Brookfield.

I also examine the relationship between WETT and two Grupo Isolux subsidiaries: (1) Iccenlux Corp., a subsidiary of Isolux Concesiones, and (2) Isolux Ingeniería USA LLC ("I-USA"), the U.S. EPC subsidiary of Isolux Ingeniería, S.A. ("Isolux Ingeniería"), all of which are ultimately owned by Grupo Isolux. These subsidiaries provide WETT with (1) corporate support services and (2) construction support services, also referred to as engineering, procurement, and construction ("EPC") services.

Second, I address regulatory issues related to WETT's status as a new utility. WETT does not currently provide transmission service and therefore does not have a current tariff or rates in place. I explain how PURA and Commission precedent require that a TSP, such as WETT, have a tariff and rates in place before operating transmission facilities. Additionally, I describe ratemaking tools which may be necessary to enable WETT to have an opportunity to earn a reasonable return on its reasonably invested capital. Ensuring this opportunity is not only required by PURA, it is also consistent with the policy established when the Commission selected new market entrants to be Competitive Renewable Energy Zone ("CREZ") TSPs. The Commission understood that fair and compensatory rates would need to be set; to do otherwise would serve to compromise the new entrant utilities' ability to energize and operate their facilities, discourage future investment in Texas, and compromise the very purposes for which the new entrants were selected in the first place. Given the Commission's broad authority to set rates for new market entrants and the flexible approach the Commission has taken with other new entrants in the past, I believe use of one or both of the ratemaking tools I discuss below is appropriate.

Third, my testimony supports WETT's proposals to address two ratemaking issues related to its status as a new electric utility. The first ratemaking issue is associated with the need to allow WETT to submit the construction costs of its transmission lines for regulatory approval prior to project completion. The Legislature has recognized that, given the costs involved in constructing CREZ facilities, CREZ transmission service providers ("TSPs") might need to begin earning a return on assets prior to project in service dates. It has provided for utilities, such as WETT, to request construction work in progress ("CWIP") on CREZ projects in rate base "when conditions warrant." Accordingly, my testimony describes why the Commission should approve WETT's request to include its capital investment through June 30, 2012 in rate base, even to the extent that this investment might be considered CWIP, both in this case and in an upcoming TCOS proceeding. I should note that WETT has proposed a preferred procedural process which will result in rates that do not include CWIP in rate base. Under that process, WETT's rates will be effective when the asset is no longer CWIP and is capable of providing service. However, if WETT's preferred process is not approved, then WETT asks that Phase II CWIP balance as of June 30, 2012, be included in rate base in this case.[1]

The other ratemaking issue relates to cost recovery of certain expenses which the Commission might otherwise deem unrecoverable if they are not known and

[1] WETT has asked for two "Phases" of rates, which are further explained in its Application and the direct testimony of Mr. Morton. Phase I includes facilities approved in WETT's first two CCN applications and currently scheduled to be completed on March 31, 2013. Phase II includes facilities approved in WETT's third CCN application and currently scheduled to be completed on May 15, 2013. Any rates set in this case will not go into effect until Phase I facilities are complete and capable of providing service, as explained in Mr. Morton's testimony. WETT's preferred process proposes that Phase II investment be incorporated into rates in an interim TCOS proceeding, with rates effective after Phase II facilities are complete and capable of providing service. If WETT's preferred process is not implemented, then WETT requests that Phase II CWIP be included in rate base in this case.

measureable. For certain WETT expenses that are not included in its cost of service based on known and measurable changes, WETT seeks a deferred accounting order to capture such expenses. My testimony demonstrates that deferral of these expenses is consistent with Texas law and Commission policy.

Q. WHAT PARTICULAR EXPERIENCE QUALIFIES YOU TO SUBMIT THIS TESTIMONY?

A. My experience as a former PUCT Commissioner qualifies me to describe the scope and applicability of Commission rules and policy regarding affiliate charges, tariff requirements, and also to describe those instances in which the Commission should exercise its discretion in including investment through June 30, 2012, in rate base and granting deferred accounting treatment. Moreover, I have knowledge of the Legislative mandates and the Commission's policies in regard to development of CREZ transmission facilities (which, in turn, are to promote the development of renewable generation resources in the Texas wholesale generation market). This background qualifies me to discuss how the Commission should apply its rules to affiliates used by the utility to construct and operate CREZ facilities and why the Commission should allow new entrants, such as WETT, to use ratemaking tools such as CWIP and deferred accounting.

Q. PLEASE PROVIDE AN OVERVIEW OF YOUR TESTIMONY.

A. As discussed above, my testimony shows how the PUCT should apply regulatory policies to WETT in several areas:

Affiliate Transactions: My testimony discusses the standards that the Commission should apply in reviewing WETT's affiliate transactions. The Commission applies several types of standards to review affiliate charges. First, PURA requires that affiliate charges meet a heightened standard of proof. Under these standards, affiliate charges must be shown to be reasonable and necessary at a reasonably detailed level, and must not be higher than the affiliate's charges to other entities. In addition, there are standards for pricing services provided by an affiliate to a utility. Services provided between a utility and an affiliate must be priced at a level that is fair and reasonable to the customers of the utility and reflects the market value of the services or the fully allocated cost to provide those services. In each instance, the general policy behind these rules is the need to prevent utilities from subsidizing affiliates by passing unreasonable affiliate charges to ratepayers.

My testimony addresses the origin of these standards. I describe how affiliate policies have traditionally been applied to shared services provided to utilities by their affiliated service companies or fuel suppliers. The market-based pricing policy that applies to affiliate services was recognized more recently in the 1999 legislation that restructured the Texas electric industry.

My testimony also reviews previous cases in which the Commission has considered WETT's relationships with its affiliates, including:

- Docket Nos. 35665 and 37902, in which the Commission selected WETT as a CREZ transmission provider based on the strength of its affiliate relationships;
- Docket No. 36856, in which the Commission approved WETT's affiliate Code of Conduct; and
- Docket No. 38568, in which the Commission granted WETT a waiver from its Code of Conduct to retain an affiliate, I-USA, as its EPC contractor for the Company's CREZ projects.

Next, my testimony applies the standards discussed above to WETT's affiliate relationships. I show how certain transactions between WETT and its affiliates comply with applicable standards. WETT has entered into several contracts with affiliates, including an Affiliate Services Agreement ("ASA") with subsidiaries of both Brookfield and Isolux Concesiones. WETT obtains corporate support services under the ASAs at the fully-allocated cost of those services, consistent with Commission practice for such services.

In addition, WETT has entered into contracts to obtain construction support services. WETT entered into a Consultant Service Agreement ("CSA") with I-USA. Then, after obtaining PUCT approval of a limited waiver of its Code of Conduct in Docket No. 38568, WETT entered into an EPC agreement (the "EPC Contract") with I-USA to complete the CREZ facilities assigned by the Commission.

WETT obtains EPC work based on the cost plus a fee. As Thomas Flaherty discusses in his direct testimony, this is a common pricing mechanism for EPC contracts in the market, and I-USA's EPC services are provided at a fee that is below market and less than what I-USA would charge other entities. As a result, WETT's affiliate contracts are consistent with the policies set out in the affiliate pricing standards.

Tariff Issues: As a new entrant, WETT currently has no approved rates that would otherwise capture such expenses. I analyze and discuss certain provisions of PURA that require WETT to have a tariff in place and rates set before it may operate as a public utility offering wholesale transmission services.

Construction Work In Progress: Under WETT's preferred approach, it would not charge rates prior to project completion based on including CWIP in rate base.

However, WETT is requesting that it be permitted to file both this case and an interim TCOS filing while certain investments are booked as CWIP. As explained in Mr. Fairchild's testimony, expenditures associated with Phase I facilities in the CWIP account were allocated to appropriate plant in service accounts. My testimony supports the use of this procedure, since a similar approach was taken in another recent new entrant case and since the facilities will be in service before attendant rates are charged. In the alternative, if WETT's preferred request for the interim TCOS treatment described above is not accepted, then WETT requests including expenditures on Phase II facilities as CWIP in rate base in this case, and my discussion of the CWIP standards applicable to CREZ justify this inclusion. I discuss how WETT's circumstances meet the requirement under Section 36.054 of PURA that require the Commission to approve CWIP treatment for CREZ utilities "if conditions warrant." Specifically, I describe why allowing WETT to place its investment in rate base is particularly important for start-up utilities, and why circumstances clearly warrant such treatment in this case. I discuss the punitive impact of "regulatory lag" on WETT if it were required to go through the Commission's usual processes for placing capital investments in rate base and discuss how such "regulatory lag" will have a greater impact on WETT than it would on a more established utility.

Deferred Accounting: WETT has requested that certain expenses be captured as known and measurable changes to its historical year, and has also requested that it be granted deferred accounting for any such expenses that are not considered known and measurable changes. If WETT's known and measurable changes are rejected, then in the absence of a deferred accounting order, those expenses would be unrecoverable by WETT. I address why it is necessary to carry out the provisions of PURA and grant

WETT's conditional request for a deferred accounting order. I explain that, by selecting new entrants to construct and operate certain CREZ facilities, the Commission recognized the unique circumstance the new entrants such as WETT would find themselves when filing their first rate application. As a new entrant, WETT has no approved rates that would otherwise capture such expenses. Accordingly, deferred accounting is an approach to allow WETT a reasonable opportunity to recover its reasonable and necessary operating expenses, as required by Section 36.051 of PURA. In addition, deferred accounting will carry out the provisions of PURA related to CREZ development. The Commission has encountered this issue before and has accommodated Sharyland Utilities, L.P. ("Sharyland") and Electric Transmission Texas, LLC ("ETT") when each of those utilities filed its first application to establish rates.

