

CHAPTER 25. SUBSTANTIVE RULES APPLICABLE TO ELECTRIC SERVICE PROVIDERS

Subchapter J. COSTS, RATES AND TARIFFS.

DIVISION 1. RETAIL RATES.

§25.231(b)(1)(F)(i) continued

- be determined in each rate case based on an allowance for contingencies of 10% of the cost of decommissioning, the most current information reasonably available regarding the cost of decommissioning, the balance of funds in the decommissioning trust, anticipated escalation rates, the anticipated return on the funds in the decommissioning trust, and other relevant factors. The annual amount for the cost of decommissioning determined pursuant to the preceding sentence shall be expressly included in the cost of service established by the commission's order.
- (ii) In the event that an electric utility implements an interim rate increase, including an increase filed under bond, an incremental change in decommissioning funding shall be included in the increase.
 - (iii) An electric utility's decommissioning fund and trust balances will be reviewed in general rate cases. In the event that an electric utility does not have a rate case within a five-year period, the commission, on its own motion or on the motion of the commission's Office of Regulatory Affairs, the Office of Public Utility Counsel, or any affected person, may initiate a proceeding to review the electric utility's decommissioning cost study and plan, and the balance of the trust.
 - (iv) An electric utility shall perform, or cause to be performed, a study of the decommissioning costs of each nuclear generating unit that it owns or in which it leases an interest. A study or a redetermination of the previous study shall be performed at least every five years. The study or redetermination should consider the most current information reasonably available on the cost of decommissioning. A copy of the study or redetermination shall be filed with the commission and copies provided to the commission's Office of Regulatory Affairs and the Office of Public Utility Counsel. An electric utility's most recent decommissioning study or redeterminations shall be filed with the commission within 30 days of the effective date of this subsection. The five year requirement for a new study or redetermination shall begin from the date of the last study or redetermination.
- (G) Accruals credited to reserve accounts for self-insurance under a plan requested by an electric utility and approved by the commission. The commission shall consider approval of a self insurance plan in a rate case in which expenses or rate base treatment are requested for a such a plan. For the purposes of this section, a self insurance plan is a plan providing for accruals to be credited to reserve accounts. The reserve accounts are to be charged with property and liability losses which occur, and which could not have been reasonably anticipated and included in operating and maintenance expenses, and are not paid or reimbursed by commercial insurance. The commission will approve a self insurance plan to the extent it finds it to be in the public interest. In order to establish that the plan is in the public interest, the electric utility must present a cost benefit analysis performed by a qualified 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. The cost benefit analysis shall present a detailed analysis of the appropriate limits of self insurance, an analysis of the appropriate annual accruals to build a reserve account

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§25.231(b)(1)(G) continued

for self insurance, and the level at which further accruals should be decreased or terminated.

- (H) Postretirement benefits other than pensions (known in the electric utility industry as "OPEB"). For ratemaking purposes, expense associated postretirement benefits other than pensions (OPEB) shall be treated as follows:
- (i) OPEB expense shall be included in an electric utility's cost of service for ratemaking purposes based on actual payments made.
 - (ii) An electric utility may request a one-time conversion to inclusion of current OPEB expense in cost of service for ratemaking purposes on an accrual basis in accordance with generally accepted accounting principles (GAAP). Rate recognition of OPEB expense on an accrual basis shall be made only in the context of a full rate case.
 - (iii) An electric utility shall not be allowed to recover current OPEB expense on an accrual basis until GAAP requires that electric utility to report OPEB expense on an accrual basis.
 - (iv) For ratemaking purposes, the transition obligation shall be amortized over 20 years.
 - (v) OPEB amounts included in rates shall be placed in an irrevocable external trust fund dedicated to the payment of OPEB expenses. The trust shall be established no later than six months after the order establishing the OPEB expense amount included in rates. The electric utility shall make deposits to the fund at least once per year. Deposits on the fund shall include, in addition to the amount included in rates, an amount equal to fund earnings that would have accrued if deposits had been made monthly. The funding requirement can be met with deposits made in advance of the recognition of the expense for ratemaking purposes. The electric utility shall, to the extent permitted by the Internal Revenue Code, establish a postretirement benefit plan that allows for current federal income tax deductions for contributions and allows earnings on the trust funds to accumulate tax free.
 - (vi) When an electric utility terminates an OPEB trust fund established pursuant to clause (v) of this subparagraph, it shall notify the commission in writing. If excess assets remain after the OPEB trust fund is terminated and all trust related liabilities are satisfied, the electric utility shall file, for commission approval, a proposed plan for the distribution of the excess assets. The electric utility shall not distribute any excess assets until the commission approves the disbursement plan.
- (2) **Expenses not allowed.** The following expenses shall never be allowed as a component of cost of service:
- (A) legislative advocacy expenses, whether made directly or indirectly, including, but not limited to, legislative advocacy expenses included in professional or trade association dues;
 - (B) funds expended in support of political candidates;
 - (C) funds expended in support of any political movement;
 - (D) funds expended promoting political or religious causes;
 - (E) funds expended in support of or membership in social, recreational, fraternal, or religious clubs or organizations;
 - (F) funds promoting increased consumption of electricity;
 - (G) additional funds expended to mail any parcel or letter containing any of the items mentioned in subparagraphs (A)-(F) of this paragraph;

Lone Star Transmission Company

**Estimation of Commercial Insurance Company Premiums
For Deductibles on All Insured Property and for Uninsured Transmission Property**

1) Expected Losses	\$ 4,521,339
2) Expense Ratio	32.22%
3) Permissible Loss Ratio	69.39%
4) Unallocated Loss Adjustment Expense	4.79%
5) Estimated Commercial Premium for Self Insurance Program	\$6,827,945

Notes:

Item 1) from Exhibits JHC-2, Page 2 and JHC-4

Item 2) is based on Consolidated Insurance Industry Expenses 2008-2009, in the A.M. Best Company publication Aggregates and Averages. Expenses are expressed as a percentage of premium and include commissions, brokerage, taxes, licenses, fees, other acquisition, and general insurance expenses.

Item 3) is the Permissible Loss Ratio and is the percentage of insurance premium available for paying losses and loss adjustment expenses. The Permissible Loss Ratio is calculated as 100% minus Item 2).

Item 4) is the provision for loss adjustment expenses that are not specifically allocable to individual claims and is expressed as a percentage of losses and allocated loss adjustment expenses. The percentage is based on the Consolidated Insurance Industry Expenses for 2008-2009 in the A.M. Best Company publication Aggregates and Averages. Allocated loss adjustment expenses such as legal fees are included with the losses.

Item 5) = (Item 1 x (100% + Item 4)) / Item 3).

PUC DOCKET NO. 40020

**APPLICATION OF LONE STAR
TRANSMISSION, LLC FOR
AUTHORITY TO ESTABLISH
INTERIM AND FINAL RATES
AND TARIFFS**

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§
§

**BEFORE THE
PUBLIC UTILITY COMMISSION
OF TEXAS**

DIRECT TESTIMONY

OF

BRIAN R. MURPHY

ON BEHALF OF

LONE STAR TRANSMISSION, LLC

January 9, 2012

INDEX TO THE DIRECT TESTIMONY OF

BRIAN R. MURPHY, WITNESS FOR

LONE STAR TRANSMISSION, LLC

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SCHEDULE II-E-3.23	List of FIT Testimony
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SCHEDULE III-B-7
SCHEDULE III-E-2
SCHEDULE III-E-3

Accumulated Provision Balances
Taxes Other Than Income Taxes
Federal Income Taxes

EXECUTIVE SUMMARY OF BRIAN R. MURPHY

In this case, I sponsor the schedules and related amounts included in Lone Star Transmission LLC's ("Lone Star" or the "Company") interim and final cost of service rates for the following components: federal income tax ("FIT"), ad valorem tax and Texas state franchise tax. My testimony demonstrates that Lone Star has complied with the applicable statutory requirements, as well as the Public Utility Commission of Texas' Rate Filing Package and Substantive Rules requirements for tax schedules and tax treatment. Specifically, my testimony:

- explains and supports the Company's method for calculating federal income taxes;
- explains why a Consolidated Tax Savings Adjustment ("CTSA") of \$0 is appropriate for Lone Star;
- describes the calculations of Accumulated Deferred Federal Income Taxes ("ADFIT") for Lone Star;
- addresses the calculation of ad valorem taxes;
- discusses the calculation of Texas state franchise tax; and
- supports the affiliate costs included in this filing for tax services provided by the Tax Department to Lone Star.

