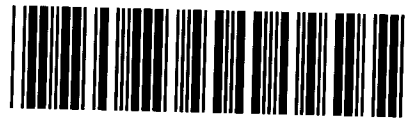


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SOAH DOCKET NO. 473-15-1556
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APPLICATION OF SOUTHWESTERN	§	BEFORE THE STATE OFFICE
PUBLIC SERVICE COMPANY FOR	§	OF
AUTHORITY TO CHANGE RATES	§	ADMINISTRATIVE HEARINGS

DIRECT TESTIMONY AND ATTACHMENTS

OF

STEVEN C. CARVER

ON BEHALF OF

ALLIANCE OF XCEL MUNICIPALITIES

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REVENUE REQUIREMENT

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SOAH DOCKET NO. 473-15-1556
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APPLICATION OF SOUTHWESTERN § BEFORE THE STATE OFFICE
PUBLIC SERVICE COMPANY FOR § OF
AUTHORITY TO CHANGE RATES § ADMINISTRATIVE HEARINGS

DIRECT TESTIMONY AND ATTACHMENTS OF STEVEN C. CARVER

TABLE OF CONTENTS

	<u>PAGE</u>
I. INTRODUCTION/SUMMARY	1
II. EDUCATION AND EXPERIENCE	2
III. SUMMARY RECOMMENDATION.....	3
IV. TEST YEAR.....	7
V. RATEMAKING ADJUSTMENTS	12
VI. POST-TEST YEAR ADJUSTMENT (AXM B-2 & C-6).....	13
VII. RATE CASE EXPENSE (AXM C-7).....	21
VIII. AMORTIZATION RESCHEDULING (AXM C-8).....	23
IX. LABOR COST ADJUSTMENT (AXM C-10)	25
X. INCENTIVE COMPENSATION (AXM C-11)	28
XI. DEPRECIATION ANNUALIZATION – AXM ACCRUAL RATES (AXM C-14)	41
XII. 2015 ACTIVE HEALTH CARE COSTS (AXM C-18).....	44
XIII. 2014 PENSION & OPEB COSTS (AXM C-19).....	46
XIV. PENSION ASSET (AXM B-4).....	49
A. Background Regarding Pension Accounting	56
B. Proposed SPS Approach	60

C.	Proposed AXM Approach.....	67
XV.	FAS106 & FAS112 LIABILITIES (AXM B-5)	77
XVI.	BASELINE COSTS (TCRF, DCRF & PCRF)	78
XVII.	CAPITAL STRUCTURE & COST RATES	81

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PUC DOCKET NO. 43695

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PUBLIC SERVICE COMPANY FOR § OF
AUTHORITY TO CHANGE RATES § ADMINISTRATIVE HEARINGS

DIRECT TESTIMONY AND ATTACHMENTS OF STEVEN C. CARVER

AXM ADJUSTMENT REFERENCE

<u>Section</u>	<u>AXM Adjustment Reference</u>
Post-Test Year Adjustment.....	B-2 & C-6
Rate Case Expense	C-7
Amortization Rescheduling.....	C-8
Labor Cost Adjustment.....	C-10
Incentive Compensation	C-11
Depreciation Annualization – AXM Accrual Rates.....	C-14
2015 Active Health Care Costs	C-18
2014 Pension & OPEB Costs.....	C-19
Pension Asset	B-4
FAS106 & FAS112 Liabilities	B-5

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**APPLICATION OF SOUTHWESTERN § BEFORE THE STATE OFFICE
PUBLIC SERVICE COMPANY FOR § OF
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DIRECT TESTIMONY AND ATTACHMENTS OF STEVEN C. CARVER

ATTACHMENTS

Attachment SCC-1	Summary of Qualifications
Attachment SCC-2	Summary of Previously Filed Testimony
Attachment SCC-3	AXM Joint Accounting Schedules
Attachment SCC-4	Historical Comparison of Pension Costs Included in Revenue Requirement
Attachment SCC-5 (p.1.)	Historical Analysis of Estimated Pension Costs Included in Revenue Requirement
Attachment SCC-5 (p.2.)	Comparison of Pension Costs in Rates & Pension Contributions
Attachment SCC-6	Key RFI Responses Relied Upon in Support of Direct Testimony

WORKPAPERS

Workpapers provided on CD.

APPLICATION OF SOUTHWESTERN § BEFORE THE STATE OFFICE
PUBLIC SERVICE COMPANY FOR § OF
AUTHORITY TO CHANGE RATES § ADMINISTRATIVE HEARINGS

I. INTRODUCTION/SUMMARY

A. Southwestern Public Service Company (hereinafter “SPS” or “Company”), a wholly owned subsidiary of Xcel Energy, Inc. (“Xcel Energy”), filed an application for a rate increase with this Commission,¹ contemporaneous with the filing of a Statement of Intent and Application for Authority to Change Rates with those municipalities who retain original jurisdiction over the Company’s tariff rates. Certain municipalities located in the service territory of SPS comprise a coalition identified as the Alliance of Xcel Municipalities (hereinafter “AXM”). AXM intervened in this proceeding before the Public Utility Commission of Texas (“Commission” or “PUC”) to represent the interests of those municipalities’ in the Company’s pending rate application. Utilitech was

1 retained by AXM to review and respond to the requested rate relief and to prepare direct
2 testimony addressing issues identified during the course of our review. Consequently, I
3 am appearing on behalf of AXM.

4 II. EDUCATION AND EXPERIENCE

5 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND**
6 **PROFESSIONAL EXPERIENCE IN THE FIELD OF UTILITY REGULATION?**

7 **A.** I graduated from State Fair Community College, where I received an Associate of Arts
8 Degree with an emphasis in Accounting. I also graduated from Central Missouri State
9 University with a Bachelor of Science Degree in Business Administration, majoring in
10 Accounting.

11 From 1977 to 1987, I was employed by the Missouri Public Service Commission
12 ("MoPSC") in various professional auditing positions associated with the regulation of
13 public utilities. In April 1983, I was promoted by the Missouri Commissioners to the
14 position of Chief Accountant and assumed overall management and policy
15 responsibilities for the Accounting Department. I provided guidance and assistance in
16 the technical development of Staff issues in major rate cases and coordinated the general
17 audit and administrative activities of the Department. In addition to my duties as Chief
18 Accountant, I was also appointed in July 1983 as Project Manager of the Missouri Staff's
19 audit of the construction costs of two nuclear generating stations owned by Missouri
20 utilities.

21 I commenced employment with the firm in June 1987. During my employment with
22 Utilitech, I have been associated with various regulatory projects on behalf of clients in
23 the States of Arizona, California, Florida, Hawaii, Kansas, Illinois, Iowa, Indiana,
24 Mississippi, Missouri, Nevada, New Mexico, New York, Oklahoma, Pennsylvania,
25 Texas, Utah, Washington, West Virginia and Wyoming. I have conducted revenue
26 requirement analyses and special studies involving various regulated industries (i.e.,

¹ *Application Of Southwestern Public Service Company For Authority To Change Rates*, Docket No. 43695, Statement of Intent, (Dec. 8, 2014).

1 electric, gas, telephone, water and steam). Additional information regarding my
2 professional experience and qualifications are summarized in Attachments SCC-1 and
3 SCC-2.

4 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY WITH THIS COMMISSION?**

5 A. Yes. This represents my fourth sponsorship of testimony filed with the Public Utility
6 Commission of Texas, all involving regulatory applications initiated by SPS.² In addition
7 and on behalf of various municipal clients, I have been actively involved in various
8 regulatory engagements concerning the regulated gas utility operations of Atmos Energy
9 Corp. before the Texas Railroad Commission.

10 **Q. PLEASE DESCRIBE HOW THE REMAINDER OF YOUR TESTIMONY IS**
11 **ORGANIZED.**

12 A. The remainder of my testimony is arranged by topical section, following the table index
13 presented previously. This index identifies the specific areas I address in testimony and
14 references the testimony pages as well as any related adjustment schedules I sponsor.

15 **III. SUMMARY RECOMMENDATION**

16 **Q. PLEASE SUMMARIZE THE PURPOSE AND CONTENT OF YOUR**
17 **TESTIMONY.**

18 A. Generally, my responsibilities in this docket encompassed the review and evaluation of
19 various elements of rate base and operating expense included within AXM's presentation
20 of overall revenue requirement. I also sponsor AXM's proposed net change in revenue
21 requirement of \$(13,570,117) (i.e., a proposed reduction) from current base rates, as set
22 forth in Attachment SCC-3, AXM's Joint Accounting Schedules.³

² Prior testimonies, all filed on behalf of AXM, include Docket Nos. 35763 (SPS general rate case), 37135 (SPS Transmission Cost Recovery Factor) and 41430 (SPS sale of transmission assets to Sharyland). I have also been involved in other SPS proceedings that were resolved by negotiated settlement prior to the filing of direct testimony on behalf of AXM.

³ Attachment SCC-3, AXM's Joint Accounting Schedules incorporate the jurisdictional allocation recommendation of AXM witness Mr. Clarence Johnson, the depreciation and amortization rate proposals of AXM witness Mr. Jack Pous and the capital structure and cost rates discussed by AXM witness Mr. David Parcell.

1 SPS originally requested the Public Utility Commission of Texas ("Commission" or
2 "PUCT") to authorize an increase in its base rates for the Texas retail jurisdiction in the
3 amount of \$64,746,197, which included a good-cause exception to P.U.C. SUBST. R.
4 25.231 ("Rule 25.231") allowing SPS to include in rate base new capital assets placed
5 into service between July 1, 2014 and December 31, 2014.

6 On March 2, 2015, SPS filed a Case Update (the "Case Update") to reflect actual plant as
7 of December 31, 2014 and other plant related changes, in lieu of its original "post-test
8 year" estimates. This Case Update filing reduced the rate increase sought by SPS in this
9 docket to produce a base rate increase of \$58,852,473.⁴

10 **Q. PLEASE IDENTIFY THE PRIMARY REASONS FOR THE LARGE**
11 **DIFFERENCE BETWEEN THE UPDATED INCREASE IN BASE REVENUE**
12 **SOUGHT BY SPS OF APPROXIMATELY \$58.8 MILLION AND THE MUCH**
13 **LOWER REVENUE RECOMMENDATION PROPOSED BY AXM.**

14 **A.** The AXM proposed revenue requirement is based upon a different and lower overall rate
15 of return recommendation (AXM witness Mr. Parcell); lower depreciation accrual rates
16 (AXM witness Mr. Pous); excludes the June 2015 reduction in firm capacity purchases
17 by Golden Spread Energy Cooperative, Inc. ("GSEC") from jurisdictional allocations
18 (AXM witness Mr. Johnson); and recognizes weather normalization and customer growth
19 adjustments (AXM witness Mr. Brosch). AXM also removed SPS's 2015 forecast of
20 active health care costs, excluded the post-test year wage increases, reversed SPS's post-
21 test year adjustment ("PTYA") request, excluded the prepaid pension asset from rate
22 base, rescheduled several amortization adjustments and excluded incentive compensation
23 costs which I sponsor. AXM's revenue requirement recommendation was calculated in a
24 manner consistent with established test year ratemaking practices of the Commission.

⁴ On March 2, 2015, SPS filed its Case Update in this docket Second Errata (i.e., *Southwestern Public Service Company's Case Update for Actual Plant as of December 31, 2014*). SPS updated and revised certain elements of the claimed revenue deficiency. AXM used the Company's updated revenue requirement as the starting point in the quantification of overall revenue requirement set forth in Attachment SCC-3.

The following table identifies the larger differences between the AXM-recommended revenue requirement⁵ and the amount proposed by SPS within its most recent Errata filing:

Description of Ratemaking Issue	Approximate Value (millions)
Rate of Return	\$(10.8)
Depreciation Accrual Rates	\$(13.3)
Jurisdictional Allocations (primarily GSEC)	\$(13.2)
Post-Test Year Adjustment-plant related	\$(12.1)
Rate Case Expense & Amortization Resch.	\$(5.6)
Pension Asset/FAS106 & FAS112 in Rate Base	\$(5.9)
Incentive Compensation	\$(3.2)
Other Property Taxes	\$(3.1)
Weather & Sales	\$(2.2)
Post-Test Year Wage Increases	\$(2.0)
2014 Pension & OPEB Costs	\$(1.2)
SPP Wheeling and Revenue Credits	\$3.9
Total	\$(68.7)

Schedule E contained in Attachment SCC-3, AXM's Joint Accounting Schedules, provides a more comprehensive reconciliation of the difference between the AXM revenue requirement and SPS's proposed Case Update.

