

## **2. Separation of corporate reporting**

Mid-American assured regulators that the regulated utility would retain its identity by maintaining its own separate reporting, financial records and employees and its own bond rating. In order for regulators to track the financial health of the utility, it must be a separate subsidiary with its own financial records. Separating utility employees from those of the parent/acquirer also provides more accurate analysis of utility operations. Maintaining its own bond rating and, thereby, its own identity is also important for a capital-intensive company like a utility because of the continuing need to raise capital to meet public service requirements. Although the utility's bond rating and financial risk are affected by that of its parent/acquirer, it is important that the utility's separate identity be maintained publicly.

## **3. Regulator access to information about subsidiary and parent**

The post-acquisition utility promised to provide the regulator all written information provided to bond rating agencies. That information is important because it typically includes very detailed information regarding the company's service territory, customer mix, financial projections, generation facilities and purchased power obligations, workforce projections, pension obligations, potential legal issues and the like. All of that information would be available in an S.E.C. filing, but not with the level of detail provided to bond rating agencies nor with projections for the future. Those data can be especially valuable if the utility is taken private and does not publish the information required by the S.E.C.

The regulator, ideally, should also have access to the financial records (income statement, balance sheet, cash flow statement) of the private equity firm (the acquirer) so that the total risk to the utility can be accurately assessed. If the merger were between two publicly traded firms, the regulator would have that information through S.E.C. reporting. As explained in Part V, above, private firms are not required to publish such information, although they must have it internally to manage their firm. The regulatory body therefore should condition merger approval on having continuing access to financial data about the acquiring private equity firm, at a level of detail comparable to what would be available if the firm were publicly traded.

## **4. Prohibition on access to utility cash**

The utility agreed that it would not make any dividend or other cash distributions to the unregulated parent that would cause its utility subsidiary common equity ratio to decline below 40% of total capital. While the ability to limit dividend distributions and cash flows to the parent from the utility helps protect the financial health of a utility, the offer simply to maintain a certain common equity ratio on the financial books of the utility subsidiary is not sufficient. As we saw in Tables 3 through 5, even though our target utility showed a utility-only equity ratio of 50% on its books, that equity is

financed with 17% parent/acquirer equity and 83% debt.<sup>40</sup> Thus the amount of equity supporting what appears to be 50% equity on the subsidiary's balance sheet is actually much less. Moreover, it would be a simple matter for the subsidiary to declare a special dividend to the parent, while the parent issued additional debt in like amount, with the proceeds then injected into the subsidiary to maintain the subsidiary capital structure equity ratio. In that scenario the utility's equity ratio is maintained but cash is transferred to the parent/acquirer while the parent/acquirer finances even more of the utility equity with debt.

A more direct way for regulators to monitor cash flows between the utility and the parent/acquirer is to require the utility to notify the commission prior to such a transfer, or request permission to do so. If the regulator believed the funds transfer to be problematic, it could prohibit or condition the transfer. The alert the regulatory body, the more the financial risk separation between the entities.

The primary means of transferring cash from a subsidiary to a parent is through dividend payments. Monies can be transferred by other means, such as inter-company loans and/or affiliate transactions. If the regulated subsidiary guarantees debt or other obligations of the parent, that guarantee represents a potential for cash flows out of the utility if the parent defaults on its obligations. MidAmerican committed that the utility would not guarantee any debt obligations of the unregulated parent or any of its affiliates. That commitment should be a minimum requirement of any buyout or merger: the utility should not guarantee any additional debt (debt in excess of the transaction debt) of the parent or other subsidiaries.

Corporate money pools also offer opportunities for regulated subsidiaries to provide cash to unregulated affiliates. Holding companies with several subsidiaries often have "money pools," a cash management facility where subsidiaries deposit or borrow cash on a daily basis. Such money pools provide a linkage between the financial operations of regulated and unregulated firms in the holding company. For example, a cash-rich utility operation could lend the holding company money pool \$50 million. A cash-poor competitive affiliate could then borrow that same \$50 million from the money pool, at a short-term debt rate. In effect, the regulated utility is lending money to the unregulated operation. Such a transaction would not violate a prohibition against utility loans to affiliates if the utility's \$50 million contribution is be characterized as "participating in the corporate money pool" and not specifically lending to any entity directly. Such a characterization would not be untrue factually but it would be misleading practically, because it would mask the actual financial linkage of the regulated and unregulated subsidiaries.

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<sup>40</sup> Table IV shows that the parent-only capital structure of the acquirer contains \$10 equity and \$50 new debt, and the total capital = \$60. The parent-only equity ratio is  $\$10/\$60 = 17\%$  and the parent-only debt ratio is  $\$50/\$60 = 83\%$ .

## **5. Single purpose entity with a single independent director**

The final criterion set out in the MidAmerican/Pacificorp ring-fencing plan calls for a "single purpose entity" (SPE)—a corporate layer placed between the parent company and the utility subsidiary. That SPE has an independent director unaffiliated with the parent, incurs no debt, cannot merge or consolidate with any other corporate entity, and cannot be dissolved as long as the parent and utility ownership relationship persists. The sole function of the additional corporate layer entity, according to Standard & Poor's, is to prevent the parent company from filing the subsidiary into bankruptcy without the approval of the independent director of the SPE.<sup>41</sup> The creation of an SPE between MidAmerican Energy Holdings Company (the unregulated parent holding company) and its regulated utility subsidiaries has been a factor in supporting a higher bond rating for the subsidiaries than for the unregulated parent holding company, which has a more leveraged capital structure.<sup>42</sup>

## **6. Non-financial considerations**

This portion of our paper has focused on a private equity buyout's financial implications. The reviewing regulator should review non-financial aspects as well. The utility should sustain service quality standards, and all construction and maintenance schedules.

