Company in the last ten years and three times the historic average.[347] Mr. Pous' recommendation will still leave the Company with approximately double the average level of

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339 *Id.* at 71.
340 *Id.*
341 *Id.*
342 *Id.*
343 *Id.* at 72.
344 *Id.*
345 *Id.*
346 *Id.*
347 *Id.*

negative net salvage that it has experienced in the last ten years.[348] Staff's recommendation of negative 14% is right in line with Mr. Pous' 15% and both indicate that the Company's recommendation should be rejected.

r) Account 369 – Distribution Services

For this account, the Company seeks negative 20% net salvage value, based on historic data that produced a five-year average of negative 20% and a ten-year average of 26%.[349] Mr. Pous recommends a negative 10% for this account.[350] He bases this recommendation on the fact that over 70% of the investment in this account is associated with underground services.[351] Underground services have a higher probability of being abandoned in place.[352]

Furthermore, the historic experience may not be representative of future experience. The historic experience is impacted by the three or four of the most severe storms in the Company's history.[353] Mr. Pous also notes that the history shows the Company retired a disproportionate level of overhead services. Underground services represent 73% of the investment, but only 47% of the retirement activity reported.[354] In addition, the Company's recommendation would result in an annual amount of negative net salvage that would be almost eight times the highest level the Company has experienced and *thirteen* times the average annual level.[355] Mr. Pous' recommendation still provides a "substantial" coverage of negative net salvage compared to historical levels.[356] The Commission should adopt Mr. Pous' recommendation.

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348 *Id.*
349 *Id.* at 73.
350 *Id.*
351 *Id.*
352 *Id.*
353 *Id.*
354 *Id.*
355 *Id.* at 74 (emphasis added).
356 *Id.*

s) Account 373 – Distribution Street Lighting

This account provides a final view of Mr. Watson's "judgment" in action. He took a five-year average of negative 27% and a ten-year average of negative 32% and – without further explanation – proposed a negative 25%.[357] Mr. Pous, on the other hand, examined the statistics behind the historical information and determined that there was a "disconnect."[358] This disconnect comes from the fact that luminaries represent 26% of the investment but 58% of the retirement activity; conductors represent 14% of the investment but only 7% of the retirements; and poles are 48% of the investment but 34% of the retirement activity.[359] This over-representation of luminaries would skew the historic net salvage amounts. The historical statistics should also account for the fact that street-lighting systems are sold, but Mr. Watson removes all aspects of historic sales.[360]

When measured on an overall basis, the Company's proposal would result in a level of negative net salvage that is five times the highest level experience by the Company in the last ten years and is almost seven times the average level for that same period.[361] Mr. Pous' recommendation still provides the Company with "significant coverage"[362] and should be adopted by the Commission.

H. Amortization of 2004 and 2006 Restructuring Costs

ATOC presented its views on this issue in Section V, G.1.

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357 *Id.*

358 *Id.* at 75.

359 *Id.*

360 *Id.*

361 *Id.*

362 *Id.*

I. Recovery of Intangible Assets

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

J. Federal Income Tax Expense

1. Consolidated Tax Savings Adjustment

ATOC supports Staff witness Candice Romines' recommendation regarding a consolidated tax savings adjustment (CTSA). Her position is clearly in line with Commission precedent. Ms. Romines recommends a CTSA in amount of $74,423,147 be included as a reduction to the federal income tax (FIT) component of cost of service.[363] The effect on FIT is $114,497,035, which is calculated as the tax gross-up factor 1.53846 times the CTSA.[364]

Consolidated tax savings are the savings realized when an affiliated group of companies file one consolidated tax return instead of a separate return for each member company. The primary advantages of consolidating the taxable income and net operating losses (NOLs) generated by the group include the immediate utilization of credits and NOLs that otherwise would need to be carried forward under the federal income tax code.[365] In Docket No. 14965, the Commission made a clear and definitive determination to "give utility customers a share of the benefits that a utility holding company enjoys when affiliates with tax losses file a consolidated tax return with a profitable utility."[366] The rationale and associated method of calculating the utility's share in that case is how the consolidated tax savings adjustment is determined.[367] It represents the value of a "tax shield" provided by the utility that allows affiliates to realize the tax advantages of the operating loses without waiting until they earn a

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[363] Direct Testimony of Candice Romines, PUCT Staff Exh. 3 at 4:4-9.