My testimony, exhibits and supporting materials together with the Company's tax schedules demonstrate that the tax amounts included in Lone Star's rate filing are reasonable and necessary and should be included in Lone Star's cost of service and recovered through rates.

DIRECT TESTIMONY OF BRIAN R. MURPHY

I. POSITION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND POSITION.

A. My name is Brian Murphy. I am Senior Tax Director for Florida Power & Light Company ("FPL"). My business address is 700 Universe Blvd., Juno Beach, Florida 33408.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am testifying on behalf of Lone Star.

Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?

A. I graduated from the University of Florida with a Bachelor of Science degree in Accounting in 1992, and a Masters of Accounting with a taxation focus in 1993. After completion of my Masters of Accounting, I joined Ernst & Young, LLP. In 1998, I joined the NextEra Energy Resources, LLC ("NEER") tax department and subsequently transitioned into the role of Manager of State and Local Tax Planning with FPL. Currently I am the Senior Director of Tax for FPL. I am responsible for providing tax advice to FPL and affiliates on a broad range of business matters including federal and state tax research, income tax accounting and support of rate case activities with respect to tax related matters.

II. PURPOSE OF DIRECT TESTIMONY

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Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to sponsor the schedules and related amounts included in Lone Star's cost of service for interim and final rates in this case for the following components: FIT, ad valorem tax and Texas state franchise tax. In addition, I describe the affiliate costs included in this filing for tax services provided to Lone Star by the FPL and NEER Tax Departments (collectively referred to as the "Tax Department").

Q. DO YOU SPONSOR OR CO-SPONSOR ANY SCHEDULES?

A. Yes. Consistent with the context of my testimony, I sponsor or co-sponsor the schedules listed in the Table of Contents.

III. FEDERAL INCOME TAXES

Q. WHAT IS THE FIT EXPENSE AMOUNT INCLUDED IN LONE STAR'S RATE REQUEST?

A. The Company's request for interim rates includes an annual FIT expense amount of \$1,736,082. The individual components are described below and can be seen on Schedule II-E-3 (interim).

1 The Company's request for final rates includes an annual FIT expense amount of
2 \$23,109,440. The individual components are described below and can be seen on
3 Schedule II-E-3 (final).
4

5 **Q. WHAT DO THE PROVISIONS OF §§36.059 AND 36.060 OF THE PUBLIC**
6 **UTILITY REGULATORY ACT ("PURA") REQUIRE?**

7 **A.** PURA §§36.059 and 36.060 address the treatment of certain tax benefits,
8 including investment tax credits ("ITC") and consolidated tax savings. The
9 requirements of these sections are discussed below:

- 10 • To the extent allowed by the Internal Revenue Code ("IRC"), PURA
11 §§36.059(b) and 36.060(c) require a utility that retains ITC to deduct it
12 from the rate base to which the credit applied. Because Lone Star does
13 not have any ITC, these sections do not apply.
- 14 • PURA §36.060(b) requires that income taxes related to inter-company
15 profits on affiliated purchases be applied to reduce the cost of the
16 property or service purchased. The tax expense included in this filing
17 has been calculated in accordance with PURA §36.060(b).
- 18 • PURA §36.060(a) requires that a CTSA be recognized in certain
19 circumstances when the utility is a member of a consolidated group for
20 federal income tax purposes. While Lone Star is currently a member
21 of a consolidated group for federal income tax purposes, the CTSA in
22 this case should be \$0 for the reasons I explain later in my testimony.

23
24 **Q. HOW HAVE FEDERAL INCOME TAXES INCLUDED IN LONE STAR'S**
25 **COST OF SERVICE BEEN CALCULATED?**

26 **A.** In addition to ensuring compliance with PURA §§36.059 and 36.060 as
27 summarized above, Lone Star's requested FIT expense has been calculated using
28 the "return" method, consistent with the Rate Filing Package Instructions and

1 Schedules. This method uses after-tax return as a starting point. Under the
2 "return" method, the equity return (or total return less interest) is adjusted for
3 items for which no tax deductions are available to offset amounts recovered
4 through revenues. This method calculates FIT expense in total with no
5 segregation between current and deferred federal income taxes. The return
6 method tax calculation provided on Schedule II-E-3 reflects a "stand-alone"
7 approach to calculating FIT expense.

8
9 **Q. PLEASE EXPLAIN WHAT YOU MEAN BY A "STAND-ALONE"**
10 **APPROACH.**

11 A. The stand-alone approach for the calculation of income taxes means that such
12 taxes are calculated only on the revenues and expenses included in the revenue
13 requirement of the utility. It excludes both the revenues and expenses of affiliated
14 companies. The income tax expense resulting from these excluded sources of
15 income and expense is borne by shareholders. This approach allocates federal
16 income taxes between customers and shareholders using the benefits/burdens
17 criteria outlined by FERC Opinion 173. FERC Opinion 173 describes the stand-
18 alone method as follows:

19 Our stand-alone method . . . does not ignore the consolidated return
20 or the tax reducing benefits the group realizes by filing such a
21 return. Unlike a separate return policy, our stand-alone policy in
22 effect looks beneath the single consolidated tax liability and
23 analyzes each of the deductions used to reduce the group's tax
24 liability to determine the deductions for which each service is
25 responsible. It then allocates to the jurisdictional service those
26 deductions which were generated by expenses incurred in
27 providing that service. In making this allocation it is irrelevant on
28 which member's return the deductions would be reported if the

group filed separate returns. Instead, the test is whether the expenses that generate the deduction are used to determine the jurisdictional service's rates. Put more simply, the test is whether the expenses are included in the relevant cost of service. If they are, the associated deductions and their tax reducing benefits will be taken into account in calculating the tax allowance for that cost of service. If the expenses are not, the deductions will not be taken into account. In this way the tax allowance will reflect the profit the ratepayers contribute to the group's consolidated taxable income.¹

Lone Star's requested FIT expense amounts and calculations are shown on Schedule II-E-3. I describe specific considerations supporting Lone Star's FIT calculations under the following subtopics: (1) CTSA; (2) ADFIT; and (3) Other FIT Issues.

A. CTSA

Q. HAS LONE STAR EVALUATED WHETHER ITS STAND-ALONE FIT SHOULD BE REDUCED FOR A CTSA PURSUANT TO PURA §36.060 IN THIS FILING?

A. Yes. The appropriate CTSA in this rate filing is \$0 and will remain so for the foreseeable future.

Q. WHY IS A CTSA OF \$0 APPROPRIATE IN THIS CASE?

A. A CTSA of \$0 is appropriate because Lone Star will be in a net operating loss ("NOL") position during the interim rate period and final rate period. Because

¹ *Columbia Gulf Transmission Co.*, Opinion No. 173, 23 FERC ¶ 61,396 (1983) (internal citations omitted).