The regulator may elect not to approve a leveraged private equity buyout of a utility. If the regulator does decide to approve the buyout, a list of conditions for approval of such a transaction is set out in the final section, below. These conditions are designed to lessen the risk to the acquired utility and its ratepayers and to give the regulator the ability to protect the utility's financial health.

### **D. Conditions for approval.**

Regulators should attempt to establish the following conditions prior to approval of a private equity buyout of a public utility.

1. Limit transaction leverage: The overall riskiness of the transaction is reduced if less debt and more private partner equity capital is used to finance the acquisition. The regulator should establish a minimum equity contribution by the acquirer; below which the additional risk is not worth any benefit from the acquisition. A 20% equity contribution is better for the long-term health of the utility than 15%, 30% is better than 20%, etc.

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<sup>41</sup> Standard & Poor's Ratings Direct, Ring-Fencing a Subsidiary, October 19, 1999.

<sup>42</sup> For example, MidAmerican Energy Holding Company's latest S.E.C. Form 10-K indicates a bond rating for the parent of "BBB+", while PacifiCorp and MidAmerican have bond ratings of "A-".

2. **Separate subsidiaries:** The utility should be a separate subsidiary with its own books and records. If the acquiring firm owns other operations, they should also become separate subsidiary corporations with separate books and boards of directors. Regulators should have access to all financial data of subsidiaries whose operations could affect the utility's financial health.
3. **Separate utility bond rating:** The utility should maintain its own bond rating. The regulators should have access to all of the detailed written material provided by the utility to the bond rating agency(ies), including financial projections. If the acquirer also maintains a bond rating (unlikely in a private equity buyout), regulators should have access to those data as well.
4. **No debt guarantees by the utility:** The utility should not be the guarantor of any debt issued by the private equity firm/acquirer or by any of the other subsidiaries owned by the acquirer. Regulatory approval should also be sought for utility issuances of debt, and preferred stock.
5. **Single purpose entity to prevent parent-induced bankruptcy of the utility:** A single-purpose corporate entity between the acquirer and the utility should be established. That entity will conduct no business of its own or issue any debt, will have an independent director that is not affiliated with either the acquirer or the utility, and exists solely to prevent an attempt by the acquirer to file the utility into bankruptcy.
6. **Cash Flow control:** Regulators should establish authority to monitor all cash flow transactions between the utility and its acquirer or other subsidiary owned by the acquirer. Such transactions include dividends, payment for goods and services received, assignment of receivables. Regulatory approval should be required for any special dividend or cash transfer, or any normal dividend that is more than 10% higher than the prior year's average.
7. **Corporate money pool:** The utility should not participate in corporate money pool short-term borrowing/lending arrangements, unless participation affords the utility substantially lower costs of short-term debt than it is able to achieve on a stand-alone basis.
8. **Regulatory treatment of consolidated debt and taxes:** Prior to the acquisition, the regulatory body should determine the manner in which it intends to treat, for ratemaking purposes, transaction debt (i.e., include some or all of it in ratemaking capital structure) and consolidated taxes (i.e., capture some or all of consolidated tax savings in ratemaking cost of service). Capturing some of the private equity firm's gain from either

leverage or the related tax savings can change the economics of the transaction.

9. Resource plans: Following the acquisition, the utility should maintain current integrated resource plans to meet future demand; or, if changes are to be made, they should be subject to regulatory review.
10. Service quality: Following the acquisition, the utility should maintain current service quality standards, or, if changes are to be made, they should be subject to regulatory review.

## **E. End Note**

In this paper, we have described mergers and acquisitions, the reasons why corporations combine, and the ways in which those combinations are undertaken. We have focused our analysis particularly on private equity buyouts of public utilities. In so doing, we have identified the different parties involved in a private equity buyout of a utility, examining their private interests in such transactions, and identifying where those private interests may conflict with the interests of the public. Finally, we have suggested methods and requirements that can address public/private interest conflicts where they occur.

How will regulators respond to the purchase of regulated utility operations by private equity firms that will occur in the future, in order to align the interests of both investors and ratepayers with the public interest in the availability of reliable utility service at the lowest reasonable cost? While the answer to that question is unclear at this point, we hope this paper has provided a framework for evaluation and analysis of a private equity buyout of a public utility and a means by which the financial health of a utility subject to such a transaction can be better assured.

**CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS**

RFI 2-3      To the extent not already provided, please provide a list of any regulatory proceedings in which a testifying expert, or a consulting expert whose mental impression or opinions have been reviewed by a testifying expert, has provided testimony during the last five years. If testimony is not publicly available, please provide a copy. If testimony is publicly available, please clearly identify where it can be accessed.