Q. PLEASE EXPLAIN HOW ATTACHMENT SCC-3, THE AXM JOINT ACCOUNTING SCHEDULES, IS ORGANIZED.

A. Attachment SCC-3 is comprised of a series of jointly sponsored and integrated accounting schedules used to document the calculation of AXM's recommended revenue excess (or deficiency). AXM Schedule A, contained within Attachment SCC-3, summarizes the proposed change in Texas jurisdictional revenue requirement. Schedule

⁵ In addition to myself, the adjustments are presented by AXM witnesses include Messrs. Michael Brosch, James Dittmer, Jacob Pous, Dave Parcell and Clarence Johnson.

1 B summarizes Rate Base, Schedule C summarizes Operating Income and Schedule D sets
2 forth the Overall Cost of Capital.⁶ At page one of Attachment SCC-3, an Index lists all
3 of the adjustment schedules contained therein and identifies the AXM witness
4 responsible for and sponsoring the contents of each schedule.

5 AXM's recommended change in SPS's revenue requirement on Schedule A is quantified
6 by first multiplying AXM's proposed Rate Base by the overall rate of return proposed by
7 Mr. Parcell from Schedule D. Net Operating Expenses are then added to the "required"
8 operating income. The resulting Total Revenue Requirement is then compared to AXM's
9 proposed Revenue Credits and Revenue at Present Rates. The difference between these
10 figures represents the additional operating income and pretax revenues SPS needs to have
11 an opportunity to earn the recommended rate of return.⁷

12 AXM Rate Base Schedule B starts with the SPS-asserted⁸ Rate Base (in column C) and
13 then posts a series of AXM-proposed adjustments (in column D) to derive the AXM
14 proposed rate base. The remaining pages of Schedule B compile each of the adjustments
15 to rate base that are sponsored by the identified AXM witness. For example, AXM
16 Adjustment/Schedule B-2 adjusts SPS's rate-base to reverse the Company's proposed
17 Post-Test Year Adjustment, as discussed in a subsequent testimony section. AXM
18 witnesses may refer to their adjustments by indicating the Joint Accounting "Schedule"
19 number (e.g., B-1, B-2, etc.) or by simply referring to AXM Adjustment B-2.

20 AXM's Operating Income Schedule C starts with the SPS-asserted Operating Income (in
21 column C) and then posts a series of AXM-proposed adjustments (in column D) to derive
22 the AXM recommended Operating Income. The remaining pages of Schedule C compile
23 and sum the individual AXM-proposed operating income adjustments, which are
24 sequentially arranged as Schedules C-1 through C-20, with the sponsoring witness

⁶ The amounts on AXM Schedules B, C and D are presented on a Total SPS basis. Throughout this testimony all general references to AXM Schedules A through E are intended to refer to those schedules contained within the AXM Joint Accounting Schedules set forth in Attachment SCC-3.

⁷ AXM Schedule A is presented in the same format as page 1 of Attachment DAB-RR-2 sponsored by SPS witness Ms. Deborah A. Blair.

⁸ The starting point for the AXM rate base and operating income schedules is SPS's Case Update filing, as noted previously.

1 identified at the top of each Schedule and on the Index. Notably, each AXM-proposed
2 operating income adjustment is quantified on the identified supporting schedule.

3 Schedule D summarizes and compares the overall cost of capital and rate of return
4 recommended by SPS to the comparable values proposed by AXM witness Parcell.
5 Finally, Schedule E reconciles the overall difference in Texas retail revenue requirement
6 being recommended by AXM, in comparison to the SPS Case Update Errata. Schedule E
7 addresses all known differences including the cost of capital, rate base and operating
8 income issues.⁹

9 IV. TEST YEAR

10 **Q. PLEASE BRIEFLY DESCRIBE THE TEST YEAR APPROACH USED IN THIS**
11 **PROCEEDING.**

12 A. SPS employed a historical test year based on the twelve months ending June 2014¹⁰ and
13 made various adjustments to the Total Company “per-book accounting information”,
14 which are generally referenced as accounting adjustments, Commission required
15 adjustments, and pro forma adjustments to quantify overall revenue requirement.¹¹

16 For ratemaking purposes, it is typically necessary and appropriate to adjust per book test
17 year revenue, expense and rate base amounts to remove out-of-period or abnormal items.
18 Further it is appropriate to recognize Commission ordered eliminations or directives, and
19 to consistently reflect known and measurable events occurring through a finite time
20 period (e.g., within the test year and/or within an established known measurable period
21 following the end of the test year). The general approach to the identification and
22 quantification of various ratemaking adjustments should consistently balance the various

⁹ It should be noted that AXM has integrated the Company’s jurisdictional model allocation detail (*see* SPS witness Blair Attachment DAB-RR-2, Case Update) into the AXM revenue requirement model comprising the Joint Accounting Schedules reflected in Attachment SCC-3. Due to the voluminous nature of this detailed information, Attachment SCC-3 does not include a printout of the pages comparable to Attachment DAB-RR-2. However, all calculations including the posting of AXM adjustments and jurisdictional allocations are included in the spreadsheet file (“AXM Rev Rqmt Attach SCC-3.xlsx”) from which Attachment SCC-3 was printed.

¹⁰ The “test year” employed by SPS in this case is the twelve-month period from July 1, 2013 through June 30, 2014. *See* the direct testimony of SPS witness Blair at page 11.

¹¹ *See* SPS witness Blair direct at 17-18.

1 elements of the ratemaking equation and capture material changes in the overall cost of
2 providing utility service through a specified date or period. This is true regardless of the
3 specific test year selected. AXM recommends that known and measurable changes
4 should be consistently recognized and limited to the test year (i.e., through June 2014),
5 plus only those post-test year changes typically and regularly allowed by the
6 Commission.

7 **Q. PLEASE EXPLAIN YOUR REFERENCE TO BALANCING THE VARIOUS**
8 **ELEMENTS OF THE RATEMAKING EQUATION.**

9 A. It is neither possible nor desirable to employ a stringent or mechanical method or
10 approach to quantify each element of the ratemaking equation (i.e., rate base, revenues,
11 expenses, capital costs, etc.). The techniques employed to determine the ongoing level of
12 revenues and expenses must be unique to the facts and circumstances underlying each
13 element because the overall revenue requirement is comprised of various dissimilar
14 elements. Rather, the test year approach should be balanced and consistently applied to
15 the various ratemaking elements. That way the resulting revenue requirement contains
16 minimal quantification distortions.

17 **Q. WHY IS THE SELECTION AND BALANCED ADJUSTMENT OF A TEST**
18 **YEAR IMPORTANT IN THE DETERMINATION OF JUST AND REASONABLE**
19 **UTILITY RATES?**

20 A. The ratemaking equation commonly employed by this Commission, and other regulatory
21 agencies, compares a required return on rate base to the investment return generated by
22 adjusted test year operating results. If the return indicated by the adjusted operating
23 results (i.e., adjusted test year operating income and rate base) is deficient, an increase in
24 revenues is required to provide the utility an opportunity to earn a “reasonable” return on
25 its investment. Conversely, an excessive return would support a reduction in utility
26 revenues and rates.

27 For the ratemaking equation to function properly and produce reasonable utility rates, the
28 components comprising the equation (i.e., rate base, revenues, expenses, and rate of
29 return) must be reasonably representative of ongoing levels, internally consistent and
30 comparable – within the context of test period parameters. To the extent that these

1 components are not reasonably synchronized, a utility may not have the opportunity to
2 earn its authorized return or, alternatively, may have the opportunity to earn in excess of
3 the return authorized. By synchronizing or maintaining the comparability of revenues,
4 expenses and investment, the integrity of the test year can be maintained with the
5 reasonable expectation that the resulting rates will not significantly misstate the ongoing
6 cost of providing utility service.

7 Consequently, it is critical that the ratemaking process properly synchronize only those
8 known and measurable changes which occur during the test year or within a reasonable
9 allowable period subsequent thereto, rather than establish utility rates on inappropriate
10 factors or inconsistent post-test year events. In this manner, regulators can best be
11 assured that rates are reasonably based on ongoing, relative cost levels.

12 **Q. COULD YOU EXPLAIN THE CONCEPT OF “KNOWN AND MEASURABLE”**
13 **CHANGES, AS THE COMPANY HAS APPLIED THAT CONCEPT IN THE**
14 **CURRENT FILING?**

15 A. Yes. In general terms, the recognition of changes or adjustments to test year rate base
16 and operating income should be consistently applied and limited to items that are fixed,
17 known and measurable for ratemaking purposes. In my opinion, the following definition
18 or explanation of the “known and measurable” concept, as commonly applied in utility
19 ratemaking, is consistent with past Commission practice:

20 **Known and measurable changes** – transactions or events that are:

21 (a) Fixed in time. A qualifying transaction or event must be “fixed” within the test
22 year or within the specified period following the test year – for example, through
23 June 2014.

24 (b) Known to occur. The transaction or event must be “known” to exist, in contrast
25 with possible, uncertain or speculative changes.

26 (c) Measurable in amount. The financial effect of the transaction or event can be
27 “measured” or accurately quantified.

28 In this context, a transaction or event should only be considered known and measurable if
29 it has been agreed to by contract or commitment, can be verified to have occurred within
30 the specified time period, is reasonable in amount and can be quantified employing
31 reliable data.

1 SPS has not presented an internally consistent approach to the test year. This has led to a
2 material overstatement in the amount of rate relief the Commission should find
3 reasonable in this proceeding. Examples of the inconsistent elements of SPS's filing
4 include:

- 5 • Major elements of rate base are based on December 2014 levels (i.e., based on the
6 Company's PYTA waiver request). However, SPS maintained retail customers
7 and constrained weather normalized sales at average test year levels without
8 adjusting for growth occurring during or subsequent to the test year. [AXM
9 witness Mr. Brosch discusses customer growth and weather normalization.]
10 Further, SPS failed to properly synchronize SPP Schedule 11 revenue credits
11 related to SPS's investment in transmission plant that it proposes to reflect with a
12 December 31, 2014 rate base valuation. [AXM witness Mr. Dittmer addresses
13 SPP Schedule 11 wheeling charges and revenue credits.]
- 14 • SPS proposed to annualize payroll expense to reflect wage rate increases
15 estimated or expected to be effective after the test year (i.e., November 2014 and
16 March 2015). SPS also adjusted health care costs to recognize 2015 forecast
17 levels while freezing pension and OPEB costs at test year levels even though the
18 2014 actuarial studies were lower. [Addressed in a subsequent testimony
19 section.]
- 20 • SPS proposed to recognize SPP Schedule 11 revenue credits and wheeling
21 charges that, in part, reach well into 2015. [AXM witness Mr. Dittmer.]
- 22 • SPS proposed to reach out to early to mid-2015 for changes in contact
23 arrangements (e.g., purchased power terms, SPP Schedule 1a fees, Lamar DC Tie
24 demand charges, point-to-point transmission revenues, etc.) without similarly
25 recognizing other offsetting changes (i.e., growth in retail customers). [AXM
26 witnesses Messrs. Dittmer and Brosch.]
- 27 • SPS proposed to increase the allocation of test year costs to Texas retail
28 customers by recognizing in isolation a 200 MW reduction in GSEC firm
29 purchases effective June 1, 2015. [AXM witness Mr. Johnson.]

30 It is not uncommon for regulatory commissions to recognize or annualize transactions
31 occurring within, or subsequent to, the historical test period for verifiable, yet balanced,
32 changes, which would materially impact a utility's future earnings. However, it is also
33 true that parties often differ on whether such transactions are consistent with commission

1 rules or practices, whether offsetting factors have been appropriately considered and how
2 far outside the test year it may be appropriate to reach for changes. In my opinion, the
3 recognition of known and measurable changes must be reasonably balanced or matched
4 with offsetting factors. Otherwise, a distorted view of the cost of service will lead to
5 improper rate adjustments contrary to regulatory policies and rules. To achieve this
6 balance it is necessary to consistently match both price and quantity changes, particularly
7 when volume changes, during or subsequent to the test year, offset price level changes.
8 The AXM adjustments improve test year balance, consistent with PUCT rules, that is
9 distorted by SPS's approach.