1 Lone Star is in a NOL position, there are no affiliated entity tax savings available
2 to Lone Star.
3

4 **Q. PLEASE BRIEFLY DESCRIBE WHY LONE STAR WILL BE IN A NET**
5 **OPERATING LOSS POSITION.**

6 A. Lone Star expects to be in a net operating loss position during the interim rate
7 period and final rate period due to accelerated tax depreciation and bonus
8 depreciation. Schedules II-E-3.1 (interim) and II-E-3 (final) provide the NOL
9 calculation for interim and final rates, respectively.
10

11 **Q. PLEASE BRIEFLY DESCRIBE ACCELERATED TAX DEPRECIATION**
12 **AND BONUS DEPRECIATION AND EXPLAIN HOW EACH OF THESE**
13 **ITEMS CONTRIBUTES TO LONE STAR'S NOL POSITION.**

14 A. Accelerated tax depreciation and bonus depreciation are income tax benefits
15 available to companies that invest in capital projects involving the purchase or
16 construction of property, plant and equipment. The tax law regarding accelerated
17 depreciation and bonus depreciation is contained in Section 167 and Section 168
18 of the IRC. Accelerated depreciation allows a taxpayer to claim tax depreciation
19 over a shorter recovery period and at an accelerated rate when compared to the
20 recovery period and rate permitted for book purposes. Bonus depreciation allows
21 a taxpayer to claim a tax deduction in the year an asset is placed in service for the
22 full amount or one-half of the purchase price, or the cost of construction, of all
23 qualified property, plant and equipment. For 2011, the tax deduction for bonus

1 depreciation is generally equal to the full cost of the asset. For 2012, one-half of
2 the cost of constructing or purchasing property, plant and equipment is currently
3 deductible, and the remaining cost may be depreciated using accelerated rates and
4 shorter lives than those used for book purposes. It should be noted that bonus
5 depreciation will apply beyond 2012 for certain assets that are constructed and
6 placed in service under long-term construction contracts. Accelerated tax
7 depreciation and bonus depreciation contributed to Lone Star's NOL position in
8 the amounts of \$30,037,551 and \$328,072,668, as shown on Schedules II-E-3.3
9 (interim) and II-E-3.3 (final), respectively.

10
11 **B. ADFIT**

12 **Q. WHAT IS ADFIT AND HOW DOES IT AFFECT RATES?**

13 A. ADFIT represents the amount of tax that will become due and payable as
14 temporary differences between book and tax of current or past periods reverse in
15 future periods. For example, a deferred income tax liability is recognized to
16 reflect the expected future consequences of tax deductions previously claimed for
17 FIT purposes, but not yet reflected on the Company's financial statements, such
18 as accelerated tax depreciation or bonus depreciation. Deferred tax expense
19 recorded on the Company's income statement is included as a recoverable cost of
20 service for regulatory purposes. Accumulated deferred income taxes recorded on
21 the Company's balance sheet generally serve to reduce the Company's rate base.

1 **Q. IS THE DISTINCTION BETWEEN PERMANENT AND TEMPORARY**
 2 **DIFFERENCES IMPORTANT TO THE INCOME TAX CALCULATION?**

3 A. Yes. A permanent difference is a book-tax difference that arises because of an
 4 exclusion of a revenue item from taxable income, such as tax-exempt interest
 5 income, or from the non-deductibility of an expense for income tax purposes,
 6 such as penalties. Deferred taxes are not recognized for items related to a
 7 permanent difference.

8

9 **Q. WHAT IS THE ADFIT COMPONENT OF RATE BASE FOR THE**
 10 **COMPANY'S INTERIM RATE REQUEST?**

11 A. The ADFIT component of rate base for the Company's interim rate request is a
 12 net deferred tax liability of \$868,041, as shown on Schedule II-E-3.7 (interim).
 13 This ADFIT is composed of two deferred tax assets and two deferred tax
 14 liabilities. The first deferred tax asset is a result of the NOL accrued during the
 15 interim rate period, with the second deferred tax asset being a result of the injury
 16 and damages reserve detailed on Schedule II-B-7 (interim). The first deferred tax
 17 liability is a result of the temporary difference related to accelerated depreciation.
 18 For income tax purposes, tax depreciation is recovered at an accelerated rate over
 19 a recovery period that is less than the asset life. For book depreciation, the asset
 20 is depreciated on a straight-line basis over the estimated useful life of the asset.
 21 The difference between tax depreciation and book depreciation creates a deferred
 22 tax liability that will reverse as book depreciation continues over the remaining
 23 estimated useful life of the asset. This computation is contained in Schedule II-E-

3.3 (interim). The second deferred tax liability is a result of the temporary difference associated with the amortization of organization expenses, which are amortized over 54 years for book purposes and over 15 years for tax purposes. This computation is detailed on Schedule II-E-3.9 (interim).

Q. WHAT IS THE ADFIT COMPONENT OF RATE BASE FOR THE COMPANY'S FINAL RATE REQUEST?

A. The ADFIT component of rate base for the Company's final rate request is also a net deferred tax liability of \$12,987,029, as shown on Schedule II-E-3.7 (final). This ADFIT is composed of three deferred tax assets and two deferred tax liabilities. The first deferred tax asset is a result of the NOL accrued during the final rate period, with the second deferred tax asset being a result of the injury and damages reserve and maintenance reserve detailed on Schedule II-B-7 (final). The third deferred tax asset is the result of the temporary difference associated with amortization of the rate case expenses, which are amortized over two years for book purposes and over 15 years for tax purposes. This computation is detailed on Schedule II-E-3.9 (final). The first deferred tax liability is again a result of the temporary differences related to accelerated depreciation, the computations for which are contained in Schedule II-E-3.3 (final). The second deferred tax liability is the result of the temporary difference associated with the amortization of organization expenses, which are detailed on Schedule II-E-3.9 (final).

1 **C. Other FIT Issues**

2 **Q. WHAT IS ASC 740 (FORMERLY SFAS 109)?**

3 A. “ASC 740” stands for Accounting Standards Codification Topic 740, Income
4 Taxes. ASC 740 addresses how companies should account for and report the
5 effects of taxes based on income.

6

7 **Q. HAS LONE STAR IMPLEMENTED ASC 740 ACCOUNTING**
8 **REQUIREMENTS FOR INCOME TAXES?**

9 A. Yes.

10

11 **Q. ARE THERE ANY RATEMAKING IMPACTS FROM IMPLEMENTING**
12 **THE ASC 740 REQUIREMENTS?**

13 A. Yes. Schedule II-E-3.7 lists the ASC 740 related deferred tax liabilities and assets,
14 and Schedule II-B-12 lists any corresponding regulatory assets and liabilities
15 recorded on the Company’s books at the end of the rate period. Accordingly, the
16 Company has treated the regulatory assets and deferred taxes consistently for
17 ratemaking purposes.

1 **Q. PLEASE BRIEFLY DESCRIBE A “FIN 48 RESERVE” FOR UNCERTAIN**
 2 **TAX POSITIONS AND INDICATE WHETHER LONE STAR HAS**
 3 **INCLUDED ANY FIN 48 AMOUNTS, LIABILITIES OR RESERVE IN ITS**
 4 **ADFIT BALANCE.**

5 **A. A “FIN 48 Reserve” is a financial accounting reserve recorded as an expense on a**
 6 **company’s income statement, and a liability on a company’s balance sheet. The**
 7 **reserve reflects an estimated tax liability, including penalties and interest, for**
 8 **uncertain income tax positions claimed on a company’s income tax return. Lone**
 9 **Star has no uncertain tax positions. Therefore, Lone Star has not included a FIN**
 10 **48 Reserve in any of its schedules in this rate filing.**

11

12 **Q. PLEASE BRIEFLY EXPLAIN THE DOMESTIC PRODUCTION**
 13 **ACTIVITIES DEDUCTION (“SECTION 199 DEDUCTION”), AND**
 14 **INDICATE WHETHER A TAX BENEFIT FOR A SECTION 199**
 15 **DEDUCTION IS REFLECTED IN THE COMPANY’S COST OF**
 16 **SERVICE CALCULATION.**

17 **A. Pursuant to Section 199 of the IRC, a company engaged in manufacturing or**
 18 **production activities is entitled to a federal income tax deduction equal to 9% of**
 19 **the lesser of its domestic production activities, or its taxable income for the year.**
 20 **According to Section 199(c)(4)(ii) of the IRC, the transmission of electricity is**
 21 **not a domestic production activity for purposes of this tax deduction. Therefore,**
 22 **the income tax expense included in Lone Star’s rate filing does not reflect a**
 23 **Section 199 Deduction.**

IV. AD VALOREM TAXES

Q. WHAT ARE AD VALOREM TAXES?

A. Ad valorem taxes are taxes assessed on the value of real property or improvements to real property or personal property.