Q. ARE YOU SPONSORING ANY EXHIBITS IN CONNECTION WITH YOUR TESTIMONY?

A. Yes. I sponsor the exhibit listed in the table of contents of this testimony.

Q. WERE YOUR TESTIMONY AND THE EXHIBIT ATTACHED THERETO PREPARED BY YOU OR UNDER YOUR DIRECT SUPERVISION?

A. Yes.

III. AFFILIATE ISSUES

A. AFFILIATE COST RECOVERY IN TEXAS

Q. PLEASE DISCUSS IN MORE DETAIL THE POLICY THAT UNDERLIES THE AFFILIATE COST RECOVERY STANDARDS.

A. There has been a longstanding concern with ensuring that utilities do not subsidize their affiliates by including unreasonable affiliate charges in rates. This concern is reflected in Section 36.058 of the Public Utility Regulatory Act ("PURA"), which provides that affiliate costs can be included in rates only if the Commission finds that they are reasonable and necessary for each item or class of items and not higher than affiliate charges to other entities. Similarly, the affiliate standards adopted in Senate Bill 7[2] in PURA Section 39.157(d) were incorporated into the Commission's code of conduct rule, Substantive Rule 25.272, to address subsidization of affiliates. *See, e.g.,* PURA § 39.157(d), (d)(11), (g) and (h). Protecting against subsidization of affiliates is a major purpose of these affiliate cost recovery standards.

Q. WHAT STANDARDS MUST BE MET FOR A UTILITY TO RECOVER AFFILIATE PAYMENTS IN RATEMAKING PROCEEDINGS?

A. Based on these statutory provisions, there are several standards that apply to affiliate costs in a utility's rates in Texas:

- *Reasonable and necessary*: affiliate costs must be shown to be reasonable and necessary at a reasonable level of specificity;
- *Not higher than*: affiliate costs must not be higher than the affiliate charges to other entities;
- *Fully-allocated cost*: a utility and its affiliates must fully allocate costs for any shared services; and
- *Market value*: affiliate services must be fair and reasonable to the utility's customers and reflect the market value of the service.

I discuss each of these standards in more detail below.

Q. WHAT ARE THE POLICIES BEHIND THE "REASONABLE AND NECESSARY" STANDARD?

A. The reasonable and necessary standard for recovery of affiliate costs is the same

[2] Act of May 27, 1999, 76th Leg., R.S., ch. 405, § 39, 1999 Tex. Sess. Law Serv. 2558, 2572 (Vernon) (at TEX. UTIL. CODE ANN. § 39.901 et seq.).

standard that is applied to the recovery of *all* utility costs through rates. Under PURA Section 36.051, the standard rate-setting formula is that rates must provide a utility with a reasonable opportunity to earn a reasonable return on its investment over and above its reasonable and necessary operating expenses. The same "reasonable and necessary" standard is in the affiliate statute in PURA Section 36.058. As a result, the standard requiring that affiliate charges be reasonable and necessary is the same standard as is applicable to all utility costs. What is different is the level of specificity required for proof of affiliate expenses. Under Section 36.058, affiliate charges must be shown to be reasonable and necessary of each item or class of items of affiliate expense. Therefore, the standard requires that affiliate expenses be shown to be reasonable and necessary at a more detailed and specific level than is required for non-affiliate expenses.

Under the PURA Chapter 36 requirements for affiliate expenses, the reasonable and necessary standard for proving affiliate expenses does not establish any particular pricing criteria for affiliate services. In other words, it does not require that affiliate services be priced at market or at any other specific level. It simply requires that they be shown to be reasonable and necessary with a reasonable level of specificity.

Q. WHAT ARE THE POLICIES BEHIND THE "NOT HIGHER THAN" STANDARD?

A. Under Section 36.058(c)(2), a utility must show that the price of affiliate charges are "not higher than" the prices charged by the supplying affiliate for the same item or class of items to affiliates or to nonaffiliated persons. This standard reflects a central concern of affiliate cost recovery policy—preventing a utility from subsidizing an affiliate by including unreasonable affiliate charges in rates. By requiring proof that the affiliate's charges to the utility are not higher than its charges to other affiliated or unaffiliated entities, this standard ensures that the affiliate is not inflating its charges to the utility relative to its charges to others. This section provides an external check on the affiliate's charges, since they are constrained by the prices the affiliate charges to third parties. However the affiliate services are priced, the utility is must show that they are not higher than the affiliate's charges to other entities.

Like the reasonable and necessary standard discussed above, this "not higher than" requirement does not establish any particular pricing standard that must be followed. It does not require that affiliate services be based on any particular criteria, only that they are not priced higher than services provided by the affiliate to other entities.

Q. WHAT POLICIES UNDERLIE THE THIRD STANDARD, THE FULLY-ALLOCATED COST PRICING STANDARD FOR SHARED SERVICES?

A. This standard was traditionally applied to integrated electric utilities prior to the era of restructuring that began in the latter part of the 1990s.[3] It has now been applied to utility holding companies that have centralized service companies to provide support services to their utility operating companies.[4] These corporate structures were viewed as efficient ways to share services that could have been provided within the utility itself.

Under this fully-allocated cost pricing standard for shared services, affiliate costs were either directly billed to the utility that received the benefit of the services or, in the case of services that benefitted more than one affiliated utility, were allocated among the

[3] *See, e.g. Railroad Commission of Texas v. Rio Grande Valley Gas Company,* 683 S.W.2d 783 (Tex. App.—Austin 1984, no writ)

[4] *See, e.g.* P.U.C. Subst. R. 25.272 (e)(1) ("In accordance with PURA and the commission's rules, a utility and its affiliates shall fully allocate costs for any shared services, including corporate support services, offices, employees, property, equipment, computer systems, information systems, and any other shared assets, services, or products.")

utilities based on the extent to which they benefitted from the services.

Q. WHAT IS THE POLICY UNDERLYING THE MARKET-BASED STANDARD FOR PRICING AFFILIATE SERVICES?

A. As noted previously, the market-based pricing standard for affiliate services was added by Section 39.157(d) as part of SB 7. This statute added a variety of code of conduct requirements relating to a utility's relationship with its affiliates including:

- Codifying the fully allocated cost standard in Section 39.157(d)(12); and
- Recognizing that affiliate services could be purchased by utilities at market-based prices under Section 39.157(d)(14).

The Commission enacted an affiliate code of conduct rule in Substantive Rule 25.272 to implement these requirements and has required utilities to adopt internal codes of conduct consistent with its rule.

The purpose of SB 7 was to introduce competition into the previously integrated, fully-regulated electric utility industry. Utilities were required to separate (unbundle) into a transmission and distribution ("T&D") function, a generation function, and a retail function. The generation and retail portions of the industry became competitive while the T&D function remained a traditionally-regulated utility. This separation of functions, along with the increased diversity in the electric industry that resulted from restructuring, created new affiliate relationships in addition to those that previously existed.

SB 7 addressed this increasing diversity of affiliate relationships, consistent with its overriding purpose of introducing competitive forces into the electric industry, through a series of affiliate relationship standards, as discussed above. Among other things, those standards recognized the existing fully-allocated cost affiliate pricing standard for shared services but also provided that the pricing of affiliate services could be market-based. As a result, the policy underlying this market-based standard is the same policy underlying SB 7, *i.e.*, market forces should govern the pricing of affiliate services. This standard recognizes that affiliate services may be provided in the competitive market, and utilities should be able to obtain those services at market-based prices.

B. WETT'S AFFILIATE SERVICES RELATIONSHIPS

Q. DESCRIBE WETT'S AFFILIATES.

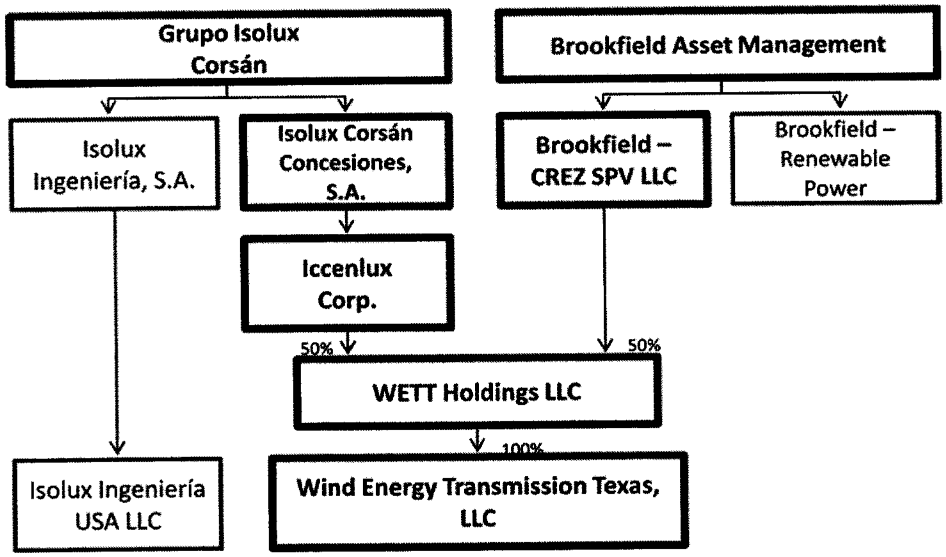
A. WETT is a Texas limited liability company formed in 2008 and is owned in equal shares by subsidiaries of Brookfield and Grupo Isolux.[5]

Brookfield is a global owner and operator of property, power and infrastructure assets. Its global transmission portfolio comprises 6,800 miles of transmission lines in Canada, Brazil, and Chile, including $1 billion of transmission development in North America.