10 **Q. BASED ON YOUR REGULATORY EXPERIENCE, IS IT REASONABLE TO**
11 **EXPECT THAT CHANGES OCCURRING SUBSEQUENT TO A RATE CASE**
12 **TEST YEAR WILL AUTOMATICALLY PUT UPWARD PRESSURE ON THE**
13 **COST OF PROVIDING UTILITY SERVICE?**

14 **A.** No. It may be anticipated that the passage of time may result in increasing expenses (and
15 investments), during periods of even modest inflation. As a result, the recognition of
16 various revenue/expense annualization and/or normalization adjustments might be
17 expected to consistently yield higher revenue requirements. However, revenue trends,
18 productivity gains and reductions in certain operating expenses may offset the
19 presumption of a generally increasing cost of service. Some utilities have been
20 successful in avoiding base rate increases for extended periods of time because favorable
21 and unfavorable revenue requirement influences can offset one another for many years.

22 All components of the ratemaking equation change over time. Consistent analysis of the
23 major cost of service components must be made to determine whether the overall revenue
24 requirement has changed materially. The key issue is whether revenues are growing
25 faster or slower than the overall costs necessary to support those revenues.

1 V. RATEMAKING ADJUSTMENTS

2 Q. PLEASE IDENTIFY AND DESCRIBE THE RATEMAKING ADJUSTMENTS
3 YOU SPONSOR.

4 A. The following outline identifies and describes the ratemaking adjustments that I sponsor.
5 Each adjustment/schedule¹² is located within Attachment SCC-3 as previously discussed:

- 6 • **Post-Test Year Adjustment:** Reverses SPS's PTYA request from rate base and
7 operating expense. (AXM Adjustments B-2 and C-6; AXM witness Mr. Dittmer
8 reverses the related property taxes in AXM Adjustment C-12; AXM Adjustment
9 C-14 annualizes depreciation based on depreciable/amortizable investment at June
10 30, 2014)
- 11 • **Rate Case Expense:** Removes SPS's estimated rate case expense for the present
12 docket, provide recovery for unamortized rate case expense from the last rate
13 proceeding and extend SPS's amortization term from one year to two years.
14 (AXM Adjustment C-7) [Rate case expenses for this proceeding, Docket No.
15 43695, have been severed-out into another docket. See SOAH Order No. 6 (Mar.
16 9, 2015).]
- 17 • **Amortization Rescheduling:** Reschedules the Company's proposed one year
18 amortization of the pension/OPEB regulatory asset and SPS's proposed
19 termination of the amortization of the gain on sale of assets to Lubbock Power &
20 Light. Both of these items are proposed to be amortized over two years. (AXM
21 Adjustment C-8)
- 22 • **Labor Cost Adjustment:** Removes SPS's proposed post-test year wage
23 increases. (AXM Adjustment C-10)
- 24 • **Incentive Compensation:** Removes financial based incentive compensation
25 from test year operations and maintenance expense.¹³ (AXM Adjustment C-11)
- 26 • **Depreciation Annualization – AXM Accrual Rates:** Annualizes book
27 depreciation expense based on the recommended accrual rates sponsored by AXM
28 witness Mr. Pous applied to depreciable/amortizable investment at June 30, 2014.
29 (AXM Adjustment C-14)

¹² In referring to the individual AXM adjustments sponsored herein, the words "adjustment" and "schedule" may be used interchangeably. For example, any reference to Adjustment B-4 or Schedule B-4 is to the same document contained within Attachment SCC-3.

¹³ Operations and maintenance expense accounts will generally be referred to as "O&M" expense accounts.

- 1 • **2015 Active Health Care Costs:** Reverses the effect of the 2015 forecast amount
2 in excess of SPS's revised test year actual amount. (AXM Adjustment C-18)
- 3 • **2014 Pension & OPEB Costs:** Revises the test year amounts for pensions and
4 retiree medical expense to reflect the 2014 actuarial study results prepared by
5 Towers Watson. (AXM Adjustment C-19)
- 6 • **Pension Asset:** Eliminates SPS's inclusion in rate base of the pension asset, net
7 of related accumulated deferred income tax ("ADIT") reserves. (AXM
8 Adjustment B-4)
- 9 • **FAS106 & FAS112 Liabilities:** Removes the liability balances for these items
10 from rate base, net of offsetting ADIT reserve balances, for consistency with the
11 elimination of the pension asset from rate base. (AXM Adjustment B-5)

12 In addition to these adjustments, which are discussed in more detail in subsequent
13 testimony sections, I am also responsible for coordinating the incorporation of AXM
14 witness Mr. Johnson's jurisdictional allocation recommendations into AXM's revenue
15 requirement model as depicted by Attachment SCC-3.

16 **Q. PLEASE GENERALLY DESCRIBE THE CONTEXT OF THE RATEMAKING**
17 **ADJUSTMENTS YOU SPONSOR.**

18 A. The focus of AXM's direct testimony has been redirected to the Company's Case Update
19 filing, which serves as the starting point for AXM's revenue requirement presentation.¹⁴
20 AXM's adjustments focus on the Case Update because calculations underlying the
21 Company's original filed revenue requirement have changed.

22 **VI. POST-TEST YEAR ADJUSTMENT (AXM B-2 & C-6)**

23 **Q. YOU PREVIOUSLY INDICATED THAT YOU WERE SPONSORING**
24 **ADJUSTMENTS TO REVERSE SPS'S PROPOSED POST-TEST YEAR**
25 **ADJUSTMENT. IS THAT THE PURPOSE OF AXM ADJUSTMENTS B-2 AND**
26 **C-6?**

27 A. Yes. In addition to AXM Adjustments B-2 and C-6 (Attachment SCC-3),¹⁵ Mr. Dittmer
28 is sponsoring an adjustment (AXM Adjustment C-12) that, in part, reverses certain

¹⁴ SPS's Case Update was filed with the Commission on March 2, 2015.

¹⁵ Hereinafter, all references to a specific AXM adjustment or schedule number will be to Attachment SCC-3, the AXM Joint Accounting Schedules.

1 property taxes related to SPS's requested Post-Test Year Adjustment ("PYTA") waiver.
2 AXM Adjustment C-14 also annualizes depreciation and amortization expense based on
3 actual depreciable/amortizable investment at June 30, 2014. These AXM adjustments are
4 intended to fully reverse the PTYA.

5 AXM's approach to quantifying revenue requirement has been carefully crafted to
6 comply with the Commission's rules and general practices. To sustain the exceptional
7 relief sought by SPS's PTYA waiver request, I believe that the Company should be
8 required to present significantly more information to demonstrate the impact of the
9 requested relief on its financial integrity and establish that absent such relief SPS would
10 be in dire financial condition.

11 **Q. PLEASE SUMMARIZE SPS'S PTYA WAIVER REQUEST.**

12 A. As discussed by SPS witness Mr. Evans, "SPS is seeking two good-cause exceptions
13 related to that [sic] the PTYAs for invested capital."¹⁶ Rule 25.231(c)(2)(F)(i) explicitly
14 provides an opportunity for consideration of a PTYA "for known and measurable rate
15 base additions (increases) to historical test year data" as specified within subclauses (I)-
16 (IV) of that Rule.

17 The first waiver relates to the requirement of Rule 25.231(c)(2)(F)(i)(II) that "each
18 capital addition comprises at least 10% of the electric utility's requested rate base,
19 exclusive of post test year adjustments and CWIP." The second waiver is "to the
20 requirement in Rule 25.231(c)(2)(F)(ii)(I) that the PTYA be included in rate base at the
21 reasonable test-year-end CWIP balance."¹⁷

22 Basically, SPS is seeking these waivers because none of the individual capital additions it
23 proposes to include in rate base, as part of the PTYA, meet the 10% threshold and,
24 further, some of the capital projects included within the test year-end CWIP balance may
25 not have included any amount for capital projects completed by December 31, 2014.

¹⁶ See Direct Testimony of Mr. Evans at 51-55.

¹⁷ *Id.*

1 Mr. Evans observes that "...the anomaly in the PTYA rule that fails to address the
2 situation that SPS's post-Test Year rate base has increased by 17%, but no single project
3 is 10% of rate base, and the effect of regulatory lag on a utility in the midst of a major
4 construction cycle...". I was certainly not involved in the process surrounding the
5 implementation of the PTYA Rule, but firmly believe that the 10% threshold is not an
6 anomaly at all – rather, it was the Commission's intent to restrict PTYA treatment to only
7 very large individual capital projects. Otherwise, Rule 25.231(c)(2)(F)(i)(II) could have
8 easily excluded any individual project limitation whatsoever.

9 In support of the waiver requests, Mr. Evans states that SPS is in the midst of a major
10 construction cycle, that regulatory lag associated with these completed construction
11 projects is having an adverse effect on SPS's financial wherewithal, and that the
12 investment in these projects need to be included in rate base as PTYAs to avoid impairing
13 the Company's financial integrity.¹⁸

14 **Q. HAS SPS SOUGHT COMMISSION APPROVAL TO INCLUDE CWIP IN RATE**
15 **BASE OR FOR SOME FORM OF DEFERRAL ACCOUNTING, IN LIGHT OF**
16 **THE FINANCIAL IMPAIRMENT REFERENCED BY MR. EVANS?**

17 A. No. In response to Texas Industrial Energy Consumers' ("TIEC") Request for
18 Information ("RFI") No. 1-10 (i.e., TIEC RFI 1-10, *see* Attachment SCC-6), SPS offered
19 the following explanation:

20 SPS is not asking the Commission to include CWIP in rate base because
21 PURA § 36.054 states, "The inclusion of construction work in progress is
22 an exceptional form of rate relief that the regulatory authority may grant
23 only if the utility demonstrates that inclusion is necessary to the utility's
24 financial integrity." In SPS's view its request for good cause exceptions
25 to include six additional months of capital additions in rate base is less
26 exceptional than an exception for CWIP in rate base.

27 SPS is not seeking to engage in deferral accounting because SPS believes
28 its approach better matches the timing of costs and the recovery of those
29 costs, and is a better remedy to addressing regulatory lag. Moreover,

¹⁸ *Id.*

1 deferred accounting does not provide assurance that the deferred amounts
2 will be recovered in rates.

3 I find it quite instructive that PURA § 36.054 defines CWIP inclusion as “an exceptional
4 form of rate relief” that may be granted “only if the utility demonstrates that inclusion is
5 necessary to the utility’s financial integrity.” In general terms, capital projects that are
6 recorded as CWIP are certainly not providing utility service until such time as the work is
7 completed and facilities are in-service and operational. However, many capital projects
8 have relatively short construction time (i.e., unlike major production facilities that may
9 take years to plan, design and construct) that could be in CWIP at June 30, 2014, or
10 started subsequent thereto, but recorded as plant-in-service at December 30, 2014.

11 Further, the exceptional inclusion of CWIP in rate base, even though not sought by SPS,
12 would offer an added benefit to ratepayers that the PTYA waiver does not. That is, the
13 inclusion of CWIP in rate base would produce a current return on investment in exchange
14 for the cessation of carrying costs (i.e., the allowance for funds used during construction
15 or “AFUDC”) that would no longer be capitalized to those capital projects. While
16 exchanging a current return (via rate base inclusion) for a deferred return (AFUDC) on
17 CWIP should only be considered when dire financial conditions have no acceptable
18 alternative remedies, ratepayers would benefit from the avoided AFUDC in future rate
19 cases.

20 I would encourage the Commission to apply a no less stringent criteria to SPS’s PTYA
21 waiver request for plant-in-service, as the Commission does for the rate base inclusion of
22 CWIP. Thus far, I have seen no showing or demonstration of the effect of the requested
23 PTYA on SPS’s financial integrity.