**Response**

Mr. Hill has testified in over 275 cases over the past 30 years. Please find attached a list of cases in which Mr. Hill has testified since 2000. That list contains the case name and number, regulatory jurisdiction, the party for whom Mr. Hill testified, and the subject matter of Mr. Hill's testimony. Mr. Hill assumes, but does not know with certainty, that any of those testimonies are publicly available through on-line access to commission archives. However, Mr. Hill has retained PDF versions of his past testimonies and, if the Company will identify the cases/testimonies it wishes to review, Mr. Hill will provide copies of those testimonies.

Mr. Kollen's expert testimony is listed on Attachment A to his Direct Testimony filed on June 21, 2012 in this proceeding and is publicly available by accessing the appropriate state or federal commission websites.

Mr. Norwood's expert testimony is listed on Attachment A to his Direct Testimony filed on June 21, 2012 in this proceeding and is publicly available by accessing the appropriate state or federal commission websites.

**ATTACHMENT:**

Stephen G. Hill, Expert Testimony since 2000 (7 pages).

Prepared by:            Christopher Brewster  
Sponsored by:        Scott Norwood, Lane Kollen, and Stephen Hill

STEPHEN G. HILL  
EXPERT TESTIMONY SINCE 2000

ARIZONA

Testimony on behalf of : Az. Corporation Commission, Residential Utility Consumer Office

Docket No. G-01551A-00-0309 – Southwest Gas Corporation – cost of equity capital / capital structure / debt refinancing

Docket No. E-01245A-03-04437 – Arizona Public Service Company – capital structure / cost of common equity / restructuring issues

Docket No. G-01551A-04-0876 – Southwest Gas Corporation – cost of equity capital / capital structure / recapitalization plan

Docket No. E-01345A-05-0816 – Arizona Public Service Company – capital structure / cost of common equity / restructuring issues

CALIFORNIA

Testimony on behalf of : Federal Executive Agencies

Application Nos. 07-05-003 through 008 - Annual Cost of Capital Proceeding; cost of equity capital

CONNECTICUT

Testimony on behalf of the Office of Consumer Counsel

Docket No. 01-05-19PH01 – Yankee Gas Services Company – capital structure / short-term debt / cost of equity capital

Docket No. 10-02-13 – Aquarion Water Company – capital structure/ corporate structure/cost of equity capital

GEORGIA

Testimony on behalf of the Governor's Office of Consumer Utility Counsel/ GPUC Commission Staff

Docket No. 14000-U – Georgia Power Company – Testimony on capital structure and the cost of equity capital / comparable earnings

Docket No. 14618-U – Savannah Electric & Power Company – Testimony on capital structure and the cost of equity capital / comparable earnings

Docket No. 18300-U – Georgia Power Company – Testimony on capital structure and the cost of equity capital / investor required market return

Docket No. 18638-U – Atlanta Gas Light – Testimony on capital structure and the cost of equity capital

Docket No. 19758-U – Savannah Electric and Power Company – Testimony on capital structure and the cost of common equity

Docket No. 20298-U – Atmos Energy – Testimony on cost of common equity and capital structure



### HAWAII

Testimony on behalf of the Hawaii Consumer Advocate/Department of Defense

Docket No. 04-0104 – Purchase of Verizon Hawaii by the Carlyle Group; developed position on financial requirements for Consumer Advocate

Docket No. 04-0113 – Hawaiian Electric Company, Testimony on cost of equity capital and capital structure.

Docket No. 06-0386 – Hawaiian Electric Company, Testimony on cost of equity capital and capital structure.

Docket No. 09-0083 – Hawaiian Electric Company, Testimony on cost of equity capital and capital structure, Hawaii Clean Energy Initiative.

Docket No. 10-0083 – Hawaiian Electric Company, Testimony on cost of equity capital and capital structure, cost of capital impact of decoupling

### KANSAS

Testimony on behalf of the Citizen's Utilities Ratepayer Board

Docket No. 01-WSRE-436-RTS – Western Resources – capital structure / cost of equity / capital structure implications of spin-off of unregulated operations

Docket No. WSRE-949-GIE – Western Resources – review of company plans to separate electric utility business from unregulated business

Docket No. 03-KGSC-602-RTS – Kansas Gas Service Company – capital structure / convertible preferred stock / cost of common equity / overall cost of capital

### KENTUCKY

Testimony on behalf of the Office of Attorney General

Case No. 2008-00427 – Kentucky-American Water Company – capital structure / cost of equity / use of book value capital structures

### LOUISIANA

Testimony on behalf of : Louisiana Public Service Commission Staff

Docket No. U-20925 – Entergy Louisiana, Inc. – Annual Rate Review/ Formula Rate Plan / FRP 2000 and FRP 2001 – Testimony on the cost of common equity capital

### MAINE

Testimony on behalf of : Public Advocate

Docket No. 2001-249 – Community Service Telephone Company – capital structure / company financial history / cost of equity

Docket Nos. 2002-99/2002-100 – Lincolnville/Tidewater Telecom – capital structure / cost of common equity capital

Docket Nos. 2002-747, 2003-34, 35, 36, and 37 – FairPoint New England Telephone Companies; testimony on capital structure, cost of common equity.

