

recognized power plant engineering firm.⁵⁵¹ As Mr. Davis discussed in his rebuttal testimony, many utilities over the past 10 to 15 years have moved to using demolition studies using data specific for their power plants, instead of relying on generic net salvage values or historically used ratios.⁵⁵²

Mr. Davis explained that for unique assets such as power plants, the cost of removal and net salvage should be determined by taking the specific characteristics of the depreciable plant into account and that this approach provides a better basis upon which to arrive at the reasonable net salvage for production plant than does use of a historical or generic net salvage value.⁵⁵³ The methodologies and approaches used by S&L in conducting the plant demolition studies were sponsored by SWEPCO witness Steven R. Bertheau, Senior Vice President and Project Director with S&L.⁵⁵⁴ In addition to the plant removal costs and salvage from the S&L studies, Mr. Davis applied two additional calculations in reaching the terminal net salvage rate for each SWEPCO power plant. These were: (i) escalation of each plant's removal cost and salvage from the S&L studies (which were stated in first quarter 2012 dollars) to an amount at the expected retirement of the plant and (ii) the addition of net salvage on interim retirements to the final net salvage rate.⁵⁵⁵

The overall net salvage rate of negative 3.4% requested by SWEPCO is inclusive of: (i) the removal costs and salvage in the S&L studies; (ii) the escalation of the S&L removal costs and salvage for each plant to the expected retirement date of the plant; and (iii) net salvage on interim retirements.⁵⁵⁶ As Mr. Davis indicated, the fact this overall net salvage rate is negative 3.4% is indicative of the reasonableness of SWEPCO's approach in contrast to the approaches of

⁵⁵¹ Direct Testimony of David A. Davis, SWEPCO Ex. 43 at 11-12 Exhibit DAD-1 at 10; Direct Testimony of Steven R. Bertheau, SWEPCO Ex. 44 at 5-11, Exhibit SRB-1; Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 17-24; Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 4-8, Exhibit SRB-1R.

⁵⁵² Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 20.

⁵⁵³ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 18-19.

⁵⁵⁴ Direct Testimony of Steven R. Bertheau, SWEPCO Ex. 44 at 6-8; Rebuttal Testimony of Steve R. Bertheau, SWEPCO Ex. 82 at 6-7, 10-33, Exhibit SRB-1R.

⁵⁵⁵ Direct Testimony of David A. Davis, SWEPCO Ex. 43 at 11-12 Exhibit DAD-1 at 10; Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 17-18, 24-28, 31-35.

⁵⁵⁶ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 21-23.

the intervenor witnesses who made recommendations without any quantifiable connection between the objections they raised and their overall net salvage recommendations.⁵⁵⁷

CARD witness Jacob Pous and Cities witness Lane Kollen took issue with SWEPCO's approach to production plant net salvage.⁵⁵⁸ Mr. Kollen based his challenge primarily on three arguments: (i) that large differences between the S&L demolition studies conducted for SWEPCO's plants in 2007 and included in SWEPCO's application in PUCT Docket No. 37364 and the studies in this case caused the S&L studies to be unreliable; (ii) that it was not proper to escalate the S&L plant removal costs and salvage to the expected retirement date; and (iii) it was not proper to include contingency allowances in the S&L studies.⁵⁵⁹ Mr. Pous challenged the demolition cost studies based on selective criticisms of methodology, including the escalation of the removal costs and salvage to the expected retirement dates, productivity factors, labor rate assumptions, crew mix assumptions, labor rates, scrap value assumptions, assumptions as to other salvageable components, inclusion of land restoration costs in the removal costs, and the exclusion of potential gains from sales of real property and water rights, and the use of contingency allowances. In their rebuttal testimonies, Mr. Bertheau and Mr. Davis fully rebutted Mr. Kollen's and Mr. Pous' positions on the S&L demolition studies.⁵⁶⁰

With respect to Mr. Kollen's contention that the differences between the S&L studies provided in Docket No. 37364 and the studies provided in this case rendered S&L's studies unreliable, Mr. Bertheau pointed out that the primary differences between the studies was that the studies in this case did not include ash pond and landfill closure costs.⁵⁶¹ Mr. Davis stated that these costs were not treated as Asset Retirement Obligations (AROs) in PUCT Docket No. 37364, but subsequently SWEPCO decided that these costs should be handled as AROs in accordance with Statement of Financial Accounting Standards (FAS) No. 143, and for this reason these costs were excluded from the S&L studies in this case.⁵⁶²

⁵⁵⁷ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 21-23.

⁵⁵⁸ Direct Testimony of Jacob Pous, CARD Ex. 2 at 17-38; Direct Testimony of Lane Kollen, Cities Ex. 3 at 58-62.

⁵⁵⁹ Mr. Davis' escalation of removal costs to the expected retirement date is discussed in Section IV.I.1.b.ii below.

⁵⁶⁰ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 4-34; Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 17-31.

⁵⁶¹ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 33-34.

⁵⁶² Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 23-24.

In his rebuttal testimony, Mr. Bertheau explained why Mr. Pous' criticisms regarding the overall methodologies and approaches used by S&L lacked merit.⁵⁶³ Unlike S&L, Mr. Pous did not provide alternative engineering studies covering the complete costs of demolition of each of SWEPCO's power plants based on the specific considerations of each plant.⁵⁶⁴ Instead, Mr. Pous employed a selective, or scatter gun, approach in criticizing the S&L studies and simply took issue with selected elements of the S&L studies.⁵⁶⁵ The S&L studies were in the mid-range between a high-level conceptual cost estimate and a more detailed cost estimate, which means they are without the more detailed cost information that would be required for a more detailed cost estimate based on specific bids from equipment vendors.⁵⁶⁶ Mr. Bertheau emphasized that it is necessary to keep in mind the purpose of the studies, and more detailed studies would be substantially more costly and would still only provide an estimate of the costs that will be incurred to remove the SWEPCO power plants upon their removal many years or decades in the future.⁵⁶⁷

With respect to Mr. Pous' contentions that a prior S&L study for an AEP plant in Indiana, the Breed plant, included a cost estimate substantially higher than the actual demolition cost incurred to date at this plant, Mr. Bertheau stated that the scope of work completed to date at this plant has not included all of the tasks included in the S&L study.⁵⁶⁸ Mr. Davis testified that the actual net salvage rate for the Breed plant associated with the work completed to date was negative 7.04%, causing Mr. Davis to question how Mr. Pous could find this example as somehow undercutting SWEPCO's overall net salvage rate of negative 3.4% or providing support for Mr. Pous' alternative judgmental net salvage rates of negative 1% or positive 15%.⁵⁶⁹

In response to Mr. Pous' contentions that the S&L studies failed to employ verifiable assumptions as to labor rates, productivity factors, scrap metal values, and material costs, Mr. Bertheau described the sources for these items used in the S&L studies and indicated that

⁵⁶³ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 4-8.

⁵⁶⁴ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 5.

⁵⁶⁵ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 5.

⁵⁶⁶ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 5.

⁵⁶⁷ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 6-7.

⁵⁶⁸ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 9-10.

⁵⁶⁹ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 22, Exhibit DAD-2R.

they constitute standard industry data.⁵⁷⁰ Mr. Bertheau further explained that, contrary to Mr. Pous' assertions, the crew mixes used in the S&L studies were reasonable and not top-heavy.⁵⁷¹ The S&L crew rates vary based on the complexity of the activities with appropriate craft mixtures of skilled and unskilled laborers; the various mixtures of laborers account for the variation in S&L's labor cost estimates.⁵⁷² Mr. Bertheau also described the flaws in Mr. Pous' criticism of the labor rates used in the S&L studies as higher than prevailing in the locality of a SWEPCO plant and explained that the estimated quantities of materials at the SWEPCO plants which formed the basis of the amount of labor required for demolition were based on existing plant drawings and observations made during the visits to the SWEPCO plants by the S&L estimator and inspection of plant drawings.⁵⁷³ Mr. Bertheau explained that Mr. Pous was incorrect to suggest that the S&L studies were not based on information specific to SWEPCO plants. In the situation cited by Mr. Pous to support his claim, the information relied upon by S&L was for another generating unit which was of similar plant design and size of the particular SWEPCO plant studied, Arsenal Hill Unit 5, and the use of information for a closely sized plant was appropriate.⁵⁷⁴

Mr. Bertheau explained that, contrary to Mr. Pous' assertions, reasonable assumptions regarding scrap metal quantities and scrap metal values were included in the S&L studies, including factors of negative 10% to account for the cost of preparing scrap metals for the scrap market and negative 15% to account for volatility in scrap metal prices.⁵⁷⁵ Mr. Bertheau also refuted Mr. Pous' contention that S&L failed to make adequate consideration for potential resale of equipment. Mr. Bertheau explained that an active market does not always exist for used power plant equipment from a plant that is demolished at the end of its useful live, which is the assumption underlying the S&L studies for the SWEPCO plants.⁵⁷⁶ Pursuant to accepted utility

⁵⁷⁰ Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 10-11, 17-18, Exhibit SRB-1R.

⁵⁷¹ Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 11-12, Exhibit SRB-1R at 4-9, 23-27, 38-42, 58-62, 73-77, 93-97, 111-113, 136-140, 168-172, 197-201, 216-220, 244-249.

⁵⁷² Rebuttal Testimony of Steven Bertheau, SWEPCO Ex. 82 at 11-12, Exhibit SRB-1R at 4-9, 23-27, 38-42, 58-62, 73-77, 93-97, 111-113, 136-140, 168-172, 197-201, 216-220, 244-249.

⁵⁷³ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 11-16.

⁵⁷⁴ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 16-17.

⁵⁷⁵ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 18-22, Exhibit SRB-2R.

⁵⁷⁶ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 22-24.

practice, S&L assumed that the SWEPCO plants will be demolished at the end of their expected useful lives following an economic approach to operating and maintaining the plants in which equipment is economically maintained and operated to the point that the O&M cost of operating it exceeds any remaining value in the plant components other than scrap value.⁵⁷⁷ Even within the AEP system which has a good amount of standardization across its generation fleet, the experience is that inter-company transfer of equipment is limited.⁵⁷⁸ In a situation cited by Mr. Pous where equipment was sold by another utility, Mr. Bertheau pointed out that the plant was prematurely retired about 10 years before the termination of its expected life which meant the equipment would have been more marketable than equipment in a plant which has run to the end of its useful life when it is retired.⁵⁷⁹

Mr. Bertheau also refuted Mr. Kollen's and Mr. Pous' contentions that the contingency factors in the S&L studies were unreasonable. The contingency factors used by S&L are necessary because of factors which will come into play over the life of the plant whose demolition cost is being estimated today.⁵⁸⁰ A power plant is subject to change in configuration over time as a consequence of changes in operating approach, improvements in technology, environmental regulations, and changes in fuel use.⁵⁸¹ A contingency is intended to account for changes of this nature at a power plant which are inevitable; and for this reason, the use of a contingency for this purpose is standard engineering practice.⁵⁸² A contingency will depend on the nature and level of the cost estimate, with a higher contingency factor in a high level conceptual study and a lower contingency factor where the scope of work has been more clearly defined and detailed bids are received from contractors and vendors.⁵⁸³ Since the S&L studies are in the mid-range between a high-level conceptual cost estimate and a more detailed cost estimate that is based on bids from contractors and vendors, Mr. Bertheau stated that the positive 15% contingency factor used by S&L is reasonable to recognize the uncertainties inherent in

⁵⁷⁷ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 22-24.

⁵⁷⁸ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 24-25.

⁵⁷⁹ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 24-25.

⁵⁸⁰ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 27-28.

⁵⁸¹ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 27-28.

⁵⁸² Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 28-29.

⁵⁸³ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 28-30.

estimating a plant's demolition estimate many years or decades before the plant is expected to be retired.⁵⁸⁴

With respect to Mr. Pous' argument that the 15% contingency factor is higher than the 10% contingency factor specified by the Commission for nuclear plant decommissioning cost estimates, Mr. Bertheau pointed out that Mr. Pous had not considered the context in which the nuclear plant decommissioning study 10% factor was specified.⁵⁸⁵ Without this context, Mr. Bertheau stated, a valid determination could not be made about the validity of the use of the 15% contingency factor in the S&L studies relative to the 10% factor for nuclear decommissioning.⁵⁸⁶

In connection with Mr. Pous' assertion that the S&L studies inappropriately included costs to improve plant sites, Mr. Bertheau explained that the costs which Mr. Pous challenged were required to restore the sites, to the extent practical, to their original condition.⁵⁸⁷ Mr. Davis explained that the site restoration costs developed by S&L represent appropriate costs of removal under accepted depreciation practices. The purpose of the depreciation calculation is to recover from customers the investment in and the costs of removal (less salvage) related to depreciable plant which provides service to customers.⁵⁸⁸ The site restoration activities do not create an enhancement of the value of land, but represent activities to restore the site to its original condition and accordingly represent costs to remove the depreciable production plant that provided services to customers.⁵⁸⁹

Mr. Davis also addressed Mr. Pous' criticism that the S&L studies failed to include the value of land and water rights. Mr. Davis stated land and water right values have no place in the depreciation calculation because the objective of the depreciation calculation is to recover from customers the investment in and the costs of removal of *depreciable* plant which provides service to customers.⁵⁹⁰ Neither land nor water rights are depreciated, and therefore customers do not

⁵⁸⁴ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 29-31.

⁵⁸⁵ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 30.

⁵⁸⁶ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 30.

⁵⁸⁷ Rebuttal Testimony of Steven R. Bertheau, SWEPCO Ex. 82 at 32.

⁵⁸⁸ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 29-30.

⁵⁸⁹ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 29-30.