24 **Q. DO YOU BELIEVE THAT SPS HAS SUFFICIENTLY DEMONSTRATED THAT**
25 **THE WAIVER REQUESTS SHOULD BE APPROVED BY THE COMMISSION?**

26 A. No. The Company’s testimony was brief on this subject but the PTYA represents the
27 largest single element of the Company’s requested rate increase. As I indicated
28 previously, the Company’s original filing supported a rate increase of about \$64,746,197.
29 In response to TIEC RFI 2-11 (*see* Attachment SCC-6), SPS stated that the “Texas retail

1 revenue impact from removing the post-Test Year plant additions and related adjustments
2 is a reduction of \$29,666,626.” Based on this Company-provided information, the PTYA
3 good-cause waiver would represent 45.8% of the increase proposed in the Company’s
4 initial filing.

5 **Q. WHAT DO YOU MEAN THAT THE COMPANY’S TESTIMONY WAS BRIEF?**

6 A. Mr. Evans is the principal Company witness presenting and supporting the PTYA waiver
7 request, which SPS claims to comprise \$29.7 million of its original rate increase
8 request.¹⁹ Table EDE-RR-7²⁰ does identify other SPS witnesses whose direct testimony
9 touch the PTYA issue, but those testimonies involve the related attendant effects, and
10 cites to SPS Schedule B-1.4 which represents a two page summary of the PTYA on the
11 Company’s direct filing. Basically, the primary support for the unique PTYA waiver
12 proposed by SPS that supports nearly half of its requested rate increase, is contained
13 within five pages of testimony provided by Mr. Evans.

14 **Q. IN FORMING THE BASIS FOR ITS PTYA WAIVER REQUEST, IS SPS**
15 **AWARE OF ANY PRECEDENT FOR THE PUCT GRANTING SUCH A**
16 **REQUEST?**

17 A. No.²¹

18 **Q. HAS SPS EVER PREVIOUSLY SOUGHT A GOOD-CAUSE EXCEPTION TO**
19 **THE PTYA RULE?**

20 A. No. This is the first case in which SPS has made such a request.²²

21 **Q. IS SPS AWARE OF ANY TEXAS UTILITY SEEKING A GOOD-CAUSE**
22 **EXCEPTION TO THE PTYA RULE?**

23 A. No.²³

¹⁹ *Id.*

²⁰ *Id.* at 55.

²¹ The SPS responses to AXM RFIs 10-1, 10-2 and 10-3 state, in part, that “SPS has not investigated whether any party has ever requested a good cause exception...and, if so, how the Commission ruled on that request...” Also, *see* the SPS responses to OPL RFI 2-10 and TIEC RFI 6-3. *See* Attachment SCC-6 for these discovery responses.

²² *See* the SPS response to AXM RFI 10-4 (*see* Attachment SCC-6).

1 Q. HAS SPS EVALUATED OR SPECIFICALLY QUANTIFIED THE EFFECT THE
2 REQUESTED GOOD-CAUSE EXCEPTION TO THE PYTA RULE WOULD
3 HAVE ON THE FINANCIAL INTEGRITY OF SPS AND XCEL ENERGY?

4 A. No.²⁴ However, SPS's response to AXM RFI 10-6 does refer to the direct testimony of
5 SPS witness Ms. Mary Schell regarding regulatory agency concerns with regulatory lag
6 and potential credit rating pressure, but no financial integrity quantification or
7 demonstration has been presented by the Company.

8 Q. REFERRING TO SPS'S CASE UPDATE FILED ON MARCH 2, 2015, WHAT IS
9 THE ACTUAL AMOUNT OF ADDITIONAL PLANT SPS HAS PROPOSED TO
10 INCLUDE IN RATE BASE?

11 A. AXM Adjustment B-2 provides a breakdown of the PTYA related plant investment,
12 accumulated depreciation and accumulated deferred income tax reserves. The following
13 table summarizes the Company's PTYA proposed plant additions on a Total SPS basis,
14 excluding New Mexico direct distribution plant:

	PYTA Plant (excl. NM Distr.)	Percentage
Intangible Plant	\$ 18,074,120	5.47%
Steam Production	13,086,703	3.96%
Other Production	271,506	0.08%
Transmission	300,134,871	90.84%
Distribution Plant – TX	(18,166,004)	-5.49%
General Plant	16,988,475	5.14%
Total	<u>\$ 330,389,672</u>	<u>100.00%</u>

15 Over 90% of the PTYA plant additions are attributable to transmission plant. Depending
16 on the nature and function of the underlying transmission projects, SPS may receive
17 immediate compensation from other members of the Southwest Power Pool ("SPP") that

²³ See the SPS response to AXM RFI 10-5 (see Attachment SCC-6).

²⁴ See the SPS responses to AXM RFI 10-6 and OPL RFI 2-12 (see Attachment SCC-6).

1 would provide for recovery of depreciation expense, operations and maintenance
2 expense, and a return on such transmission plant investment between rate cases.²⁵

3 **Q. AT PAGE 27 OF HIS DIRECT TESTIMONY, MR. EVANS IDENTIFIED**
4 **CAPITAL EXPENDITURES AS ONE OF THE MAJOR COST PRESSURES**
5 **CAUSING SPS TO FILE THIS RATE CASE. ARE YOU CONTENDING THAT**
6 **SPS HAS NOT MADE OR WILL NOT CONTINUE TO MAKE SIGNIFICANT**
7 **CAPITAL EXPENDITURES?**

8 A. No. At page 27 of his direct testimony, Mr. Evans stated: "Since the end of the test year
9 in SPS's last base rate case (from July 1, 2013 through June 30, 2014), SPS placed into
10 service more than \$430 million (total company) of production, transmission, distribution,
11 and other infrastructure capital investment." In further support of the SPS's PTYA
12 waiver request, Mr. Evans' Table EDE-RR-6 at page 51 indicates that the Company's
13 plant additions from July 2012 through June 2014 have exceeded \$815 million. There is
14 no question that SPS has committed and will continue to commit significant resources to
15 support capital expenditures and plant additions.

16 However, SPS has not demonstrated that its financial condition has been or is expected to
17 be sufficiently dire to support SPS's extraordinary PTYA waiver request in this
18 proceeding. During calendar years 2013 and 2014, SPS achieved an average ROE of
19 8.84% and 8.72%, respectively.²⁶ While I am confident that the Company would have
20 preferred to achieve even higher average ROE levels, these recent levels are quite healthy
21 particularly in the context of SPS having added over \$1.1 billion of new plant since July
22 2012.²⁷

²⁵ The immediate recovery of the majority of the annual transmission revenue requirements associated with SPS's investment in transmission projects designated as "Base Plan Upgrade Projects" is discussed at length in the direct testimony of Mr. Dittmer. Also, *see* Attachment SCC-6 for these SPS discovery responses.

²⁶ *See* the SPS responses to RFIs AXM 17-16 and 17-17 (Docket No. 43695) and 11-8 (Docket No. 42004). Also, *see* Attachment SCC-6 for these responses.

²⁷ \$815 million of SPS plant additions from July 2012 through June 2014 (Mr. Evans' Table EDE-RR-6 at page 51) plus \$330 million of plant additions from July-December 2014 (Ms. Blair's DAB-RR-2, pp. 36-37, Case Update filing).

1 Q. YOU PREVIOUSLY REFERRED TO MR. EVANS' TABLE EDE-RR-7 WHICH
2 IDENTIFIES OTHER SPS WITNESSES WHOSE DIRECT TESTIMONY
3 ADDRESS PTYA RELATED ATTENDANT IMPACTS. WHAT SUBJECT OR
4 TOPICS DO THOSE WITNESSES ADDRESS?

5 A. Table EDE-RR-7 indicates that the listed witnesses address accumulated depreciation,
6 deferred income taxes, Schedule 11 expense and revenues, property taxes, franchise fees,
7 gross margins tax, gross receipts tax, and deferred tax expense.

8 Rule 25.231(c)(2)(F)(i)(IV) discusses the phrase "attendant impacts" as follows:

9 Where the attendant impacts on all aspects of a utility's operations
10 (including but not limited to, revenue, expenses and invested capital) can
11 with reasonable certainty be identified, quantified and matched. Attendant
12 impacts are those that reasonably follow as a consequence of the post test
13 year adjustment being proposed.

14 While the attendant impacts listed in Table EDE-RR-7 represent PTYA-specific items,
15 SPS has narrowly limited its waiver requests. There are other quantifiable and matching
16 changes that have occurred subsequent to June 2014 that tend to offset or mitigate the
17 magnitude of SPS's PTYA request on overall revenue requirement. As discussed above,
18 the test year approach should be balanced and consistently applied to the various
19 elements of the ratemaking equation in order to introduce minimal quantification
20 distortions into the calculation of overall revenue requirement.

21 Mr. Brosch has identified additional revenues that should be recognized in the event the
22 Commission adopts SPS's PTYA waiver.²⁸ Similarly, Mr. Dittmer identified additional
23 SPP Schedule 11 revenue credits that should be synchronized with the additional
24 December 2014 transmission investment that SPS proposes to include in rate base via the
25 PTYA. In a subsequent section, I also propose the elimination of the prepaid pension
26 asset from rate base. However, if the PTYA is allowed and the pension asset is included

²⁸ As further discussed by Mr. Brosch, SPS has not recognized any customers added after June 30, 2014 in the residential and smaller commercial classes. Billing determinants have increased for large transmission-level customers, in the six months following the test year. Adjustments in both areas would increase revenues and partially offset SPS's PTYA waiver request, if granted by the Commission.

1 in rate base, the pension asset should instead be limited to the lower balance at December
2 31, 2014 of \$153,681,000 (Total SPS),²⁹ net of related ADIT reserves.

3 To be clear, the Commission should deny SPS's PTYA waiver request. However, if the
4 Commission does grant the requested waivers over the objection of AXM, the resulting
5 change in Texas retail revenue requirement would be improperly quantified if these
6 additional offsetting adjustments identified by Messrs. Brosch and Dittmer were not also
7 considered.

8 VII. RATE CASE EXPENSE (AXM C-7)

9 Q. PLEASE DESCRIBE AXM ADJUSTMENT C-7.

10 A. In quantifying overall revenue requirement, the direct testimonies of SPS witnesses
11 Deborah A. Blair (pages 65-67) and Evan D. Evans (pages 29, 73-77) propose to
12 amortize the estimated rate case expense from the current proceeding and the
13 unamortized balance of rate case expense from the Company's last Texas retail rate case
14 over a 12-month or one-year period. AXM Adjustment C-7 (Attachment SCC-3)
15 proposes to remove SPS's estimated cost of the current rate case, recognizing that the
16 Commission has severed the issue of rate case expenses for the current rate case, and to
17 amortize the remaining balance of the cost of the last two rate cases over a two-year
18 period.³⁰

19 Q. WHAT AMOUNT OF RATE CASE EXPENSE DID SPS PROPOSE TO 20 INCLUDE IN THE CURRENT TEST YEAR RATE CASE?

21 A. Ms. Blair (Attachment DAB-RR-2, page 255) and Mr. Evans (EDE-RR-5) provide the
22 estimated rate case expense for the current proceeding in the amount \$4,345,400. Mr.
23 Evans describes this estimate as "assuming a fully litigated case with a hearing, post-
24 hearing briefing, exceptions and replies to exceptions, and motions for rehearing and

²⁹ See Attachment SCC-4, column F, line 29.

³⁰ SOAH Order No. 6, Granting Motion to Sever and Establishing New Docket, severed the review of rate case expenses relating to the current rate case to Docket No. 44498. The recovery of rate case expenses associated with Docket Nos. 40824 and 42004 remain subject to recovery and consideration in Docket No. 43695.

1 replies.”³¹ SPS is also requesting recovery of \$784,724 and \$1,737,216 of unamortized
2 rate case expenses from Docket Nos. 40824 and 42004, respectively. These amounts
3 represent the unamortized balance of rate case expenses as of June 30, 2015 (i.e., based
4 on an assumed effective date of rates from this docket of July 1, 2015). In total, SPS
5 originally sought to recover \$6,867,340 of rate case expense over twelve months.