Q. WHAT IS THE AD VALOREM TAX EXPENSE INCLUDED IN LONE STAR'S INTERIM RATE REQUEST?

A. The ad valorem tax expense included in Lone Star's interim rate request is \$716,715, as shown on Schedule II-E-2 (interim). The ad valorem tax expense is computed by reducing the property in service by the intangible costs (*i.e.*, non-taxable items) and accumulated depreciation. The resulting taxable value was then multiplied by the tax rate to calculate ad valorem tax expense for the interim rate period. These computations are detailed on II-E-2 (interim).

Q. WHAT IS THE AD VALOREM TAX EXPENSE INCLUDED IN LONE STAR'S FINAL RATE REQUEST?

A. The ad valorem tax expense included in Lone Star's final rate request is \$12,375,415, as shown on Schedule II-E-2 (final). The ad valorem tax expense is computed by reducing the property in service by the intangible costs (*i.e.*, non-taxable items) and accumulated depreciation. The resulting taxable value was then multiplied by the tax rate to calculate ad valorem tax expense for the final rate period. These computations are detailed on II-E-2.1 (final).

1 **Q. HOW DOES THE COMPANY PROPOSE TO REFLECT INCREMENTAL**
2 **AD VALOREM TAX INCREASES OR DECREASES IN THE FUTURE?**

3 A. As discussed in the direct testimony of Lone Star witness Richard Cribbs, the
4 Company is proposing that changes in ad valorem taxes (as compared to the level
5 included in the final rates in this case) would be adjusted through an Ad Valorem
6 Tax Rider.

7
8 **Q. IS THIS A FAIR AND BALANCED WAY TO ADDRESS THE**
9 **UNCERTAINTY SURROUNDING AD VALOREM TAXES?**

10 A. Yes. Ad valorem taxes are subject to legislative and administrative changes that
11 are beyond Lone Star's control. An Ad Valorem Tax Rider ensures that the
12 amount collected through rates will reflect the amount paid by Lone Star.

13

14 **V. TEXAS STATE FRANCHISE TAX**

15 **Q. WHAT IS THE TEXAS STATE FRANCHISE TAX?**

16 A. According to the Texas Comptroller of Public Accounts, the Texas franchise tax
17 is a privilege tax imposed on each taxable entity formed or organized in Texas or
18 doing business in Texas.

19

20 **Q. WHAT AMOUNT HAS LONE STAR INCLUDED IN COST OF SERVICE**
21 **FOR THE TEXAS STATE FRANCHISE TAX?**

22 A. Lone Star is requesting that \$128,569 in Texas state franchise tax expense be
23 included in interim rates and \$980,731 in Texas state franchise tax expense in

final rates. Those amounts are shown on Schedule II-E-2 (Taxes Other than Federal Income Taxes). Schedule II-E-2 (interim) provides information supporting the Company's interim rate request, and Schedule II-E-2 (final) provides information supporting the final rate request.

Q. HOW IS THE TEXAS STATE FRANCHISE TAX SHOWN ON SCHEDULE II-E-2 CALCULATED?

A. The tax included in both the interim rate request and the final rate request is calculated as 1% of the taxable margin, which is defined as 70% of total revenue, in accordance with Texas law. In both the interim rate request and the final rate request the tax calculation is shown on WP/II-E-2-Attach.

VI. AFFILIATE CHARGES FOR TAX SERVICES

Q. WHAT SERVICES AND EXPERTISE DOES THE TAX DEPARTMENT PROVIDE TO LONE STAR?

A. The Tax Department performs tax research, tax return filing and tax compliance services. In addition, the Tax Department provides technical support on federal, state and local tax issues, and tracks and analyzes federal and state tax legislation ("Tax Services"). Members of the Tax Department are typically Certified Public Accountants and Tax Attorneys licensed in one or more states. Collectively, the group is made up of seasoned professionals with diverse work experience in both regulated and unregulated industries.

1 **Q. ARE THE AFFILIATE COSTS RELATED TO TAX SERVICES**
2 **REASONABLE AND NECESSARY?**

3 **A.** Yes. The Tax Services that the Tax Department provides to Lone Star are an
4 essential and necessary cost of doing business and are not duplicative of any other
5 service provided to or by Lone Star. By relying on the Tax Department for its tax
6 needs, Lone Star receives an experienced depth of service (resources and
7 expertise) at a reasonable cost. The direct testimony of Mr. Cribbs speaks to the
8 cost related to Tax Services.

9
10 **VII. CONCLUSION**

11 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

12 **A.** The tax amounts discussed in my testimony and reflected on the Company's
13 Schedules are reasonable and necessary and should be included in Lone Star's
14 cost of service in this case.

15
16 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

17 **A.** Yes, it does.

STATE OF Florida §
COUNTY OF Palm Beach §

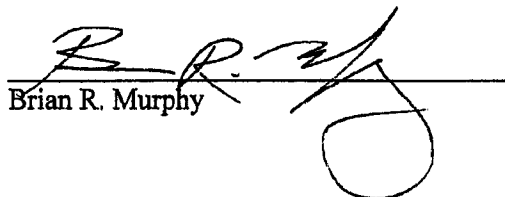
AFFIDAVIT OF BRIAN MURPHY

BEFORE ME, the undersigned authority, on this day personally appeared Brian R.

Murphy, who, having been placed under oath by me, did depose as follows:

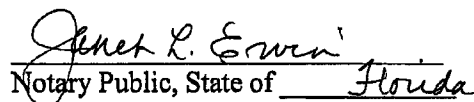
1. "My name is Brian R. Murphy. I am of sound mind and capable of making this affidavit. The facts stated herein are true and correct based upon my personal knowledge. My current position is Senior Tax Director for Florida Power & Light Company.
2. I have prepared the foregoing direct testimony and the attached exhibits offered by me are true and correct to the best of my knowledge."

Further affiant sayeth not.


Brian R. Murphy

22nd SUBSCRIBED AND SWORN TO BEFORE ME by the said Brian R. Murphy this
day of December, 2011.




Notary Public, State of Florida

PUC DOCKET NO. 40020

APPLICATION OF LONE STAR	§	BEFORE THE
TRANSMISSION, LLC FOR	§	
AUTHORITY TO ESTABLISH	§	PUBLIC UTILITY COMMISSION
INTERIM AND FINAL RATES	§	
AND TARIFFS	§	OF TEXAS

DIRECT TESTIMONY

OF

JAY JOYCE

ON BEHALF OF

LONE STAR TRANSMISSION, LLC

January 9, 2012

INDEX TO THE DIRECT TESTIMONY OF

JAY JOYCE, WITNESS FOR

LONE STAR TRANSMISSION, LLC

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LIST OF EXHIBITS

EXHIBIT JJJ-1	Participation by Jay Joyce in Utility Proceedings
EXHIBIT JJJ-2	Commission Rule 25.231(c)(2)(B)(iii)
EXHIBIT JJJ-3	Cash Working Capital Calculations
EXHIBIT JJJ-4	Summary of Lead-Lag Study

LIST OF SPONSORED/CO-SPONSORED SCHEDULES (INTERIM AND FINAL)

SCHEDULE II-B-9	Rate Base Accounts – Cash Working Capital
SCHEDULE III-B-9	TCOS – Cash Working Capital

EXECUTIVE SUMMARY OF JAY JOYCE

I have performed a lead-lag study to measure the cash working capital ("CWC") allowances required for the operations of Lone Star Transmission, LLC ("Lone Star" or the "Company") during both the interim and final rate periods. The lead-lag days developed in my study are applied to the interim rate revenue requirement and the final rate revenue requirement in order to determine the appropriate CWC requirements for each of these rate periods. As shown on my Exhibit JJJ-3, my lead-lag study establishes that the CWC requirement for Lone Star's interim rate period is negative \$295,724 and is negative \$4,740,830 for the final rate period.