Isolux Concesiones is the largest non-public Spanish engineering, construction, public services, and real estate development company. It has experience in the development, construction and operation of 13 transmission lines totaling over 4,100 miles and has an ownership interest in four other transmission systems under development totaling 1,640 miles. Another subsidiary of the parent Grupo Isolux, Isolux Ingeniería, has established an American subsidiary, I-USA, to support the development of WETT's CREZ projects.

[5] This organization chart is sponsored by and also provided in the direct testimony of WETT's General Manager, Wayne Morton.

WETT 2012 Organization Chart



Together Brookfield and Isolux Concesiones provide WETT with a significant base of expertise and experience for financing, constructing, and managing the CREZ transmission facilities that the Commission has assigned to the Company. Furthermore, as discussed in the testimony of Wayne Morton, the potential for engaging in self-dealing affiliate transactions is minimized because WETT is co-owned equally by subsidiaries of Brookfield and Isolux Concesiones. This is because, as a practical matter, WETT's owners can only operate by unanimous consent, and each owner is able and motivated to review affiliate charges from the other to ensure they are reasonable, and thus recoverable. This results in a very real and effective measure of affiliate oversight within WETT.

Q. WHAT ARRANGEMENTS HAS WETT ENTERED INTO TO OBTAIN SERVICES FROM ITS AFFILIATES?

A. The affiliate services provided to WETT fall into two broad categories: corporate support services and construction support services.

In terms of corporate support services, WETT has entered into the Affiliate

Service Agreements ("ASAs") to obtain these corporate support services from subsidiaries of Brookfield and Isolux Concesiones.[6] Services provided to date under these agreements include assistance with executive management, project management, financing, regulatory support, and human resources. As I discussed earlier in my testimony, this type of affiliate relationship is common in the Texas market, since other utilities obtain corporate services at fully-loaded cost from a parent or other affiliate, just as WETT does with its ASAs.[7]

In terms of construction support services, WETT has also entered into a Consultant Service Agreement ("CSA") and an EPC Contract with I-USA for construction support services.[8] Services provided under the CSA included initial engineering and transmission planning and design. The engineering work performed under the CSA was provided by I-USA prior to starting work under the EPC Contract. This was necessary because, given the timeline for the Texas CREZ projects, engineering and design work for WETT's project needed to begin even before the anticipated dates for signing the EPC Contract and closing on funding for the project.

Services provided under the EPC Contract include engineering the CREZ facilities, procuring materials for the facilities, and constructing the facilities. I-USA will also manage other contractors working on the CREZ projects. To my knowledge, the Commission has not previously reviewed an EPC contract of an affiliate pursuant to applicable affiliate transaction standards.

---

[6] Affiliate Services Agreements between Iccenlux and WETT and Brookfield Power US Asset Management LLC and WETT, both dated July 26, 2011, attached to the direct testimony of Daryl Pullin.

[7] See, e.g. *Application of Electric Transmission Texas, LLC for a Certificate of Convenience and Necessity, for Regulatory Approvals, and Initial Rates*, Direct Testimony of Michael Heyeck at 4 (Jan. 1, 2007).

[8] Consultant Service Agreement between WETT and I-USA, dated December 15, 2010; Engineering, Procurement and Construction Contract between [WETT], as Owner and [I-USA], as Contractor For the Wind Energy Transmission Project, dated April 19, 2011, both attached to the direct testimony of Daryl Pullin.

Q. WHAT ARE THE PRICING TERMS OF WETT'S CONTRACTS WITH ITS AFFILIATES?

A. Services under the ASAs are provided to WETT at fully-allocated cost. As Mr. Flaherty describes in more detail in his testimony, this is generally accepted practice in the industry and these services are directly billed to WETT. The services provided by WETT's affiliates through the ASAs are similar in nature to the services provided to other Texas utilities by their parent companies, such as the services provided to ETT by its parent American Electric Power Company, Inc. ("AEP"), which were addressed by the Commission in Docket No. 33734. Like AEP's corporate support services to ETT, the services provided to WETT through the ASAs are ongoing and are provided at fully loaded cost. Isolux Concesiones and Brookfield do not charge a fee for these services.

As described in Section 2B of the ASA, WETT has retained the right to obtain corporate support services from other parties, presumably if it finds them available at a lower cost or more efficiency elsewhere. As discussed in the testimony of Thomas Flaherty, the utility that engages a parent or other affiliate for these types of services usually is contractually required to obtain such services exclusively from the affiliate. Thus, I believe that the ASAs not only provide reasonable and necessary services to WETT on terms similar to those used in similar contracts by other utilities in Texas, but that the ASAs' terms are actually preferable to other similar contracts.

In contrast to at-cost pricing contained in the corporate support service contracts, construction support services provided by I-USA under the CSA and the EPC Contract are priced based on cost plus a 4% fee. The reason for this is that the design, engineering, construction, and procurement services are one-time events rather than ongoing activities. As discussed in Mr. Flaherty's testimony, this cost-plus arrangement is very common in the market for EPC services. In fact, as Mr. Flaherty discusses in his testimony, I-USA's 4% fee is below the low end of the market range (5%–10%) of margins for EPC agreements for transmission line projects. Further, Mr. Flaherty also discusses that I-USA's parent, Isolux Ingeniería, typically charges fees higher than 4% for similar EPC projects in the nearest geographic regions in which it operates.

In sum, the corporate support services under the ASAs, which represent traditional, ongoing utility-type functions, are provided at cost, much the same way these services are provided at cost between other Texas utilities and their affiliates. The one-time construction support agreements under the CSA and the EPC Contract are provided at cost plus a fee (4%) that is lower than market and no higher than what I-USA would charge a non-affiliated party.

As I discuss in Section VI, below, both types of pricing mechanisms comply with the affiliate standards contained in PURA and Commission rules.

C. PREVIOUS COMMISSION REVIEW OF WETT AFFILIATES

Q HAS THE COMMISSION REVIEWED WETT'S AFFILIATE RELATIONSHIPS IN PREVIOUS CASES?

A. Yes. The Commission has evaluated WETT's affiliate relationships in several prior cases. Initially, WETT applied to build CREZ transmission facilities in Docket No. 35665, the CREZ transmission provider selection case.[9] In that case, WETT presented itself as a start-up joint venture backed by the strength and experience of its co-owners, Brookfield and Grupo Isolux, in financing, constructing and operating transmission

[9] The final assignment of CREZ projects to WETT was made in Docket No. 37902, after the order in Docket No. 35665 was reversed by the Travis County District Court and remanded to the Commission.

facilities. WETT indicated its intent to use Grupo Isolux or an affiliated company to provide EPC services for the CREZ lines.[10] WETT also discussed with the Commission during the hearing the option of receiving EPC services priced at cost plus a fee.[11]

Q. WHAT DID WETT DO AFTER ITS SELECTION AS A CREZ TRANSMISSION PROVIDER?

A. In accordance with the Commission's CREZ transmission provider selection orders in Docket Nos. 35665 and 37902, WETT filed its affiliate Code of Conduct in Docket No. 36856, and WETT's Code of Conduct was approved by the Commission on July 15, 2009. The pricing provisions of WETT's Code of Conduct are consistent with the provisions of the Commission's code of conduct rule. Namely, WETT and its affiliates shall fully allocate costs of shared services and prices for affiliate services will be based on market-based pricing that is fair and reasonable to customers.

Q. DID WETT APPLY FOR A WAIVER OF THE CODE OF CONDUCT REQUIREMENTS WITH RESPECT TO ITS EPC CONTRACT WITH I-USA?

A. Yes. Although the statute is not clear on whether a waiver was actually necessary, on August 17, 2010, WETT filed for authorization in Docket No. 38568 to enter into an EPC agreement with I-USA. WETT's application for a limited waiver of its Code of Conduct noted that sharing of engineering services was restricted under the Commission's code of conduct rule, although such sharing had been authorized for other Texas utilities.[12] The application also noted some ambiguity about whether I-USA would

[10] *See, e.g., Commission Staff's Petition for Selection of Entities Responsible for Transmission Improvements Necessary to Deliver Renewable Energy from Competitive Renewable Energy Zones*, Docket No. 35665, Buckman Responsive Testimony at 4-5; Trefois Responsive Testimony at 4, 6-9, 12-13.

[11] *See Commission Staff's Petition for Selection of Entities Responsible for Transmission Improvements Necessary to Deliver Renewable Energy from Competitive Renewable Energy Zones*, Docket No. 35665, Hearing Transcript at 1121 (December 4, 2008).