6 **Q. WHY SHOULD THE AMORTIZATION OF RATE CASE EXPENSE ALLOWED**
7 **FOR RECOVERY IN THE CURRENT PROCEEDING INCLUDE ANY**
8 **REMAINING UNAMORTIZED COSTS FROM DOCKET NOS. 40824 AND**
9 **42004?**

10 A. The settlement agreement that resolved SPS’s last base rate case included an agreement
11 among the Parties that the Company could recover the cost of processing those rate cases
12 over a three-year amortization period.³² The agreement also provided that, if SPS filed
13 for rate relief prior to the end of the three-year amortization period, any unamortized
14 balance of rate case expense would be allowed in the next rate case. The current
15 proceeding is the next rate case.

16 **Q. WHY HAS SPS PROPOSED A ONE-YEAR PERIOD TO AMORTIZE RATE**
17 **CASE EXPENSE?**

18 A. Mr. Evans discusses the one-year, or twelve month amortization period, explaining:
19 “SPS remains in a significant multi-year capital spending cycle, and during that time SPS
20 will place numerous capital projects in service, which will make it necessary for SPS to
21 continue filing frequent rate cases, approximately 12 months apart.” The Company’s
22 stated desire for a 12-month amortization term is to avoid potentially overlapping
23 amortizations resulting from successive rate cases.³³

³¹ See Direct Testimony of Evan Evans at page 73.

³² *Id.*

³³ *Id.* at 29.

1 Q. DO YOU BELIEVE THAT SPS'S EXPECTATION THAT IT MIGHT FILE
2 ANNUAL RATE CASES JUSTIFIES THE COMPANY'S PROPOSED ONE
3 YEAR AMORTIZATION OF RATE CASE EXPENSE?

4 A. No. It may be desirable to link the amortization term to the interval between rate case
5 filings. However, the magnitude of the \$6.9 million, now reduced to about \$2.5 million
6 due to SOAH Order No. 6, of cumulative rate case expense SPS is seeking to recover
7 through rates in this proceeding raises significant concerns of potential over-collection
8 risk from the perspective of the Company's customers. If \$2.5 million were included in
9 rates and the interval between rate cases was precisely twelve months, the Company
10 would theoretically recover the intended amount in revenues and no remaining
11 amortization would carry-over to the next rate case. However, there is no certainty that
12 the interval between rate cases will be exactly twelve months. For every month that
13 interval increases, the Company would continue to recover a roughly proportionate share
14 of the \$2.5 million through rates without any matching expense offset. This could lead to
15 the significant over-recovery of these costs given the magnitude of the rate case expense
16 estimate. For that reason, I recommend a two-year amortization period to mitigate such
17 over-collection risk. It is preferable to address possible overlapping amortizations of rate
18 case expenses due to frequent SPS rate filings than expose ratepayers to potentially
19 significant over payment of the cost of processing rate cases, which would only benefit
20 SPS and its shareholders.

21 Q. DOES AXM ADJUSTMENT C-7 AMORTIZE THE COMPANY'S RATE CASE
22 EXPENSES FOR DOCKET NOS. 40824 AND 42004 OVER A TWO YEAR
23 PERIOD?

24 A. Yes. AXM Adjustment C-7 includes the \$2,521,940 remaining unamortized balance of
25 rate case expenses from the last two proceedings, amortized over two years.

26 VIII. AMORTIZATION RESCHEDULING (AXM C-8)

27 Q. PLEASE EXPLAIN THE PURPOSE OF AXM ADJUSTMENT C-8.

28 A. AXM Adjustment C-8 (Attachment SCC-3) reschedules the amortization of two separate
29 items for ratemaking purposes. First, SPS witness Ms. Blair discusses the proposed

1 amortization of deferred pension and OPEB costs in the net amount of \$3,583,510 over a
2 one-year period, citing to "reasons explained by Mr. Evans."³⁴

3 Second, Ms. Blair also briefly refers to SPS's proposal to net the remaining Lubbock
4 ("LP&L") gain amortization and the TUCO refund against rate case expenses, as further
5 discussed by Mr. Evans.³⁵ The Lubbock gain was originally scheduled to be amortized
6 over a four-year period beginning February 16, 2011 (Docket No. 38147). In the last rate
7 case (Docket No. 42004), the settlement agreement provide for a three-year amortization
8 of numerous balances, including the unamortized balance of the LP&L gain on sale.
9 Thus, as of July 1, 2015, the remaining balance of the gain on sale will be \$2,226,277.
10 SPS proposes to offset that amount against the amount of total rate case expenses subject
11 to amortization in this docket.³⁶

12 AXM Adjustment C-8 (Attachment SCC-3) proposes to amortize both the deferred
13 pension and OPEB costs as well as the LP&L gain over a two-year period consistent with
14 the amortization term I propose for rate case expense.

15 **Q. WHY IS SPS RECOMMENDING A ONE-YEAR AMORTIZATION OF**
16 **DEFERRED PENSION AND OPEB COSTS?**

17 A. Ms. Blair states: "For the reasons explained by Mr. Evans, the deferred pension and
18 OPEB expense should be amortized over one year. Accordingly, I have added
19 \$3,583,510 to the cost of service, as shown on page 50, line 654 of Attachment DAB-RR-
20 2."³⁷

21 **Q. IS THE REASON STATED BY MR. EVANS FOR THE ONE-YEAR**
22 **AMORTIZATION THE SAME AS PREVIOUSLY DISCUSSED REGARDING**
23 **THE COMPANY'S RECOMMENDED AMORTIZATION OF RATE CASE**
24 **EXPENSE?**

25 A. Yes. Mr. Evans discusses this at page 29 of his direct testimony, which was partially
26 quoted in my testimony section on rate case expense.

³⁴ See Direct Testimony of Deborah Blair at 63-64.

³⁵ *Id.* at 66 and Direct Testimony of Evan Evans at 74-75.

³⁶ See Direct Testimony of Evan Evans at 74-75.

1 **Q. WHAT ARE THE COMPONENTS OF THE \$3,583,510 OF DEFERRED**
2 **PENSION AND OPEB COSTS SPS PROPOSES TO AMORTIZE OVER ONE**
3 **YEAR?**

4 A. In the settlement agreement in Docket No. 42004, the signatory Parties agreed that \$6.6
5 million of pension and OPEB costs deferred as of December 31, 2012, should be
6 amortized over a three-year period beginning on June 1, 2014. The settlement agreement
7 further specified that SPS may include any unamortized balance of the pension and
8 OPEB deferral in its next rate case, if the three-year amortization has not been
9 completed.³⁸ Assuming the rates in the pending docket become effective on July 1, 2015,
10 the unamortized portion of the \$6.6 million deferral would be \$4,274,171 (total
11 Company).³⁹

12 In addition, SPS has deferred a net negative pension and OPEB credit of \$690,662 since
13 June 2014. The \$3,583,510 of pension and OPEB costs is the sum of the unamortized
14 amount from the last rate case (\$4,274,171) and the net negative deferral (\$690,662).

15 **Q. WHY IS SPS PROPOSING TO COMBINE THE DEFERRED RATE CASE**
16 **EXPENSES WITH THE LUBBOCK GAIN TO BE AMORTIZED OVER ONE**
17 **YEAR?**

18 A. Presumably, Mr. Evans was attempting to show a lower net balance to be amortized and
19 to achieve administrative simplicity by combining several deferral balances. As long as
20 the amortization term is the same, the total amount of amortization expense is not
21 affected by recording the amortizations on a net or gross basis.

22 **IX. LABOR COST ADJUSTMENT (AXM C-10)**

23 **Q. PLEASE DESCRIBE AXM ADJUSTMENT C-10.**

24 A. AXM Adjustment C-10 (Attachment SCC-3) removes a portion of the Company's
25 estimated labor costs allocated to operation and maintenance ("O&M") expense. This

³⁷ See Direct Testimony of Deborah Blair at 64.

³⁸ See *Id.* at 63 and Docket No. 40824, *Unopposed Stipulation*, p. 6, par. IV.(b), filed April 30, 2013.

³⁹ If the rates resulting from this proceeding become effective materially before or after July 1, 2015, the unamortized balances and annual amortization amount should be recalculated accordingly.

1 expense is attributable to wage increases that may go into effect after the end of the test
2 year. Even though these wage increases may not be effective until November 2014 and
3 March 2015, SPS proposes to include these post-test year expenses in test year expenses.

4 **Q. WHAT METHOD DID THE COMPANY EMPLOY TO ANNUALIZE**
5 **EMPLOYEE WAGES FOR RATEMAKING PURPOSES?**

6 A. SPS witness Ms. Blair explains that test year employee wages were annualized based on
7 the “the three-month total of employee wages from April through June 2014 and
8 multiplying it by four to arrive at an annual amount of employee wage expense as of the
9 end of the Test Year.”⁴⁰ This approach was designed to recognize employee levels at or
10 near the end of the historic test year and capture the annual effect of employee wage
11 increases granted and effective during the test year (i.e., bargaining in November 2013 and
12 non-bargaining in March 2014). This annualization adjustment increased test year expense
13 by about \$5.1 million (total Company).⁴¹

14 SPS also quantified an adjustment to include in test year expense certain post-test year
15 employee wage increases budgeted to be effective November 2014 (3.0% for SPS
16 bargaining employees) and March 2015 (3.0% for SPS and XES non-bargaining
17 employees). The recognition of these post-test year wage increases results in additional
18 test year expense of about \$3.1 million (total Company).⁴²

19 **Q. DOES AXM ADJUSTMENT C-10 REMOVE BOTH OF THESE**
20 **ANNUALIZATION ADJUSTMENTS?**

21 A. No. AXM Adjustment C-10 only removes the post-test year wage increases.

⁴⁰ See Direct Testimony of Deborah Blair at 44.

⁴¹ *Id.* at 45.

⁴² See Direct Testimony of Deborah Blair at 45-46. “Bargaining employees likely will receive a wage increase effective in November 2014 as a result of labor contract negotiations and arbitration, and non-bargaining employees will receive a wage increase in March 2015.” All XES employees are non-bargaining while SPS has both bargaining and non-bargaining. The budgeted post-test year wage rate changes “increased labor costs by \$3,140,852 (total company), as shown on page 164, line 275 of Attachment DAB-RR-2.”

1 **Q. WHY IS IT APPROPRIATE TO REMOVE THE EFFECT OF THE POST-TEST**
2 **YEAR WAGE INCREASES FROM SPS'S PROPOSED TEST YEAR EXPENSE?**

3 A. In another testimony section, I discuss the importance of a balanced and consistent
4 approach in quantifying the various test year elements of the ratemaking equation (i.e.,
5 rate base, revenues, expenses, capital costs, etc.). The recognition of these post-test year
6 wage increases is only one element of the distortive approach SPS has taken in
7 quantifying and supporting the requested rate increase.