⁵⁹⁰ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 28-31.

pay for these assets through the depreciation calculation.⁵⁹¹ Customers are charged a rate of return on land and water rights through inclusion of investment in rate base, but no mechanism in the rate making process requires the customers to pay for the cost of land or water rights.⁵⁹² Since land and water rights are not depreciated and customers are not charged for these assets, the cost or sale value of these assets should not be considered when preparing a depreciation study.⁵⁹³ Further, SWEPCO has no current plans, Mr. Davis stated, to sell or reuse land or water rights.⁵⁹⁴

The practice of the Commission has been to consider the sale proceeds from such non-depreciable items only when they occur, and not in advance through the depreciation calculation.⁵⁹⁵

The preponderance of the weight of the record evidence establishes that the demolition studies performed by S&L to determine SWEPCO's production plant net salvage are well crafted, use reasonable assumptions, and produce reliable plant removal costs and salvage for use in the calculation of SWEPCO's requested production plant overall net salvage value of negative 3.4%. In fact, in Docket No. 39896, the ALJs recognized that in lieu of unproductive non-specific arguments and counter-arguments related to the factors affecting plant removal costs, an approach similar to the one that SWEPCO has employed in this case should be presented.⁵⁹⁶

The response of the intervenors to the S&L studies presented by SWEPCO, however, has been to pick at selected aspects of the studies and then either recommend that the S&L studies be entirely disregarded (Kollen) or recommend alternative production plant overall net salvage rates of negative 1% or positive 15% (Pous) without providing quantifiable connections between a specific criticism and the overall net salvage recommendation. Rather than the selective approach taken by the intervenors, SWEPCO submits that these studies should be judged on the overall reasonableness of the methodology employed, of the information considered, of the assumptions used, of the data underlying these assumptions, and of the judgments made in

⁵⁹¹ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 29-30.

⁵⁹² Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 29-30.

⁵⁹³ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 29-30.

⁵⁹⁴ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 29-30.

⁵⁹⁵ *See, e.g.*, Docket No. 38339, Order on Rehearing at 5, FoF Nos. 136-138, 139A, 139B (Jun. 23, 2011).

⁵⁹⁶ Docket No. 39896, Proposal for Decision at 131 (July 6, 2012).

performing the studies. When this is done, the only conclusions which reasonably can be reached are that the S&L studies have been amply demonstrated to be reasonable and that the intervenors' criticisms do not raise any credible ground to reject the S&L studies.

In fact, the Indiana Utility Regulation Commission recently considered similar demolition studies performed by Mr. Bertheau for SWEPCO's affiliate, Indiana Michigan Power Company (IMPC) and rejected criticisms similar to many of those posed by CARD and Cities in this case.⁵⁹⁷ In connection with the S&L studies presented by IMPC, the Indiana Commission concluded:

The evidence of record shows that S&L is well-qualified with specific expertise in producing demolition cost estimate studies and that the S&L demolition cost estimates are clearly substantiated and based on site specific data, assumptions consistent with prudent industry practices and previous S&L demolition estimates. This Commission has long accepted and relied on site specific S&L demolition studies for purposes of establishing depreciation rates.⁵⁹⁸

A similar determination should be made in this case.

ii. Escalation of production plant removal costs to the expected retirement date

Mr. Davis escalated the production plant removal costs and salvage from the S&L studies (which were stated in first quarter 2012 dollars) to the expected final retirement date of each plant using an inflation rate of 2.5%.⁵⁹⁹ The source of the inflation rate used by Mr. Davis is the "Livingston Survey" dated December 2011 published by the research department of the Federal Reserve Bank of Philadelphia.⁶⁰⁰

Mr. Kollen and Mr. Pous contended that escalating the S&L production plant removal costs to the expected final retirement date of each plant was not appropriate.⁶⁰¹ Both Mr. Kollen

⁵⁹⁷ Indiana Utility Regulatory Commission, *Petition of Indiana Michigan Power Company for Authority to Increase its Rates*, Cause No. 44075, Order of the Commission at 105-106, 109 (Feb. 13, 2013), at <<https://myweb.in.gov/IURC/eds/Guest.aspx?tabid=28&dn=SEARCHDOCKETEDCASE>> last visited on February 25, 2013.

⁵⁹⁸ Indiana Utility Regulatory Commission, *Petition of Indiana Michigan Power Company for Authority to Increase its Rates*, Cause No. 44075, Order of the Commission at 106 (Feb. 13, 2013), at <<https://myweb.in.gov/IURC/eds/Guest.aspx?tabid=28&dn=SEARCHDOCKETEDCASE>> last visited on February 25, 2013.

⁵⁹⁹ Direct Testimony of David A. Davis, SWEPCO Ex. 43 at 11.

⁶⁰⁰ Direct Testimony of David A. Davis, SWEPCO Ex. 43 at 11.

⁶⁰¹ Direct Testimony of Lane Kollen, Cities Ex. 3 at 63; Direct Testimony of Jacob Pous, CARD Ex. 2 at 34-36.

and Mr. Pous took the position that customers should only pay current costs through rates. Mr. Pous also asserted that such escalation was atypical for the industry.

In his rebuttal testimony, Mr. Davis addressed the positions taken by Mr. Kollen and Mr. Pous.⁶⁰² Mr. Davis stated that the objective of the depreciation calculation is to recover, over the life of plant, the final terminal removal costs comprising the cost expected to be incurred when the plant is removed at the end of its useful life.⁶⁰³ In support, Mr. Davis cited the NARUC publication Public Utility Depreciation Practices which states at page 18:

The goal of accounting for net salvage is to allocate the net cost of an asset to accounting periods, making due allowance for net salvage, positive or negative, that will be obtained when **the asset is retired**. (emphasis added)⁶⁰⁴

Mr. Davis stated that depreciation practices recognized by NARUC explicitly provide that terminal net salvage included in the depreciation calculation should be made at the value expected to be incurred when the plant is retired and not made in current dollars as suggested by Mr. Kollen and Mr. Pous.⁶⁰⁵

In response to Mr. Kollen's and Mr. Pous' arguments that it would be unfair to include in current rates a cost component that is calculated to be incurred when a plant is retired, and for this reason the costs should be discounted to current dollars, Mr. Davis pointed out that discounting future removal costs would not be correct because customers receive a return on the net salvage component of accumulated depreciation as a reduction to rate base which reduces the required return to be included in rates.⁶⁰⁶ Also, Mr. Davis explained, discounting future removal costs would be inconsistent with straight-line depreciation calculations which are designed to produce equal annual depreciation amounts through the calculation of depreciation rates which allocate the remaining cost of a utility's investment, including terminal net salvage, over the remaining life of the investment.⁶⁰⁷ Discounting the net salvage cost to the current value consequently would not match the economic reality reflected in the accounting practice of

⁶⁰² Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 24-28.

⁶⁰³ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 24.

⁶⁰⁴ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 26.

⁶⁰⁵ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 26.

⁶⁰⁶ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 27.

⁶⁰⁷ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 27.

straight-line depreciation, would shift an increasing depreciation cost in all succeeding rate cases, and create a risk that costs to retire a plant would be imposed on customers after its retirement.⁶⁰⁸

In response to Mr. Pous' contention that escalating the production plant net salvage was atypical of the industry, Mr. Davis indicated that other jurisdictions in which AEP operates have accepted the practice of escalating generating unit retirement costs to the date of retirement.⁶⁰⁹ Mr. Davis cited a decision by the Indiana Utility Regulatory Commission endorsing the practice for a non-AEP utility.⁶¹⁰ In its decision, the Indiana Commission found that:

Not factoring inflation into dismantlement costs to be incurred in the future would understate these costs, with the result that the future customers would have to pay costs arising from facilities that are not serving them. This result flies in the face of the matching principle followed by this Commission. Moreover, current customers receive a benefit by factoring inflation, as it may allow a reduction in rate base because of the increased accumulated reserve for depreciation.⁶¹¹

In a similar but different context, nuclear decommissioning cost, this Commission has determined that terminal retirement costs properly should be stated in the amount expected as of the date of a plant's retirement and not at a cost discounted to current dollars because this treatment is necessary to avoid back-end loading of costs to future ratepayers.⁶¹²

The preponderance of the record evidence supports SWEPCO's escalation of the S&L production plant removal costs to the expected retirement of each power plant as being reasonable and proper, and the ALJs should adopt this aspect of SWEPCO's calculation of the production plant overall net salvage rate of negative 3.4%.

iii. Inclusion of net salvage on interim retirements in the production plant net salvage

Net salvage on interim retirements is a component of SWEPCO's requested overall production plant net salvage rate of negative 3.4%.⁶¹³ Mr. Davis explained that net salvage on

⁶⁰⁸ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 27-28.

⁶⁰⁹ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 26.

⁶¹⁰ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 27.

⁶¹¹ Indiana Utility Regulatory Commission, *Petition of PSI Energy, Inc. to Increase its Rates*, Cause No. 42359, Order at 71 (May 18, 2004) at <<https://myweb.in.gov/IURC/eds/Guest.aspx?tabid=28&dn=SEARCHDOCKETEDCASE>> last visited on February 25, 2013.

⁶¹² *Application of Texas Utilities Electric Company for Authority to Change Rates and Investigation of the General Counsel into the Accounting Practices of Texas Utilities Electric Company*, Docket No. 11735, 20 P.U.C. BULL. 1029, 1215-1217, 1454 (FoF No. 126) (May 27, 1994).

⁶¹³ Direct Testimony of David A. Davis, SWEPCO Ex. 81, Exhibit DAD-1 at 10, Exhibit DAD-2 at 6-14.

interim retirements represents salvage amounts net of removal costs incurred in connection with interim retirements.⁶¹⁴ Interim retirements and net salvage on interim retirements are a fact of production plants as a consequence of retirement of equipment that will occur prior to the retirement of a power plant.⁶¹⁵ Net salvage on interim retirements is not a component of the plant demolition studies performed by S&L discussed previously, and, consequently, must be included in the depreciation study separately.⁶¹⁶ The addition of net salvage on interim retirements, accordingly, is a necessary adjunct to SWEPCO's approach of calculating production plant net salvage using plant-specific engineering studies, because in its absence, an important component of net salvage which SWEPCO will incur would be missing from the depreciation calculation.⁶¹⁷

While Mr. Pous did not take the position that either interim retirements or net salvage on interim retirements are not appropriate or are inconsistent with accepted depreciation practices,⁶¹⁸ he recommended that this component of the production plant net salvage calculation be eliminated based on what he characterized as "the Commission's long-standing precedent."⁶¹⁹ However, the sole Commission decision which Mr. Pous cited for this position is Finding of Fact No. 100 in the recent ETI rate case, PUCT Docket No. 39896.⁶²⁰ As discussed in Section IV.I.1.a.ii *supra*, the Commission's decision in Finding of Fact No. 100 in PUCT Docket No. 39896 addressed the inclusion of interim retirements in the calculation of production plant average remaining life and **not** the net salvage calculation.⁶²¹

In considering SWEPCO's inclusion of net salvage on interim retirements in the production plant net salvage calculation, a crucial consideration is that rather than using a generic or historically used net salvage rate, SWEPCO used an approach based on plant-specific engineering studies to calculate plant removal costs and salvage. In the cases where the

⁶¹⁴ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 33.

⁶¹⁵ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 32.

⁶¹⁶ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 33.

⁶¹⁷ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 33.

⁶¹⁸ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 31.

⁶¹⁹ Direct Testimony of Jacob Pous, Cities Ex. 2 at 37.

⁶²⁰ Direct Testimony of Jacob Pous, Cities Ex. 2 at 40.

⁶²¹ See Docket No. 39896, Proposal for Decision at 122-125 (Jul. 6, 2012); particularly *id.* at 125 ("ETI should not be allowed to use the interim retirement methodology to adjust downward the remaining lives of production plant accounts.").

Commission rejected the use of interim retirements, the utility did not employ the plant-specific engineering study approach which SWEPCO used in this case, but rather based the production plant net salvage request on a generic or historical net salvage rate which the utility adjusted for certain factors.⁶²²

SWEPCO urges the ALJs to evaluate the merits of what SWEPCO has done in this case based on the record evidence which establishes material factual differences between how SWEPCO has calculated production plant depreciation and what was done in prior Texas cases, such as Docket No. 39896 and 14965. When what SWEPCO has done to calculate production plant net salvage is taken into account, it is apparent that no substantive justification has been raised to reject Mr. Davis' inclusion of net salvage on interim retirements in the calculation of the production plant net salvage, and the differing facts of this case from prior precedent mean that the prior precedent should not control the decision on this matter in this case.

The preponderance of the record evidence supports SWEPCO's inclusion of net salvage on interim retirements to the expected retirement of each power plant as being reasonable and proper, and the ALJs should adopt this aspect of SWEPCO's calculation of the production plant overall net salvage rate of negative 3.4%.

2. Transmission Plant

Contested issues regarding Transmission Plant involve: (i) the life parameter for FERC Account 355–Poles and Fixtures; (ii) the net salvage rate for FERC Account 353–Station Equipment; (iii) the net salvage rate for FERC Account 355–Poles and Fixtures; and (iv) the net salvage rate for FERC Account 356–Overhead Conductor.

a. Life parameter for FERC Account 355–Poles and Fixtures

SWEPCO proposed a life parameter of 50 S0 for Account 355.⁶²³ This life parameter is based on the mathematical goodness of fit criterion (least sum of squared deviations).⁶²⁴ Card

⁶²² Docket No. 39896, Proposal for Decision at 127 (Jul. 2, 2012) (“ETI witness Watson started with the negative 5 percent net salvage factor approved for ETI in Docket No. 16705....Consideration of the increase in the cost of removal over...[a] 13-year period resulted in an increase in the cost of removal and a corresponding increase in the negative net salvage from negative 5 percent to negative 8.5 percent.”); Docket No. 14965, Proposal for Decision at 207-08 (Jan. 21, 1997) (“Because Mr. Rolf believes that net cost of salvage will rise in the future, he argues that the net salvage factor should be raised to [negative] ten percent....the Judges conclude that depreciation costs should not take into account interim additions or retirements or future net salvage costs greater than [negative] five percent.”).

⁶²³ Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-1 at 22.