[364] *Id.*

[365] *Id.* at 6:9-16.

[366] *Application of Central Power and Light Company for Authority to Change Rates and to Reconcile Fuel Costs*, Docket 14965, Second Order on Rehearing, Page 12 of 112 (October 16, 1997).

[367] PUCT Staff Exh. 3 at 8:4-10.

profit.[368] In particular, the value was defined in that case as the "amount of consolidated tax savings over the last fifteen years that would not have been realized by affiliates as of the test year but for their affiliation with "the utility multiplied by the time-value of money."[369]

As further discussed by Staff witness Romines, the CTSA calculation nets each member's taxable income and losses over a 15-year period.[370] To the extent the positive member entities provide taxable income to shield the continuing losses, the CTSA recognizes the utilization of those losses and allocates them to the positive member entities. The value of the utility's share, as established in Docket No. 14965, is the tax effect of the continuing losses allocated to the utility, multiplied by the long-term cost of debt.[371] These guiding principles are significant because they are different than the tax code actually used to calculate federal income tax and this difference is intentional and important.[372] In fact, the CTSA does not place a value on the acceleration of loss utilization actually provided by consolidation during the 15-year period.[373] The Docket 14965 method treats the 15-year period as one tax year as it relates to the timing of NOL utilizations.[374] Based on this long history of how to treat and calculate the CTSA, the Staff recommends that the Company include a CTSA consistent with Docket No. 14965 as explained in Ms. Romines' testimony. ATOC supports the Staff's and Ms. Romines' recommended CTSA.

a) Appropriateness of Making a CTSA

ATOC presented its views on this issue in Section VII, J.1.

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368 Docket No. 14965, Second Order on Rehearing, FOF 111 (October 16, 1997).

369 *Id.*, FOF 112B.

370 PUCT Staff Exh. 3 at 9:3-4.

371 *Id.* at 9:12-14.

372 *Id.* at 11:11-13.

373 *Id.* at 10:7-8.

374 *Id.* at 10:8-10.

b) Calculation of a CTSA

ATOC presented its views on this issue in Section VII, J.1.

2. FIN 48

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

3. Oncor's Change to a Partnership

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

K. State and Local Taxes

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

1. Ad Valorem (Property) Taxes

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

2. Texas Gross Margin Tax

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

3. Franchise Fees

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

L. Automated Meter Recovery

Mr. Pous takes issue with the prudence of Oncor's expenditures related to automated metering equipment during 2006 and 2007. The standard Mr. Pous relies on in forming his prudence argument has been previously utilized by the Commission and is as follows: "The exercise of that judgment and the choosing of one of a select range of option which a reasonable utility manager would exercise or choose in the same or similar circumstances, given the information or alternatives available at the point and time such judgment is exercised or

judgment is given."[375] Under this standard Mr. Pous believes, at a minimum, that the Company's investment in PLC and BPL meters during 2006 and 2007 was imprudent.

Oncor had $459,859,262 of investment in distribution meters as of the end of the test year.[376] Of that amount, the Company had $144 million corresponding to investment in its Smart Grid, which corresponds to its investment in automated meters.[377] Smart Grid in its simplest terms can be described as "various types of devices and technology that can be installed on an electric utility grid that provides some real time understanding of what is occurring on the system at all times."[378] Oncor in its efforts to develop its Smart Grid deployed automated meter infrastructure and enabling software. The first generation of automated meter technology allowed Oncor to perform one way power line carrier communications ("PLC"). Oncor began to deploy the next generation of automated meters, broadband over power line (BLP), in 2004. Oncor also continued to invest in PLC. The Company currently has 590,000 automated meters in service.[379]

The Texas Legislature since at least 2005 has been encouraging Smart Grid Technologies when they passed a variety of bills meant to encourage the transition from conventional meters to smart meters.[380] In response to this new law the Commission promulgated P.U.C. SUBST. R. 25.130.[381] This rule required the Company to change the type of meters it was deploying to accommodate additional functionality that the Company's automated metes were not capable of

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375 ATOC Exh. 2 at 94:3-7.