To accurately measure the CWC allowance requirements for Lone Star's operations, my lead-lag study used the following parameters:

- The lead-lag study was performed in accordance with Commission Rule 25.231(c)(2)(B)(iii);
- The lead-lag study used a cash method and did not consider non-cash items;
- The amortization of expenses that the Company classifies as "prepaid expenses" for ratemaking purposes was quantified and excluded from the revenue requirements used to calculate the CWC requirements; and
- Lone Star was able to provide actual, Company-specific data for use in the lead-lag study with only one exception; the vacation adjustment applicable to payroll lead days. In that instance, I reviewed vacation lead days related to payroll that have been recently approved in utility rate cases. I relied on this information because it tends to be reasonably consistent among utilities and the result benefits customers by reducing Lone Star's working capital requirement.

Detailed information supporting my CWC calculations is contained in the summary of the lead-lag study accompanying my testimony, as well as in workpapers. This evidence together with my testimony establishes that I have accurately calculated CWC

requirements that are fair, reasonable, and reflective of Lone Star's actual practices. In sum, the interim and final CWC requirements shown on Exhibit JJJ-3 to my direct testimony should be approved for inclusion in Lone Star's respective rate bases.

DIRECT TESTIMONY OF JAY JOYCE

I. POSITION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Jay Joyce. My business address is Expergy®, 325 N. St. Paul Street, Suite 2100, Dallas, Texas 75201.

Q. PLEASE DESCRIBE YOUR CURRENT POSITION.

A. I am president of Expergy, which provides expert consulting services to the energy and utility industries.

Q. BRIEFLY DESCRIBE YOUR EXPERIENCE AND QUALIFICATIONS.

A. I graduated from the University of Texas with a Bachelor of Business Administration degree in Finance. I earned a Master of Business Administration degree from Southern Methodist University. While at Southern Methodist University, I was employed by Reed-Stowe & Co. as a Senior Consultant.

In 1995, I joined the Management Consulting division of Deloitte & Touche LLP (now Deloitte Consulting) as a Manager. In 1997, I was promoted to Senior Manager. My responsibilities included project management for utility-related projects including cash working capital studies and preparation of expert testimony before various commissions, courts, and other governmental authorities.

1 In January 2003, I resigned from Deloitte to join Management Applications
2 Consulting ("MAC"), a small professional services firm specializing in utility rate
3 matters. In 2004, four professionals, including several MAC partners and myself,
4 formed Alliance Consulting Group, a professional services firm headquartered in
5 Dallas and focused on the utility industry. In December 2008, I sold my interest
6 in the Alliance partnership, and I launched my own consulting firm, Expergy.
7

8 **Q. HAVE YOU PREVIOUSLY TESTIFIED AS AN EXPERT WITNESS?**

9 A. Yes. I have previously testified before, or submitted written testimony to, the
10 Public Utility Commission of Texas ("Commission"), the Public Utilities
11 Commission of Ohio, the Arkansas Public Service Commission, the Railroad
12 Commission of Texas, the Public Service Commission of West Virginia, the
13 Texas Commission on Environmental Quality, the Virginia State Corporation
14 Commission, the U.S. District Court for the Northern District of California, and
15 the Superior Court of Fulton County, Georgia. Exhibit JJJ-1 provides a listing of
16 the utility proceedings in which I have appeared as an expert witness, participated
17 as an expert, or made formal presentations in utility matters.
18

19 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?**

20 A. I am testifying on behalf of Lone Star.

II. INTRODUCTION

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Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to sponsor the results of the lead-lag study used to measure the CWC allowance required for the Company's operations. The calculations of CWC amounts are attached as Exhibit JJJ-3, and the summary of the lead-lag study is Exhibit JJJ-4 to my testimony. My study supports the CWC allowances that are included in both the interim rate requested by the Company and the final rate that will be implemented upon placing the entire transmission line in service, a process which is described in more detail by Lone Star witnesses Michael Grable and Richard Cribbs. The lead-lag days developed in my study are applied to the interim rate revenue requirement and the final rate revenue requirement in order to determine the appropriate CWC requirements for each rate period.

Q. DO YOU SPONSOR ANY EXHIBITS IN SUPPORT OF YOUR TESTIMONY?

A. Yes. I sponsor the exhibits listed in the table of contents.

Q. WERE THESE EXHIBITS PREPARED BY YOU OR UNDER YOUR DIRECT SUPERVISION?

A. Yes.

1 **Q. DO YOU SPONSOR OR CO-SPONSOR ANY SCHEDULES?**

2 A. Yes. Consistent with the context of my testimony, I sponsor or co-sponsor the
3 Schedules listed in the table of contents.
4

5 **Q. CAN YOU PROVIDE A DEFINITION OF CWC AS A RATE BASE**
6 **COMPONENT?**

7 A. Yes. CWC is a component of utility rate base that is the average amount of
8 capital provided by investors to bridge the gap between the time when
9 expenditures are required to provide services and the time when collections are
10 received for such services.
11

12 **Q. WOULD YOU EXPLAIN HOW CWC IS MEASURED FOR RATE BASE**
13 **PURPOSES?**

14 A. Yes. It is a common practice for regulators to establish the total costs incurred in
15 providing service (*i.e.*, the Cost of Service) and to use such costs as the basis upon
16 which rates are fixed and charged for the services provided. A significant
17 component of Cost of Service is the cost of financing the investor capital required
18 to build facilities and maintain ongoing operations. In some instances, the
19 funding supplied by investors, such as the capital required to build facilities or to
20 maintain supplies, is measurable from readily available information, such as
21 financial statements. Other investor supplied funds cannot be easily identified in
22 the Company's financial records; thus, the level of funding used to support these
23 investor capital requirements must be determined through special analyses. Such

1 special analyses have been labeled as lead-lag studies, and the results labeled as
2 CWC requirements. When the various components of the rate base, including
3 CWC, are adequately identified and combined, a correct and reliable measure of
4 investor capital funding is produced. Below I describe in more detail the
5 meanings of the terms "lead" and "lag."

6

7 **Q. WHAT IS A LEAD-LAG STUDY?**

8 A. A lead-lag study uses historical data and actual payment requirements to measure
9 the differences in the time frames between (1) the time services are rendered until
10 the revenues for those services are received and (2) the time that the costs
11 associated with items used in providing those services, such as labor and materials
12 are incurred until they are paid for. The differences between these periods are
13 expressed in days, which are then multiplied by the average daily operating
14 expenses to produce the working capital required for operations.¹

15

16 **Q. WHAT STANDARDS DID YOU APPLY IN DEVELOPING YOUR LEAD-**
17 **LAG STUDY?**

18 A. My lead-lag study was prepared consistent with the requirements set forth in
19 Commission Rule 25.231(c)(2)(B)(iii) and is based on the most accurate,
20 Company-specific data available at the time the study was conducted. I have
21 included Commission Rule 25.231(c)(2)(B)(iii) as Exhibit JJJ-2 to my testimony.