⁶²⁴ Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-2 at 225, 240; Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 41.

witness Pous recommended that 54 L1 be used as the life parameter based on his opinion that SWEPCO's approach sacrificed a better fit near the top and middle of the observed life tables and misplaces the emphasis in the curve fitting process.⁶²⁵

In his rebuttal testimony, Mr. Davis indicated that rather than Mr. Pous' qualitative reasons for deviations, the best mathematical fit is the appropriate conclusion for the FERC Account 355 life parameter based on the account data, and stated that visual observation of Mr. Pous' graph clearly demonstrates superior matching of the data by the 50 S0 life parameter over the entire period analyzed as opposed to Mr. Pous' recommended 54 L1 life parameter.⁶²⁶

For the reasons set forth by Mr. Davis, SWEPCO's recommended life parameter of 50 S0 for FERC Account 355 is reasonable and should be adopted, and the ALJs should reject Mr. Pous' recommended 54 L1 life parameter.

b. Net salvage for FERC Account 353--Station Equipment

SWEPCO requested a net salvage rate of negative 13% for FERC Account 353.⁶²⁷ This net salvage rate is based on the mathematical average of data for FERC Account 353 for the most recent 10-year period 2002-2011.⁶²⁸ CARD witness Jacob Pous recommended a net salvage rate of 0% for FERC Account 353.⁶²⁹ Mr. Pous based his recommendation on the fact that the most recent year of net salvage for FERC Account 353 was negative 5%, and his belief that in light of this recent experience, SWEPCO should have given more significance to several factors that Mr. Pous maintained indicated a trend to a less negative value.⁶³⁰

In his rebuttal testimony, Mr. Davis discussed each of the factors which Mr. Pous asserted indicated a trend to a less negative net salvage value for FERC Account 353. As Mr. Davis explained, each of the factors Mr. Pous relied upon either failed to employ a systematic approach to the data, was incorrect, failed to recognize that adjustments to remove a transaction not expected to be representative of future experience is appropriate, or was

⁶²⁵ Direct Testimony of Jacob Pous, CARD Ex. 2 at 65-66.

⁶²⁶ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 44-45.

⁶²⁷ Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-1 at 22.

⁶²⁸ Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-2 at 209, 284; Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 49-50.

⁶²⁹ Direct Testimony of Jacob Pous, CARD Ex. 2 at 49.

⁶³⁰ Direct Testimony of Jacob Pous, CARD Ex. 2 at 49.

conjectural and speculative.⁶³¹ Mr. Davis pointed out Mr. Pous' use of just one year's data as indicative of a trend is not a valid analytical approach.⁶³² Nor does one year's data justify ignoring the rest of the Company's data or serve as a basis to disregard that body of data and substituting for it a generalized and unsupported assertion that a number of utilities rely on a positive net salvage, when other utilities such as ETI in PUCT Docket No. 39896 was granted a negative 20% net salvage rate for FERC Account 353.⁶³³ With respect to Mr. Pous' criticism of SWEPCO's removal of a transaction involving a transformer transfer to Public Service Company of Oklahoma, Mr. Davis pointed out that the NARUC publication Public Utility Depreciation Practices recognizes the appropriateness of eliminating a transaction that would not be expected to be representative of future experience.⁶³⁴ Lastly, rather than relying on quantifiable support for his recommendation of a net salvage rate of 0% for FERC Account 353, Mr. Davis notes that Mr. Pous relies on unquantifiable and speculative generalizations such as potential economies of scale and increases in scrap copper values because of a resurgence in the economies of China and India.⁶³⁵

The preponderance of the record evidence supports SWEPCO's requested net salvage rate for FERC Account 353 of negative 13% as being reasonable, and the ALJs should reject Mr. Pous' recommended rate of 0%.

c. Net salvage for FERC Account 355—Poles and Fixtures

SWEPCO requested a net salvage rate of negative 67% for FERC Account 355.⁶³⁶ This net salvage rate is based on the mathematical average of the data for FERC Account 355 for the most recent 10-year period 2002-2011.⁶³⁷ CARD witness Jacob Pous recommended a salvage rate for FERC Account 355 of negative 45% based on his position that the period from 2002 to 2011 exhibits large annual fluctuations, with the most recent four-year period 2008-2011

⁶³¹ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 47-49, 50-52.

⁶³² Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 50.

⁶³³ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 50-51.

⁶³⁴ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 51.

⁶³⁵ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 52.

⁶³⁶ Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-1 at 22.

⁶³⁷ Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-2 at 211, 286; Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 52-53.

averaging negative 48%, and that guidance should therefore be sought from industry information.⁶³⁸

In his rebuttal testimony, Mr. Davis discussed each of the factors cited by Mr. Pous to support his recommended net salvage rate for FERC Account 355 and demonstrated the lack of merit in each of them. Mr. Davis pointed out that Mr. Pous' approach is extremely selective, choosing outdated industry data when it serves his purpose, but arbitrarily choosing SWEPCO data such as the most recent four-year data for 2008-2011 when it serves his purpose.⁶³⁹ In addition, Mr. Pous advances speculative propositions such as undefined potential economies of scale or future productivity improvements which the Company's experience support regarding a mass property account such as FERC Account 355.⁶⁴⁰ Mr. Davis further pointed out that Mr. Pous offered no quantifiable support for his recommendation of negative 45% for FERC Account 355, and Mr. Pous' comment that his recommendation is more negative than the rate set for SWEPCO 1984 in SWEPCO's rate case prior Docket No. 37364 is not relevant to setting depreciation rates going forward in 2013.⁶⁴¹

The preponderance of the record evidence supports SWEPCO's requested net salvage rate of negative 67% for FERC Account 355 as being reasonable, and the ALJs should reject Mr. Pous' recommendation of a rate of negative 45%.

d. Net salvage for FERC Account 356—Overhead Conductor

SWEPCO requested a net salvage rate of negative 40% for FERC Account 356.⁶⁴² This net salvage rate is based on an analysis of data for FERC Account 356 for the most recent 10-year period 2002-2011 adjusted to remove unusual and non-recurring items.⁶⁴³ CARD witness Jacob Pous recommended a net salvage rate for FERC Account 356 of negative 25% principally based on an argument that the records maintained by SWEPCO did not permit a level of granularity, *i.e.*, level of contractor expenditures, linear feet of conductor retired each year,

⁶³⁸ Direct Testimony of Jacob Pous, CARD Ex. 2 at 52-53.

⁶³⁹ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 47-49, 53-54.

⁶⁴⁰ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 54.

⁶⁴¹ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 54-55.

⁶⁴² Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-1 at 22.

⁶⁴³ Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-2 at 212, 287; Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 55.

activity due to emergency situations, etc., which Mr. Pous maintained was necessary to arrive at a reasonable net salvage rate.⁶⁴⁴

In his rebuttal testimony, Mr. Davis stated that Mr. Pous' argument contending that the level of data maintained by SWEPCO is inadequate constitutes a diversionary attempt to create the misleading impression that the availability of this type of data would provide a more conclusive result.⁶⁴⁵ SWEPCO does not keep and is not required to keep the level of data indicated by Mr. Pous.⁶⁴⁶ Moreover, maintaining this level of detail would be a major undertaking requiring changes in systems and additional work by numerous individuals with questionable benefit.⁶⁴⁷ There is no reason to believe that the additional detail would yield a superior or even more accurate result.⁶⁴⁸ Mr. Davis also pointed out that the other factors cited by Mr. Pous in support of his recommendations for FERC Account 356 consist of inappropriate or selective use of information, outdated industry information, speculative conjecture about possible economies of scale, or faulty assumptions related to the potential effects of increased scrap copper prices on net salvage for FERC Account 356.⁶⁴⁹ Given that transmission conductor is predominantly aluminum and not copper, copper prices are of little relevance to FERC Account 356.⁶⁵⁰

The preponderance of the record evidence supports SWEPCO's requested net salvage rate for FERC Account 356 of negative 40% as being reasonable, and the ALJs should reject Mr. Pous' recommendation of negative 25%.

3. Distribution Plant

The contested Distribution Plant contested issues involve: (i) the life parameter for FERC Account 367-Underground Conductor and (ii) the net salvage rate for FERC Account 362-Substation Equipment. CARD witness Jacob Pous recommended that SWEPCO's requested life parameter for FERC Account 364-Distribution Poles of 50 L0 should be revised to 54 L0. On further investigation, Mr. Davis agreed with this recommendation which reduces the requested

⁶⁴⁴ Direct Testimony of Jacob Pous, CARD Ex. 2 at 54-55.

⁶⁴⁵ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 47-49, 56.

⁶⁴⁶ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 47-49, 56.

⁶⁴⁷ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 47-49, 56.

⁶⁴⁸ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 47-49, 56.

⁶⁴⁹ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 57.

⁶⁵⁰ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 57-58.

depreciation expense by \$716,339 on a total Company basis and \$254,802 on a Texas jurisdictional basis.⁶⁵¹

a. Life parameter for FERC Account 367–Underground Conductor

SWEPCO proposed a life parameter of 45 R2.5 for FERC Account 367.⁶⁵² This life parameter is based on the goodness of fit criterion (least squared deviations).⁶⁵³ Mr. Pous recommended a life parameter for FERC Account 367 of 50 R1.5 based on the actuarial results and his considerations of change in the life characteristics and technological underpinning of the investment in the account.⁶⁵⁴ In his rebuttal testimony, Mr. Davis stated that rather than using Mr. Pous' qualitative reasons for deviations, reliance on best mathematical fit was the appropriate conclusion given the account data, and stated that visual observation of Mr. Pous' graphs clearly demonstrates superior matching of data by the 45 R2.5 parameter over the entire period analyzed as opposed to 50 R1.5.⁶⁵⁵

For the reasons set forth by Mr. Davis, SWEPCO's recommended life parameter of 45 R2.5 for FERC Account 367 is supported by the preponderance of the record evidence as being reasonable, and the ALJs should reject Mr. Pous' recommended 50 R1.5 life parameter.

b. Net salvage for FERC Account 362–Substation Equipment

SWEPCO's requested a net salvage rate of negative 16% for FERC Account 362.⁶⁵⁶ This net salvage rate is based on an analysis of salvage and removal costs for FERC Account 362 over the 28-year period 2002-2011 after making adjustments to remove unusual and nonrecurring items.⁶⁵⁷ CARD witness Jacob Pous recommended a net salvage rate for FERC Account 362 of negative 5% primarily based on his positions that the account contains significant quantities of

⁶⁵¹ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 43-44.

⁶⁵² Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-1 at 22.

⁶⁵³ Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-2 at 326, 403-04; Rebuttal Testimony of David A Davis, SWEPCO Ex. 81 at 41.

⁶⁵⁴ Direct Testimony of Jacob Pous, CARD Ex. 2 at 71.

⁶⁵⁵ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 41.

⁶⁵⁶ Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-1 at 22.

⁶⁵⁷ Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-2 at 304, 418; Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 58-59.

copper, the results of sales of equipment in one year should have been included in the data, and fluctuations in annual net salvage justified consideration of industry data.⁶⁵⁸

In his rebuttal testimony, Mr. Davis discussed each of the factors which Mr. Pous maintained warranted a negative 5% net salvage rate rather than the negative 16% requested by SWEPCO. As to Mr. Pous' claim about the level of copper in FERC Account 362, Mr. Davis pointed out that Mr. Pous failed to provide quantifiable support or calculations that the amounts of copper in a transformer would offset the costs of retiring or removing a distribution substation.⁶⁵⁹ While Mr. Pous cited the approximately \$1.5 million net salvage associated by the sale of a substation, Mr. Davis stated that Mr. Pous had failed to recognize that transactions which are not representative of what would be expected in the future should be eliminated as recognized by the NARUC publication Public Utility Depreciation Practices at page 158.⁶⁶⁰ Mr. Davis further discussed that Mr. Pous reliance on non-quantifiable generalizations about economies of scale, industry data which is outdated, and unsubstantiated claims that greater level of detail in SWEPCO's records (which are not required and would be costly to implement) would yield or produce a superior or even more accurate result.⁶⁶¹

The preponderance of the evidence supports SWEPCO's requested net salvage rate for FERC Account 362 of negative 16% as being reasonable, and the ALJs should reject Mr. Pous' recommended net salvage rate of negative 5%.

4. General Plant

There is only one contested issue involving General Plant, this is the net salvage rate for FERC Account 390—General Structures and Improvements.

SWEPCO requested a net salvage rate of negative 7% for FERC Account 390.⁶⁶² This net salvage rate was based on an analysis of salvage and removal costs for the account for the 28-year period 1984-2011 after making certain adjustments to remove unusual and non-recurring items.⁶⁶³ CARD witness Jacob Pous recommended a net salvage rate for FERC Account 390 of

⁶⁵⁸ Direct Testimony of Jacob Pous, CARD Ex. 2 at 56.

⁶⁵⁹ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 59.

⁶⁶⁰ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 60.

⁶⁶¹ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 60-61.

⁶⁶² Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-1 at 22.

⁶⁶³ Direct Testimony of David A. Davis, SWEPCO Ex. 43, Exhibit DAD-2 at 485, 497; Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 62.

positive 25% based on his belief that a more positive net salvage rate was suggested by a sale of a building which occurred in 2004 and the fact a substantial portion of the removal experienced in the historical record consisted of asbestos removal in 1996.⁶⁶⁴

In his rebuttal testimony, Mr. Davis indicated that his review of Mr. Pous' testimony on FERC Account 390 led him to conclude that both the asbestos removal in 1996 and the sale of the office building in 2004 should be eliminated from the data.⁶⁶⁵ Elimination of these two years with higher than normal salvage and removal amounts produces a net salvage rate for the 1984-2011 period of negative 3%.⁶⁶⁶ Changing SWEPCO's requested net salvage rate for FERC Account 390 from the rate of negative 7% initially requested to negative 3% reduces the requested depreciation expense on a total Company basis by \$97,594 and on Texas jurisdictional basis by \$32,938.

Mr. Davis stated that Mr. Pous' recommended net salvage rate of positive 25% for FERC Account 390 was unreasonable and should be rejected. With respect to Mr. Pous' suggestions that many of the retirements in FERC Account 390 are individual items and SWEPCO is likely to sell a building rather than removing it, Mr. Davis pointed out that removing many individual items such as lighting systems, air conditioning systems and roofs can be costly, especially in relation to the cost of a building that is 50 to 100 years old.⁶⁶⁷ Moreover, the sale value of a building can depend on many factors including the condition of its structure, its age, and its location.⁶⁶⁸ Sale value of a building can be negative or positive relative to original value, and the sale value that will be realized in the future is not subject to projection with reliance.⁶⁶⁹ This is why the best course of action is to consider SWEPCO's history, which is what Mr. Davis based his recommendation rather than Mr. Pous' non-quantifiable generalizations and assertions.

The preponderance of the record evidence supports SWEPCO's modified requested net salvage value for FERC Account 390 of negative 3% as being reasonable, and the ALJ's should reject Mr. Pous' recommended net salvage rate of positive 25%.

⁶⁶⁴ Direct Testimony of Jacob Pous, CARD Ex. 2 at 58-60.

⁶⁶⁵ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 64.

⁶⁶⁶ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 64, Exhibit DAD-4R.

⁶⁶⁷ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 63.

⁶⁶⁸ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81.

⁶⁶⁹ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 63-64.