376 *Id.* at 92:1-4.

377 *Id.* at 925-8.

378 *Id.* at 92:11-14.

379 *Id.* at 93:1-3.

380 *Id.* at 93:4-8.

381 *Id.* at 93:11-14.

providing."[382]

Even though the Legislature encouraged the transition to more sophisticated technology and the Commission rules require replacement of the existing meters, Mr. Pous still believes that the Company still acted imprudently with their investment decisions. Mr. Pous takes particular exception with automated meter investment in 2006 and 2007. Based on the Commission's standard of prudence and only taking into consideration the information available to the Company at the time it made its decision, they still made an imprudent investment during those years. After the Legislature passed the bills encouraging Smart Grid technologies the Commission initiated a rulemaking project in 2005 to establish the parameters of the implementation.[383] Oncor was a party to this project and provided "its first response to the Commission regarding its rule making in January of 2006."[384] They continued to be involved in the project throughout the process and were very aware of the particulars of the rule.[385] The rule was adopted on May 14, 2007.

Oncor claims that not until May 14, 2007 were they actually aware that the rule would require them replace recently added investment in automated meters. This argument does not make any sense for Oncor. Oncor had at its disposable as an active participate in the project information on what the rule looked like throughout the process. Oncor should have been able to take this information into account before investing hundreds of millions of dollars.[386] To not take into account the information they had before the actual rule was approved was imprudent. In fact, Oncor stated in a response for the project that "'data using 15 minutes intervals is

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382 *Id.*

383 Rulemaking Related to Advanced Metering, Project No. 31418 (May 14, 2007).

384 ATOC Exh. 2 at 94:20-21.

385 *Id.* at 94:21-23.

386 *Id.* at 95:8-14.

currently the standard for IDR or meters.'"[387] The Company admitted that the automated meters they were investing in could not provide date at 15-minute intervals which was the industry standard for Smart Grid technology.[388]

During the years 2006 and 2007 Oncor continued to invested in automated meters technology.[389] In fact, Oncor's investment in its automated meter account went up approximately 25% over the balance at the end of 2005.[390] That means Oncor, even "when faced with the knowledge of an impending rule regarding Smart Grid technologies and recognition of an industry standard that isn't supported by the type of metering the Company was pursuing, the Company management decide to increase the investment of an approximate $400 million account by almost 25%."[391] The decision to expand the investment in a technology that would not meet the requirements of the new rule was imprudent. As an example of a Company not rushing into expensive investments when faced with regulatory uncertainty, Mr. Pous cited to an example involving Entergy Texas, Inc (Entergy). In the 1990s and early 2000s in fuel reconciliation cases Entergy was repeatedly asked "why the Company was not building generation to meet load when it was short on capacity."[392] Entergy responded that because of regulatory uncertainty related to electric deregulation the Company did not pursue an "avenue that would have been beneficial for customers because of concern for regulatory treatment of its costs."[393] Unlike this example from Entergy, Oncor took the opposite course and continued to invest in a technology they knew would be inadequate once the new rule went into effect.

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[387] *Id.* at 35:17-19.

[388] *Id.* at 95:19-21.

[389] *Id.* at 96:1-3.

[390] *Id.* at 96:6-7.

[391] *Id.* at 96:7-11.

[392] *Id.* at 96:18-20.

[393] *Id.* at 96:20-23.

Mr. Pous pointed out that he is unaware of any utility in Texas that invested in automated metering in 2006 and 2007 like Oncor.[394] As a partial defense to its expenditures Oncor claimed that they were on the forefront of developing and deploying new technology. However, since the industry standard is the ability to provide data in 15-minute intervals it seems that Oncor's investment decisions were not be keeping with the forefront of automated meter technology.[395] Also, if indeed Oncor had no options in 2006 and 2007 to investment in automated meter technology that would soon be obsolete Oncor has provided no studies or information that would verify this position.[396] Nothing Oncor has provided in evidence would justify the investment decision to invest in a technology that would become obsolete in such a short period of time or that would indicate that the decision was prudent. ATOC recommends the disallowance of "$80,425,616 of gross investment, and that $2,815,438 of accumulated provision for depreciation associated with such investment be removed from rate base."[397]

M. Payments to Cities for Regulatory Expenses

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

VIII. COST ALLOCATION AND RATE DESIGN

A. Creation of a Primary Substation Rate Case

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

B. Cost Allocation

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

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394 *Id.* at 97:1-4.