Docket No. 2004-112 – Bangor Hydro-Electric Company; testimony on capital structure; market-based cost of common equity, overall cost of capital

Docket No. 112/339 – Bangor Hydro-Electric Company; Central Maine Power; stranded cost hearings, lower risk of guaranteed returns, cost of common equity capital for electric

Docket No. 2005-155 – Verizon Maine – Alternative Form of Regulation/Rate Proceeding; cost of equity capital for a local distribution company and capital structure / competition

Docket No. 2007-215 – Central Maine Power Company; cost of equity, capital structure

#### MARYLAND

Testimony on behalf of : Maryland Peoples' Counsel

Case No. 8890 – Pepco/Delmarva Merger – financial and capital structure issues related to the proposed merger

Case No. 8883 – Baltimore Gas & Electric Company – business separation of Constellation Energy – financial and capital structure issues related to the proposed business separation

Case No. 8920 – Washington Gas Light Company – Capital structure, cost of capital

Case No. 8959 - Washington Gas Light Company – Capital structure, cost of capital

Case No. 8994 – Delmarva Power & Light – Capital structure, financial cross-subsidization, cost of capital benchmark for merger review.

Case No. 8995 – Potomac Electric Power Company – Capital structure, financial cross-subsidization, cost of capital benchmark for merger review.

Case No. 9221 – Baltimore Gas and Electric Company – Return to be included in cash working capital allowance of standard offer service.

Case Nos. 9226, 9232 – Demarva Power & Light, Potomac Electric Power – Return to be included in cash working capital allowance of standard offer service.

#### MASSACHUSETTS

Testimony on behalf of: Attorney General of Massachusetts

Docket No. 09-30 – Bay State Gas Company - Cost of equity/ Financial market conditions/ Decoupling Impact on Cost of Equity Capital

#### MINNESOTA

Testimony on behalf of: Minnesota Department of Public Service

Docket Nos. P404 et. Al./CI-oo-712 – Sherburne County Rural Telephone Company - Cost of equity/ capital structure/ relative competitive risk of rural telephone companies

#### MISSOURI

Testimony on Behalf of Office of Missouri Public Service Commission / Trigen-Kansas City Energy Corporation

Docket No. ER-2007-0002 and 0003 – Ameren-UE, cost of capital, capital structure, market value versus book value capital structure

Docket No. HR-2008-0300 – Trigen-Kansas City Energy Corporation – capital structure, cost of equity capital, overall cost of capital

Docket No. ER-2008-0318– Ameren-UE, cost of capital, capital structure, overall cost of capital

Docket No. ER-2010-0036—AmerenUE; Cost of equity capital

File No. HR-2011-0241 – Veolia Energy Kansas City, Inc. – capital structure, cost of equity capital, overall cost of capital

#### MONTANA

Testimony on Behalf of the Montana Consumer Counsel

Docket No. D2002.5.59 – Montana-Dakota Utilities Company, cost of equity / capital structure / overall cost of capital.

Docket No. D2004.4.50– Montana-Dakota Utilities Company, gas operations, cost of equity / capital structure / overall cost of capital.

#### NEW HAMPSHIRE

Testimony on behalf of the Office of Consumer Advocate

Docket No. DT02-110, Verizon New Hampshire; cost of common equity and capital structure in both a TELRIC and traditional rate base rate of return cases.

Docket No. DE 04-177; Public Service Company of New Hampshire; cost of equity capital of integrated generation operations.

Docket No. DE-06-028; Public Service Company of New Hampshire, cost of equity capital, capital structure.

#### NORTH CAROLINA

Testimony on behalf of the North Carolina Department of Insurance

Docket No. 1073 – Private Passenger Automobile Insurance Rate Proceeding – cost of capital/fair rate of return

Docket No. 1174 – Private Passenger Automobile Insurance Rate Proceeding – cost of capital/fair rate of return

Docket No. 1235 – Private Passenger Automobile Insurance Rate Proceeding – cost of capital/fair rate of return

Docket No. 1407 – Private Passenger Automobile Insurance Rate Proceeding – cost of capital/fair rate of return

#### OKLAHOMA

Testimony on behalf of the Oklahoma Corporation Commission; Attorney General of Oklahoma

Cause No. 200300076 – Public Service Company of Oklahoma – cost of capital/ capital structure/ leverage adjustment to cost of capital

#### PENNSYLVANIA

Testimony on behalf of : Office of Public Advocate

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Docket No. R-00027975 – York Water Company, cost of capital / capital structure

Docket No. R-00038805 – Aqua Pennsylvania Water Company, cost of capital/ capital structure

Docket No. R-00049884 - Pike County Light & Power Company; cost of capital/ capital structure

Docket No. R-00051030 – Aqua Pennsylvania Water Company, cost of capital/ capital structure / market value capital structures

Docket No. R-00061346 – Duquesne Light Company, cost of capital/ capital structure/ market-value capital structure

Docket No. R-2010-2161694 – PPL Electric Utilities Corporation – cost of capital/capital structure

Docket No. R-2010-2179522 – Duquesne Light Company – cost of capital / capital structure / overall cost of capital

#### TEXAS

Testimony on behalf of : Office of Public Utility Counsel, Allied Coalition of Cities

Docket No. 22344 – Texas Universal Cost of Service Hearings – capital structure / cost of capital

Docket No. GUD 9400 (Before the Texas Railroad Commission) – TXU Gas – capital structure/ cost of capital

Docket No. 28840 – AEP Texas Central Company – capital structure / economic environment / cost of capital