5. Depreciation Reserve

a. Legal authority applicable to the Depreciation Reserve

SWEPCO calculated its requested depreciation rates using a straight line, average remaining life type methodology based on historical costs from SWEPCO's property records and, as discussed in Section IV.I.1.b.i *supra*, also used engineering estimates of removal costs for production plant.⁶⁷⁰ The straight-line methodology used by SWEPCO conforms to P.U.C. SUBST. R. 25.231(b)(1)(B) which states that cost of service includes:

Depreciation expense based on original cost and computed on a straight line basis as approved by the commission. Other methods of depreciation may be used when it is determined that such depreciation method is a more equitable means of recovering the cost of the plant.

Under the straight line, remaining life methodology, original cost of plant, adjusted for net salvage, less accumulated depreciation is recovered over the remaining life of the plant.⁶⁷¹ As of the end of the historical test year, December 31, 2011, SWEPCO's actual, or book, accumulated depreciation reserve exceeded a calculated hypothetical amount that would have been accumulated as of that date had the new depreciation parameters requested been in effect in prior periods.⁶⁷² The depreciation reserve which would have been accumulated as of December 31, 2011, had the new depreciation parameters been in effect in prior years, is often referred to as the "theoretical depreciation reserve." The amount by which the actual accumulated depreciation reserve is more than or less than the theoretical depreciation reserve is often referred to as a "theoretical depreciation reserve" surplus or deficiency.

Treatment of a utility's book accumulated depreciation reserve is addressed by P.U.C. SUBST. R. 25.231(c)(2)(A)(ii) which provides that:

Reserve for depreciation is the accumulation of recognized allocations of original cost, representing recovery of initial investment, over the **estimated useful life of the asset**. Depreciation shall be computed on a straight line basis or such other method approved under subsections (b)(1)(B) of this section over the expected useful life of the item or facility. (emphasis added)

This rule makes it explicit that the amortization of a utility's depreciation reserve will occur over the expected useful life of plant.

⁶⁷⁰ Direct Testimony of Davis A. Davis, SWEPCO Ex. 43 at 9-10, Exhibit DAD-1 at 5-6.

⁶⁷¹ Direct Testimony of Davis A. Davis, SWEPCO Ex. 43 at 10; Rebuttal Testimony of David A. Davis, SWEPCO Ex. 83 at 10.

⁶⁷² Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 9-10.

In PUCT Docket No. 38339, the most recent CenterPoint Electric Delivery Company, LLC (CenterPoint) rate case, several intervening parties urged the Commission to reduce current rates by amortizing CenterPoint's theoretical depreciation reserve surplus over a period of years substantially shorter than the remaining life of the plant.⁶⁷³ The ALJ's recommended rejection of the intervenors' proposals to amortize any portion of CenterPoint's accumulated depreciation reserve over a period shorter than the remaining life of the assets.⁶⁷⁴ The Commission agreed and adopted Finding of Fact Nos. 118 and 119 which provide:

118. The use of the remaining life depreciation method to recover differences between the theoretical and actual depreciation reserves is the most appropriate method and should be continued.
119. It is reasonable for CenterPoint to calculate depreciation reserve allocations on a straight line basis over the remaining, expected useful life of the item or facility.⁶⁷⁵

Similarly, in PUCT Docket No. 39896, the recent ETI case, TIEC took the position that a portion of ETI's requested depreciation expense for production plant should not be allowed taking the position that ETI had a surplus in the production plant.⁶⁷⁶ The ALJs recommended denial of TIEC's position, stating:

The commission has consistently used the remaining life, straight-line methodology for determining depreciation rates, and that methodology requires that the remaining life of the asset be determined, and that depreciation rates be established to recover the asset's remaining cost in equal installments over that life.⁶⁷⁷

The Commission agreed with the ALJs and adopted Finding of Fact Nos. 95-97:

95. P.U.C. SUBST. R. 25.231(c)(2)(ii)[sic] states that the reserve for depreciation is the accumulation of recognized allocations of original cost, representing the recovery of initial investment over the estimated useful life of the asset.
96. Except in the case of the amortization of general plant deficiency, the use of the remaining life depreciation method to recover differences between theoretical

⁶⁷³ *Application of CenterPoint Electric Delivery Company, LLC, for Authority to Change Rates*, Docket No. 38339, Order on Rehearing, FoF Nos. 118-119 (Jun. 23, 2011) ("Docket No. 38339"); *see id.*, Proposal for Decision at 87-91 (Dec. 3, 2011).

⁶⁷⁴ *See* Docket No. 38339, Proposal for Decision at 90 (Dec. 3, 2011).

⁶⁷⁵ Docket No. 38339, Order on Rehearing, FoF Nos. 118-119.

⁶⁷⁶ Docket No. 39896, Order on Rehearing at FoF Nos. 95-97 (Nov. 2, 2012); *see id.*, Proposal for Decision at 132 (Jul. 5, 2012).

⁶⁷⁷ Docket No. 39896, Proposal for Decision at 132 (Jul. 5, 2012).

and actual depreciation reserves is the most appropriate method and should be continued.

97. It is reasonable for ETI to calculate depreciation reserve allocations on a straight-line basis over of the remaining expected life of the item or facility.⁶⁷⁸

b. Opposing parties' recommended treatment of the theoretical reserve

TIEC proposed that SWEPCO's theoretical depreciation reserve surplus for production plant be amortized over a ten-year period rather than over the remaining life of the assets.⁶⁷⁹ Mr. Pollock argued that such an amortization was justified by the magnitude of SWEPCO's theoretical depreciation reserve surplus, would enhance generational equity, was a recognized practice, was consistent with the remaining life method of depreciation, and would provide rate mitigation.⁶⁸⁰

In his rebuttal testimony, Mr. Davis explained that amortization of the production plant hypothetical depreciation reserve surplus would actually create greater intergenerational inequities as compared to the traditional remaining life method applied on a straight-line basis.⁶⁸¹ It would do so because it would provide customers during the next 10 years with an artificial benefit while requiring customers in future periods to pay significantly higher costs.⁶⁸² In contrast, the traditional remaining life method applied on a straight-line basis treats all future customers equally by returning the difference in equal amounts to all customers over the remaining life of the assets which is fair to all customers.⁶⁸³

Mr. Davis also stated that the amortization proposed by Mr. Pollock is only an accepted practice where the whole life method is used, as opposed to the remaining life method favored by this Commission.⁶⁸⁴ Mr. Davis stated that the use of an arbitrary period to amortize the theoretical surplus effectively constitutes discontinuation of use of the remaining life technique in favor of a whole life type calculation.⁶⁸⁵

⁶⁷⁸ Docket No. 39896, Order on Rehearing at 21 FoF Nos. 95-97.

⁶⁷⁹ Direct Testimony of Jeffry Pollock, TIEC Ex. 1 at 47, 51.

⁶⁸⁰ Direct Testimony of Jeffry Pollock, TIEC Ex. 1 at 46.

⁶⁸¹ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 14.

⁶⁸² Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 14.

⁶⁸³ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 14.

⁶⁸⁴ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 15-16.

⁶⁸⁵ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 16.

Contrary to Mr. Pollock's contentions that SWEPCO's theoretical depreciation reserve is by far greater than experienced by other utilities, Mr. Davis pointed out that SWEPCO's production plant depreciation reserve was comparable in magnitude to the depreciation reserve surplus in the CenterPoint case, Docket No. 38339, in which the Commission denied amortization of a theoretical depreciation reserve.⁶⁸⁶ CenterPoint's reserve surplus for distribution plant was 22.6% compared to a 26% reserve surplus for SWEPCO generation plant.

Mr. Davis further stated that Mr. Pollock's proposal would increase reduce accumulated depreciation and increase rate base which would require a greater return component in future rates and require substantially higher depreciation expense when the amortization ends. All things being equal, the required future rate increase would persist over a longer period of time and would be compounded by future capital expenditures which could be substantial.⁶⁸⁷

The Commission has consistently supported the use of the straight-line, remaining life methodology to calculate depreciation rates which automatically amortizes any theoretical surplus or deficit over the remaining life of the assets. The arguments Mr. Pollock raised in favor of amortization of SWEPCO's production plant theoretical reserve surplus are the same as those raised in PUCT Docket Nos. 38339 and 39896. TIEC has not provided any valid reason, which has not previously been considered by the Commission and rejected to deviate from the rulings on this matter in PUCT Docket Nos. 38339 and 39896. The preponderance of the record evidence supports what SWEPCO requests, and the ALJs should reject Mr. Pollock's proposal and adopt SWEPCO's requested treatment which is consistent with Commission precedent adopted.

J. Mountaineer Carbon Capture & Storage Project Amortization

Section II.D. above discusses the Mountaineer Carbon Capture and Storage (CCS) project, including what it is and why its costs should be recovered as a regulatory asset included in rate base. SWEPCO seeks to recover this asset through a five-year amortization period, which results in \$475,922 in cost of service.⁶⁸⁸ Please see Section II.D. above for a full discussion of this subject.

⁶⁸⁶ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 11-12.

⁶⁸⁷ Rebuttal Testimony of David A. Davis, SWEPCO Ex. 81 at 14.

⁶⁸⁸ Direct Testimony of Randall W. Hamlett, SWEPCO Ex. 34 at 30.

K. Labor Costs [PO Issue 30]

1. Payroll – AEPSC and SWEPCO

By Commission rule, “rates are to be based upon an electric utility’s cost of rendering service to the public during a historical test year, adjusted for known and measurable changes.”⁶⁸⁹ As described in SWEPCO’s direct testimony and filing package, SWEPCO made two such known and measurable adjustments to its test year payroll. Payroll costs were updated (1) annualizing the base payroll to the salary rates in effect at the end of the test year and (2) recognizing the effect of the merit and general increases that were awarded in 2012.⁶⁹⁰ Because these increases were awarded in 2012, they are both known and measurable. This adjustment is consistent with other such adjustments approved by the Commission in previous rate proceedings.⁶⁹¹ No party, including Cities, disputes this fact.

While not disputing the known and measurable nature of the adjustments, Cities witness Ms. Cannady recommends they be ignored.⁶⁹² Ms. Cannady alleges (1) the level of base payroll at test year end already included significant increases occurring during the test year and (2) the Company is currently conducting a study to identify actions to potentially reduce employee-related expenses.

As an initial matter, Ms. Cannady misunderstands or mischaracterizes the increase in payroll experienced during the test year. The total increase experienced during the test year included not only the merit and general increases to base payroll awarded in 2011 but also the effects of changes in the employee population and overtime pay.⁶⁹³ However, more importantly, Ms. Cannady ignores the fact that, despite increases in base pay implemented during the test year, the Company’s base payroll was and continues to be below market. As shown in SWEPCO’s direct case, the Company’s compensation is below the market median for all types

⁶⁸⁹ P.U.C. SUBST. R. 25.231(a).

⁶⁹⁰ Direct Testimony of Randall W. Hamlett, SWEPCO Ex. 34 at 20; Rebuttal Testimony of Randall W. Hamlett, SWEPCO Ex. 73 at 49.

⁶⁹¹ *E.g., Application of El Paso Electric Company for Authority to Change Rates*, Docket No. 9165, 16 P.U.C. BULL. 605 (Aug. 22, 1990), adopted Examiner’s Report at 97; See also Texas Railroad Commission, Statement of Intent to Change the Rate CGS and Rate PT of Atmos Pipeline Texas, GUD No.10000, Final Order at FoF No. 62 (April 18, 2011).

⁶⁹² Ms. Cannady’s recommendation should be rejected. However, if her recommendation were to be adopted, the correct calculation of the adjustment is shown in the Rebuttal Testimony of Randall W. Hamlett, SWEPCO Ex. 73 at Exhibit RWH-3R.

⁶⁹³ See Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 4-5.

of positions and the increases that occurred where in line with market practices. In addition, not only have 2012 base pay increases already taken place, the majority of 2013 base pay increases are scheduled to take effect on or before April 1, 2013. Accordingly, by early 2013, the Company's salary levels will already be higher than those that the Company has requested be included in its cost of service.⁶⁹⁴ In any event, the salary increases implemented during the test year have not been challenged as unreasonable and there is no reason to ignore known and measurable changes to those test year levels.

While it is true that AEP is conducting a study that includes an analysis of employment levels, the pending results of this study are neither known nor measurable and should not be a factor in the Company's ability to include the merit and general increases actually provided to employees in 2012. As part of this continuing study, AEP and its operating companies announced during the first week of January 2012 initial operational, organizational, and staffing changes. However, the study is not yet complete. The review to date has identified the reduction of less than ten positions currently working at SWEPCO. Most employee reductions will be made at AEPSC.⁶⁹⁵

The impact on SWEPCO of eliminating positions at AEPSC is not yet known, and is not expected to be fully realized in 2013. In addition to the elimination of positions, there will also be a severance cost under AEP's existing severance plan that will be allocated to SWEPCO to achieve the reductions. For future years past 2013, where the full attendant impact of any reduction in employees results in a net decrease in costs, that decrease will be reflected in SWEPCO rate filings.⁶⁹⁶ As explained at hearing by SWEPCO witness Ms. Elich, the entire project and process is far from complete. And, while there have been many AEPSC employees identified as being affected by the study, many have already found other employment within AEP and many continue to look for other opportunities within the AEP system.⁶⁹⁷ Also, offsetting the potential for position eliminations throughout the AEP system is an effort to convert some outside contractor roles into new positions within the system. As Ms. Elich concluded, the

⁶⁹⁴ Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 6.

⁶⁹⁵ Rebuttal Testimony of Venita McCellon-Allen, SWEPCO Ex. 65 at 29.

⁶⁹⁶ Rebuttal Testimony of Venita McCellon-Allen, SWEPCO Ex. 65 at 29.

⁶⁹⁷ Confidential Tr. at 1347-49. This information is general enough in nature as to not be confidential.

purpose of the study is to achieve efficiencies and take advantage of process improvements.⁶⁹⁸ That effort is far from over.

To put it simply, as stated by SWEPCO witness Mr. Hamlett, “There is always the potential for expenses to be reduced or to increase.”⁶⁹⁹ The current study is part of the Company’s continuing efforts to control costs, achieve efficiencies, and position the Company to provide service to its customers at a reasonable cost. Studies such as this should be encouraged by the Commission and do not pose a barrier to making a known and measurable adjustment to test year expenses, consistent with Commission rules and precedent.