¹ Accounting for Public Utilities, Robert L. Hahne, *et al.*, Matthew Bender, §5.06 (1983, as updated).

1 **Q. IS YOUR LEAD-LAG STUDY IN THIS CASE CONSISTENT WITH THE**
2 **LEAD-LAG STUDIES YOU PERFORM FOR INCUMBENT UTILITIES?**

3 A. Yes. Both rely substantially on actual data applicable to the company at issue. In
4 the case of Lone Star, virtually all of the data used in the lead-lag study is actual
5 Company data for the twelve month period ended June 30, 2011, which was the
6 most recent data available at the time my study was conducted. In fact, the only
7 instance in which I needed to rely on information that was not Company-specific
8 was for the vacation adjustment applicable to payroll lead days. In that instance, I
9 reviewed vacation lead days that have been recently approved in utility rate cases.
10 I relied on this information because it tends to be reasonably consistent among
11 utilities.

12
13 **Q. IS IT REASONABLE TO APPLY THE RESULTS OF YOUR LEAD-LAG**
14 **STUDY TO THE INTERIM AND FINAL RATE PERIODS IN ORDER TO**
15 **CALCULATE LONE STAR'S CWC REQUIREMENTS?**

16 A. Yes. The lead-lag patterns developed in the lead-lag study are expected to
17 continue into the future. The method I have followed is basically the same
18 method used in every rate proceeding at this Commission. More specifically, I
19 used actual Company-specific data to develop the lead-lag days, and those results
20 were applied to the estimated revenue requirements during the rate periods.
21 Information that was not specific to Lone Star was used only in the single instance
22 where such information was unavailable and could not be reasonably expected to
23 exist.

1 Q. DO YOU ANTICIPATE THAT THE COMPANY'S PAYMENT
2 PATTERNS WILL REMAIN SUBSTANTIALLY THE SAME FROM THE
3 INTERIM RATE PERIOD THROUGH THE FINAL RATE PERIOD?

4 A. Yes. The payment patterns are anticipated to be the same, and the lead-lag study I
5 have performed is valid for both periods. As noted in Accounting for Public
6 Utilities: "...absent significant changes in receipt patterns for revenue or payment
7 patterns of expenses, the lead-lag days determined will be valid for a period of
8 two to three years and can be applied to the dollars of revenues, expenses, etc., in
9 future cases."²

10

11 **III. LEAD-LAG STUDY APPROACH**

12 Q. PLEASE DESCRIBE THE GENERAL APPROACH YOU USED TO
13 CONDUCT THE LEAD-LAG STUDY FOR LONE STAR.

14 A. I conducted two days of on-site interviews in April 2011. Additional interviews
15 were conducted later via teleconference. I requested and had discussions with
16 personnel knowledgeable about billing, collections/accounts receivable, factoring
17 or sale of receivables, payroll, employee benefits, accounts payable, affiliate
18 transactions, payroll taxes, sales taxes, property taxes, state franchise taxes, local
19 gross receipts taxes, public utility commission taxes, income taxes, and bank
20 balances in non-interest-bearing accounts. Based on these interviews, I requested
21 and received data regarding the Company's payments, payment patterns, and

² Accounting for Public Utilities, Robert L. Hahne, *et al.*, Matthew Bender, §5.05 (1983, as updated).

1 payment requirements that I used to develop the lead-lag study. This information
2 is reflected in my workpapers.

3
4 **Q. WHAT TYPES OF ACTUAL LONE STAR DATA WERE YOU ABLE TO**
5 **OBTAIN AND USE IN YOUR STUDY?**

6 A. I obtained actual Lone Star data for every aspect of the study with one exception,
7 which I discuss later in my testimony. Based on this information, I was able to
8 calculate lead and lag days specific to Lone Star. The information I received from
9 Lone Star included the following:

- 10 • Actual signed agreements between Lone Star and affiliates;
- 11 • Actual historical payment data from Lone Star to affiliates;
- 12 • Historical accounting data;
- 13 • Actual billing and collection rules applicable to Lone Star;
- 14 • Actual due dates established by governmental agencies and contracts
15 applicable to Lone Star;
- 16 • The actual payout patterns of the Company's incentive compensation
17 program;
- 18 • The actual Lone Star payroll calendar;
- 19 • Actual Texas State Franchise Tax filing documents and requirements
20 for Lone Star;
- 21 • Actual historical payroll tax data for Lone Star; and
- 22 • Actual historical payroll withholding data for Lone Star.

1 **Q. ONCE YOU OBTAINED THE DATA, HOW DID YOU DEVELOP THE**
2 **LEAD-LAG STUDY?**

3 A. The lead-lag study for Lone Star reflects anticipated payment patterns associated
4 with the interim rate period of April 1, 2012, through March 31, 2013, and with
5 the final rate period of April 1, 2013, through March 31, 2014. In order to
6 accurately measure investor supplied capital, I developed the lead-lag study using
7 the following parameters:

- 8 1. The lead-lag study uses a cash method and does not consider non-
9 cash items;
- 10 2. The lead-lag study was performed in accordance with Commission
11 Rule 25.231(c)(2)(B)(iii). For example, to determine the lead days
12 for expenses, the later of the invoice due date or the payment clear
13 date is used. If the payment was made by check, check float lead
14 (*i.e.*, the average time between check date and encashment) was
15 also applied to the expense lead; and
- 16 3. The amortization of those expenses that the Company classifies as
17 “prepaid expenses” for ratemaking purposes is specifically
18 quantified and excluded from the revenue requirements used to
19 calculate Lone Star’s CWC requirements.

20

21 **Q. PLEASE DESCRIBE THE APPLICATION OF THE TERMS “LEAD”**
22 **AND “LAG” AS USED IN THE LEAD-LAG STUDY.**

23 A. The terms “lead” and “lag” have been applied in various ways. For purposes of
24 this presentation, I have used the terms “revenue lag” and “expense lead” as
25 follows:

- 26 1. Revenue lag – the number of days of lag time between providing
27 electric transmission service to the Company’s customers and the
28 subsequent receipt of payments for service.

- 1 2. Expense lead – the number of days of lead time between the service
2 period of goods or services used by the Company to provide electric
3 transmission service and the payments to vendors for those goods
4 and services.

5
6 **Q. HOW DID YOU DEVELOP THE LEAD AND LAG DAYS IN YOUR**
7 **LEAD-LAG STUDY?**

8 A. I developed the composite revenue lag days from the anticipated billing and
9 payment patterns of the Company's customers. Similarly, I developed the
10 expense lead days for each of the various categories of system expenses by
11 measuring the period of time from when the costs will be incurred until payments
12 are made for such costs.

13
14 **Q. HAVE YOU SUBMITTED EXHIBITS THAT REFLECT ACCURATE**
15 **MEASUREMENTS OF THESE INVESTOR PROVIDED FUNDS?**

16 A. Yes. Exhibit JJJ-3 contains the calculations and results of the lead-lag study as
17 those results apply to electric transmission services that will be provided by Lone
18 Star. As shown in this exhibit, for both the interim and final rates, the net
19 difference between the computed Revenue Lag days and the computed Expense
20 Lead days was multiplied by the average daily revenue requirements of the
21 system in order to produce the net CWC required.

1 **A. Revenue Lag**

2 **Q. HOW WAS THE REVENUE LAG DEVELOPED IN THE LEAD-LAG**
3 **STUDY?**

4 A. Revenue Lag consists of four components: (1) the service lag measured from the
5 middle of the period for which service is billed; (2) the billing lag that reflects the
6 time required to process and record bills; (3) the collection lag that identifies the
7 time delay between the recording of bills and the receipt of the billed revenues;
8 and (4) the delay in the bank's clearance of deposited check payments. The total
9 number of days produced by the four components represents the amount of time
10 between providing transmission service to customers and the receipt of the related
11 revenues for such service.