8 In addition to these increases budgeted to be effective well beyond the historic test year,
9 SPS is apparently in negotiations with its bargaining unit employees regarding wages.
10 Various requests for information have been submitted in this proceeding that sought
11 actual percentage increases and effective dates of wage/salary increases actually granted
12 to employees (AXM RFI 17-6), questioned whether the post-test year increases were
13 known and measurable (TIEC RFI 2-8), requested copies of the board of director meeting
14 minutes that approved the wage/salary increases (Staff RFI 1-9), and sought a copy of the
15 new bargaining agreement (Staff RFI 1-10). The common theme to these RFIs is that the
16 requested information is not available, because of ongoing collective bargaining
17 agreement negotiations between SPS and the union. However, on April 29, 2015, SPS
18 provided a supplemental response to Staff RFI 1-9, indicating that "Approval of the 3%
19 2015 merit base salary increases occurred on February 26, 2015 and base salary increases
20 were effective March 16, 2015." Since non-bargaining salary increases are approved by
21 Xcel Energy Inc.'s Chief Executive officer, there are no board minutes for the non-
22 bargaining 3% base salary increase.⁴³

23 **Q. HOW WAS AXM ADJUSTMENT C-10 QUANTIFIED?**

24 A. AXM Adjustment C-10 was quantified by resetting the Company's budgeted 3.0%
25 (November 2014) and 3.0% (March 2015) wage increases to 0.0%. This adjustment was

⁴³ See Attachment SCC-6 for the SPS responses to ATM RFI 17-6, Staff RFI 1-9, Staff RFI 1-9(SUPP4), Staff RFI 1-10 and TIEC RFI 2-8.

quantified by utilizing the methodology and calculations employed in SPS's Case Update filing to remove the post-test year wage increases.⁴⁴

X. INCENTIVE COMPENSATION (AXM C-11)

Q. PLEASE DESCRIBE AXM ADJUSTMENT C-11.

A. The Company proposed two adjustments to operations and maintenance ("O&M") expense relating to incentive compensation costs. With regard to the Annual Incentive Plan ("AIP"), the Company "eliminated the portion of the annual incentive compensation that exceeded the target" and "removed all of the incentive compensation that relate to financial goals." The Company also eliminated the Long-Term Incentive Compensation plan ("LTI") from the cost of service.⁴⁵ These SPS adjustments reduce (total Company) test year O&M expenses for AIP and LTI by \$2,261,634 and \$695,206, respectively.⁴⁶

AXM Adjustment C-11 (Attachment SCC-3) removes from test year expense the cost of the financial based "affordability trigger" element of AIP.⁴⁷

Q. PLEASE SUMMARIZE THE INCENTIVE COMPENSATION COSTS NOT ADJUSTED BY SPS.

A. According to SPS witnesses Blair and Reed, the Company has completely removed the LTI from O&M expense, but seeks to recover from ratepayers \$5,202,078 (total Company) for the AIP plan and \$1,343,457 (total Company) for the Xcel Energy Wholesale Energy Marketing and Trading Supplemental Incentive Programs ("SIP").⁴⁸ The following table summarizes the test year amounts SPS included in O&M expense for these programs:

⁴⁴ The wage increase adjustment did not change between SPS's original filing and the Case Update filing. See SPS spreadsheet file "DAB-RR-2_1.3-non-plant data Input-Dec Update.xlsx", tab "Wage Adjustment."

⁴⁵ See Direct Testimony of Deborah Blair at 46-47 and Direct Testimony of Jill H. Reed at 14 (SIP).

⁴⁶ SPS's Case Update filing did not change or revise these incentive compensation adjustment amounts.

⁴⁷ See Direct Testimony of Jill H. Reed at 26.

⁴⁸ See Direct Testimony of Deborah Blair at 47 and Direct Testimony of Jill H. Reed at 36 (AIP) and 41 (SIP).

	Total Company Amounts			
	AIP	LTI	SIP	Total
<u>Adjusted Per Book:</u>				
XES	\$ 4,813,909	\$ 1,567,248	\$ 1,343,457	\$ 7,724,614
SPS	2,657,633	436,446		3,094,079
Subtotal	7,471,542	2,003,694	1,343,457	10,818,693
<u>SPS Adjustments:</u>				
XES	(1,526,517)	(1,567,248)		(3,093,765)
SPS	(735,117)	(436,446)		(1,171,563)
Subtotal	(2,261,634)	(2,003,694)	-	(4,265,328)
<u>SPS Proposed:</u>				
XES	3,287,392	-	1,343,457	4,630,849
SPS	1,922,515	-	-	1,922,515
Total	\$ 5,209,907	\$ -	\$ 1,343,457	\$ 6,553,364
<u>Sources:</u>				
AIP: "DAB-RR-2_1.3 - non-plant Input - Dec Update.xlsx", tab "Incentive to Target".				
LTI: "DAB-RR-2_1.2 - Adjustments - Dec Update.xlsx", tab "Long Term Incentive".				
SIP: SPS witness Reed direct at 41. [AXM attributed to XES.]				

Q. PLEASE GENERALLY DESCRIBE THE ANNUAL INCENTIVE PLAN OFFERED BY THE COMPANY.

A. SPS witness Reed generally discusses incentive compensation as a component of the cash compensation offered to employees:⁴⁹

Companies can provide cash compensation to employees either solely through base salary or through a combination of base salary and incentive compensation. Xcel Energy's AIP reflects the latter approach. That is, rather than providing all of an employee's compensation as base salary, Xcel Energy provides a portion as incentive compensation. This incentive compensation is a part of the total cash compensation package provided to employees, and it is only through inclusion of this incentive compensation that Xcel Energy's compensation levels are market-competitive with those paid by other companies.

Ms. Reed also summarizes AIP, whose cost SPS seeks to recover from ratepayers in this docket.⁵⁰

⁴⁹ See Direct Testimony of Jill H. Reed at 23.

1 Xcel Energy's AIP is a broad-based program that covers exempt, [footnote
2 omitted] non-bargaining employees across all states in which Xcel Energy
3 operates. Each eligible employee has a set of performance objectives
4 upon which incentive compensation is tied. The employee's target annual
5 incentive compensation is expressed as a percentage of base salary. The
6 percentage is determined by the employee's position or level within the
7 organization and, when combined with the employee's base salary,
8 delivers a market-competitive level of total cash compensation. The
9 program uses the earnings per share of Xcel Energy as an affordability
10 trigger for payments from the AIP. If the overall affordability trigger for
11 payment is not met, the program does not pay any incentive compensation.
12 [Emphasis Added]

13 The Company's responses to Office of Public Utility Counsel ("OPUC") RFIs 7-5 and 8-
14 3 generally explain SPS's assumptions in determining the "target" level of AIP for
15 purposes of this case.⁵¹

16 **Q. WHY DOES THE COMPANY OFFER INCENTIVE COMPENSATION PLANS?**

17 A. At pages 14-25 of her direct testimony, SPS witness Ms. Reed describes the objectives
18 and goals of the Company's compensation programs, comprised of base salary and
19 incentive compensation, which include:

- 20 • Attract, retain and motivate skilled employees at reasonable cost (pages 14 & 16);
- 21 • Provide employees with market competitive compensation (page 45);
- 22 • Promote superior employee performance (pages 24-25);
- 23 • Promote customer satisfaction, reliability, safety, and environmental goals (page
24 24);
- 25 • Help Excel Energy and SPS achieve overall operational excellence (page 25); and
- 26 • Reduce overall labor costs by shifting compensation from base salary to incentive
27 compensation which avoids the compounding effect of annual pay raises (page
28 25).

⁵⁰ See Direct Testimony of Jill H. Reed at 26. Additional terms of this incentive plan is included in related confidential plan documents attached to the direct testimony of Ms. Reed: 2013 and 2014 Xcel Energy non-bargaining AIP booklets [Attachments JHR-RR-2(CONF) and JHR-RR-3(CONF)].

⁵¹ The response to OPUC RFI 7-5 indicates that the "AIP target used for Test Year revenue requirement purposes was the 2015 AIP target." See Attachment SCC-6 for the responses to OPUC RFIs 7-5 and 8-3.

1 More specifically, as to the inclusion of incentive compensation in Xcel Energy's overall
2 compensation plan, Ms. Reed states: "There are two fundamental tenets related to
3 incentive compensation that are well-accepted in the industry: (1) it promotes superior
4 employee performance; and (2) it reduces labor costs. Thus, Xcel Energy incorporates
5 incentive compensation to provide these benefits for customers."⁵²

6 **Q. PLEASE EXPLAIN YOUR EARLIER REFERENCE TO THE FINANCIAL**
7 **BASED "AFFORDABILITY TRIGGER" ELEMENT OF AIP IN THE CONTEXT**
8 **OF AXM'S RECOMMENDED DISALLOWANCE OF INCENTIVE**
9 **COMPENSATION EXPENSES.**

10 A. Beginning with the 2012 plan year, AIP was modified to remove "earnings as a
11 Corporate goal" which resulted in a significant reduction of the percentage of AIP related
12 to a financial component for 2012 and beyond.⁵³ However, the broader "affordability
13 trigger" is based on consolidated earnings per share ("EPS"), not on company-specific
14 (i.e., SPS) or state-specific (i.e., Texas) financial results.

15 The following table sets forth the minimum consolidated EPS trigger, below which AIP
16 will not pay-out, and actual EPS results for 2012 through 2014:⁵⁴

Performance Level	2012 Plan Year EPS	2013 Plan Year EPS	2014 Plan Year EPS
Threshold	\$1.75	\$1.85	\$1.90
Actual Result	\$1.82	\$1.95	\$2.03

17 **Q. IF CONSOLIDATED EPS EXCEEDS THE "THRESHOLD" LEVEL, DOES**
18 **THAT ACHIEVEMENT HAVE ANY IMPACT ON THE AMOUNT OF**
19 **INCENTIVE COMPENSATION PAYABLE TO ELIGIBLE EMPLOYEES?**

20 A. Yes. The AIP will be "funded" at a 50% level if consolidated EPS attains the
21 affordability trigger or threshold. Achievement of EPS at higher levels does increase the

⁵² See Direct Testimony of Jill H. Reed at 24.

⁵³ See Direct Testimony of Ruth K. Lowenthal at pages 29-30 (Docket No. 42004).

⁵⁴ See SPS response to AXM RFI 17-12 (see Attachment SCC-6).

level of AIP available to employees up to a maximum of 150% of the target amount.⁵⁵
The following table compares the target and actual AIP amounts for plan years 2012
through 2014:

<u>Total SPS O&M</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Target AIP			
SPS	\$2,000,255	\$2,088,313	\$2,016,489
XES	3,532,116	3,685,187	3,994,079
Actual AIP			
SPS	2,731,256	2,619,586	N/A
XES	4,970,059	5,167,019	N/A

Source: SPS response to AXM RFI 17-12.

For context, the following table shows SPS's contribution to the consolidated net income
and EPS threshold trigger achieved in 2013 and 2014.⁵⁶

<u>Net Income (000s)</u>	<u>2014 YE</u>	<u>2014 EPS</u>	<u>2013 YE</u>	<u>2013 EPS</u>
PSCO	\$ 454,494	\$ 0.90	\$ 453,289	\$ 0.91
NSPM	404,915	0.80	393,346	0.79
SPS	129,852	0.26	115,368	0.23
NSPW	70,642	0.14	59,468	0.12
Wyco/West Gas	17,964	0.04	17,633	0.04
Total Regulated	\$ 1,077,867	\$ 2.14	\$ 1,039,104	\$ 2.09
Eloigne	(451)	-	(810)	-
Holding Co.	(56,408)	(0.11)	(70,549)	(0.14)
Other	(396)	-	587	-
Total Nonreg	\$ (57,255)	\$ (0.11)	\$ (70,772)	\$ (0.14)
Total Xcel-Ongoing	\$ 1,020,612	\$ 2.02	\$ 968,332	\$ 1.95
PSRI	694	-	94	-
FERC 205 Filing	0	-	(20,192)	(0.04)
Total Xcel-Cont Ops	\$ 1,021,306	\$ 2.03	\$ 948,234	\$ 1.91

The contribution of SPS to the Xcel Energy consolidated operating results was below all
other entities comprising the regulated operations in terms of average achieved return on

⁵⁵ See Direct Testimony of Jill H. Reed at 29. Additional information for the 2013 and 2014 AIP can be observed at SPS Attachment JHR-RR-2(CONF) at 6 and JHR-RR-3(CONF) at 6, respectively

⁵⁶ See SPS response to AXM RFI 17-16 (see Attachment SCC-6). Total regulated EPS was \$2.09 and \$2.14 in 2013 and 2014, respectively.

1 equity ("ROE") in 2013 and the second lowest in 2014. SPS's average ROE was also
2 below Xcel Energy's return on a consolidated basis:⁵⁷

Average ROE	2014	2013
NSP-M	8.70%	9.24%
NSP-W	10.77%	10.44%
PSCO	9.47%	9.62%
SPS	8.72%	8.84%
Total Regulated	9.14%	9.42%
Xcel Energy	10.29%	10.40%

3 The EPS threshold (i.e., affordability trigger) level in both 2013 and 2014 was achieved
4 on both a regulated operations and consolidated basis with below average financial
5 contribution from SPS. Therefore, the "affordability trigger" design element of AIP
6 would appear to provide limited incentive and opportunity to motivate an individual SPS
7 employee to make a meaningful contribution to achieve the consolidated EPS threshold.