2. Incentive Compensation

a. Annual Incentive Compensation

The primary issue regarding annual incentive compensation is whether to allow recovery in rates of incentive compensation related to what the Commission has termed “financial” performance measures; that is, performance targets tied to earnings and income.⁷⁰⁰ Most recently, the ALJs in PUCT Docket No. 39896 addressed the Commission’s precedent regarding this issue, and concluded that “[t]he proper question to be asked is whether they [financially based performance measures] provide benefits most immediately or predominantly to shareholders.”⁷⁰¹ In PUCT Docket No. 39896, the ALJs, and ultimately the Commission, determined that the utility had not provided evidence justifying a different conclusion from prior cases determining that financial measures were of primary benefit to shareholders and should be excluded from rates.

The AEP annual incentive plan and the testimony in this case justify a different conclusion. The total amount of annual incentive compensation requested by SWEPCO (for both Company and AEPSC employees) is \$10,728,117 (Total Company).⁷⁰² The amount related to financial objectives is \$940,789 (Total Company).⁷⁰³ SWEPCO witness Andrew Carlin

⁶⁹⁸ Tr. at 1360-61.

⁶⁹⁹ Rebuttal Testimony of Randall W. Hamlett, SWEPCO Ex. 73 at 50.

⁷⁰⁰ Docket No. 39896, Proposal for Decision at 175 (rejecting expansion of “financial” measures to performance related to cost control).

⁷⁰¹ Docket No. 39896, Proposal for Decision at 171-172; see also Order on Rehearing, at FoF Nos. 129, 130.

⁷⁰² Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 28.

⁷⁰³ Redacted Direct Testimony of Jeffry Pollock, TIEC Ex. 1 at Exhibit JP-13. Arguments of certain intervenors aimed at expanding the types of performance measures deemed “financial” are addressed below.

presented the Company's case regarding incentive compensation. Without doubt, Mr. Carlin's testimony showed that there are a number of reasons for including incentive compensation, including financially based incentives, in rates that may be said to apply generally to incentive compensation plans and have been considered in prior cases by the PUCT. These reasons, however, should be further considered in the context of the unique aspects of SWEPCO's evidence regarding the design and effects of AEP incentive compensation, which point to direct benefit to customers, as opposed to shareholders, from incentive based performance measures.

Mr. Carlin's testimony explained that. AEP provides no more total base and incentive compensation than is necessary to on average provide overall compensation that is at the median of the levels provided by similar companies.⁷⁰⁴ Due to the use of incentive compensation, SWEPCO and AEPSC base pay levels are lower than those of companies that provide no incentive pay.⁷⁰⁵ Without incentive pay (including the portion attributable to financial measures), SWEPCO's and AEPSC's salaries would not be at market competitive levels. In that situation, SWEPCO and AEPSC could not attract the knowledgeable, experienced and qualified employees it needs to conduct its utility business, unless they increased base compensation to equal the combination of base and incentive pay provided by their competitors in the employment market.⁷⁰⁶

This shows that the totality of SWEPCO/AEPSC compensation is no more than is reasonable and necessary to pay its employees if the entire amount were simply included as base salary. In other words, there is no incremental cost to including financially based annual incentives in rates; it is just a positive means of paying out what is undisputedly an overall reasonable level of compensation, while incenting useful and productive employee behavior.⁷⁰⁷ "The Company provides incentive compensation [including financially based incentives] because it improves Company performance without increasing overall compensation expense."⁷⁰⁸

⁷⁰⁴ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 5, 15-17.

⁷⁰⁵ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 7.

⁷⁰⁶ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 7-9, 16-17.

⁷⁰⁷ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 18; Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 11-12.

⁷⁰⁸ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 20.

The direct, predominant benefits to customers in general of annual incentive compensation are described at length in Mr. Carlin's testimony.⁷⁰⁹ Mr. Carlin further explained the "financial" aspects of the incentive plan, as well as key differences between the AEP incentive plan and its ratemaking treatment from previous cases regarding incentive compensation. For the Utility Group incentive plan, for instance, 10% of the performance targets relate to financial performance (return on equity). The remainder of the performance targets are devoted to operational measures.⁷¹⁰ The financial component of the plan, however, has produced substantial benefits for customers over the fifteen years of its existence that are already reflected in test year expense.⁷¹¹ This is particularly the case since under SWEPCO's proposal, only the "target" level of incentive compensation (the amount necessary to achieve market median pay) is included in rates.⁷¹² Since SWEPCO's price for its service is fixed between rate cases, the only way that employees can control the Company's actions in a manner to positively affect earnings is by controlling costs.⁷¹³ After each rate proceeding, the positive impact of these efforts is experienced directly by customers.

Once a rate case such as this one is filed, customers receive 100% of the accumulated benefits associated with the reduced cost of service and improved operating performance that are reflected in the test year cost upon which rates are set. Shareholders receive only the potential, marginal benefit that may be produced while the new rates are in effect. To eliminate financial incentive compensation from rates would provide all of the associated benefits to customers driven by the financial performance targets without requiring them to pay any of the associated costs.⁷¹⁴ Moreover, because SWEPCO seeks only the target level necessary to provide market competitive salary offers, any amount of incentive pay in the future above target is funded by

⁷⁰⁹ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 19-21; Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 13, 15-16, 18-19.

⁷¹⁰ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 22, 23-24.

⁷¹¹ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 25.

⁷¹² Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 28.

⁷¹³ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 22, 29-31; Tr. at 523-24; Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 9.

⁷¹⁴ Tr. at 483-484; Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 13; Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 28-29.

shareholders.⁷¹⁵ Based on these benefits (which have not been the subject of discussion in prior cases) and the additional customer benefits he describes in his testimony,⁷¹⁶ Mr. Carlin demonstrates the financially based incentive compensation directly and substantially benefits customers.

In response to this testimony, tailored directly to the specific design and impact of the AEP annual incentive program, intervenor and Staff witnesses continue to rely on generic references to prior Commission rulings and, in the case of CARD witness Mr. Garrett, on extensive recitations of his impression of the approach of other regulatory jurisdictions to incentive compensation. These testimonies do not, however, meaningfully address the salient question of whether the AEP's plan and its ratemaking treatment, and particularly its financial incentive measures, provide predominant benefits to customers. In this respect, Mr. Carlin's testimony is not rebutted.⁷¹⁷

Scope of "Financially-Based" Performance Measures

While contending that SWEPCO is improperly acting contrary to PUCT precedent, several of the intervenor witnesses themselves ask the Commission to act contrary to recent rulings regarding the scope of what is to be considered financially-based incentive compensation. In PUCT Docket No. 39896, the ALJs rejected attempts by intervenor witnesses, including Mr. Garrett, to apply the "financial" label to performance measures related to cost control, since the evidence showed that such measures clearly benefitted customers.⁷¹⁸ No different result should apply here. Cities witness Cannady's complaint that SWEPCO did not adequately support the budgets that form the basis for some of the cost control measures⁷¹⁹ is clearly contradicted by the very substantial amount of proof from Company witnesses Carlin, Meyers,

⁷¹⁵ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 32; Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 9.

⁷¹⁶ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 30-31 (financial aspects of program encourage fiscal discipline, conserve capital and promote financial stability, supports reasonable cost of capital); Tr. at 530 (providing variable incentive pay allows Company to retain earnings that would otherwise go to incentive compensation in a lean year); Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 18-19.

⁷¹⁷ CARD witness Garrett also provides a laundry list of alleged policy bases for rejecting incentive compensation in general, which the Commission obviously has not adopted (since it allows recovery of incentive compensation in rates) and which Mr. Carlin disposes of in his rebuttal testimony. Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 6-14.

⁷¹⁸ Docket No. 39896, PFD at 175-176; Order on Rehearing at 1 (adopting PFD except as otherwise noted).

⁷¹⁹ Direct Testimony of Constance Cannady, Cities Ex. 2 at 37-38.

Flaherty, and all of the Company's affiliate class witnesses, regarding the robustness of the processes and outcomes of AEP budgeting processes, and the incentives that process provides to employees.⁷²⁰

CARD witness Garrett and OPUC witness Szerszen also recommend expansion of the "financial" label to performance measures not previously designated as such by the Commission. These witnesses argue that both what they term the "regulatory" performance measures and all or portions of the "strategic" performance measures should be used to increase the level of costs excluded as financially-based, as follows (amounts include SWEPCO direct and AEPSC allocated amounts):

Measure	Garrett Adjustment ⁷²¹	Szerszen Adjustment ⁷²²
Regulatory	\$398,174	\$462, 658
Strategic	\$1,508,137	\$409,721

The treatment of these items as predominantly beneficial to shareholders is unsupported by the evidence as well as by prior Commission rulings. Although the "regulatory" measure includes assessment of rate recovery as one element, it is more broadly based on progress toward and achievement of regulatory objectives. SWEPCO employees' ongoing efforts to take steps to ensure ongoing successful interactions with regulators and comply with regulatory requirements are not predominantly shareholder oriented. Even as to rate relief, as Mr. Carlin's rebuttal explains, obtaining changed rate levels through proper regulatory processes directly promotes customers' interests in paying only rates determined just and reasonable after regulatory review.⁷²³ Mr. Carlin's rebuttal further explains that AEP's performance measures for "strategic initiatives relate predominantly to obtaining regulatory approvals, rather than "specific rates of rate recovery with direct financial implications."⁷²⁴ Furthermore, Furthermore, in this respect, it

⁷²⁰ Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 15-16; Direct Testimony of Brenda Meyers, SWEPCO Ex. 37 at 4-6; Direct Testimony of Thomas Flaherty, SWEPCO Ex. 55 at Section VII.A; *see, e.g.*, Direct Testimony of Jeffrey Hoersdig, SWEPCO Ex. 33 at Section IV.

⁷²¹ Redacted Direct Testimony of Mark Garrett, CARD Ex. 5 at 30.

⁷²² Redacted Direct Testimony of Carol Szerszen, OPUC Ex. 2 at 40-41.

⁷²³ Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 21.

⁷²⁴ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at Exhibit ARC-8, p. 12 of 15; Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 21-22.

is noteworthy that Mr. Garrett's adjustment for strategic initiatives, listed above, is much larger than that of Dr. Szerszen. The difference appears to be explained by Dr. Szerszen's proper recognition that strategic efforts such as obtaining timely completion of Turk construction directly benefit customers, and should not be excluded from rates.⁷²⁵

b. Long-Term Incentive Compensation

SWEPCO seeks recovery in rates of its test year target level of \$5,114,255 (Total Company, SWEPCO and AEPSC combined) for long-term incentive compensation.⁷²⁶ Intervenors and Staff contend that SWEPCO's long-term incentive compensation is wholly financially based and should be excluded from rates.⁷²⁷ The reasons explained by Mr. Carlin for including long term incentive compensation in rates, and the benefits to customers, are much like those addressed to annual incentive compensation, and are explained in Mr. Carlin's direct and rebuttal testimonies.⁷²⁸ SWEPCO therefore incorporates by reference the discussion above regarding annual incentives.

SWEPCO's long term incentive compensation includes performance units and restricted stock units. While performance units are awarded based on financial performance (total shareholder return and Earnings Per Share performance),⁷²⁹ this is not the case with Restricted Stock Units (RSUs). RSUs are awarded strictly due to the passage of time; they are no more and no less than retention or continuity awards that are paid because an employee sticks around long enough to earn them.⁷³⁰ As such, they have no associated financial performance target, which has been the reason for the disallowance of long term incentive compensation in past Commission cases. Forty percent of the long-term incentives (\$2,045,072) consists of RSUs.⁷³¹

⁷²⁵ Tr. at 1079-1081.

⁷²⁶ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 34.

⁷²⁷ TIEC witness Pollock's recommendations would disallow around 90% of the long-term incentive compensation. Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 23.

⁷²⁸ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 33-38; Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 23-29.

⁷²⁹ Direct Testimony of Andrew R. Carlin, SWEPCO Ex. 41 at 33.

⁷³⁰ Tr. at 482, 537.

⁷³¹ Tr. at 482.

3. Executive Perquisites

SWEPCO's revenue requirement includes \$16,350 (Total Company) for executive perquisites, primarily composed of financial counseling expense.⁷³² Staff witness Luna and OPUC witness Szerszen recommend its disallowance since it involves a benefit limited to high level AEP executive personnel.⁷³³ Dr. Szerszen expects that such employees could pay for this service themselves.

As Mr. Carlin explains, however, the executives' ability to pay is irrelevant. The fact is, the provision of such benefits is necessary to provide a market competitive compensation package to persons whose services are highly sought out in the employment marketplace in which SWEPCO and AEPSC compete. Moreover, these benefits are provided through outsourcing in a manner that avoids the expense of providing additional specialized Human Resources staff.⁷³⁴ This cost is reasonable and necessary and should be approved.

4. Relocation

In PUCT Docket No. 39896, the ALJs determined, over Staff's contrary recommendation, that Entergy Texas relocation assistance expense in the amount of \$436,723 should be included in rates. The ALJs were persuaded that, without such a program, the utility would be at a competitive disadvantage in obtaining qualified employees.⁷³⁵ In this case, Staff again opposed recovery by SWEPCO of its very similar relocation expense of \$574,588 (Total Company, SWEPCO and AEPSC allocated combined).⁷³⁶ Staff witness Luna, however, agreed that at least in some instances, relocating an employee and paying the expense would be a "good choice" for SWEPCO.⁷³⁷

Mr. Carlin, moreover, explained precisely why the relocation expense sought by the Company represents just the type of "good choice" supporting recovery. Relocation expense is paid by the Company as necessary to attract and retain employees needed in the competitive labor market in which it operates. The value of the benefit is scaled according to whether home

⁷³² Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 32.

⁷³³ Redacted Direct Testimony of Joe Luna, Staff Ex. 3 at 12-13; Redacted Direct Testimony of Carol Szerszen, OPUC Ex. 2 at 45-46.

⁷³⁴ Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 32-33.

⁷³⁵ Docket No. 39896, Proposal for Decision at 181.

⁷³⁶ Redacted Direct Testimony of Joe Luna, Staff Ex. 3 at 10-11.