12
13 The first of these four components, the *service lag*, measures the time span over
14 which services are provided. The critical feature of this measure is that it
15 establishes the *common point* from which the timing difference between cost
16 incurrence and revenue recovery is measured. For example, assume that a cost is
17 incurred, recorded, and is paid 15 days after the end of the service period. Further
18 assume that the revenues for the related services are recovered 20 days after the
19 end of the service period. In these circumstances, the net recovery lag is 5 days
20 regardless of the point in time used as the starting point. These assumed
21 conditions illustrate that the cost incurrence and cost recovery periods must be
22 measured from a common point. That point may be at the beginning of the
23 period, at the end of the period, or at some point in between. This Commission

1 has consistently adopted an approach that relies on the mid-point of the service
2 period which assumes that service will be provided evenly over the service
3 period. Consistent with the Commission's precedent, I used the mid-point of the
4 service period in my analysis.

5
6 The second component is the time consumed in the billing process, or the *billing*
7 *lag*. In Lone Star's billing process, this period is the difference from the end of
8 the billing period to the date the invoice is mailed to the Distribution Service
9 Providers ("DSPs").³ The Company anticipates that its billing process will require
10 one business day to process and mail the paper invoices. Based on the Company's
11 expectation, I have used a 1.58 day billing lag in order to reflect that in some
12 instances the next business day is more than one actual day due to weekends and
13 holidays.

14
15 The third component, the *collection lag*, reflects the time between billing for the
16 services rendered and the receipt from customers of the revenues billed. The
17 collection lag days are based on the actual expected collection lag under
18 Commission Rule 25.202(a)(1), which states that, "An invoice for transmission
19 service shall be paid so that the TSP will receive the funds by the 35th calendar
20 day after the date of issuance of the invoice, unless the TSP and the transmission
21 service customer agree on another mutually acceptable deadline." Consistent
22 with the Commission's Rule, I have used a 35-day collection lag.

³ Per Commission Rule 25.202, "Within a reasonable time after the first day of each month, transmission service providers (TSPs) shall issue invoices for the prior month's transmission service."

The fourth component of the revenue recovery lag, the *cash receipts float*, represents the time between the receipt of funds from customers until the funds clear the banks and are available to the Company. The cash receipts float is based on the anticipated float under Commission Rule 25.202(a)(1), which states that, “All payments shall be made in immediately available funds payable to the TSP, or by wire transfer to a bank named by the service provider or by other mutually acceptable terms.” Since all payments from the DSPs are electronic, Lone Star’s cash receipts float is zero days.

Each of these revenue lag components was totaled to arrive at total revenue lag days.

B. Expense Lead – Operation and Maintenance Expenses

Q. PLEASE EXPLAIN THE OTHER OPERATION AND MAINTENANCE (“O&M”) EXPENSE LEAD DAYS.

A. In determining the lead days for this group of expenses, I separated total system expenses into four groups – regular payroll costs, incentive payroll costs, third-party O&M costs (e.g., materials, services, etc.), and affiliate transactions. I measured the lead days for each of these groups independently.

1 **1. Regular Payroll**

2 **Q. HOW DID YOU DETERMINE THE LEAD DAYS FOR THE PAYROLL**
3 **COSTS?**

4 A. I based the lead days for payroll on the Company's wage payment process that
5 employs bi-weekly pay periods. Employees are paid on Thursday after the end of
6 the Saturday-Friday pay period, except when the Thursday payday falls on a
7 holiday. In such cases, the payday is moved up to Wednesday. I computed the
8 lead days for payroll costs by determining the average days of service being
9 reimbursed and adding the days between the end of each service period and the
10 payment to employees. This calculation produces the number of total days
11 between the middle of the period for which employees' costs are recorded and the
12 disbursement of the payments. These calculations were based on actual historical
13 Company data for the twelve months ended June 30, 2011. Holidays are also
14 based on actual historical data for the twelve months ended June 30, 2011.

15
16 **Q. DID YOU MAKE ANY ADJUSTMENT TO THE PAYROLL LEAD DAYS**
17 **IN YOUR LEAD-LAG STUDY?**

18 A. Yes. I have adjusted the payroll lead days to incorporate the effects of vacation
19 pay using a 7.5% vacation factor.

1 **Q. WHAT IS THE BASIS FOR YOUR VACATION ADJUSTMENT TO**
2 **PAYROLL LEAD DAYS?**

3 A. As I mentioned earlier, Lone Star's employees are generally new to the Company,
4 and a vacation pattern has not yet been established. In order to address this fact, I
5 based the vacation adjustment on comparable data from recent utility rates cases.
6 The cases that I reviewed are detailed in my workpapers. As my workpapers
7 show, vacation patterns are generally consistent among utilities, and thus provide
8 a reasonable basis on which to make a vacation adjustment to Lone Star's payroll
9 lead days.

10
11 **Q. WHAT EFFECT DOES YOUR DECISION TO INCLUDE A VACATION**
12 **ADJUSTMENT HAVE ON THE WORKING CAPITAL ANALYSIS?**

13 A. While the Commission's Rule does not require a vacation adjustment to payroll
14 lead days, my decision to include a vacation adjustment to payroll lead days
15 represents a conservative approach that benefits customers by reducing Lone
16 Star's working capital requirement.

17
18 **Q. DID YOU CONSIDER CHECK FLOAT FOR PURPOSES OF**
19 **DETERMINING THE LEAD DAYS ATTRIBUTABLE TO PAYROLL**
20 **COSTS?**

21 A. Yes. The historical Company data for the twelve months ended June 30, 2011,
22 establishes that all of the Company's employees utilize direct deposit, so payroll
23 check float is zero days.

1 2. **Incentive Payroll**

2 **Q. PLEASE EXPLAIN THE CALCULATION OF LEAD DAYS FOR LONE**
3 **STAR'S INCENTIVE PAYROLL.**

4 A. The Company has an annual incentive program. The Company's annual
5 incentives were paid on March 10, 2011. These incentives were based on
6 calendar year 2010 performance. I based the lead days on the weighted days
7 between the midpoint of the service period and the date the incentives were paid.
8 A copy of the Company's incentive program is included in my workpapers.

9
10 3. **Other Non-Affiliate O&M Costs**

11 **Q. HOW WERE THE LEAD DAYS DETERMINED FOR THE REMAINING**
12 **NON-AFFILIATE EXPENSES IN THE O&M EXPENSE GROUP?**

13 A. The measure of lead days for the expenses in this group of Other Operation and
14 Maintenance Expenses was based upon random sampling of these expenses for
15 the period January 1, 2011 through June 30, 2011. In addition, I verified that the
16 payment patterns identified in the random sample were consistent with Lone
17 Star's ongoing payment patterns by examining a random sample of these
18 expenses for the period July 1, 2011, through September 30, 2011.

19
20 **Q. HOW WAS THE MID-POINT OF THE SERVICE PERIOD FOR OTHER**
21 **NON-AFFILIATE O&M COSTS IDENTIFIED?**

22 A. Consistent with the ruling of the Commission in AEP Texas Central Company's
23 Docket No. 33309, the study estimates the midpoint of the service period

1 independently for each invoice rather than assuming that the invoice date is the
2 midpoint of the service period for all invoices. I carefully examined each of the
3 sample items to determine the service period and the invoice due date. Consistent
4 with the requirements of the Commission, the effects of the amortization of
5 prepaid expenses were removed.