8 **Q. THE TWO PRIOR TABLES SHOW THAT, BETWEEN 2013 AND 2014, SPS**
9 **INCREASED NET INCOME FROM ABOUT \$115.4 MILLION TO \$129.9**
10 **MILLION AND AVERAGE ROE CHANGED FROM 8.84% TO 8.72%. WHAT**
11 **WAS THE CONTRIBUTION OF SPS-TEXAS TO CONSOLIDATED NET**
12 **INCOME IN THOSE YEARS?**

13 A. Xcel Energy does not calculate contribution to consolidated net income by state. [AXM
14 RFI 17-16(h)]

15 **Q. AT PAGE 29 OF HER DIRECT TESTIMONY, MS. REED STATES THAT "SPS**
16 **IS ONLY SEEKING RECOVERY OF THE TARGET LEVEL OF AIP AS A**
17 **PART OF THE TEST YEAR REVENUE REQUIREMENT." IS THE "TARGET"**
18 **LEVEL HIGHER THAN THE "THRESHOLD" LEVEL?**

19 A. Yes. Achievement of the threshold level is the minimum consolidated EPS trigger that
20 must be met for any incentive payout to occur. If the consolidated EPS is below the
21 threshold EPS, no payout occurs regardless of individual employee performance. Ms.

⁵⁷ See the SPS responses to RFIs AXM 17-16 and 17-17 (Docket No. 43695) and 11-8(f) and AXM RFI 29-8 (Docket No. 42004). Also, see Attachment SCC-6 for these responses.

1 Blair reduced the amount of AIP expense to the 100% target, not the 50% threshold, from
2 the achieved 120.22% for XES (i.e., Xcel Energy Services Inc.) and 122.75% for SPS.⁵⁸

3 **Q. HOW DID YOU QUANTIFY THE AMOUNT OF THE FINANCIAL**
4 **COMPONENT OF AIP YOU RECOMMEND FOR DISALLOWANCE?**

5 A. When AIP was restructured in 2012, the entire incentive plan mechanism was shifted
6 from a mix of financial and non-financial metrics to a financial based plan that as a pre-
7 condition must achieve an "affordability trigger" before any otherwise qualifying
8 employees will receive any payout. The performance of the individual employee only
9 determines that employee's level of participation in any payout. An incentive payout and
10 the overall magnitude of such a payout are determined by consolidated EPS.

11 Consequently, the AIP expense amount not removed by SPS (i.e., at the 100% target)
12 represents the financial component. The Company provided detailed calculations
13 supporting the portion of the AIP adjustment removed by Ms. Blair.⁵⁹ Those same
14 calculations, prepared on a total SPS basis, serve as the foundation for AXM Adjustment
15 C-11.

16 **Q. PLEASE EXPLAIN WHY YOU PROPOSE DISALLOWANCE OF ALL**
17 **INCENTIVE PLAN FINANCIAL COMPONENTS.**

18 A. There are several reasons why such disallowances are appropriate. First, incentive plans
19 often focus on corporate-wide or segment financial results, including regulated entities
20 located in other States and non-regulated entities or operations. Those Company
21 employees directly or indirectly supporting the provision of regulated electric service in
22 Texas may have limited ability or opportunity to materially affect the consolidated, or
23 even segment, financial results through their day-to-day work activities. For example, in
24 2013 and 2014, SPS contributed only \$0.23 and \$0.26, respectively, of the \$1.95 and

⁵⁸ See SPS spreadsheet file "DAB-RR-2_1.3 - non-plant data Input - Dec Update.xlsx" tab "Incentive to Target".

⁵⁹ *Id.*

1 \$2.02 consolidated EPS from Xcel's continuing operations actually achieved in both
2 years.⁶⁰

3 Further, efforts by SPS employees to enhance (i.e., increase) consolidated financial
4 results may not be consistent with the interests of SPS's Texas retail customers or
5 reasonable pricing of regulated services – particularly, given SPS's historically modest
6 contribution to consolidated earnings.

7 Second, beginning at page 26, Ms. Reed discusses the structure of AIP, including
8 performance goals (i.e., individual, business area and corporate levels), the weighting of
9 these performance goals by salary tier/grade and key performance indicators. These
10 performance objectives for eligible employees only determine the extent to which each
11 employee participates in any AIP payout. However, the aggregate funding of AIP is
12 determined by achieving consolidated financial targets (e.g., the threshold affordability
13 trigger, target and maximum payout range) that, by definition, are not directly linked to
14 customer service, employee safety, cost reductions, individual employee performance, or
15 operational achievements or efficiencies unique to SPS's Texas service territory.

16 Third, the cost of the Company's discretionary incentive plan should be funded by the
17 increased levels of net income, cash flow and other related financial resources, rather
18 than through inclusion in the determination of overall revenue requirement used to
19 support prices charged to SPS's Texas retail customers. This is reasonable because to the
20 extent that the inclusion of financial targets in the incentive plan assists the Company in
21 achieving improved financial results the plans should pay for themselves. Between 2013
22 and 2014, Xcel's consolidated net income from continuing operations increased by about

⁶⁰ According to SPS's responses to RFIs AXM 11-7(c) and AXM 29-6 (Docket No. 42004) and AXM 17-15(c) (Docket No. 43695), one adjustment was made to 2013 actual EPS as a result of the Federal Energy Regulatory Commission's Order in *Golden Spread Elec. Coop., Inc. v. Southwestern Pub. Serv. Co.*, Opinion No. 501-A, 144 FERC ¶ 61,132 (2013). That adjustment increased 2013 actual EPS of \$1.91 by \$0.04 to \$1.95 for AIP purposes. No adjustments were made to 2014 financial results to determine EPS for AIP. See Attachment SCC-6 for these responses.

1 \$73 million and SPS's net income contribution by about \$14.5 million – after recognizing
2 actual cost of AIP.⁶¹

3 Obviously, a decision by management to incur incentive compensation costs is an
4 indication that such costs were viewed as reasonable by the Company. However, absent
5 a showing that such costs provide direct, tangible benefits to ratepayers, the Commission
6 should not allow above-the-line ratemaking treatment for all discretionary costs incurred
7 by management. The Commission should only permit recovery of the cost of incentive
8 plan metrics reasonably identifiable with customer service, employee safety, cost
9 reduction, individual employee performance, or operational achievements or efficiencies.
10 The current AIP structure relegates these types of desirable non-financial metrics to a
11 secondary status below consolidated EPS.

12 **Q. ARE PAYOUTS UNDER AIP DISCRETIONARY?**

13 A. Yes.⁶² Incentive compensation plans are typically designed to award employees for high
14 levels of performance, which should motivate employees to demonstrate achievement of
15 predefined goals and objectives. If incentive plan payouts were guaranteed, such
16 payments could simply be called “base salary.”

17 **Q. IN OTHER UTILITY RATE CASE PROCEEDINGS, HAVE YOU**
18 **RECOMMENDED THAT THE UTILITY BE ALLOWED TO RECOVER THAT**
19 **PORTION OF INCENTIVE COMPENSATION COSTS REASONABLY**
20 **APPORTIONED TO CUSTOMER SERVICE, SAFETY OR EMPLOYEE TASK**
21 **METRICS?**

22 A. Yes. Ms. Reed's Tables JHR-RR-11 - SPS and JHR-RR-12 - XES (page 38) contends
23 that a modest but increasing portion of AIP costs in 2013 (6.0% SPS, 5.0% XES) and
24 2014 (11.2% SPS, 17.9% XES) are associated with financial metrics. Ms. Reed contends
25 the remainder of such costs are related to operational metrics. I disagree.

⁶¹ See SPS response to AXM RFI 17-16(e). Total Xcel continuing operations net income increased by \$73,072,000, from \$948,234,000 (2013) to \$1,021,306,000 (2014) while SPS net income increase by \$14,484,000 from \$115,368,000 (2013) to \$129,852,000 (2014). Also, see Attachment SCC-6.

⁶² See SPS Attachments JHR-RR-2(CONF) at 14 and JHR-RR-3(CONF) at 13. These documents represent the 2013 and 2014 Xcel Energy Non-Bargaining Exempt Employee Annual Incentive Program.

1 Q. DID YOU CONSIDER ANY ALTERNATIVES TO AXM'S RECOMMENDED
2 FINANCIAL COMPONENT DISALLOWANCE, SUCH AS ALLOWING
3 RECOVERY OF INCENTIVE COSTS AT THRESHOLD FINANCIAL LEVELS
4 OR SOME SHARING OF SUCH COSTS BETWEEN RATEPAYERS AND
5 SHAREHOLDERS?

6 A. No. I have reviewed a number of incentive compensation plans over the years. Such
7 plans often include some form of financial element, either for purposes of determining
8 whether earnings are sufficient for the entity to financially afford incentive awards or as a
9 discrete element of incentive metrics. However, it is relatively common for incentive
10 compensation plans to include non-financial performance indicators or individual
11 employee objectives that provide a direct connection or linkage to the day-to-day
12 performance of an employee, whether that employee qualifies for an incentive award, and
13 how much of an award the employee is eligible to receive.

14 Q. EARLIER, YOU STATED THAT "REGULATORS NEED NOT ALLOW
15 ABOVE-THE-LINE RATEMAKING TREATMENT FOR ALL
16 DISCRETIONARY COSTS INCURRED BY MANAGEMENT ABSENT A
17 SHOWING THAT SUCH COSTS PROVIDE DIRECT, TANGIBLE BENEFITS
18 TO RATEPAYERS." COULD YOU FURTHER ELABORATE ON THIS
19 STATEMENT?

20 A. Yes. In general terms, the mere incurrence of a cost by a utility is not sufficient to ensure
21 recoverability from ratepayers. Costs must be actually incurred, reasonable in amount,
22 necessary for utility purposes, and of direct benefit to ratepayers. Utility management
23 has broad discretion as to how it spends its available resources. However, the ultimate
24 question is the extent to which ratepayers should bear the burden of the utility's costs. In
25 considering amendments to Part 65 of the Federal Communications Commission ("FCC")
26 rules prescribing the components of rate base and net income for dominant carriers, the
27 FCC discussed the framework surrounding its proposed changes.

28 7. In developing our proposal, we were guided by two historically applied
29 principles – the "used and useful" standard and the benefit-burden test.
30 The "used and useful" standard denotes property dedicated to the efficient
31 conduct of a utility's business, presently or within a reasonable period.
32 That standard reflects the principles that owners of public utilities must
33 receive an opportunity to be compensated for the use of their property in
34 providing a public service and that ratepayers must not be forced to pay a

1 return on investment that does not benefit them directly. The benefit-
2 burden test is based on the principle that the party who bears the financial
3 burden of a particular utility activity should also reap the benefits resulting
4 therefrom. We proposed to apply these two general principles to specific
5 assets and asset categories established in Part 32 of our Rules, which will
6 become effective January 1, 1988. [footnote omitted]⁶³

7 This passage is a quote from the telecommunications arena a number of years ago.
8 However, the concept applies equally to a regulated electric public utility such as SPS.

9 AXM's approach follows the conceptual framework of the "benefit-burden" test even
10 though incentive compensation is only partially allocable between capital and expense
11 accounts. In other words, the party who benefits from a particular transaction or activity
12 should bear the related financial burden. SPS's Texas ratepayers should not be
13 responsible for that portion of incentive plan costs related to financial metrics unless
14 SPS's Texas ratepayers benefited from the achievement of the incentive targets (i.e.,
15 improvement in consolidated financial results), or the Company employees supporting
16 SPS's Texas operations substantially contribute to or otherwise impact the achievement
17 of those results.

18 Incentive compensation is a method of providing monetary awards to the work force
19 through unguaranteed payment programs that is made in addition to base wages.
20 Incentive compensation plans are typically designed to attract, retain and motivate
21 employees, enhance teamwork and encourage high levels of achievement, and to
22 facilitate the accomplishment of specific corporate, business unit and individual goals.
23 Individual employees are theoretically incented to perform well by directly influencing
24 their day-to-day actions and activities – because if they do not achieve the established
25 target levels, they will not receive incentive compensation pay. However, those targets
26 should not be easy or impossible to attain or set at levels that an individual employee or
27 group of employees can do little to achieve (e.g., consolidated financial targets).

⁶³ CC Docket No. 86-497, FCC Report and Order, released December 24, 1987, par. 7.