Docket No. 32093 – Centerpoint Energy – capital structure/ cost of capital

Docket Nos. 33309 and 33310 – AEP Texas Central Company and AEP Texas North Company – capital structure/cost of equity capital

Docket No. 38929 – Oncor Electric Delivery Company, LLC – capital structure / cost of equity capital / overall cost of capital

Docket No. 38480 – Texas-New Mexico Power Company – capital structure / cost of equity / overall cost of capital

#### VERMONT

Testimony on behalf of : Vermont Department of Public Service

Docket No. 6167 – Bell Atlantic – Vermont – alternative regulatory plant / capital structure / cost of capital

Docket No. 7336 – Central Vermont Public Service – capital structure / cost of equity / overall cost of capital

#### VIRGINIA

Testimony on behalf of : U.S. Navy/Department of Defense

Case No. PUE-2009-00019 – Virginia Dominion Power – statutory allowed return / capital structure / cost of capital.

Case No. PUE-2011-00027 – Virginia Dominion Power – statutory allowed return / capital structure / cost of capital.

#### WASHINGTON

Testimony on behalf of: Attorney General's Office and Washington Utilities and Transportation Commission Staff

Docket No. UG-011570/1-Puget Sound Power & Light; Interim/Emergency Rate Case/ financial need / bond rating impact of purchased power losses

Docket No. UG-031885 – Northwest Natural Gas; capital structure / cost of common equity capital

Docket No. UE-032065 – PacifiCorp; capital structure / cost of common equity capital

Docket No. UE-040640000/UG-040641 – Puget Sound Energy; capital structure / cost of common equity capital

Docket No. UE-050684 – PacifiCorp; cost of common equity / capital structure / overall cost of capital

Docket No. UE-0501090 – PacifiCorp/Mid-American Energy Holding Company Merger Application; financial aspects of merger / leverage at parent company

Docket No. UT-051291 – Sprint/Nextel – Merger/Spin-off of regulated telephone operations; financial aspects of spin-off / leverage at parent company

Docket Nos. UE-050482 & UG-050483 - Avista Utilities – testimony on cost of equity capital / capital structure / economic environment

Docket Nos. UE-060266/UG-060267 – Puget Sound Energy, cost of equity capital/ capital structure/ overall cost of capital

Docket Nos. UE-072300/UG-072301 – Puget Sound Energy, cost of equity capital/ capital structure/ overall cost of capital

Docket Nos. UE-072375 – Puget Holdings LLC and Puget Energy, acquisition proposal by private equity firm for utility operations of Puget Energy

Docket Nos. UE-090704/UG-090705— Puget Sound Energy, cost of equity capital/ capital structure and costs associated with private equity corporate structure/ overall cost of capital

Docket No. UT-090842—Frontier Communications/Verizon merger; Financial Issues related to merger.

#### WEST VIRGINIA

Testimony on behalf of: Consumer Advocate Division of the West Virginia Public Service Commission

Case No. UT-09-0871 – Frontier Communications/Verizon merger; Financial Issues related to merger.

#### WISCONSIN

Testimony on behalf of: Wisconsin Citizens' Utilities Board

Docket Nos. 9403-YI-100 and 6680-UM-100 – Alliant Energy – merger-related issues/unregulated investment limitation

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Docket No. 6680-UR-112, Wisconsin Power & Light – capital structure / cost of common equity / overall cost of capital

Docket No. 6680-CE-171, Wisconsin Power & Light – cost of common equity / fixed rate of return for wind generating plant

Docket No. 6680-CE-170, Wisconsin Power & Light – cost of common equity / fixed rate of return for coal generating plant

Docket No. 05-UR0104, Wisconsin Power & Light – Wisconsin treatment of OBS (off-balance sheet) obligations in the ratemaking process/ cost of capital.

CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS

RFI 2-4      Please admit or deny that Lone Star is required to comply with the NERC Reliability Standards. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Admit. It is Cities' understanding that Lone Star is required to comply with applicable mandatory NERC Reliability Standards.

Prepared by:      Scott Norwood  
Sponsored by:      Scott Norwood

CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS

RFI 2-5      Please admit or deny that Lone Star may be subject to penalties if it fails to comply with the NERC Reliability Standards. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Admit.

Prepared by:      Scott Norwood  
Sponsored by:      Scott Norwood



CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS

RFI 2-6      Please admit or deny that Lone Star is required to comply with the ERCOT Protocols. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Admit. It is Cities' understanding that Lone Star is required to comply with applicable mandatory ERCOT Protocols.

Prepared by:      Scott Norwood  
Sponsored by:      Scott Norwood

**CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS**

RFI 2-7      Please admit or deny that Lone Star may be subject to penalties if it fails to comply with the ERCOT Protocols. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Admit.

Prepared by:      Scott Norwood  
Sponsored by:     Scott Norwood

**CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS**

RFI 2-8      Please admit or deny that Lone Star will incur incremental O&M expense upon placing its Phase II facilities in service. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Admit. Cities believe it is likely that Lone Star will incur incremental O&M expense after placing its Phase II facilities in service.

Prepared by:      Scott Norwood  
Sponsored by:    Scott Norwood

CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS

RFI 2-9      Please admit or deny that Lone Star will incur incremental A&G expense upon placing its Phase II facilities in service. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Admit. It is likely that Lone Star will incur incremental A&G expense after placing its Phase II facilities in service.