[12] *Application of Wind Energy Transmission Texas, LLC for a Limited Waiver with Respect to its Code of Conduct,*

be classified as a competitive affiliate subject to competitive bidding requirements.[13] Accordingly, WETT requested limited waivers of the code of conduct rule, to the extent necessary, to authorize it to enter into an EPC agreement with I-USA. On November 23, 2010, the Commission approved WETT's request, though the prudency of associated costs was not addressed.

D. WETT'S COMPLIANCE WITH AFFILIATE POLICIES

Q. DO WETT'S CONTRACTS WITH ITS AFFILIATES COMPLY WITH THE AFFILIATE PRICING AND COST RECOVERY POLICIES APPLICABLE TO ELECTRIC UTILITIES?

A. Yes. WETT's affiliate contracts comply with PURA's affiliate standards because the contracts do not subsidize affiliates by paying them an unreasonable amount for their services. The services WETT receives from its affiliates are priced at fully-allocated cost or, in the case of EPC work, cost plus a 4% fee. The services priced at fully-allocated cost do not subsidize affiliates because, by definition, the affiliates receive compensation that recovers only their cost of providing the service. Similarly, the arrangements for EPC services do not subsidize I-USA because, as discussed in the direct testimony of Mr. Flaherty, they are priced at or below market price. As a result, WETT's affiliates receive a reasonable level of compensation and are not subsidized by their charges to WETT.

Q. ARE THE AFFILIATE CORPORATE SUPPORT SERVICES THAT WETT RECEIVES UNDER THE ASA'S AT FULLY-ALLOCATED COST CONSISTENT WITH APPLICABLE COST RECOVERY STANDARDS?

A. Yes. Those services are based on actual costs incurred to provide services for

---

Docket No. 38568, Application at 5-6 (Aug. 11, 2010).

[13] *Id.* at 3-4.

WETT's benefit, and are billed to WETT much like affiliate shared services costs have been charged to Texas utilities for many years, such as those approved for ETT in Docket No. 33734. Since these costs are directly billed to WETT, cost responsibility is more precisely assigned than using allocation factors.

As discussed in the testimony of Wayne Morton, Brookfield and Isolux Concesiones have significant experience and expertise in providing the types of services needed by WETT and are positioned to provide those services more efficiently and at a lower cost than WETT could likely acquire such services on its own. Many utilities use a parent company's shared services for this reason. As Mr. Morton discusses, the Commission's selection of WETT to construct and operate CREZ transmission facilities was based in part on its recognition of WETT's ability to call upon its affiliates' significant transmission experience all over the world.[14]

Based on my review of other witnesses' testimony regarding the structure of the ASAs for corporate support services and the descriptions of the expenditures incurred under the ASAs, I conclude that the services provided to WETT by its affiliates are: (1) reasonable and necessary; (2) not higher than what Brookfield and Isolux Concesiones charge to other entities; (3) fully and appropriately allocated; and (4) fair, reasonable, and at or below market value.

Q ARE THE CONSTRUCTION SUPPORT SERVICES PROVIDED UNDER THE CSA AND THE EPC CONTRACT WITH I-USA CONSISTENT WITH

[14] "When I compared [what] . . . WETT has in parts of the world, they have significantly more – at least Isolux has significantly more transmission experience." Tr. at 132-22 (Jan. 14, 2009 Open Meeting, Chmn. Smitherman); "WETT has vast international experience and . . . among the new entrants was, frankly, one of the more impressive proposals, albeit ambitious in their original submission." "WETT has more financial resources . . . in addition to much more experience in transmission, and they bring a new set of experiences. . . ." Tr. at 40, 65 (Jan. 29, 2009 Open Meeting, Comm'r Anderson).

APPLICABLE COST RECOVERY STANDARDS?

A. Yes. The CSA and the EPC Contract are examples of affiliate services based on the market-driven standards adopted in PURA Section 39.157(d) and the Commission's code of conduct rule in Substantive Rule 25.272. The pricing mechanism in these contracts is based on actual costs incurred by I-USA plus a small (4%) fee. As discussed in Mr. Flaherty's testimony, cost plus fee pricing is consistent with contracts commonly used in the market for these types of services.

I believe that these contracts are consistent with the affiliate standards in PURA and the Commission's rules for several reasons. First, the EPC services are provided solely to WETT and therefore the costs are all directly billed to WETT, rather than based on allocation factors. As a result, it is clear that all of the affiliate services provided under these agreements directly benefit WETT and no other entity. Second, the fee in the CSA and the EPC Contract is consistent with the market-based standard for affiliate services in PURA Section 39.157(d), the Commission's code of conduct rule, and WETT's internal Code of Conduct. Accordingly, there is no affiliate subsidization because I-USA has stated that it would provide the same services at similar or higher margins to non-affiliated entities in the competitive market. Mr. Flaherty's testimony also supports the reasonableness of these charges since he indicates that a 4% fee is actually lower than market standards. Accordingly, I believe I-USA is providing services at prices no higher than what it would charge non-affiliated customers.

In sum, based on my review of these analyses and testimony regarding these contracts' terms, I conclude that the construction support services provided to WETT are: (1) reasonable and necessary; (2) not higher than what I-USA would charge to other entities; (3) fully and appropriately allocated; and (4) fair, reasonable, and at or below market value.

Q. WHAT DO YOU CONCLUDE ABOUT WETT'S AFFILIATE RELATIONSHIPS AND PRICING?

A. WETT obtains valuable experience and expertise from its affiliates, Brookfield, Isolux Concesiones, and their subsidiaries, at fully-allocated cost or cost plus a small fee based on the market for such services, to facilitate its construction and subsequent operation of the CREZ facilities assigned to it by the Commission. I conclude that those services, and the costs associated with them, comply with the policies governing affiliate services pricing and cost recovery in Texas.

IV. NEED TO HAVE A TARIFF IN PLACE BEFORE OPERATING TRANSMISSION FACILITIES

Q. MUST WETT HAVE A RATE SET AND TARIFF APPROVED BEFORE ITS TRANSMISSION FACILITIES CAN BE PLACED IN SERVICE?

A. Yes. WETT does not currently provide transmission service and therefore does not have a current tariff and rates in place but will need to have a tariff in place before it starts providing service to customers. As this Commission is aware, WETT is a new entrant to the wholesale electric transmission market in Texas. It was one of three new entrants picked by the Commission in the TSP selection docket to construct various CREZ facilities. Accordingly, WETT has no current rates set by the PUCT, much less rates that would allow it to recover the costs of operating its CREZ facilities once the facilities are capable of providing service.

Q. WHY IS THIS AN ISSUE IN THIS CASE AND HOW SHOULD THE COMMISSION HANDLE IT?

A. When PURA was enacted, the existing utilities already had rates in place. Thus, this issue was not raised until new entrants sought to provide service in the Texas market.

It is clear, however, that WETT will need to have a tariff *before* providing service. Specifically, PURA § 36.051 states that "the regulatory authority *shall* establish the utility's overall revenues ... on the utility's invested capital used and useful in providing service" (emphasis added). This mandatory language suggests that rates must be in place when facilities are used and useful. Similar mandatory language in § 32.101(a) requires utilities to file tariffs. Additionally, PURA § 36.004(b) states that a "person may not knowingly receive or accept a service from an electric utility for a compensation greater *or less than* the compensation prescribed by the tariff" (emphasis added). This suggests electricity consumers could not accept service from a TSP without a tariff in place. I believe that, read together, these provisions indicate that a TSP cannot operate facilities in Texas until it has a tariff and rates in place.

This outcome is consistent with previous decisions involving new electric utilities. For example, in Sharyland's original rate case, the Administrative Law Judge noted in Order No. 3 that, "SU also states that without approval of its proposed interim rates and tariff, SU would be unable to initiate tariffed service to customers within its service area."[15] The ALJ then agreed, finding "that SU's request for approval of interim rates and tariff has merit."[16] Accordingly, I believe that a utility must have rates in place before placing facilities in service based on PURA's structure and on Commission precedent. As applied to WETT, I believe this means WETT cannot energize its line until a tariff and rates are approved by the Commission.

---

[15] *Application of Sharyland Utilities, L.P. for Authority to Establish Initial Rates and Tariff*, Docket No. 21591, Order No. 3 at 1 (Dec. 13, 1999).
[16] *Id.*

V. RATEMAKING ISSUES

Q. ARE THERE ANY SPECIFIC ISSUES THAT THE COMMISSION MUST CONSIDER IN ESTABLISHING WETT'S RATES?

A. As I discuss below, the Commission should consider two ratemaking issues related to WETT's position as a new electric utility. These ratemaking issues result from the fact that, as a new entrant provider of CREZ transmission, WETT is incurring costs associated with developing CREZ facilities but has no mechanism to begin to recover its expenses or earn a return on its invested capital. Because of this, I believe the Commission may need to use certain ratemaking tools, such as CWIP or deferred accounting, to ensure WETT has an opportunity to earn a reasonable return on its reasonably invested capital. Use of these tools is well within the Commission's broad ratemaking authority, especially given the flexible approach the Commission has taken with past new entrants. Use of these tools is also good policy, as setting fair and compensatory rates for new entrants will permit them to energize and operate their facilities and help encourage future investment in Texas, the very purposes for which the new entrants were selected in the first place.