⁷³⁷ Tr. at 1723-1724.

ownership is involved or not. It is set to reflect average actual moving costs. The situations in which the benefit is granted are limited, after case by case evaluation, to those in which a suitable candidate cannot be found locally, either through an internal transfer or through the local employment market.⁷³⁸

Finally, Mr. Luna is simply incorrect in asserting that relocation expense should not be included in rates because it is only available to management level employees. As Mr. Hoersdig explains, relocation costs were expended to assist with employee relocations for a variety of non-management jobs, demonstrating that relocation expense is not by any means some type of extraordinary executive benefit, as Mr. Luna implies.⁷³⁹

L. Pension and Related Benefits [PO Issue 28]

1. Pensions

Pursuant to PURA § 36.065(a), pension and other post-employment benefit expenses are “determined by actuarial or other similar studies in accordance with generally accepted accounting principles.” GAAP for pensions is determined by FAS 87. In PUCT Docket No. 33309, the Commission recognized that the term “other post-employment benefits” in PURA § 36.065(a) includes post-retirement benefits other than pensions, known as OPEBs, which are governed by Statement of Financial Accounting Standards No. 106 (FAS 106) as well as post-employment benefits which are governed by Statement of Financial Accounting Standards No. 112 (FAS 112).⁷⁴⁰

SWEPCO’s pension expense included in the requested cost of service is based on the pension cost of \$8,306,420 on a total Company basis calculated in the 2012 actuarial report attached to SWEPCO witness Hugh E. McCoy’s direct testimony as Exhibit HEM-5A and 5B.⁷⁴¹ All of the actual economic and demographic data included in the 2012 actuarial report were complete, known and measurable as of December 31, 2011.⁷⁴² Mr. McCoy stated that the pension expense amount in the 2012 actuarial report is the amount that is representative of the cost that will be incurred during the period the rates in this case will be in effect and discussed

⁷³⁸ Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 33-34; Tr. at 532-535.

⁷³⁹ Rebuttal Testimony of Jeffrey W. Hoersdig, SWEPCO Ex. 72 at 12.

⁷⁴⁰ Docket No. 33309, Order on Rehearing at CoL No. 25 (Mar. 3, 2008); *id.*, Proposal for Decision at 111-113 (Aug. 30, 2007).

⁷⁴¹ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 12-13, Exhibit HEM-5A.

⁷⁴² Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 13.

the factors causing the pension expense in the 2012 actuarial report to be higher than the amount of \$7,487,657 on a total Company basis for calendar year 2011.⁷⁴³ These factors include a more conservative long-term rate of return on plan investments reflecting the decline in interest rates and amortization of 2008 investment losses which are being phased-in as an increase to pension costs over a five-year period. Increased investment income on the substantial pension contributions which SWEPCO made in 2010 and 2011 acts to offset the increases caused by the prior two factors.⁷⁴⁴

Cities witness Candace T. Cannady recommended that pension expense for the pension costs that are “qualified” under the Employee Retirement Income Security Act (ERISA) be based on the average amount incurred over the four-year period 2008-2011.⁷⁴⁵ Ms. Cannady’s position appears to be based on the premise that the phrase “in the amount the regulatory authority finds reasonable” permits the Commission to selectively disregard the actuarial underpinnings of GAAP pension expense under FAS 87 contemplated by PURA § 36.065(a) and to override the quantitative results of GAAP pension accounting based on qualitative judgments.⁷⁴⁶

In his rebuttal testimony, Mr. McCoy addressed Ms. Cannady’s recommendation regarding pension expense.⁷⁴⁷ First, Mr. McCoy explained that Ms. Cannady’s assertion that SWEPCO had delayed pension fund contributions and missed an opportunity to reduce pension cost was not correct.⁷⁴⁸ Ms. Cannady implied that SWEPCO had contributed less than its pension cost, but this is not what actually occurred.⁷⁴⁹ Since the inception of FAS 87, SWEPCO’s cumulative contributions have been \$152 million compared to pension cost of \$39 million as set forth in Exhibit HEM-1R.⁷⁵⁰ Even considering the period since 2008 upon which Ms. Cannady focused, SWEPCO’s contributions have exceeded pension costs by \$41 million.⁷⁵¹ Consequently, even with the market losses since the financial collapse of late

⁷⁴³ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 17, 19.

⁷⁴⁴ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 19.

⁷⁴⁵ Redacted Direct Testimony of Candace Cannady, Cities Ex. 2 at 44.

⁷⁴⁶ *See, e.g.*, Redacted Direct Testimony of Candace Cannady, Cities Ex. 2 at 41-43.

⁷⁴⁷ Rebuttal Testimony on Hugh E. McCoy, SWEPCO Ex. 79 at 28-30.

⁷⁴⁸ Rebuttal Testimony on Hugh E. McCoy, SWEPCO Ex. 79 at 28.

⁷⁴⁹ Rebuttal Testimony on Hugh E. McCoy, SWEPCO Ex. 79 at 28.

⁷⁵⁰ Rebuttal Testimony on Hugh E. McCoy, SWEPCO Ex. 79 at 28, Exhibit HEM-1R.

⁷⁵¹ Rebuttal Testimony on Hugh E. McCoy, SWEPCO Ex. 79 at 28.

2008, the extra contributions reduced the actuarial pension cost which SWEPCO requests in this case by \$11 million.⁷⁵²

Mr. McCoy also explained that Ms. Cannady's criticisms that SWEPCO has been tardy in incorporating pension plan changes unlike other companies are simply not true.⁷⁵³ And, in fact, Ms. Cannady appears to be unaware that when SWEPCO adopted a cash balance formula in 2001 that reduced pension expense, it made a comparable change to those which Ms. Cannady contended had been made by other companies.⁷⁵⁴

Mr. McCoy also addressed Ms. Cannady's reliance on a recent Railroad Commission decision as support for her proposed establishment of a 4.5-year average pension expense instead of the actuarially determined cost under GAAP in accordance with PURA § 36.065(a).⁷⁵⁵ This averaging is inconsistent with FAS 87 GAAP accounting. SWEPCO's pension cost has risen recently mainly as a result of the five year phase-in of the effect of 2008 market losses.⁷⁵⁶ In 2013, the last year of the phase-in, SWEPCO's pension cost is expected to be \$13.0 million, about \$4.7 million greater than the \$8.3 million requested in this case.⁷⁵⁷ The averaging suggested by Ms. Cannady, which is contrary to FAS 87 GAAP accounting, would only add an additional smoothing to the smoothing already included in FAS 87 pension cost.⁷⁵⁸

Unlike this Commission, the Railroad Commission is not subject to PURA § 36.065(a), which is part of PURA, TEX. UTIL. CODE §§ 11.001 through 66.016. The Railroad Commission instead is subject to the Gas Utility Regulatory Act (GURA), TEX UTIL. CODE §§ 101.001 through 124.002. Accordingly, in connection with a matter which is govern by a specific provision of PURA applicable to the Commission, a Railroad Commission decision has little, if any, relevance to the determination this Commission must make and does not shed any useful light on the appropriate interpretation of PURA § 36.065(a).

The applicable legal authorities and the preponderance of the record evidence supports SWEPCO's request to base the pension expense in cost of service on the total Company amount

⁷⁵² Rebuttal Testimony on Hugh E. McCoy, SWEPCO Ex. 79 at 28.

⁷⁵³ Rebuttal Testimony on Hugh E. McCoy, SWEPCO Ex. 79 at 29.

⁷⁵⁴ Rebuttal Testimony on Hugh E. McCoy, SWEPCO Ex. 79 at 29.

⁷⁵⁵ Rebuttal Testimony on Hugh E. McCoy, SWEPCO Ex. 79 at 29.

⁷⁵⁶ Rebuttal Testimony on Hugh E. McCoy, SWEPCO Ex. 79 at 30.

⁷⁵⁷ Rebuttal Testimony on Hugh E. McCoy, SWEPCO Ex. 79 at 30.

⁷⁵⁸ Rebuttal Testimony on Hugh E. McCoy, SWEPCO Ex. 79 at 30.

of \$8,306,420 determined by the 2012 actuarial report, and the ALJs should reject Ms. Cannady's arguments to the contrary as lacking merit.

2. OPEBs

SWEPCO's OPEB expense in the requested cost of service is based on the OPEB cost of \$5,928,523 on a total Company basis calculated in the 2012 actuarial report attached to Mr. McCoy's direct testimony as Exhibit HEM-5C.⁷⁵⁹ All of the actual economic and demographic data included in the 2012 actuarial report were complete, known and measurable as of December 31, 2011.⁷⁶⁰ Mr. McCoy stated that OPEB amount in the 2012 actuarial report is the amount which is representative of the cost that will be incurred during the period the rates in this case will be in effect.⁷⁶¹ The amount of OPEB cost in the 2011 actuarial report was \$4,840,535 on a total Company basis.⁷⁶² Mr. McCoy explained that the factors principally contributing to the increase in OPEB cost in the 2012 actuarial report over the amount in the 2011 actuarial report are the decline in interest rates and the lower assumed long-term rate of return on plan investments.⁷⁶³

Ms. Cannady recommended that the OPEB expense be the amount incurred in the historical test year.⁷⁶⁴ She based her recommendation on three factors: (i) an assertion that the reductions from the 2010 workforce reduction appeared to be missing from the 2012 actuarial study; (ii) Turk Plant employees inflated 2012 costs; and (iii) the potential that a recently completed benefits study could catalyze cost reductions in OPEB expense.⁷⁶⁵

Mr. McCoy explained that contrary to Ms. Cannady's assertion, the employee reduction resulting from the 2010 workforce reduction was fully included in both the 2011 and the 2012 actuarial reports.⁷⁶⁶ Mr. McCoy posited that it was likely that because Ms. Cannady saw a reduction in OPEB cost in the 2011 actuarial report followed by an increase in OPEB cost in the 2012 actuarial report, she concluded that the reduction in 2011 resulted from the 2010 workforce

⁷⁵⁹ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 21-22, Exhibit HEM-5C.

⁷⁶⁰ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 22.

⁷⁶¹ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 25.

⁷⁶² Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 25, Exhibit HEM-2.

⁷⁶³ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 25.

⁷⁶⁴ Redacted Direct Testimony of Candace Cannady, Cities Ex. 2 at 46-47.

⁷⁶⁵ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 80 at 30-33.

⁷⁶⁶ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 31.

reduction and the increase in OPEB costs in 2012 resulted from a failure to include the effect of the 2010 workforce reduction.⁷⁶⁷ However, Mr. McCoy stated, the principal drivers of the increase in 2012, as explained in his direct testimony, were the decline in interest rates and lower assumed long-term rate of return on plan investments, and the decrease between 2010 and 2011, rather than being driven by the 2010 workforce reduction, was attributable to the imposition of a flat amount on the retiree life insurance benefit.⁷⁶⁸

Mr. McCoy also explained that contrary to Ms. Cannady's assertion that there is a direct relationship between number of participants and the OPEB obligation, a reduction in participants does not necessarily result in a reduction in OPEB obligation.⁷⁶⁹ Unlike pension cost where the pension obligation stops growing if a participant retires early, the OPEB obligation can increase or decrease through a workforce reduction as a result of two different causes.⁷⁷⁰ For an employee who terminates employment before fulfilling the OPEB vesting requirements, the OPEB obligation would go to zero.⁷⁷¹ But for an employee who has fulfilled the OPEB vesting requirements, a termination of service can increase the OPEB obligation, in some cases substantially, and create an actuarial loss. The assumption in the OPEB actuarial study is that employees are on average expected to retire at age 61; consequently, a retirement before age 61 of an employee with vested OPEB rights will increase the OPEB obligation because it increases the number of years during retirement at the higher medical cost prior to the employee's qualification for Medicare at age 65.⁷⁷²

In response to Ms. Cannady's assertion that Turk plant employees inflated 2012 OPEB costs, Mr. McCoy pointed out that the total number of active employees in the 2012 actuarial report was actually 3% lower than in the prior year, so Turk plant employees had no significant effect.⁷⁷³

Finally, Mr. McCoy addressed Ms. Cannady's contentions regarding future reductions in OPEB costs that potentially could be catalyzed by the recently completed employee benefits

⁷⁶⁷ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 31.

⁷⁶⁸ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 31.

⁷⁶⁹ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 31.

⁷⁷⁰ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 32.

⁷⁷¹ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 32.

⁷⁷² Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 32-33.

⁷⁷³ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 33.

study, by pointing out that it would not be proper to selectively incorporate potential future cost decreases while ignoring costs that will increase in 2013.⁷⁷⁴ For example, as a result of the five-year phase-in of 2008 investment losses, pension cost will increase by \$4.7 million in 2013.⁷⁷⁵

The applicable legal authorities and the preponderance of the record evidence supports SWEPCO's request to base the OPEB expense in cost of service on the total Company amount of \$5,928,523 determined by the 2012 actuarial report, and the ALJs should reject Ms. Cannady's arguments to the contrary as lacking merit.

3. Post-Employment Benefits

SWEPCO based the post-employment benefit expense included in the requested cost of service on the amount of negative \$947,747 on a total Company basis calculated in the 2012 actuarial report attached to Mr. McCoy's direct testimony as Exhibit HEM-5D.⁷⁷⁶ All of the underlying actual economic and demographic data included in the 2012 actuarial report were complete, known and measurable as of December 31, 2011.⁷⁷⁷ The negative post-retirement cost (*i.e.*, a credit to cost of service) resulting from a decrease of the amount of the benefit obligation between the 2012 actuarial study and the 2011 actuarial study, Mr. McCoy stated, was due to a decrease in participants on long-term disability.⁷⁷⁸

Ms. Cannady opposed SWEPCO's requested treatment of post-employment benefit cost included in cost of service.⁷⁷⁹ She was bothered by the fact the amount for 2012 was less negative than in 2011, asserted that the entire amount in 2011 had been credited to O&M expense based on her conclusion that rate filing package did not allocate any of the post-employment benefit to capital, and recommended a reduction to cost of service of \$283,865 total Company and \$95,645 Texas jurisdiction as a consequence.⁷⁸⁰

In his rebuttal testimony, Mr. McCoy explained that the mere fact that a credit to cost of service is lower, *i.e.*, less negative, in one year as opposed to another year does not mean the

⁷⁷⁴ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 33.

⁷⁷⁵ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 33; Rebuttal Testimony of Randall W. Hamlett, SWEPCO Ex. 73 at 59-62.

⁷⁷⁶ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 26, Exhibit HEM-5D.

⁷⁷⁷ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 27.

⁷⁷⁸ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 26, Exhibit HEM-3.

⁷⁷⁹ Redacted Direct Testimony of Candace Cannady, Cities Ex. 2 at 47-48.