Prepared by:      Scott Norwood  
Sponsored by:      Scott Norwood

CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS

RFI 2-10      Please admit or deny that Lone Star will have an Abilene field office. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Admit. Based on Lone Star's representations in this case, it is Cities' understanding that Lone Star intends to have a field office in or around Abilene.

Prepared by:            Scott Norwood  
Sponsored by:         Scott Norwood

CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS

RFI 2-11      Please admit or deny that Lone Star has excluded rental costs related to its Abilene field office from its Phase I rate request. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Admit. It is Cities' understanding that Lone Star has excluded rental costs related to its Abilene field office from its Phase I O&M request.

Prepared by:            Scott Norwood  
Sponsored by:         Scott Norwood

CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS

RFI 2-12      Please admit or deny that Lone Star will place in service approximately 320 miles of transmission line during Phase II. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Admit. Based on Lone Star's representations in this case, it is Cities' understanding that Lone Star intends to place in-service approximately 320 miles of transmission line during Phase II.

Prepared by:      Scott Norwood  
Sponsored by:      Scott Norwood

**CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS**

**RFI 2-13**      Please admit or deny that Lone Star has excluded all O&M expense related to the operation of approximately 320 miles of transmission line from its Phase I rate request. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. Much of the \$3.26 million in transmission operations expense and \$2.45 million in A&G expense that Lone Star has requested in its Phase I rates is related to the 320 miles of transmission line which the Company intends to place in-service during Phase II. But for the 320 miles of transmission line that the Company intends to place in-service during Phase II, Lone Star would not have hired as many employees for which it is requesting relating O&M and A&G expenses in Phase I rates.

Prepared by:            Scott Norwood  
Sponsored by:         Scott Norwood



CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS

RFI 2-14      Please admit or deny that NERC Reliability Standard FAC-003-3, R1 requires each transmission owner to manage vegetation to prevent encroachments into the minimum vegetation clearance distance of the transmission owner's lines operated at 200 kV or higher. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. It is Cities' understanding, based on review of the NERC website, that the referenced standard is currently pending regulatory approval. (*See* <http://www.nerc.net/standardsreports/standardsummary.aspx>.) Moreover, Cities have not conducted the legal analysis necessary to determine whether the requirements of pending NERC Reliability Standard FAC-003-3, R1 are as stated above.

Prepared by:            Scott Norwood  
Sponsored by:         Scott Norwood

**CITIES' RESPONSES TO LONE STAR'S  
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**RFI 2-15**      Please admit or deny that during Phase II Lone Star will be a transmission owner subject to NERC Reliability Standard FAC-003-3, R1. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. It is Cities' understanding, based on review of the NERC website, that the referenced standard is currently pending regulatory approval. (See <http://www.nerc.net/standardsreports/standardsummary.aspx>.) Moreover, Cities have not conducted the legal analysis necessary to determine whether the requirements of pending NERC Reliability Standard FAC-003-3, R1 are likely to be applicable to Lone Star during Phase II.

Prepared by:            Scott Norwood  
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CITIES' RESPONSES TO LONE STAR'S  
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RFI 2-16      Please admit or deny that NERC Reliability Standard FAC-003-3, R6 requires each transmission owner to perform a vegetation inspection of 100% of its applicable transmission lines operated at 200 kV or higher at least once per calendar year. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. It is Cities' understanding, based on review of the NERC website, that the referenced standard is currently pending regulatory approval. (See <http://www.nerc.net/standardsreports/standardssummary.aspx>.) Moreover, Cities have not conducted the legal analysis necessary to determine whether the requirements of pending NERC Reliability Standard FAC-003-3, R6 are as stated above.

Prepared by:            Scott Norwood  
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CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS

RFI 2-17      Please admit or deny that during Phase II Lone Star will be a transmission owner subject to NERC Reliability Standard FAC-003-3, R6. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. It is Cities' understanding, based on review of the NERC website, that the referenced standard is currently pending regulatory approval. (See <http://www.nerc.net/standardsreports/standardsummary.aspx>.) Moreover, Cities have not conducted the legal analysis necessary to determine whether the requirements of pending NERC Reliability Standard FAC-003-3, R6 are likely to be applicable to Lone Star during Phase II.

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**CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
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RFI 2-18      Please admit or deny that NERC Reliability Standard FAC-003-3, R7 requires each transmission owner to complete 100% of its annual vegetation work plan of applicable lines to ensure no vegetation encroachments occur within the minimum vegetation clearance distance. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. It is Cities' understanding, based on review of the NERC website, that the referenced standard is currently pending regulatory approval. (See <http://www.nerc.net/standardsreports/standardssummary.aspx>.) Moreover, Cities have not conducted the legal analysis necessary to determine whether the requirements of pending NERC Reliability Standard FAC-003-3, R7 are as stated above.

Prepared by:            Scott Norwood  
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CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS

RFI 2-19      Please admit or deny that during Phase II Lone Star will be a transmission owner subject to NERC Reliability Standard FAC-003-3, R7. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. It is Cities' understanding, based on review of the NERC website, that the referenced standard is currently pending regulatory approval. (See <http://www.nerc.net/standardsreports/standardsummary.aspx>.) Moreover, Cities have not conducted the legal analysis necessary to determine whether the requirements of pending NERC Reliability Standard FAC-003-3, R7 are likely to be applicable to Lone Star during Phase II.