The first issue is associated with the need to allow WETT to pass along construction costs of its transmission lines prior to project completion. The Legislature has recognized that, given the costs involved in constructing CREZ facilities, new electric utilities, such as WETT, might need to begin earning a return on assets prior to project in service dates and has provided for utilities, such as WETT, to request that CWIP be placed in rate base.

The second issue relates to cost recovery of certain expenses which the Commission might otherwise deem unrecoverable because they are not known and measureable.

A. RATE BASE

Q. WETT'S PREFERRED REQUEST IS THAT IT BE PERMITTED TO INCLUDE CAPITAL INVESTMENTS THROUGH JUNE 30, 2012 IN RATE BASE IN THIS CASE AND THAT ADDITIONAL CAPITAL INVESTMENT BE INCLUDED IN AN UPCOMING TCOS PROCEEDING FILED BEFORE CERTAIN FACILITIES ARE CAPABLE OF PROVIDING SERVICE. DO YOU BELIEVE THIS REQUEST SHOULD BE GRANTED?

A. Yes. Typically, until a facility is completed, its costs are booked as CWIP, which is included in a utility's rate base only if the utility establishes that CWIP recovery is necessary for its financial integrity. However, the Legislature established a different standard for CREZ facilities, for which CWIP can be included in rate base "if conditions warrant" pursuant to PURA §§ 36.054 and 35.004(d). I believe that this new standard allows the Commission to address the unique ratemaking challenges facing CREZ new entrants such as WETT, and that its application is warranted here.[17]

Despite having statutory authority to do so, WETT's preferred approach does not ask that these costs be included in rates before the facilities are capable of providing service, like a traditional CWIP request. Instead, WETT is asking that these costs be

[17] In fact, this is essentially the arrangement reached by agreement in Docket No. 40020, the Lone Star rate case. *Application of Lone Star Transmission, LLC for Authority to Establish Interim and Final Rates and Tariffs*, Docket No. 40020, Agreement for the Procedural Processing of the Application in Docket No. 40020 at 1 (May 4, 2012). The parties in that case agreed not to oppose a request by Lone Star for a "good cause" exception to file an interim update of its transmission rates established in Docket No. 40020, pursuant to P.U.C. Subst. R. 25.192(h) ("Interim TCOS"). The good cause exception would allow Lone Star to include in its Interim TCOS filing the incremental original cost of plant investment in subsequent facilities, including Allowance for Funds Used During Construction ("AFUDC"). As I understand the Lone Star settlement, the "incremental original cost of plant investment in subsequent facilities" discussed in the settlement could be considered CWIP because it will be included in an interim TCOS proceeding filed before construction is complete on the facilities.

considered in the current rate case while the facilities are still under construction, with rates to be effective only when associated facilities are capable of providing service (at which time WETT's investment will transfer to a plant in service account). This is the approach that was taken in the Lone Star rate case. WETT asks that CREZ CWIP be included in rate base only if its preferred approach is not approved, in which case WETT has asked that its Phase II CWIP balance as of June 30, 2012, also be included in rate base.

Q. **WHAT IS CWIP?**

A. CWIP is construction work in progress, an accounting classification for fixed assets (such as a transmission line) which are under construction and not yet in service. While construction is ongoing, construction costs are booked to a CWIP account, which allows the utility to track costs for the facilities during their construction. Under most circumstances, costs reflected in the CWIP account are not included in rates until the project is complete or in service.

Q. **WHAT IS WETT REQUESTING TO INCLUDE IN RATE BASE AND WHY SHOULD THE COMMISSION GRANT THAT REQUEST?**

A. The Commission should allow WETT to include its capital investment through June 30, 2012, in its rate base for two reasons: (1) WETT is building CREZ facilities and the Legislature has indicated that the Commission should encourage the development of these types of transmission facilities and therefore apply a more favorable standard when deciding whether to include CREZ CWIP in rate base, and (2) WETT is a new entrant, so it faces ratemaking issues that incumbent utilities do not face—specifically, a lengthy process that might otherwise be required if WETT had to complete construction, file a rate case, and then obtain an approved tariff before energizing facilities.

The fact that WETT is building CREZ facilities means it can include CWIP in rate base "if conditions warrant" and does not need to show that CWIP is necessary to its financial integrity, which is otherwise the traditional test for CWIP inclusion under PURA § 36.054(a). Under both the CREZ CWIP and the traditional CWIP standard, WETT must establish that its project is not inefficiently or imprudently planned or managed in order to include attendant CWIP in rate base. PURA § 36.054(b). Under this statutory construct, WETT would be entitled to request inclusion of CWIP in rate base and immediately begin charging rates based on the return earned on that CWIP balance.

However, as I stated previously, WETT's preferred approach does not request that it earn a return on CWIP before its facilities are capable of providing service; it is merely requesting that its costs be assessed in this rate case before construction is completed, with rates effective when construction is complete. WETT only requests CWIP in rate base for recovery before certain facilities are completed if its preferred approach is not approved.

Given the CREZ CWIP standard and given that WETT is a new entrant and other new entrants have received similar treatment, I believe that conditions warrant the inclusion of WETT's prudently-managed investment in rate base. By allowing WETT to include capital investment through June 30, 2012, in its rate base, the Commission would enable WETT to have rates set and a tariff approved before its facilities are capable of providing service. This satisfies PURA's requirement that a utility is to have a tariff *before* providing service discussed in the previous section, and allows WETT's facilities to be placed into service expeditiously after they are completed.

Q. DO YOU HAVE ANY RECOMMENDATIONS IF THE COMMISSION DECLINES TO INCLUDE WETT'S CAPITAL INVESTMENT IN RATE BASE?

A. As I said, I believe that inclusion of that investment is warranted here, but if the Commission does not wish to permit WETT to include investment in rate base based on the CREZ CWIP standard, then I recommend that WETT be permitted to treat its investment as a post test-year adjustment.

PUCT Substantive Rule 25.231(c)(2)(F) contains the requirements in order to include known and measurable rate base additions as increases to historical test year data. Those requirements include: (a) the additions to WETT"s rate base would be recorded to FERC account 101 or 102; (b) the post test year addition is at least 10% of the requested rate base; (c) the plant addition is deemed by the Commission to be in-service before the rate year begins; and (d) the other impacts on such addition to rate base have been identified.

I believe WETT can satisfy all of these requirements. Its plant will be recorded to Account 101, electric plant in service, which includes the transmission plant accounts. The amount of rate base will be 100% of its requested rate base, given that WETT is a new entrant. The Commission will have the opportunity to deem the plant in service (or at least capable of providing service, given that it is a CREZ project). Finally, WETT has identified the attendant costs of including the plant in service, such as expenses and capital expenditures.

Q. WETT HAS ALSO ASKED TO INCLUDE ADDITIONAL INVESTMENT IN AN INTERIM TCOS UPDATE. WHAT IS THE REASON FOR REQUESTING APPROVAL IN A FUTURE INTERIM TCOS FILING?

A. WETT's preferred approach is to seek a good cause waiver to include investment in a future interim TCOS update. If WETT's waiver request for a future TCOS proceeding is denied, then WETT asks in the alternative that it be permitted to include CWIP in rate base in this case. Again, this request is only asked in the alternative in the event that WETT's preferred interim TCOS approach is not approved.

WETT should be permitted to include additional investment in a future interim TCOS update even if that update is filed before the attendant facilities are capable of providing service. Pursuant to PUCT Substantive Rule 25.192(h)(1), utilities are permitted to update their TCOS "twice per calendar year to reflect changes in invested capital." Under normal circumstances, this invested capital would include only plant in service. However, WETT has requested a good cause waiver of this rule to permit it to recover additional investment, even investment booked as CWIP at the time of filing, in a future interim TCOS filing. I believe that this waiver should be granted because WETT is making large transmission investments, and is having to file its rate case early to allow its investment and expenses to be litigated and rates set before its facilities are capable of providing service. This early filing date means that WETT had not accrued significant portions of its costs at the time of filing. In fact, as discussed in the testimony of Mr. Morton, WETT's Phase I facilities constitute less than 65% of WETT's total CREZ project, and WETT had not accrued even all of its costs associated with Phase I by June 30, 2012. This means that much of WETT's investment is excluded from this rate case and will need to be incorporated into rate base in another proceeding.

If WETT is forced to wait until its Phase II construction is complete before filing an interim TCOS update to include Phase II investment in its rate base, then WETT will suffer "regulatory lag" on Phase II investments that will likely exceed its rate base. Regulatory lag results when there is a significant gap between the time that costs are incurred and the time when the regulator permits recovery. A result of "regulatory lag" is that the utility permanently loses an opportunity to recover a return on its investment for the time period in question. In this case, "regulatory lag" will have a particularly severe impact on WETT because as a start up utility it is not currently earning a return on its investment for transmission lines under construction which require large capital expenditures.

I believe that much of this problem could be avoided by permitting WETT to incorporate additional incremental investment into a future interim TCOS update after this rate case even if those updates are filed before the associated facilities are complete. This would permit WETT to time its interim TCOS updates to be approved as Phase II becomes capable of being placed in service. In that manner, WETT could incorporate much of its remaining investment into rate base in a timely manner.