⁷⁸⁰ Redacted Direct Testimony of Candace Cannady, Cities Ex. 2 at 48.

lower credit in the second year is not reasonable.⁷⁸¹ Since SWEPCO's post-employment cost was properly calculated in accordance with GAAP under FAS 112 in accordance with the requirements of PURA § 36.065(a), Mr. McCoy pointed out that other than her feelings, Ms. Cannady had not provided any basis to justify adoption of any result different from the treatment of post-employment cost proposed by SWEPCO.⁷⁸²

With respect to Ms. Cannady's claim that the rate filing package did not allocate any of the adjustment to test year post-employment benefit cost to capital, it is clear she is wrong. Workpaper WP/A-3.12 supports the adjustments to Schedule A of the rate filing package and shows that, in making the adjustment for FAS 112 post-employment cost to reflect the change between 2011 cost and 2012 cost of \$973,747 sponsored by Mr. McCoy, SWEPCO applied the O&M payroll expense ratio of 71.3%, with 28.7% of the adjustment being allocated to capital.⁷⁸³

The applicable legal authorities and the preponderance of the record evidence supports SWEPCO's request to base the post-employment benefit amount in cost of service on the total Company amount of negative \$947,747 determined by the 2012 actuarial report, and the ALJs should reject Ms. Cannady's arguments to the contrary as lacking merit.

4. Supplemental Pension Plan Expense

Included in the pension cost which SWEPCO requested to be included in cost of service were non-qualified, or supplemental, pension costs, meaning that these costs do not meet certain ERISA requirements and protections.⁷⁸⁴ As Mr. McCoy indicated in his direct testimony, the same pension benefit formula applies to all employees regardless of pay level.⁷⁸⁵ Consequently, the distinction between qualified and non-qualified amounts for SWEPCO has no bearing on the amount of costs that are reasonable and necessary to meet SWEPCO's requirements to provide reasonable and adequate pensions to employees.⁷⁸⁶

Although the qualified and non-qualified, or supplemental, pension plans are based on the same formula, actuarial reports typically are prepared separately for each and this provides the

⁷⁸¹ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 34.

⁷⁸² Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 34.

⁷⁸³ Rate Filing Package Volume 11, SWEPCO Ex. 10A at WP/A-3.12.

⁷⁸⁴ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 16-17, Exhibit HEM-2.

⁷⁸⁵ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 17.

⁷⁸⁶ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 16-17.

segregated information required by accounting and reporting rules.⁷⁸⁷ The supplemental plan simply replaces the portion of pension benefits that an employee would lose under the qualified plan limits.⁷⁸⁸

OPUC witness Carol Szerszen and CARD witness Mark Garrett recommended that the non-qualified pension costs be excluded based on Commission precedent which they asserted supports such exclusion.⁷⁸⁹

On rebuttal both Mr. McCoy and SWEPCO witness Andrew R. Carlin responded to Dr. Szerszen's and Mr. Garrett's recommendations.⁷⁹⁰ Mr. Carlin stated that the Company needs many employees with experience, knowledge, capacities and skills who are scarce within the job market; this enables these employees to command compensation that exceeds the ERISA qualified plan limits.⁷⁹¹ Given the competitive market for such employees, the cost associated with attracting and retaining such employees is not discretionary if the Company is to provide utility service to customers efficiently and effectively.⁷⁹² Mr. Carlin pointed out that Dr. Szerszen's assertion that the total rewards package the Company provides to these employees would be adequate without the supplemental pension is simply an unsupported assertion with no basis in reality.⁷⁹³ Contrary to Dr. Szerszen's assertion, supplemental pension is not an additional benefit above and beyond what is needed to provide market competitive compensation, and SWEPCO's customers benefit from the supplemental pension benefit in the same way they benefit from the provision of base pay to employees.⁷⁹⁴

Addressing Mr. Garrett's comment that officers of a corporation have a duty of loyalty to the corporation and these individuals will put the interests of the corporation first, Mr. Carlin stated that his understanding is that duty to the corporation requires officers to put the interests of

⁷⁸⁷ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 16.

⁷⁸⁸ Direct Testimony of Hugh E. McCoy, SWEPCO Ex. 40 at 17.

⁷⁸⁹ Redacted Direct Testimony of Carol Szerszen, OPUC Ex. 2 at 46-48; Redacted Direct Testimony of Mark Garrett, CARD Ex. 5 at 41-44.

⁷⁹⁰ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 34-36; Rebuttal Testimony of Andrew R. Carlin, SWEPCO Ex. 80 at 29-33.

⁷⁹¹ Rebuttal Testimony of Andrew R. Carlin SWEPCO Ex. 80 at 30.

⁷⁹² Rebuttal Testimony of Andrew R. Carlin SWEPCO Ex. 80 at 31.

⁷⁹³ Rebuttal Testimony of Andrew R. Carlin SWEPCO Ex. 80 at 31.

⁷⁹⁴ Rebuttal Testimony of Andrew R. Carlin SWEPCO Ex. 80 at 31.

the corporation ahead of their own, but not necessarily ahead of the interests of customers.⁷⁹⁵ Also, many of the employees who receive supplemental pension benefits are not officers.⁷⁹⁶

Mr. McCoy stated that both Dr. Szerszen and Mr. Garrett are incorrect to suggest that the supplemental benefit exceeds adequate compensation or provides additional benefits not provided by the general pension plan.⁷⁹⁷ The supplemental benefit under the pension benefit formula applicable to all employees simply replaces the portion that the employee would not receive under the ERISA qualified plan limits.⁷⁹⁸

With respect to Dr. Szerszen's and Mr. Garrett's reliance on the Commission decision in Docket No. 39896, Mr. McCoy referred to the PFD in that case and to the indication that Entergy Texas had "three types supplemental executive retirement plans" and the ALJs' conclusion that these plans "constitute benefits over and above the Company's standard retirement plan."⁷⁹⁹ SWEPCO's situation regarding the supplemental retirement benefit, Mr. McCoy stated, is different, as its supplemental pension benefit includes no benefits over the Company's "standard benefit package," but instead represents the portion of the Company's standard benefit formula for all employees that cannot be paid from the qualified plan under the ERISA limits.⁸⁰⁰

Based on the nature of the Company's supplemental pension benefits as described by Mr. McCoy, the decision in Docket No. 39896 is not applicable to these benefits, and the ALJs should approve the inclusion of the entirety of SWEPCO's pension costs in cost of service, including those attributable to the supplemental benefit.

M. Federal Income Tax and Consolidated Tax Savings Adjustment [PO Issue 23]

The only contested federal income tax issue in this case involves the consolidated federal consolidated tax savings (CTS) adjustment. In its rate filing package, SWEPCO did not include a CTS adjustment in the cost of service because SWEPCO believes that such an adjustment is

⁷⁹⁵ Rebuttal Testimony of Andrew R. Carlin SWEPCO Ex. 80 at 31.

⁷⁹⁶ Rebuttal Testimony of Andrew R. Carlin SWEPCO Ex. 80 at 31.

⁷⁹⁷ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 35.

⁷⁹⁸ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 35.

⁷⁹⁹ Docket No. 39896, Proposal for Decision at 178, 180 (Jul. 7, 2012).

⁸⁰⁰ Rebuttal Testimony of Hugh E. McCoy, SWEPCO Ex. 79 at 36.

not necessary for SWEPCO's customers to realize their fair share of the tax savings from the AEP consolidated return pursuant to PURA § 36.060.⁸⁰¹

In *GTE-SW v. Pub. Util. Comm'n*,⁸⁰² the Supreme Court ruled that the Commission has discretion in determining a utility's "fair share" of the savings from the filing of a consolidated tax return and is not compelled by PURA § 36.060 to include losses of affiliates in determining the utility's "fair share" reduction under PURA § 36.060. Accordingly, the Commission has the discretion to find that the interest tax shield calculation taking into account the effect of affiliates' losses and corresponding adjustment to cost of service is not necessary to ensure that SWEPCO's customers receive a fair share of savings from the consolidated tax return. Moreover, under *GTE-SW*, the Commission has the discretion to adopt the benefits/burdens criteria outlined by the Federal Energy Regulatory Commission in FERC Opinion 173 in determining whether customers receive a fair share of savings from the consolidated tax return.⁸⁰³

Cities witness Lane Kollen took the position that a CTS adjustment should be adopted based on the Commission's prior practice and noted that SWEPCO had provided a calculation of a CTS adjustment in Exhibit JBB-2 to Mr. Bartsch's direct testimony which he updated in the response to Cities RFI No. 14-1.⁸⁰⁴

In his rebuttal testimony, Mr. Bartsch reiterated the basis for SWEPCO's opposition to a CTS adjustment and its position that since the costs that give rise to an affiliate's losses were not included in cost of service and borne by customers, it is not appropriate to include the tax benefits or time value of money related to those losses in cost of service by reducing federal income tax expense.⁸⁰⁵ In the event the Commission, however, determines that a CTS adjustment should be made in this case, Mr. Bartsch stated that it should use the calculation in Exhibit JBB-2 to his direct testimony as updated in the response to Cities RFI 14-1 which in

⁸⁰¹ Direct Testimony of Jeffrey B. Bartsch, SWEPCO Ex. 45 at 24-25.

⁸⁰² 901 S.W. 2d 401, 409-411 (Tex. 1995).

⁸⁰³ Direct Testimony of Jeffrey B. Bartsch, SWEPCO Ex. 45 at 25-26.

⁸⁰⁴ Direct Testimony of Lane Kollen, Cities Ex. 4 at 64-71.

⁸⁰⁵ Rebuttal Testimony of Jeffrey B. Bartsch, SWEPCO Ex. 83 at 4-5.

accordance with the Commission's decision in Docket No. 38339 is not grossed up for income taxes.⁸⁰⁶

For the reasons set forth in Mr. Bartsch's direct and rebuttal testimonies, the ALJs should decline to include a CTS adjustment as a reduction to SWEPCO's cost of service.

N. Storm Amortization [PO Issue 15]

In SWEPCO's recent base rate case, PUCT Docket No. 37364, the Commission approved recovery of a storm regulatory asset of \$3.6 million, to be amortized over three years or \$100,000 per month. Thus, beginning in May 2010, SWEPCO began amortizing \$100,000 per month. Therefore, during the test year, SWEPCO properly recorded \$1.2 million of amortization.⁸⁰⁷

Despite the properly recorded \$1.2 million of test year amortization, SWEPCO recognized that the approved amortization was scheduled to end in April 2013. Therefore, SWEPCO made a post-test year adjustment to reduce its test year amortization from \$1.2 million to \$400,000 to reflect the fact that all but \$400,000 of the regulatory asset would be amortized by January 2013.⁸⁰⁸ And, given that the rates associated with this rate case became effective a month after originally anticipated, SWEPCO is not opposed to further reducing its test year amortization to \$300,000.

SWEPCO's post-test year adjustment is reasonable under the circumstances. Absent this rate case, the approved amortization would have ceased in April 2013, yet rates would not have changed in April 2013. This is simply one of the facts that result from Commission approval of base rate treatment for this type of regulatory asset. And, it is unlikely that new rates will be implemented the month following the full amortization of that asset. Thus, this rate case has benefited customers when this issue is viewed in isolation, in that the amortization reflected in rates will be reduced from \$1.2 million to \$300,000.⁸⁰⁹

In the alternative, SWEPCO proposes to recover the remaining \$300,000 of the approved regulatory asset in the true-up that will follow this case. There will be a true-up for the difference between SWEPCO's temporary rates and the final rates approved in this

⁸⁰⁶ Rebuttal Testimony of Jeffrey B. Bartsch, SWEPCO Ex. 83 at 6; PUCT Docket No. 38339, Order on Rehearing at 5-8, 30 (FoF Nos.145, 146A and 146B) (Jun. 23, 2011).

⁸⁰⁷ Rebuttal Testimony of Randall W. Hamlett, SWEPCO Ex. 73 at 34.

⁸⁰⁸ Rebuttal Testimony of Randall W. Hamlett, SWEPCO Ex. 73 at 34.

⁸⁰⁹ Rebuttal Testimony of Randall W. Hamlett, SWEPCO Ex. 73 at 36-37.

proceeding.⁸¹⁰ Such a rate treatment will allow full recovery of the approved regulatory asset and address the piecemeal “over-recovery” argument put forth by some of the intervenors.

O. Fuel and Logistics Expense Allocation [PO Issues 29, 30]

The costs incurred by SWEPCO during the test year for the Fuel and Logistics class of affiliate service were reasonable and necessary and charged at a price not higher than that AEPSC charged to other benefited AEP operating companies. The purpose of the Fuel and Logistics organization is to provide a reliable supply of fuel (e.g., coal and natural gas) at the lowest reasonable cost to the AEP operating companies. More specifically, this organization provides fuel procurement, fuel contract negotiation and administration, fuel inventory management, fuel price forecasting, property oversight of fuel-related services, planning and analysis, and management of mining-related operations.⁸¹¹

Because the Fuel and Logistics organization provides services to all of the AEP operating companies, allocation methodologies are developed to provide fair and reasonable allocations of the costs of services provided for the benefit of multiple affiliates. *However*, before applying any allocation methodology, any activity performed for a single affiliate is identified and the related cost is directly assigned to that single affiliate.⁸¹² In fact, of the FERC Account 501 Fuel and Logistics organization charges to SWEPCO (those at issue), more than half were directly assigned. Only after costs are directly assigned to those single affiliates benefited are reasonable cost allocation methodologies applied so that the remaining costs are billed to the companies benefiting from the service. In the case of the Fuel and Logistics organization, a volume-driven allocation methodology is used where the cost driver is volume-based and the data is available. Volume-driven methodologies make particular sense for an organization whose purpose it is to provide a reliable supply of fuel to the AEP operating companies. In total, 94% of the costs in question have been directly assigned to SWEPCO or allocated to SWEPCO using a volume-based methodology.⁸¹³

Staff witness Luna recommends that the AEPSC FERC Account 501 Fuel and Logistics costs be completely allocated, basing that allocation to the AEP operating companies on a single

⁸¹⁰ Rebuttal Testimony of Randall W. Hamlett, SWEPCO Ex. 73 at 37; *See also* SOAH Order No. 3 adopting agreement on temporary rates.

⁸¹¹ Rebuttal Testimony of Jeffrey W. Hoersdig, SWEPCO Ex. 72 at 29-30.

⁸¹² Rebuttal Testimony of Jeffrey W. Hoersdig, SWEPCO Ex. 72 at 30.