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CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
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RFI 2-20      Please admit or deny that NERC Reliability Standard PRC-005-1.1b, R1 requires each transmission owner to have a protection system maintenance and testing program for protection systems that affect the reliability of the bulk electric system. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. It is Cities' understanding, based on review of the NERC website, that the referenced standard is currently pending regulatory approval. (See <http://www.nerc.net/standardsreports/standardssummary.aspx>.) Moreover, Cities have not conducted the legal analysis necessary to determine whether the requirements of pending NERC Reliability Standard PRC-005-1.1b, R1 are as stated above.

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**CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS**

RFI 2-21      Please admit or deny that during Phase II Lone Star will be a transmission owner subject to NERC Reliability Standard PRC-005-1.1b, R1. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. It is Cities' understanding, based on review of the NERC website, that the referenced standard is currently pending regulatory approval. (See <http://www.nerc.net/standardsreports/standardsummary.aspx>.) Moreover, Cities have not conducted the legal analysis necessary to determine whether the requirements of pending NERC Reliability Standard PRC-005-1.1b, R1 are likely to be applicable to Lone Star during Phase II.

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CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
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RFI 2-22      Please admit or deny that NERC Reliability Standard TOP-002-3, R1 requires each transmission owner to have an operational planning analysis that represents projected system conditions that will allow it to assess whether the planned operations for the next day within its transmission operator area will exceed any of its facility ratings or stability limits during anticipated normal and contingency event conditions. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. It is Cities' understanding, based on review of the NERC website, that the referenced standard is currently pending regulatory approval. (See <http://www.nerc.net/standardsreports/standardssummary.aspx>.) Moreover, NERC Reliability Standard TOP-002-3, R1 applies to Transmission Operators. Based on Cities' understanding of NERC definitions, each transmission owner may not necessarily be a Transmission Operator. In addition, Cities have not conducted the legal analysis necessary to determine whether other requirements of pending NERC Reliability Standard TOP-002-3, R1 are as stated above.

Prepared by:            Scott Norwood  
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**CITIES' RESPONSES TO LONE STAR'S  
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**RFI 2-23**      Please admit or deny that during Phase II Lone Star will be a transmission owner subject to NERC Reliability Standard TOP-002-3, R1. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. It is Cities' understanding, based on review of the NERC website, that the referenced standard is currently pending regulatory approval. (See <http://www.nerc.net/standardsreports/standardssummary.aspx>.) Moreover, Cities have not conducted the legal analysis necessary to determine whether the requirements of pending NERC Reliability Standard TOP-002-3, R1 are likely to be applicable to Lone Star during Phase II.

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CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
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RFI 2-24      Please admit or deny that NERC Reliability Standard TOP-003-2, R1 requires each transmission operator to create a documented specification for the data necessary for it to perform its operational planning analysis and real time monitoring. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. It is Cities' understanding, based on review of the NERC website, that the referenced standard is currently pending regulatory approval. (See <http://www.nerc.net/standardsreports/standardsummary.aspx>.) Moreover, Cities have not conducted the legal analysis necessary to determine whether the requirements of pending NERC Reliability Standard TOP-003-2, R1 are as stated above.

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**CITIES' RESPONSES TO LONE STAR'S  
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RFI 2-25      Please admit or deny that during Phase II Lone Star will be a transmission owner subject to NERC Reliability Standard TOP-003-2, R1. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. It is Cities' understanding, based on review of the NERC website, that the referenced standard is currently pending regulatory approval. (See <http://www.nerc.net/standardsreports/standardssummary.aspx>.) Moreover, Cities have not conducted the legal analysis necessary to determine whether the requirements of pending NERC Reliability Standard TOP-003-2, R1 are likely to be applicable to Lone Star during Phase II.

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**CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS**

RFI 2-26      Please admit or deny that NERC Reliability Standard TOP-004-2, R6 requires each transmission owner to develop, maintain and implement formal policies and procedures to provide for transmission reliability. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. NERC Reliability Standard TOP-004-2, R6 applies to Transmission Operators. Based on Cities' understanding of NERC definitions, each transmission owner may not necessarily be a Transmission Operator.

Prepared by:            Scott Norwood  
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**CITIES' RESPONSES TO LONE STAR'S  
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**RFI 2-27**      Please admit or deny that during Phase II Lone Star will be a transmission owner subject to NERC Reliability Standard TOP-004-2, R6. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Admit.

Prepared by:      Scott Norwood  
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**CITIES' RESPONSES TO LONE STAR'S  
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**RFI 2-28**      Please admit or deny that NERC Reliability Standard TOP-006-2, R2 requires each transmission owner to monitor applicable transmission line status, real and reactive power flows, voltage, load-tap-changer settings, and status of rotating and static reactive resources. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. NERC Reliability Standard TOP-006-2, R2 applies to Reliability Coordinators, Transmission Operators and Balancing Authorities. Based on Cities' understanding of NERC definitions, each transmission owner may not necessarily be a Reliability Coordinator, Transmission Operator or Balancing Authority.

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CITIES' RESPONSES TO LONE STAR'S  
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AND REQUESTS FOR ADMISSIONS

RFI 2-29      Please admit or deny that during Phase II Lone Star will be a transmission owner subject to NERC Reliability Standard TOP-006-2, R2. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Admit.