These facilities will be subject to prudence review and reconciliation at the utility's next rate case under PUCT Substantive Rule 25.192(h)(2). Due to this rule, I believe that rate payers are sufficiently protected. Even if WETT were permitted in an interim TCOS update to earn a return on investment that is later deemed imprudent and unrecoverable in a rate case, WETT would have to refund "any amounts…found to have been unreasonable or unnecessary, plus the corresponding return and taxes."[18]

Q. CAN YOU PLEASE SUMMARIZE YOUR THOUGHTS ON WETT'S REQUESTS FOR THE INCLUSION OF INVESTMENT THROUGH JUNE 30, 2012, IN RATE BASE?

[18] P.U.C. Subst. R. 25.192(h)(2).

A. The PUCT should permit WETT to include its investment through June 30, 2012, in rate base even to the extent that investment may be considered CWIP under the CREZ standard in PURA § 36.054 because WETT is constructing CREZ facilities. The Commission should allow this regulatory treatment because WETT is a new entrant, and allowing it to recover CWIP allows it to have a tariff in place before it begins providing service.

Further, the Commission should grant WETT a good cause waiver to allow the inclusion of additional investment in a future interim TCOS update, even if that update is filed while such investment is booked as CWIP. This is because WETT's Phase I capital investment requested in this application is not as large compared to the remaining Phase I and Phase II capital investment, which will be incorporated into rate base using interim TCOS filings. Often, an incumbent utility's interim TCOS filings involve rate base additions that are small and incremental when compared to its existing rate case. However, WETT's interim TCOS update will likely be comparatively large, making WETT particularly vulnerable to a permanent loss of a return on its capital due to regulatory lag. Allowing WETT to file its interim TCOS update while some of the included investment is booked as CWIP will mitigate much of the undue regulatory lag because WETT can charge the resultant rate shortly after the facilities are capable of providing service. At the same time, ratepayers are protected from imprudent costs, since interim TCOS updates are subject to reconciliation. In this instance, WETT would not charge rates resulting from this interim TCOS filing until the asset is capable of providing service. If such good cause waiver is not permitted, then the Commission should allow WETT to include CWIP in rate base in this case.

B. <u>DEFERRED ACCOUNTING TREATMENT</u>

Q. WHAT IS DEFERRED ACCOUNTING TREATMENT?

A. A deferred accounting order reflects a determination by the Commission that it is appropriate for a utility to defer expenses related to certain activities and record them as a regulatory asset for which recovery can be sought in a future rate proceeding.

Q. WHY IS WETT SEEKING A DEFERRED ACCOUNTING ORDER AS PART OF ITS RATE APPLICATION?

A. As discussed above, WETT has no current rates set by the PUCT since it is a new wholesale market entrant and therefore has no mechanism to allow it to recover the costs of operating its CREZ facilities once the facilities are capable of providing service.

To address type of situation, the Commission has previously allowed new transmission companies, such as Sharyland and ETT, to use a projected test year.[19] A projected test year allows the utility to seek rate recovery from the Commission on projected rather than historical expenses, as is the normal practice at the PUCT.

However, concerns have been expressed by the PUCT Staff[20] and some Commissioners[21] over whether the Commission had the authority to allow the use of projected test year.

---

[19] *Application of Sharyland Utilities L.P. to Establish Initial Rates and Tariff,* Docket 21591, Final Order (July 26, 2000); *Application of Electric Transmission Texas, LLC for Regulatory Approvals and Initial Rates,* Docket 33734, Order on Rehearing (December 21, 2007).

[20] See, e.g., *Application of Lone Star Transmission, LLC for Authority Establish Interim and Final Rates and Tariffs,* Docket 40020, Commission Staff's Initial Brief on Threshold and Legal/Policy Issues at 15 (March 2, 21012) ("In the absence of such an exceptional circumstance, PURA Section 36.051 and 36.053 prohibit the setting of rates based on projected invested capital rather than original cost.")

[21] See Commissioner Anderson's comments at the April 12, 2012 Open Meeting in Docket 40020, Tr. at 13 ("So with that in mind, I think our rules require an actual test year. Don't think we can use a future test year, or should, rather. There's been no actual application for a good cause exception filed, for example, And that's the only way we can do it because our rules, I think, clearly require a test year.").

Due to the recent uncertainty regarding the continued use of a projected test year, WETT is using data from a historical period in this case. WETT has adjusted this historic data, for known and measurable changes as permitted by PUCT Substantive Rule 25.231(a). However, in the event that any of its O & M expenses are not considered known and measurable changes, WETT is requesting deferred accounting for those expenses.

I believe that deferred accounting is appropriate because these expenses are being incurred to support a unique situation where WETT is seeking to establish its rates for the first time and, therefore, lacks data for certain expenses in its historical year needed to determine its operating costs going forward. Under this circumstance, deferred accounting treatment will afford the Company a reasonable opportunity for cost recovery, because such expenses are not contained in WETT's existing rates (because it has no rates).

Q. DOES THE COMMISSION HAVE AUTHORITY TO GRANT DEFERRED ACCOUNTING TREATMENT?

A. Yes. In *State v. Public Utility Commission of Texas*, the Supreme Court of Texas held that the Commission has statutory authority to employ deferred accounting when necessary to carry out the provisions of PURA.[22] In Docket No. 26942, the Commission cited the Supreme Court precedent for the proposition that it has express authority to provide for deferred accounting to implement PURA:

> The Texas Supreme Court held that PURA § 14.151 authorizes the Commission to order deferred accounting, if such deferred accounting is to implement another provision of PURA. The Court also held that PURA § 14.001 provides the Commission with the authority to regulate a utility's business and to do anything

[22] 883 S.W.2d 190, 196 (Tex. 1994).

implied in PURA that is necessary or convenient for the Commission's exercise of its power.[23]

As demonstrated below, the Commission has exercised its authority to employ deferred accounting in a variety of circumstances.[24]

Q. UNDER WHAT CIRCUMSTANCES HAS THE COMMISSION GRANTED DEFERRED ACCOUNTING TREATMENT IN THE PAST?

A. The Commission has exercised discretion when necessary to carry out the provisions of PURA.

For example, the Commission recently approved deferred accounting treatment in Docket No. 39240,[25] the LCRA Transmission Services Corporation ("LCRA") transmission case involving the Gillespie to Newton CREZ line. In that case, LCRA explained that it had expended funds on the line consistent with the Commission's desire to develop routes for certain high priority CREZ lines required to relieve transmission congestion from West Texas wind farms. While LCRA expended funds to route the line, the Commission ultimately decided to cancel the line and replaced it with a more cost-

[23] *Petition of Texas-New Mexico Power Company for Approval of Regulatory Asset Treatment of Expenses Related to System Benefit Fund Payments*, Docket No. 26942, Preliminary Order at 3 (Mar. 27, 2003).

[24] The Commission's authority to issue a deferred accounting order is not limited to cases where the financial integrity of the utility is at stake. In a recent case, the Commission explained that the financial integrity standard "is not appropriate for all circumstances and the Commission has applied different standards." *Application of Entergy Texas, Inc. For Authority To Change Rates, Reconcile Fuel Costs, And Obtain Deferred Accounting Treatment*, Docket No. 39896. Preliminary Order at 9 (November 11, 2011). See also, *Petition of EGSI for Approval of Regulatory Asset Treatment of Expenses Related to System Benefit Fund Payments*, Docket No. 24687, Order No. 3 (Jan. 3, 2002). The Commission's discussion of this item at the January 23, 2002 open meeting indicated support for the ALJ's determination:

> MS. LINGO: Before you is the certified issue by the Commission's ALJ from January 3, 2002. The question is, "What is the appropriate standard to apply when determining whether a regulatory asset should be created for a utility that seeks to create a regulatory asset for payments remitted in advance of assessing the system benefit fee?"
>
> COMM. KLEIN: Well -- and here, I think, as far as the standards go -- and, you know, I do see that, you know, we're not limited to only a financial integrity standard -- or I interpret it that way.

Transcript of Proceedings Before the PUCT, Docket No. 24687, Agenda Item No. 16 at Tr. 69.

[25] *Petition of LCRA Transmission Services Corporation for a Commission Determination that LCRA May Seek Cost Recover in the Future for Certain CREZ Related Costs*, Docket No. 39240, Order (June 6, 2011).

effective project. Nevertheless, Commission Staff recommended, and the Commission ordered, that LCRA be allowed deferred accounting treatment for the costs related to the cancelled line.

Similarly, in Docket No. 38339,[26] the most recent CenterPoint Energy Houston Electric LLC ("CenterPoint") rate case, the Commission allowed CenterPoint to accrue expenses related to future changes in Medicare reimbursement because those changes were too far into the future to be included in the current rate case. In this instance, the Commission's deferred accounting order preserved for future review a set of costs that would be incurred over a period of time, outside of the utility's test year, and which the utility would not otherwise have a reasonable opportunity to recover.

Finally, in Docket No. 26942, the Commission allowed Texas-New Mexico Power Company ("TNMP") to defer expenses related to the System Benefit Fund.[27] In that case, TNMP explained that it was required to make System Benefit Fund payments that were not contemplated at the time of its last rate case. The Commission allowed deferral of funds expended by TNMP since the expenditures were required by PURA but not reflected in TNMP's rates.