395 *Id.* at 97:9-16.

396 *Id.* at 97:17-26.

397 *Id.* at 98:1-4.

1. Direct Assignment of Costs to Wholesale Customers

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

2. Gradualism

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

3. Transmission Cost Allocation Factor

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

4. Other Allocation Issues

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

C. Weather Normalization Adjustment

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

D. Power Factor Adjustment

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

E. Waiver of Demand Ratchet Provisions

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

1. Loads with Maximum Annual Demand of 20 kW or Less

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

2. Municipally-Owned Loads

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

F. Street Lighting

ATOC supports the Steering Committee of Cities served by Oncor (SCOCO) witness Karl Nalepa's a testimony regarding street lighting rate design. Mr. Nalepa shows that contrary

to Oncor's claim Oncor's proposed 10% cap, which SCOCO supports, on any increases to municipalities' unmetered street lighting service is not a subsidy.[398] It would be more accurate to say "that the 10% cap reflects the inequality of the non-coincidence peak ("NCP") demand allocation methodology used by Oncor that is based on the maximum use by class."[399] The method Oncor utilizes fails to take into consideration the benefits of night-time usage. The premise of Oncor's method is that "distribution facilities are built to meet the maximum demand of the customer, but this is only true of the immediate localized facilities such as service drops."[400] Street lighting peaks at night so Oncor does not build primary lines based on a combination of Residential, Commercial and Lighting load. The lines are not built for off-peak night-time periods, but instead for the hottest summer afternoon.

No cost of service study can perfectly assign cost. There has to be a band of reasonableness in any allocation method to recognize unique circumstances. Lighting's off-peak characteristic is such a circumstance. The NCP allocation methodology over allocates costs to off-peak customers such as the lighting class.[401] In addition, there is a "public good argument to be made for street lighting. It helps reduce crime and assists in public safety and therefore the Commission has recognized the reasonableness of assigning a portion of its costs to other classes.[402] ATOC agrees with Mr. Nalepa that the "charge for unmetered street lighting should not be more than the charge for metered street lighting."[403] The Street Lighting rates should reflect their off-peak nature and be reduced to a level where the average cost for unmetered street

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398 Direct Testimony of Karl J. Nalepa, Cities Exh. 3 at 35:14-16.

399 *Id.* at 35:19-36:1.

400 *Id.* at 36:2-4.

401 *Id.* at 36:22-23.

402 *Id.* at 37:6-10.

403 *Id.* at 37:12-13.

lighting is no greater than the average cost off metered street lighting."[404]

G. Other Changes in Rate Design and Billing Units

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

H. Rider FFCRF – Franchise Fee Cost Recovery Factor

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

I. Rider UFCRF – Underground Facilities Cost Recovery Factor

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

J. Rider SLM – Street Light Maintenance Cost Recovery Factor

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

K. Rider EECRF – Energy Efficiency Cost Recovery Factor

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

L. Rider SCUD – State Colleges and Universities Discount

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

M. Rider NDC – Nuclear Decommissioning Charge

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

N. Discretionary Service Charges

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

O. Company-Specific Terms and Conditions and Tariff Language

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

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[404] *Id.* at 37:13-38:2.

IX. PRAYER

For the reasons noted above ATOC respectfully requests that the Commission adopt the recommendations presented in the testimonies of its witnesses, Mr. Parcell and Mr. Pous and the positions ATOC advocates in its Initial Brief.

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ATTORNEYS FOR ATOC

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of **Initial Brief of the Alliance of TXU/Oncor Customers** upon the affected parties and their legal representatives by fax, and/or certified mail, return receipt requested on this 4th day of March 2009.

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Alfred R. Herrera