⁸¹³ Rebuttal Testimony of Jeffrey W. Hoersdig, SWEPCO Ex. 72 at 30-31.

method: the dollar amount of three types of “contract commitments.” Mr. Luna’s recommendation completely ignores that much of the AEPSC Fuel and Logistics costs are incurred to provide services to a single benefiting operating company (*e.g.*, more than half of the services provided to SWEPCO were provided for the benefit of SWEPCO alone). Further, the methodology proposed by Mr. Luna includes the cost of contractual commitments that are not even the responsibility of the Fuel and Logistics organization. In addition to fuel procurement contractual commitments, Mr. Luna proposes to allocate the AEPSC FERC Account 501 Fuel and Logistics costs based on “Energy and Capacity Purchase” and “Construction Contracts for Capital Assets” contract commitments, neither of which is related to the services provided by the Fuel and Logistics organization.⁸¹⁴ Indeed, neither Energy and Capacity Purchase contracts nor Construction Contracts for Capital Assets is related to the type of costs recorded in FERC Account 501 – Fuel, as this account “shall include the cost of fuel used in the production of steam for the generation of electricity.”⁸¹⁵

At its core, Mr. Luna’s recommendation stems from the mistaken belief that almost 40% of the AEPSC Fuel and Logistics costs have been allocated to SWEPCO. Mr. Luna wrote, “An analysis of the data reveals that based on the allocation method used by AEPSC, it is charging almost 40% of its total fuel logistics expenses to SWEPCO.”⁸¹⁶ Mr. Luna is incorrect. It is true that SWEPCO received 39% of the Fuel and Logistics costs charged to FERC Account 501. However, what is not reflected in Mr. Luna’s testimony is that some AEP operating companies record Fuel and Logistics costs in FERC Account 152 – Fuel Stock, later reclassifying the costs to FERC Account 501 as the fuel is consumed.⁸¹⁷ When the total of services provided by the Fuel and Logistics organization is analyzed, it is revealed that SWEPCO received 19% of the costs of that organization.⁸¹⁸ Mr. Luna’s mistake is shown in his own testimony, where he states that he requested that SWEPCO provide a schedule “for the selected sample of FERC accounts”

⁸¹⁴ Rebuttal Testimony of Jeffrey W. Hoersdig, SWEPCO Ex. 72 at 31-32.

⁸¹⁵ FERC Uniform System of Accounts, Account 501, 18 CFR pt. 101.

⁸¹⁶ Redacted Direct Testimony of Joe Luna, Staff Ex. 3 at 33.

⁸¹⁷ FERC Account 501 reflects this option: “Fuel handling expenses may be charged to this account [501] as incurred or charged initially to account 152, Fuel Stock Expenses Undistributed . . . In the latter event, they shall be cleared to this account [501] on the basis of the fuel used.” 18 CFR pt. 101.

⁸¹⁸ Rebuttal Testimony of Jeffrey W. Hoersdig, SWEPCO Ex. 72 at 28.

after his review of a sample of “high dollar FERC accounts.”⁸¹⁹ Mr. Luna simply mistakes the those Fuel and Logistics costs recorded in FERC Account 501 for the totality of costs attributable to the AEPSC Fuel and Logistics organization.

P. Director & Officer Liability Insurance

For both Directors and Officers Liability Insurance (DOLI) and Fiduciary Liability Insurance (FLI) policies, AEP and its subsidiaries, including SWEPCO, are direct beneficiaries under multiple insuring clauses. Corporate indemnification coverage insures AEP and its subsidiaries for their obligations to defend and indemnify directors, officers, and fiduciaries of the Company while acting in their official capacity. Direct corporate liability coverage in a DOLI policy grants explicit protection for AEP and its subsidiaries corporate liability arising from claims alleging securities laws or rules violations. In FLI policies a component of the coverage is explicitly for the benefit of AEP and its subsidiaries and its employee benefit plans. Directors, officers and fiduciaries are not covered under these respective insuring clauses, so any implication that DOLI and FLI policies are solely aimed at protecting their personal wealth simply is incorrect.⁸²⁰

Furthermore, the purchase of DOLI and FLI policies is a normal cost of business for not only utilities such as SWEPCO, but for many companies across all industries. OPUC witness Dr. Szerszen is correct in her assertion that DOLI policies help to attract qualified and capable directors and officers. However, she is incorrect with her contention that the greater portion of DOLI insurance benefits accrue to a company's shareholders, officers and directors. As discussed above, AEP and its subsidiaries, including SWEPCO, are the primary beneficiaries of DOLI and FLI policies. DOLI and FLI policies exist to allow quality directors, officers, and fiduciaries to make sound business decisions without a cloud of uncertainty regarding potential lawsuits hanging over their heads. These sound business decisions can result in lower costs, which certainly benefit customers.⁸²¹

All of these facts have led the Commission in the past to allow such expenses. The Commission has adopted the findings that such corporate liability policies primarily protect the company, not the individuals. Such coverage does not imply that the policies are primarily or

⁸¹⁹ Redacted Direct Testimony of Joe Luna, Staff Ex. 3 at 32-33.

⁸²⁰ Rebuttal Testimony of Jeffrey W. Hoersdig, SWEPCO Ex. 72 at 9.

⁸²¹ Rebuttal Testimony of Jeffrey W. Hoersdig, SWEPCO Ex. 72 at 9-10.

even marginally intended to cover mismanagement. And, corporations of all sizes have found it impossible to prudently operate without such insurance policies, much less to obtain the services of qualified directors and officers.⁸²² The Commission later found that the cost of directors' liability insurance should be included in the cost of service, as it "is difficult to imagine someone being willing to serve as a director of a major corporation without the protection that the liability insurance provides."⁸²³ For these same reasons, expenses associated with DOLI and FLI should be allowed in this case.

Q. Convenience Payments

The Company uses the services of Jackson Kelley, P.L.L.C. to assist in the monitoring of carbon legislation, which is wholly separate from providing an advocacy role related to carbon legislation. As a matter of "convenience," Ohio Power Company made the payments for the benefit of multiple AEP affiliates. The monitoring of legislation is a Commission-recognized reasonable and necessary business expense to ensure that the AEP operating companies are properly positioned to react to and comply with legislation affecting the companies. Specifically, legislation related to carbon emissions could have a direct impact on SWEPCO's generating fleet.⁸²⁴

PURA Sec. 36.062 states that the Commission may not consider for ratemaking purposes "an expenditure for legislative advocacy." The AEP system closely tracks all legislative advocacy costs because they are generally not allowed in any rate recovery mechanism. In fact, the FERC Uniform System of Accounts requires that the AEP system account for legislative advocacy costs in Account 426.4. All affiliate transactions meeting the Account 426.4 criteria related to legislative advocacy were removed from the requested affiliate request in this proceeding.⁸²⁵

⁸²² *Application of Gulf States Utilities Company for Authority to Change Rates*, Docket Nos. 7195 and 6755, at Examiners' Report, Section IX.C.7, adopted by Order (May 16, 1988).

⁸²³ *Application of Houston Lighting and Power Company for Authority to Change Rates*, Docket Nos. 8425 and 8431, Final Order at FoF No. 191 (Sept. 18, 1990).

⁸²⁴ Rebuttal Testimony of Jeffrey W. Hoersdig, SWEPCO Ex. 72 at 25.

⁸²⁵ Rebuttal Testimony of Jeffrey W. Hoersdig, SWEPCO Ex. 72 at 19.

R. Injuries and Damages Expense

Rates “are to be based upon an electric utility’s cost of rendering service to the public during a historical test year, adjusted for known and measurable changes.”⁸²⁶ During the test year, SWEPCO reasonably incurred \$4,540,265 of expense in FERC Account 925 – Injuries and Damages.⁸²⁷ No party alleges that these expenses were anything but reasonably incurred. Therefore, their requests to adjust the test year incurred expense constitute an unfounded allegation that there is a known and measurable change to be made.

Staff witness Mr. Luna and Cities witness Mr. Kollen specifically recommend a disallowance of \$550,000 from the test year expense related to settlement of lawsuits. However, settlement of lawsuits is a standard practice to avoid high litigation costs and potential adverse litigated outcomes and is considered a normal cost of doing business.⁸²⁸ Again, there is no evidence or even an allegation that these amounts were unreasonably incurred. So, should the Commission remove \$550,000 from the test year, as recommended by Staff, then it would seem reasonable to add back recovery of this amount over three years (*i.e.*, \$183,333 as a test year amortization), given that Mr. Luna does not contend the \$550,000 was imprudently incurred.⁸²⁹

S. Office Supplies Expense

In response to discovery, SWEPCO provided Staff witness Mr. Luna 89 pages of invoices and other supporting documents associated with several test-year entries in FERC Account 921 – Office Supplies and Expenses. As explained in that response, “these costs are normal necessary costs that one would reasonably expect an on-going business to incur year after year such as travel, conferences, business related events, software, relocation services, studies, safety equipment, meeting expenses and meals.” Mr. Luna’s sole reason for his recommended disallowance is “In reviewing the following SWEPCO invoices, I find that the expenses do not appear to be office supplies, are not reasonable and necessary and should not be borne by the rate payers.”⁸³⁰ Mr. Luna’s opinion is in conflict with the Uniform System of Accounts and the facts surrounding these expenses.

⁸²⁶ P.U.C. SUBST. R. 25.231(a).

⁸²⁷ Rebuttal Testimony of Randall W. Hamlett, SWEPCO Ex. 73, Exhibit RWH-2R.

⁸²⁸ Rebuttal Testimony of Randall W. Hamlett, SWEPCO Ex. 73 at 38.

⁸²⁹ Rebuttal Testimony of Randall W. Hamlett, SWEPCO Ex. 73 at 39.

⁸³⁰ Redacted Direct Testimony of Joe Luna, Staff Ex. 3 at 17.

Items expressly included in FERC Account 921 include “Meals, traveling and incidental expenses.” The majority of Mr. Luna’s recommended disallowances represent meals during employee meetings, events, and storm restoration activities and are a normal cost of utility business. Mr. Luna’s other recommended disallowances are related to conference registrations, services for an economic impact study, and company logo items, all of which are includable in Account 921 and are part of the reasonable and necessary cost of doing business in the utility industry.⁸³¹

T. Temporary Labor

Mr. Luna’s reason for recommending a disallowance of these reasonable and necessary costs is contained in the single, false statement that “My review of the years 2007 through 2011 revealed that the Company’s request for Temporary Labor was above the norm by (\$101,642).”⁸³² In truth, Temporary Labor for this period averaged \$137,520, well more than Mr. Luna’s mythical norm of \$67,494.⁸³³ Further, as explained in both the discovery response and rebuttal testimony, “beginning in 2010 with the acquisition of Valley Electric (VEMCO) requiring temporary meter reading and customer service labor as well as some regulatory filings during the year, [temporary labor] expenses began to climb. Test year amounts have increased by approximately \$54,000 from 2010. These increases are primarily due to a full year of temporary labor from the aforementioned VEMCO facility.”⁸³⁴ While temporary labor expenses did increase from 2010 to the test year, there is no indication that these expenses are anything other than reasonable and necessary expenses incurred to provide service to customers. And, with the acquisition of VEMCO, these expenses are (and were during the test year) allocated over a larger base of customers.

U. Turk Independent Monitor Costs

In its November 9, 2012 Errata filing (SWEPCO Ex. 23), SWEPCO removed from its requested cost of service \$337,303 for Turk independent monitor (E3 Consulting) costs that had been inadvertently included in SWEPCO’s request. There is no further adjustment to be made.

⁸³¹ Rebuttal Testimony of Randall W. Hamlett, SWEPCO Ex. 73 at 63.

⁸³² Redacted Direct Testimony of Joe Luna, Staff Ex. 3 at 30.

⁸³³ See SWEPCO’s Response to Staff RFI 29-5, SWEPCO Ex. 110.

⁸³⁴ SWEPCO’s Response to Staff RFI 29-5, SWEPCO Ex. 110; Rebuttal Testimony of Randall W. Hamlett, SWEPCO Ex. 73 at 70-71.

V. Separation Costs

The AEP system made a reasonable and necessary separation payment made to Ms. Susan Tomasky, former President of AEP Transmission, in connection with her retirement. As is customary with such payments, the payment was accompanied by a release of claims agreement containing, among other items, certain non-solicitation, confidentiality, and cooperation obligations. This type of separation payment is not uncommon for senior executives such as Ms. Tomasky and is a result of her employment.⁸³⁵

Only Staff witness Mr. Luna questions this reasonable and necessary test year expense. He makes only two allegations, both unfounded. First, he suggests on page 23 of his testimony that this expense resulted from an employment practice that “was potentially questionable or that resulted in a compromise settlement.”⁸³⁶ Contrary to Mr. Luna’s unfounded suggestion, Mr. Luna was quite clearly informed in discovery that there “were no costs billed to SWEPCO in 2011 related to discriminatory employment practices.”⁸³⁷ Second, Mr. Luna suggests this expense is not typical or on-going. As an initial matter, as noted above, this type of separation payment is not uncommon for senior executives such as Ms. Tomasky, was paid in connection with her retirement with the Company, and was consideration for the post-employment agreements made by Ms. Tomasky. Further, Mr. Luna fails to recognize that this payment is a component of the Finance, Accounting, and Strategic Planning class of affiliate service. The reasonableness of this class of affiliate service is examined and supported at great length on pages 58 through 82 of Mr. Hoersdig’s direct testimony, subjecting the expenditures to headcount and cost trend, benchmarking, and budget v. expenditure analysis. Provided as Exhibit JWH-14 to that testimony is the “roadmap” to the testimony, exhibits, and workpapers providing evidence that the overall level of costs within the Finance, Accounting, and Strategic Planning class of affiliate services are reasonable and necessary. That evidence remains unrefuted. So, while the AEP system will not make any more separation payments to Ms. Tomasky, the expense remains a reasonable and necessary one and the level of Finance, Accounting, and Strategic Planning expenses are representative of the level of expense expected

⁸³⁵ Rebuttal Testimony of Jeffrey W. Hoersdig, SWEPCO Ex. 72 at 22-23.

⁸³⁶ Redacted Direct Testimony of Joe Luna, Staff Ex. 3 at 23.

⁸³⁷ Rebuttal Testimony of Jeffrey W. Hoersdig, SWEPCO Ex. 72 at Exhibit JWH-4R.