Q. **HOW DO THESE CASES SUPPORT WETT'S REQUEST FOR DEFERRED ACCOUNTING IN THIS SITUATION?**

A. These cases show that the Commission has exercised discretion to grant deferred accounting treatment in a number of different circumstances when necessary to carry out various provisions of PURA. As in those cases, WETT is proposing to defer expenses so

---

[26] *Application of CenterPoint Electric Delivery Company, LLC for Authority to Change Rates*, Docket No. 38339, Order at 9-10 and 31 (May 12, 2011).

[27] *Petition of Texas New Mexico Power Company for Approval of Regulatory Asset Treatment of Expenses Related to System Benefit Fund Payments*, Docket No. 26942, Order (Aug. 22, 2003).

that WETT will have a reasonable opportunity to recover those expenses. By allowing deferred accounting treatment, the Commission will be carrying out the Legislature's objectives.

Q. WHAT PURA PROVISIONS WILL BE CARRIED OUT BY GRANTING WETT's APPLICATION FOR A DEFERRED ACCOUNTING ORDER?

A. Granting WETT's request for deferred accounting is necessary to ensure that PURA §§ 36.051 and 36.003 are carried out.

Q. HOW DOES DEFERRED ACCOUNTING CARRY OUT THE PROVISIONS OF PURA §§ 36.051 AND 36.003?

A. Section 36.051 provides that utility rates must be sufficient to provide a utility with a reasonable opportunity to recover its reasonable and necessary operating expenses, as well as provide an opportunity to earn a reasonable return. Rates must meet these requirements, moreover, in order to be just and reasonable under PURA § 36.003. Given that WETT does not currently have rates in effect, deferred accounting will allow WETT to have a reasonable opportunity to recover costs for adjustments to its historic year that it would otherwise not have an opportunity to recover.

Q. IS DEFERRED ACCOUNTING NECESSARY TO CARRY OUT OTHER PROVISIONS OF PURA?

A. Yes. Deferred accounting is an appropriate means of carrying out the provisions of PURA relating to CREZ development. Fair regulatory treatment of CREZ new entrants sends a signal to the market that the PUCT is sensitive to the concerns of new investors. I believe this will carry out the Legislature's objectives of developing both a competitive wholesale electricity markets and renewable energy resources as a means of bolstering wholesale competition in the generation market.

VI. SUMMARY AND CONCLUSION

Q. GIVEN YOUR REVIEW OF WETT'S PRACTICES AND YOUR EXPERIENCE IN THIS INDUSTRY, PLEASE SUMMARIZE YOUR TESTIMONY.

A. First, I believe that WETT's affiliate contracts (specifically the ASAs, the CSA, and the EPC Contract) comply with the applicable legal and regulatory standards in PURA and the Commission's rules for affiliate transactions:

- Corporate support services under the ASAs cover ongoing functions that a utility would use in performing its regular utility functions and are provided to WETT at cost, consistent with traditional regulatory practice.
- Construction support services under the CSA and the EPC Contract cover one-time or non-recurring construction project functions that a utility would typically contract to a third party and pay market rates for such services.
- The CSA and the EPC Contract provided to WETT on a cost plus a fee basis comply with the legal requirements governing affiliate transactions because these services are provided to WETT at a cost lower than market and less than what I-USA would charge a non-affiliated party.
- Costs incurred by WETT under the agreements described above are reasonable and necessary, are no higher than what the affiliates would charge to independent third parties, and are fair, reasonable, and at or below market value.

Second, I conclude that PURA and Commission precedent require that a TSP such as WETT have a tariff in place and rates set before operating transmission facilities.

Finally, I believe that the Commission should exercise discretion to address certain ratemaking issues related to WETT's position as a new transmission company. The Commission should find that:

- WETT's request to include its Phase I capital investment through June 30, 2012, in rate base, to the extent that request may be considered a request to include CWIP in rate base, is consistent with the standard for CWIP associated with CREZ facilities and should be granted.

- In the alternative, WETT requests that its initial rates be set using actual Phase I capital costs as of June 30, 2012 included in rate base under the post-test year known and measurable adjustments incorporating appropriate costs for Phase I pursuant to P.U.C. SUBST. R. 25.231(c)(2)(F).

- WETT's request for a waiver to include investment that may be considered CWIP as part of an interim TCOS filing should be granted in order to minimize regulatory lag and to allow for timely recovery of WETT's initial investment in CREZ transmission infrastructure in Texas.

- In the alternative, WETT's request to include Phase II CWIP in rate base in this case is consistent with the CWIP standard for CREZ facilities and should be granted.

- WETT's request for deferred accounting treatment of its operating expenses, if necessary, is reasonable. Deferred accounting would carry out provisions of PURA that allow for a reasonable opportunity for cost recovery and Legislative mandates seeking to develop renewable energy resources and bring new entrants into the wholesale electric transmission market in Texas.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes. However, I reserve the right to make changes or corrections as necessary.

STATE OF TEXAS §

§

COUNTY OF Harris §

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

My name is Brett A. Perlman. I am of legal age and a resident of the State of Texas. The foregoing direct testimony and the attached exhibits offered by me are true and correct, and the opinions stated therein are accurate, true and correct.

Brett A. Perlman

SUBSCRIBED AND SWORN TO BEFORE ME by the said Brett A. Perlman this 18 day of August, 2012.

NOTARY PUBLIC
STATE OF TEXAS
PATRICIA GABRIELA SQUIER
My Commission Expires
[illegible]

Notary Public, State of Texas

THIS PAGE WAS LEFT BLANK INTENTIONALLY

EXHIBIT BAP-1

RESUME OF BRETT A. PERLMAN

Brett A. Perlman
5643 Del Monte Drive
Houston, TX 77056
Brett.Perlman@vectorconsultants.com

O: 713-933-8836
C: 281-686-1030

EXPERIENCE

VECTOR ADVISORS Houston, TX
President 2003 – present

General management consulting practice focused on advising senior executives and management teams on business strategy, product and strategic marketing, and merger and acquisition issues in the telecommunications and electric utility industries.

- **M&A advisory:** M&A advisory work includes strategy, due diligence and deal structuring activities for private equity and hedge funds. Representative projects include:
  - Advising two large private equity companies on the $39 billion acquisition of TXU, the largest LBO in history
  - Confidential due diligence project for a private equity company on a $10 billion electric utility acquisition
  - Market sizing and competitive analysis project for an energy services company on an acquisition for new market entry strategy
- **Utility business strategy:** Corporate strategy and marketing projects for utility companies, energy retailers, and independent power producers focused on helping clients build new businesses and enter new markets.
  - Retail energy market assessment for a utility seeking to enter into the ERCOT market
  - Designing a new product strategy for a UK-based retail electricity provider
  - Developing a customer valuation model for a large utility's retail business
  - Creating valuation models to assess retail market economics for a new market player interested in entering the Texas retail electricity market
  - Advising a private-equity funded acquirer of ERCOT generation assets on wholesale market issues
- **Clean energy business strategy:** Clean energy consulting projects with emerging companies including business strategy, new product development, and marketing and communications projects.
  - Assisting a private equity financed European power electronics company focused on entering U.S. renewables integration and solar inverter market
  - Advising a rapidly growing recently listed demand response provider with corporate development activities supporting a national expansion strategy
  - Assisting a renewable energy developer with RPS and project development issues in the ERCOT market

PUBLIC UTILITY COMMISSION OF TEXAS Austin, TX
Commissioner 1999 – 2003

Appointed by then-Governor George W. Bush to serve as one of three Commissioners of a large, high profile state agency (240 employees, $12 million annual budget) with oversight responsibility and regulatory authority for Texas' $4 billion telecommunications and $15 billion electric utility industries. (www.puc.state.tx.us)

Charged with leading a complex, multi-year industry restructuring process for the state's telecommunications and electric utility industries which has been widely recognized as one of the most successful electric utility industry restructuring in the U.S. Nationally recognized as an expert in electric utility industry and telecommunications issues.

- **Market Strategy**: Responsible for leading Commission-driven stakeholder processes to restructure Texas' electric utility and telecommunications industries.
    - **Texas Electric Choice Program**: Led the complex multi-year, multi-billion dollar market design and business process implementation process that resulted in the opening of the state's wholesale and retail electric utility industry to competition. Texas' restructuring efforts are widely acknowledged as the model for electric industry competition and have been recognized for:
        - Creating the nation's largest renewable energy market which has attracted investment from both domestic and international wind developers
        - Country's most dynamic and highly competitive retail electric markets which provide consumers with choice of new products and services
        - Most competitive wholesale electricity market which allowed utility and independent power producers led to invest more in Texas than anywhere in the U.S.
    - **Local telecommunications market opening**: Led the process for creating both retail and wholesale pricing structures that opened the Texas local telecommunications market to competition and created one of the most competitive telecommunications markets in the U.S.

- **Business Process Redesign:** Oversaw the creation of The Electric Reliability Council of Texas (ERCOT) www.ercot.com, a 400-person organization that manages Texas' power grid, and its implementation of the business processes that facilitate millions of daily transactions in the Texas electric market.

- **Leadership**: Provided strategic direction and executive leadership to a 240 employee organization and oversaw a $12 million annual budget.

- **Thought Leadership**: Developed and produced national conferences including *The National Summit on Broadband Deployment.* Author of several articles for *The Electricity Journal*, the leading policy journal for the U.S. electricity industry.