6
7 **4. Other O&M – Affiliate Transactions**

8 **Q. HOW DID YOU DEVELOP THE LEAD DAYS ASSOCIATED WITH**
9 **AFFILIATE TRANSACTIONS?**

10 **A.** There are three types of affiliate transactions: (1) transactions between Lone Star
11 and NextEra Energy Resources, LLC ("NEER"), (2) transactions between Lone
12 Star and Florida Power & Light Company ("FPL"), and (3) transactions between
13 Lone Star and NextEra Energy Transmission, LLC ("NEET"). Affiliate charges
14 are settled in the month following the month in which charges are incurred. Thus,
15 the service period is calculated from the mid-month to the appropriate date in the
16 following month. The lead on the monthly affiliate charges is calculated using the
17 later of the actual payment clear date or the payment due date set forth in the
18 agreements among the affiliated entities. These calculations were based on actual
19 historical Company data for the twelve months ended June 30, 2011. The actual
20 signed affiliate agreements that govern these transactions are included in my
21 workpapers.

C. Expense Lead – Current Federal Income Tax Expense

Q. WHAT ARE THE LEAD DAYS ASSIGNED TO FEDERAL INCOME TAXES?

A. As required by Commission Rule 25.231(c)(2)(B)(iii)(IV)(-f-), the lead days for federal income taxes were calculated by measuring the days between the mid-points of the annual calendar year service periods (as the tax is incurred throughout the year) and the actual payment dates. Payment of at least 100% of the estimated tax for the year must be made in quarterly payments on April 15th, June 15th, September 15th, and December 15th. If the scheduled payment date falls on a weekend or holiday, the quarterly payment is made on the first workday after the indicated date. Lone Star will not pay any current federal income taxes in either the interim or final rate periods; therefore, the CWC associated with current FIT in both periods is \$0.

D. Expense Lead – Depreciation, Deferred Federal Income Tax Expense and Return

Q. DOES YOUR LEAD-LAG STUDY INCLUDE NON-CASH ITEMS, SUCH AS DEPRECIATION, DEFERRED INCOME TAX EXPENSES AND RETURN?

A. No. Commission Rule 25.231(c)(2)(B)(iii) provides that, “The lead-lag study will use the cash method; all non-cash items, including but not limited to depreciation, amortization, deferred taxes, prepaid items, and return (including interest on long-term debt and dividends on preferred stock), will not be considered.” Consistent with this requirement, the above items were not considered in my lead-lag study.

E. Expense Lead and Lag – Taxes Other than Income Taxes

Q. WHAT TAXES ARE INCLUDED IN TAXES OTHER THAN INCOME TAXES?

A. This group of taxes consists of (1) Payroll-related taxes (FICA, Federal Unemployment, and State Unemployment); (2) State Franchise Taxes; and (3) Ad Valorem Taxes.

Q. HOW WERE THE LEAD OR LAG DAYS FOR PAYROLL-RELATED TAXES MEASURED?

A. The payment leads or lags for the various payroll taxes were calculated from the midpoints of the applicable work periods to the respective payment dates of the taxes. Federal and State Unemployment taxes are paid after the end of each quarter based on that quarter's wages up to the annual limit. These calculations were based on actual historical Company data for the twelve months ended June 30, 2011.

Q. WHAT IS THE BASIS FOR YOUR CALCULATION OF THE LAG DAYS FOR STATE FRANCHISE TAXES?

A. My calculation is based on the State Franchise Tax statute applied to the calculation of the lead-lag days. To determine the average lead days for State Franchise Taxes, the study utilizes the statutory payment requirements and resultant pattern. This requires that the study recognize that the Company will pay State Franchise Taxes in May 2012 in order to conduct business in the State

1 of Texas from January 1 through December 31, 2012. This calculation is
2 consistent with the calculation of the lead-lag days for all of the other expenses
3 and revenues included in the lead-lag study.

4
5 **Q. IS YOUR CALCULATION OF THE LAG DAYS FOR THE STATE**
6 **FRANCHISE TAX CONSISTENT WITH THE MOST RECENT RULING**
7 **BY THIS COMMISSION?**

8 A. Yes, it is.⁴ In addition, my calculation of lag days for the State Franchise Tax is
9 consistent with the recent ruling on the issue by the Railroad Commission of
10 Texas.⁵

11
12 **Q. HOW WERE THE LEAD DAYS FOR AD VALOREM TAXES**
13 **MEASURED?**

14 A. The payment lead for ad valorem taxes was calculated from the midpoint of the
15 period for which the tax was assessed to the due date. Lone Star intends to pay its
16 ad valorem taxes by the due date in order to avoid the substantial penalties for late
17 payments. This is consistent with the general practice within the utility industry
18 and is reasonable.

⁴ Docket No. 38339, CenterPoint Energy Houston Electric, Commission's Order on Rehearing issued on June 23, 2011, Finding of Fact No. 50.

⁵ GUD No. 10000, Atmos Pipeline—Texas, Finding of Fact No. 55 (Final Order issued April 19, 2011).

1 **F. Other Component – Payroll Withholdings**

2 **Q. PLEASE EXPLAIN THE OTHER COMPONENT THAT YOU HAVE**
3 **INCLUDED IN CWC.**

4 A. The Other CWC component captures payroll withholdings. This item represents
5 deductions for non-investor sources of capital not explicitly deducted from rate
6 base. Payroll withholdings are not, however, directly measured in the analysis of
7 expenses and must be separately included in the CWC measure. These
8 calculations were based on actual historical Company data for the twelve months
9 ended June 30, 2011.

10
11 **IV. CONCLUSION**

12 **Q. WHERE DO YOU PROVIDE THE DETAILED CALCULATIONS AND**
13 **METHODOLOGIES USED IN THE LEAD-LAG STUDY?**

14 A. Exhibit JJJ-4 is a summary of the lead-lag study. The lead-lag study and the
15 associated workpapers provide detailed information regarding the specific
16 calculations used for each of the lead-lag study components. The supporting
17 documentation can be found in the workpapers and electronic files associated
18 with my testimony and Schedules II-B-9 (interim) and II-B-9 (final).

19
20 **Q. WHAT WERE THE RESULTS OF THE LEAD-LAG STUDY?**

21 A. The CWC requirement for Lone Star for purposes of interim rates is negative
22 \$295,724, and for purposes of final rates is negative \$4,740,830, as shown on

1 Exhibit JJJ-3. I have provided these results to Mr. Cribbs for inclusion in rate
2 base.

3

4 **Q. ARE THE RESULTS OF THIS LEAD-LAG STUDY REASONABLE?**

5 A. Yes. The calculations of CWC requirements resulting from this lead-lag study are
6 reflective of actual or anticipated Company practices, are fair and reasonable, and
7 should properly be included in their respective rate bases.

8

9 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

10 A. Yes, it does.

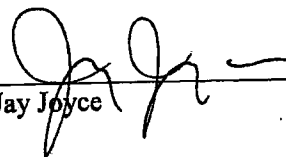
STATE OF TEXAS §
 §
COUNTY OF DALLAS §

AFFIDAVIT OF JAY JOYCE

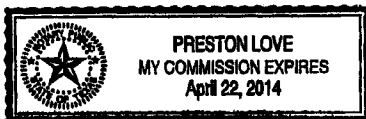
BEFORE ME, the undersigned authority, on this day personally appeared Jay Joyce,
who, having been placed under oath by me, did depose as follows:

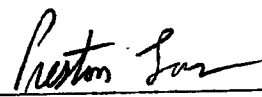
1. “My name is Jay Joyce. I am of sound mind and capable of making this affidavit.
The facts stated herein are true and correct based upon my personal knowledge.
My current position is President of Expergy.
2. I have prepared the foregoing direct testimony and the attached exhibits offered
by me are true and correct to the best of my knowledge.”

Further affiant sayeth not.


Jay Joyce

SUBSCRIBED AND SWORN TO BEFORE ME by the said Jay Joyce this 20th day of
December, 2011.




Notary Public, State of Texas