1 **Q. IF THE COMPANY FAILS TO ACHIEVE THE CORPORATE FINANCIAL**
2 **TARGET, WILL SHAREHOLDERS BE REQUIRED TO FOREGO ALL**
3 **BENEFITS ASSOCIATED WITH THE INCLUSION OF INCENTIVE PLAN**
4 **COSTS IN UTILITY RATES?**

5 A. No. Since incentive compensation is “at-risk” to the employee, the amount of such
6 compensation from year-to-year is not fixed, regular, nor even certain to occur – provided
7 the target objectives are not easily attainable. Employees do not receive incentive
8 payments and the Company would not incur any incentive compensation expense if
9 minimum financial targets are not met. In other words, if the EPS affordability trigger is
10 not met, there will be no AIP awards regardless of individual employee performance.

11 Assuming incentive compensation is allowed in utility revenue requirement, the amount
12 embedded in rates would directly contribute to increased utility profits if minimum
13 financial targets are not met. Utility rates would have been set to allow recovery of
14 incentive compensation costs that the utility did not incur. In other words, under the
15 Company’s base-rate recovery approach, ratepayers would be placed at-risk to fund the
16 level of incentive plan costs included in rates (i.e., at a selected target level), regardless of
17 payout, while employees would be at-risk because targets might not be achieved for any
18 number of reasons. At the same time, neither the Company nor its shareholders would
19 necessarily be at-risk for the amount of incentive pay included in test year expense, as the
20 allowed expenses would be recovered through rates regardless of future payouts.

21 **Q. ARE YOU AWARE OF MS. REED’S CONTENTION AT PAGE 25 OF HER**
22 **DIRECT TESTIMONY THAT INCENTIVE PAY “DOES NOT BECOME A**
23 **PERMANENT FIXED COST” BECAUSE IT MUST BE RE-EARNED EACH**
24 **YEAR AND THAT “AIP REDUCES OUR OVERALL LABOR COSTS BY**
25 **AVOIDING THE COMPOUNDING EFFECT OF ANNUAL BASE PAY**
26 **INCREASES”?**

27 A. Yes. I disagree. AIP looks and feels like a “permanent fixed cost” from the perspective
28 of the customers of SPS to the extent that incentive costs are included in base rates and
29 the underlying financial targets are set at attainable levels. The following table shows the
30 increasing target and actual AIP expenses subject to being “re-earned” each year.

SPS O&M (Total Company)				
	Target AIP		Actual AIP	
	SPS	XES to SPS	SPS	XES to SPS
2012 Plan Year	\$ 2,000,255	\$ 3,532,116	\$ 2,731,256	\$ 4,970,059
2013 Plan Year	2,088,313	3,685,187	2,619,586	5,167,019
2014 Plan Year	2,016,489	3,994,079	N/A	N/A
2015 Plan Year	2,167,232	4,054,125	N/A	N/A

Sources: SPS response to RFIs AXM 17-7 and 17-12 (see Attachment SCC-6)

Further, AIP payouts to individual employees are determined by applying a calculated percentage to base wages, as described in SPS's response to OPUC RFI 6-21. So, the compounding effect of annual base pay increases over time is not completely avoided, because annual wage increases are still granted and are embedded in the base pay to which an individual's incentive target rate would be applied. Any analysis attempting to estimate an asserted reduction in costs by avoiding the compounding effect of annual base pay should consider the increasing trend of incentive compensation awards over time and the ongoing base pay increases on which "at risk" compensation to the employee is based.

Q. DO YOU HAVE ANY FURTHER COMMENTS REGARDING THE COMPANY'S PROPOSED AIP ADJUSTMENTS?

A. Yes. Ms. Reed explains that "Ms. Blair presents an adjustment to the Test Year revenue requirement to remove the dollar amount of annual incentive compensation expense above the target level of expense."⁶⁴ In response to AXM RFI 17-7 (see Attachment SCC-6), SPS provided additional information showing how that AIP target level was quantified and stated, in part: "As clarification, please refer to SPS's response to Question No. OPUC 6-21, in which SPS explains that the Test Year amount for AIP expense was reduced to meet the 100 percent AIP target for 2015...Please refer to the table below for additional support of the 2015 target amounts." [Emphasis added]

⁶⁴ See Direct Testimony of Jill H. Reed at 36.

1

	SPS	XES	Total
Total Cost Amount	3,257,133	33,683,863	
Percent to SPS O&M	67%	12%	
Amount to SPS O&M	2,167,232	4,054,125	6,221,357

2 Although the Company has proposed to reduce test year AIP to reflect 100% of the
3 target, SPS did not quantify this adjustment based on the 2014 target level but instead
4 chose to reach out to capture a higher 2015 target level.

5 **XI. DEPRECIATION ANNUALIZATION – AXM ACCRUAL RATES**
6 **(AXM C-14)**

7 **Q. PLEASE DESCRIBE AXM ADJUSTMENT C-14.**

8 A. AXM Adjustment C-14 (Attachment SCC-3) annualizes book depreciation rates based on
9 the depreciation accrual rates recommended by AXM witness Mr. Pous.

10 **Q. HOW WAS AXM ADJUSTMENT C-14 QUANTIFIED?**

11 A. Book depreciation was annualized by multiplying the regulated investment in depreciable
12 plant included in rate base by the accrual rates proposed by AXM. The aggregate amount
13 of the pro forma depreciation expense was then compared to the amount of depreciation
14 expense proposed by the Company in its Case Update filing. The resulting incremental
15 change in depreciation expense is attributable to AXM's proposed change in book
16 depreciation accrual rates. To quantify this adjustment a comparison was made between
17 the pro forma depreciation resulting from the AXM's proposed depreciation rates and the
18 annualized level recommended by the Company.

19 **Q. YOU PREVIOUSLY DISCUSSED A RECOMMENDATION THAT THE**
20 **COMMISSION NOT ADOPT SPS'S POST-TEST YEAR ADJUSTMENT. IS**
21 **AXM ADJUSTMENT C-14 BASED ON THE COMPANY'S DEPRECIABLE**
22 **PLANT BALANCES AT JUNE 2014 CONSISTENT WITH THE PTYA**
23 **RECOMMENDATION?**

24 A. Yes.

1 **Q. ARE THERE ANY OTHER MATTERS THAT EFFECT THE**
2 **QUANTIFICATION OF PRO FORMA DEPRECIATION EXPENSE THAT**
3 **SHOULD BE IDENTIFIED?**

4 A. Yes. Setting aside the development and presentation of new depreciation and
5 amortization rate proposals, which are addressed by SPS witnesses Mr. Watson and Ms.
6 Perkett and AXM witness Pous, the process of reviewing, verifying and testing the steps
7 underlying the Company's annualization process and integration of AXM's
8 recommendations is complex. As summarized by SPS witness Ms. Blair, the Company
9 quantified six separate depreciation adjustment steps:⁶⁵

10 1. The depreciation rates SPS actually applies to depreciable plant in recording
11 depreciation expense on its books and records is a "blended" rate that considers
12 not only the depreciation rates authorized by this Commission but also rates
13 approved in the New Mexico and wholesale (FERC) jurisdictions. The first SPS
14 adjustment was to "unblend" the book depreciation expense to reflect the current
15 Texas approved depreciation rates.

16 2. The second SPS adjustment recognizes the difference between the unblended
17 depreciation expense and the annualized level of book depreciation expense based
18 on depreciable plant at test year-end (June 2014) and the currently authorized
19 Texas depreciation rates.

20 3. The third SPS adjustment reflects the difference between annualized depreciation
21 expense from step 2 and annualized depreciation expense using the new
22 depreciation rates presented by Mr. Watson and recommended by Ms. Perkett as
23 applied to test year-end depreciable plant.

24 4. The fourth SPS adjustment captures the change in depreciation expense resulting
25 from the Company's recommended new depreciation rates applied to the post-test
26 year adjustment to depreciable plant (December 2014) rather than test year-end
27 (June 2014 per step 3).

⁶⁵ See Direct Testimony of Deborah Blair at 68-70.

1 5. The fifth adjustment eliminates depreciation expense related to electric meters and
2 line transformers assigned to the Texas jurisdiction that should be assigned to
3 New Mexico.

4 6. The final adjustment eliminates the Asset Retirement Obligation regulatory
5 credits (FERC Account 407) and the related depreciation depletion and accretion
6 expense, which net to zero in the Company's cost of service.

7 The review and verification process is further complicated by the fact that the existing
8 and proposed depreciation rates are applied not only at a FERC account level, but by
9 generating unit (i.e., different rates for each generating station for each plant account), in
10 the case of production plant, and vintage-based amortization for general plant accounts.

11 While reviewing the detailed spreadsheet files underlying these annualization steps and
12 editing the AXM revenue requirement model (i.e., the source of Attachment SCC-3) to
13 accommodate Mr. Pous' depreciation rate recommendations (AXM Adjustment C-14), I
14 observed what appeared to be an inadvertent cell formulae error that resulted in too little
15 depreciation on transportation assets being attributed to capital/clearing accounts (i.e.,
16 depreciation expense was overstated).⁶⁶

17 During a teleconference on March 16, 2015, SPS representatives confirmed the
18 transportation depreciation error which was the subject of AXM RFI 28-1 (*see*
19 Attachment SCC-6). However, the annualization of depreciation expense using Mr.
20 Pous' recommended depreciation/amortization rates, as quantified by AXM Adjustment
21 C-14, corrects the identified calculation error.

⁶⁶ For regulatory accounting purposes, a portion of depreciation on transportation and work equipment is typically removed from depreciation expense and charged to capital projects or clearing accounts based on the use of such assets to support business activities other than operating and maintenance work. SPS uses a fleet utilization factor to recognize this expense credit in calculating revenue requirement. *See* SPS Case Update Attachment DAB-RR-2, pages 258-260, line 22 and supporting spreadsheet "Depreciation Expense Adjustments - Dec Update.xlsx".

1 **XII. 2015 ACTIVE HEALTH CARE COSTS (AXM C-18)**

2 **Q. PLEASE DESCRIBE AXM ADJUSTMENT C-18?**

3 A. SPS has proposed a known and measurable adjustment to the June 2014 test year based
4 on an “actuarial calculation performed by Towers Watson for 2015 active health care
5 costs.”⁶⁷ AXM Adjustment C-18 (Attachment SCC-3) reverses the effect of the 2015
6 forecast amount in excess of SPS’s revised test year actual amount. This AXM
7 adjustment reduces SPS’s proposed health care expense by \$540,820 (total Company).⁶⁸

8 **Q. PLEASE EXPLAIN YOUR REFERENCE TO SPS’S REVISED TEST YEAR**
9 **ACTUAL AMOUNT.**

10 A. In direct testimony, SPS witness Mr. Schrubbe explained that the “per book numbers for
11 active health care amounts include estimates because there is generally an average lag of
12 approximately 30 days between when health care is provided and when SPS receives a
13 bill for that care.” Recognizing that SPS is self-insured for health care benefits provided
14 to employees, the Company’s original filing included an adjustment increasing the
15 accrual basis amounts recorded during the test year to include claims incurred, but not
16 recorded in the amount of \$471,336 (total Company).⁶⁹ This resulted in an adjusted per
17 book expense for health care benefits in the amount of \$13,684,322.⁷⁰

18 In a supplemental response to AXM RFI 14-14,⁷¹ SPS explained that it had discovered an
19 error in its original adjustment to include the incurred but not recorded charges in test
20 year expense. The correction of this error had the effect of increasing the adjusted test
21 year expense from \$13,684,324 (total Company) to \$13,814,106 (i.e., an increase of
22 \$129,782), which decreases the Company’s “known and measurable adjustment from

⁶⁷ See Direct Testimony of Richard Schrubbe at 30.

⁶⁸ See SPS response to AXM RFI 14-14 (2/25/2015 supplemental response). Also, see response in Attachment SCC-6.

⁶⁹ See Direct Testimony of Deborah Blair at 62.

⁷⁰ See SPS response to AXM RFI 1-2 [Exhibit SPS-AXM 1-2(V)(CD)] and AXM RFI 14-14 (2/25/2015 supplemental response). Also, see responses in Attachment SCC-6.

⁷¹ *Id.*