MCKINSEY & COMPANY, INC. Houston, TX
Consultant 1993 – 1999

McKinsey is the trusted advisor and counselor to many of the most influential businesses and institutions in the world. McKinsey provides consulting services to more than 70% of *Fortune* magazine's most admired list of companies. www.mckinsey.com

Provided strategic advice to senior executives of Fortune 500 companies. Specialized in information technology, telecommunications, and utility deregulation issues.

Selected accomplishments included:

- $600 million acquisition and partnership program for a leading PC manufacturer's entry into the internetworking product market
- $400 million acquisition strategy for national long distance telephone carrier's entry into the network management business
- Internet distribution strategy for a leading PC manufacturer that re-engineered its manufacturing process and distribution channel
- Market opportunity assessment for the leading natural gas trader to develop an innovative industry-wide electronic trading system
- Business strategy for a large five state electric utility to address electricity deregulation

LAW PRACTICE: Practiced as attorney with two nationally recognized law firms. Focused on litigation and administrative law before federal district and appellate courts and the U.S. Supreme Court including telecommunications, transportation, employment, and civil rights cases. Active in numerous pro bono activities including public housing and *guardian ad litem* cases.

JENKINS & GILCHRIST, Houston, TX 1989 – 1991
Practiced civil litigation and negotiation before state and federal courts including product liability, business tort, federal securities and contract law cases.

AKIN, GUMP, STRAUSS HAUER & FELD, Washington, DC 1985 – 1989
Founded in 1945 Akin, Gump is the 25th largest law firm in the United States (*The National Law Journal*, November 13, 2006) and ranks as a Global 50 Law Firm (*Practical Law Company*, February 2006) www.akingump.com

EDUCATION

HARVARD UNIVERSITY, Cambridge, MA
JOHN F. KENNEDY SCHOOL OF GOVERNMENT
Master of Public Administration 1993

UNIVERSITY OF TEXAS LAW SCHOOL, Austin, TX
Juris Doctor 1984

- **Texas Law Review,** *Associate Editor* 1983 – 1984
- **Texas Law Review,** *Member* 1982 – 1983
- **Teaching Quizmaster** 1983 – 1984

NORTHWESTERN UNIVERSITY, Evanston, IL
B.A. Economics 1981

- Graduated *Phi Beta Kappa* and in the top 10% of class
- Junior year abroad at University of Sussex, Brighton, U.K.

AFFILIATIONS

National Association of Regulatory Utility Commissioners, *Member Board of Directors*
Federal Communications Commission – National Association of Regulatory Utility Commissioners Joint Commission on Broadband Deployment, *State Member*
Texas Lyceum, *Director*
Leadership Houston, *Member Class XIV*

EXHIBIT BAP-1

List of Testimony Before Courts and Regulatory Bodies

Date	Party Supported	Case	Venue
2003	Wal-Mart	Feasibility of a Large User Access Program For Electric Service Choice	Arkansas PSC
2003	UTex Communications	UTex Communications Post Interconnection Dispute	PUCT
2005	Southwestern Bell	RLH v. Southwestern Bell	Federal District Court California
2006	PacificCorp	PacificCorp Holdings v. USA	Federal District Court Oregon
2008	PPM Energy	Coastal Habitat Alliance v. Jerry Patterson, et al.	State District Court Austin
2009	UTex Communications	Southwestern Bell Telephone LP v. UTex Communications	Federal District Court Austin
2009	City of Houston	CEHE's Storm Recovery Surcharge Case	PUCT
2010	City of Houston	CenterPoint Energy rate case	PUCT
2011	Entergy	Entergy Rate Case	PUCT

THIS PAGE WAS LEFT BLANK INTENTIONALLY

PUC DOCKET NO. 40606

APPLICATION OF WIND ENERGY	§	BEFORE THE
TRANSMISSION TEXAS, LLC	§	
FOR AUTHORITY TO	§	PUBLIC UTILITY COMMISSION
ESTABLISH INITIAL RATES	§	
AND TARIFFS	§	OF TEXAS

DIRECT TESTIMONY OF

J. KAY TROSTLE

ON BEHALF OF

WIND ENERGY TRANSMISSION TEXAS, LLC

AUGUST 2012

TABLE OF CONTENTS TO THE DIRECT TESTIMONY OF J. KAY TROSTLE, WITNESS FOR WIND ENERGY TRANSMISSION TEXAS, LLC

LIST OF EXHIBITS

Exhibit JKT-1	Resume of J. Kay Trostle
Exhibit JKT-2	Spreadsheet of Rate Case Expenses and Exceptions

LIST OF SCHEDULES

Schedule II-E-4.5	Rate Case Expenses

WORKPAPERS

Booz & Co.
Expergy
FINCAP, Inc.
Naman Howell Smith & Lee
Alliance Consulting Group
Smith Trostle & Huerta LLP
Vector Advisors
Duggins Wren Mann & Romero, LLP
Sussex Economic Advisors, LLC
R.W. Beck, Inc./SAIC

EXECUTIVE SUMMARY

At this time, Wind Energy Transmission Texas, LLC ("WETT") is seeking to recover total rate case expenses of $2,097,038. This number will change either in a severed Rate Case Expense Docket, or through supplemental filings if not severed from the Rate Case.

Based upon the complexity of issues, the scope of services provided, and the importance of this initial rate case for WETT, WETT's current request for reimbursement of $2,097,038 is reasonable. The hourly rates charged by the lawyers and consultants are within the range of reasonable rates for experienced counsel and consultants representing utilities before the Public Utility Commission of Texas. The number of attorneys and consultants within the various firms working on this matter at any given time was reasonable/minimized. The invoices accurately documented hours worked and services provided, except as noted. Disbursements that are subject to special scrutiny (e.g., hotels, valet parking, designer coffee, airfare, meals in excess of $25) were either nonexistent or, if reflected on the invoices, are noted as exceptions and WETT is not seeking recovery of those expenses.

The time spent by WETT and the total expenses incurred by the law firms and consultants is proportional to the efforts necessary to represent WETT's interest, given the complexity of the case and the total revenue at stake, and is reasonable.

DIRECT TESTIMONY OF J. KAY TROSTLE

I. INTRODUCTION AND QUALIFICATIONS

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

A. My name is J. Kay Trostle. I am a partner in the law firm of Smith Trostle & Huerta LLP (formerly Smith Trostle LLP from March 2006 to September 2011). My office address is 4401 Westgate Blvd., Suite 330, Austin, Texas 78745.

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

A. I am presenting testimony on behalf of Wind Energy Transmission Texas, LLC ("WETT" or the "Company").

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A: I received both a BA and a JD degree from the University of Texas. I was admitted to practice in Texas in 1979. I have focused on administrative law since 1981, and more specifically on utility law since 1986. I represent clients in administrative and regulatory litigation dealing with a wide array of utility matters. Since 1986 my practice has been primarily before the Public Utility Commission of Texas ("PUC" or "Commission"), Texas Commission on Environmental Quality ("TCEQ"), State Office of Administrative Hearings ("SOAH"), Railroad Commission of Texas ("Railroad Commission"), and the Electric Reliability Council of Texas ("ERCOT"). Beginning in 1986, while a hearings examiner at what was then called the Texas Water Commission (now TCEQ), and subsequently during my employment in the hearings division of the PUC from 1987 through 1995, and then at SOAH, where I was the Director of the Utility Division from September 1995 through

January 1997, I presided over numerous utility rate proceedings as a hearings examiner and subsequently as an administrative law judge. Since February 1997 I have represented clients in a number of major contested cases before the PUC, TCEQ, Railroad Commission, and SOAH. The utility cases in which I have been involved include major rate cases, complaint cases, certification matters, and commission inquiries. My resume is included as Exhibit JKT-1 to this testimony.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY TO THE COMMISSION?

A: Yes. I testified before this Commission as an expert witness on rate case expenses in the following cases:

(1) In PUC Docket No. 28813, SOAH Docket No. 473-04-3554, *Petition to Inquire into the Reasonableness of the Rates and Services of Cap Rock Energy Corporation*, I testified in support of Cap Rock Energy Corporation's rate case expenses (December 2004);

(2) I also prepared and filed testimony on behalf of Entergy Gulf States, Inc. ("EGSI") in PUC Docket No. 31544, SOAH Docket No. 473-06-0092, *Application of Entergy Gulf States, Inc. for Recovery of Transition to Competition Costs,* which settled prior to the convening of the hearing on the merits (August 2005).

(3) I testified on behalf of the Cities served by AEP Texas Central Company in PUC Docket No. 32758, *Application of AEP Texas Central Company for a Competition Transition Charge Pursuant to P.U.C. Subst. R. 25.263(n)* (August 2006).

(4) I testified on behalf of Cities in PUC Docket No. 33309, *Application of AEP Texas Central Company for Authority to Change Rates* and PUC Docket No. 33310 *Application of AEP Texas North Company for Authority to Change Rates* (March 2007).

(5) I was engaged by Xcel Energy to review Southwestern Public Service Company ("SPS")'s rate case expenses and present testimony on the utility's behalf in PUC Docket No. 35763, *Application of Southwestern Public Service Company Authority to Change Rates, to Reconcile Fuel and Purchased Power Costs for 2006 and 2007, and to Provide a Credit for Fuel Cost Savings*; however that case settled before I prepared testimony.