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**CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS**

RFI 2-30      Please admit or deny that NERC Reliability Standard EOP-001-0.1b, R3 requires each transmission owner to develop, maintain and implement a set of plans to mitigate operating emergencies for insufficient generating capacity; develop, maintain and implement a set of plans to mitigate operating emergencies on the transmission system; develop, maintain and implement a set of plans for load shedding; and develop, maintain and implement a set of plans for system restoration. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. NERC Reliability Standard EOP-001-0.1b, R3 applies to Transmission Operators and Balancing Authorities. Based on Cities' understanding of NERC definitions, each transmission owner may not necessarily be a Transmission Operator or Balancing Authority.

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**CITIES' RESPONSES TO LONE STAR'S  
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AND REQUESTS FOR ADMISSIONS**

RFI 2-31      Please admit or deny that during Phase II Lone Star will be a transmission owner subject to NERC Reliability Standard EOP-001-0.1b, R3. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Admit. The effective date of the referenced standard was April 1, 2005.

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CITIES' RESPONSES TO LONE STAR'S  
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RFI 2-32      Please admit or deny that NERC Reliability Standard EOP-005-2, R10 requires each transmission owner to include within its operations training program annual system restoration training for its system operators to ensure the proper execution of its restoration plan. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Cities can neither admit nor deny. NERC Reliability Standard EOP-005-2, R10 applies to Transmission Operators. Based on Cities' understanding of NERC definitions, each transmission owner may not necessarily be a Transmission Operator.

Prepared by:            Scott Norwood  
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CITIES' RESPONSES TO LONE STAR'S  
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RFI 2-33      Please admit or deny that during Phase II Lone Star will be a transmission owner subject to NERC Reliability Standard EOP-005-2, R10. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Cities can neither admit nor deny. Cities believe that Lone Star's requested Phase II rates are likely to be in effect when the referenced standard becomes enforceable on July 1, 2013; however, this outcome is not certain at this time.

Prepared by:            Scott Norwood  
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CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS

RFI 2-34      Please admit or deny that NERC Reliability Standard EOP-008-1, R6 requires each transmission owner to have primary and backup functionality that do not depend on each other for the control center functionality required to maintain compliance with reliability standards. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Cities can neither admit nor deny. NERC Reliability Standard TOP-008-1, R6 applies to Reliability Coordinators, Transmission Operators and Balancing Authorities. Based on Cities' understanding of NERC definitions, each transmission owner may not necessarily be a Reliability Coordinator, Transmission Operator or Balancing Authority.

Prepared by:            Scott Norwood  
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**CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS**

RFI 2-35      Please admit or deny that during Phase II Lone Star will be a transmission owner subject to NERC Reliability Standard EOP-008-1, R6. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Cities can neither admit nor deny. Cities believe that Lone Star's requested Phase II rates are likely to be in effect when the referenced standard becomes enforceable on July 1, 2013; however, this outcome is not certain at this time.

Prepared by:            Scott Norwood  
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CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
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RFI 2-36      Please admit or deny that Lone Star will have two substations in service during Phase I. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Admit. Based on Lone Star's representations in this case, it is Cities' understanding that Lone Star intends to have two substations in service during Phase I.

Prepared by:            Scott Norwood  
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CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
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RFI 2-37      Please admit or deny that Lone Star will have five substations in service during Phase II. If you answer this question with any answer other than "Admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Deny. Based on Lone Star's representations in this case, it is Cities' understanding that Lone Star intends to have three substations in service during Phase II.

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CITIES' RESPONSES TO LONE STAR'S  
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AND REQUESTS FOR ADMISSIONS

RFI 2-38      Assume for the purposes of this question that Lone Star will incur Phase II O&M expenses that are incremental to the Phase I O&M expenses. With that assumption, please admit or deny that if the Phase II O&M expenses that are incremental to the Phase I O&M expenses are not approved for recovery in this proceeding, Lone Star will be forced to forgo recovery of the incremental Phase II O&M expenses until a subsequent rate case. If you answer this question with any answer other than an unqualified "admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Cities can neither admit nor deny. Lone Star's future recovery of Phase II O&M expenses ultimately depends upon the actual (versus allowed) future expenditure levels in all areas of its operations, future load growth and other such factors that are presently unknown.

Prepared by:            Scott Norwood  
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CITIES' RESPONSES TO LONE STAR'S  
SECOND REQUESTS FOR INFORMATION  
AND REQUESTS FOR ADMISSIONS

RFI 2-39      Assume for the purposes of this question that Lone Star will incur Phase II A&G expenses that are incremental to the Phase I O&M expenses. With that assumption, please admit or deny that if Phase II A&G expenses that are incremental to the Phase I A&G expenses are not approved for recovery in this proceeding, Lone Star will be forced to forgo recovery of the incremental Phase II A&G expenses until a subsequent rate case. If you answer this question with any answer other than an unqualified "admit," please explain the basis for your answer and produce all documents supporting your answer.

**Response**

Cities can neither admit nor deny. Lone Star's future recovery of Phase II A&G expenses ultimately depends upon the actual (versus allowed) future expenditure levels in all areas of its operations, future load growth and other such factors that are presently unknown.

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