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SOAH DOCKET NO. 473-19-3864
PUC DOCKET NO. 49421

APPLICATION OF CENTERPOINT	**§**	**BEFORE THE STATE OFFICE**
ENERGY HOUSTON ELECTRIC, LLC	**§**	**OF**
FOR AUTHORITY TO CHANGE RATES	**§**	**ADMINISTRATIVE HEARINGS**

TEXAS COAST UTILITIES COALITION'S EXCEPTIONS TO THE PROPOSAL FOR DECISION

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TEXAS COAST UTILITIES COALITION'S
EXCEPTIONS TO THE PROPOSAL FOR DECISION

INTRODUCTION

The Texas Coast Utilities Coalition[1] ("TCUC") of cities limits its Exceptions to the Proposal for Decision ("PFD") ("Exceptions") to the issues of cost of capital and the appropriate capital structure for CenterPoint Energy Houston Electric, LLC ("CEHE"), and the proper depreciation rates and depreciation expense for CEHE.

TCUC joins in and supports the positions presented by the Gulf Coast Coalition of Cities ("GCCC"), and the City of Houston and the Houston Coalition of Cities (collectively, the "Houston Coalition") on issues addressed in their exceptions. Further, TCUC expressly reserves the right to address all issues in its reply exceptions raised by other parties in their exceptions.

For convenience and the sake of brevity, TCUC includes in its Exceptions, only those sections of the Administrative Law Judges' ("ALJs") PFD to which TCUC excepts.

III. RATE OF RETURN [PO Issues 4, 5, 7, 8, 9]

The Texas Coast Utilities Coalition of cities ("TCUC") excepts to the Administrative Law Judges' ("ALJs") Proposal for Decision ("PFD") with regard to the ALJs' proposed return on equity of 9.45%[2] and the ALJs' proposed capital structure of 55% long-term debt and 45% common equity.[3] More specifically, TCUC excepts to the ALJs' proposed findings of fact ("FOF") numbers 186 – 188, 206 – 207, and 209.

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[1] The Texas Coast Utilities Coalition of cities is comprised of the Cities of Baytown, Clute, Freeport, League City, Pasadena, Pearland, Shoreacres, West Columbia, and Wharton.

[2] Proposal for Decision ("PFD at __") at 117.

[3] PFD at 174.

Thus, TCUC's urges as its primary recommendation that the Commission amend FOF Nos. 186 – 188, 206 – 207, and 209 to read as follows:

186. A return on equity (ROE) of ~~9.45%~~ 9.00% will allow CenterPoint a reasonable opportunity to earn a reasonable return on its invested capital.

187. The results of the discounted cash flow model, the risk premium approach, and the capital asset pricing model support an ROE of ~~9.45%~~ 9.00%.

188. A ~~9.45%~~ 9.00% ROE is consistent with CenterPoint's business and regulatory risk.

206. A capital structure composed of ~~55%~~ 60% long-term debt and ~~45%~~ 40% equity is reasonable in light of CenterPoint's business and regulatory risks.

207. A capital structure composed of ~~55%~~ 60% long-term debt and ~~45%~~ 40% equity ~~will help~~ provides CenterPoint the ability to attract capital from investors at reasonable costs.

208. CenterPoint's reasonable overall rate of return is as follows:

COMPONENT	CAPITAL STRUCTURE	COST OF CAPITAL	WEIGHTED AVERAGE COST OF CAPITAL
LONG-TERM DEBT	~~55%~~ 60%	4.38%	2.63% ~~2.41%~~
COMMON EQUITY	~~45%~~ 40%	8.97% ~~9.42%~~[4]	3.59% ~~4.24%~~
TOTAL	100.00%		6.22% ~~6.65%~~

A. Return on Equity [PO Issue 8]

The ALJs state that "The mathematical analyses demonstrate that the reasonable range for CenterPoint's ROE is between 9.0% and 10.0%. A mid-point of this range would result in an ROE of 9.5% for CenterPoint."[5] But the ALJs' statement is inconsistent with their summary of the evidence regarding the parties' ROE analyses.

The record establishes that the intervenors and Staff's recommended ROEs were in a range of ROEs from 7.30% to 9.92%. An ROE range of 7.30% to 9.92% mathematically produces an average ROE of 8.61%, a return on equity much closer to Dr. Woolridge's analyses, which mathematically produced a return on equity of 8.65%. Employing the concept of gradualism to changes in CEHE's return on equity, Dr. Woolridge proposed a specific

[4] TCUC proposes a return on equity of 9.00%. Taking into account the ALJs' proposed adjustment to CEHE's return on equity produces a return on equity of 8.97%. A return on equity of 9.00% results in an overall rate of return of 6.23%. *See* TCUC Initial Post-Hearing Brief at 2 ("TCUC Initial Brief").

[5] *See* PFD at 170.

percentage of 9.00%.[6] The table below, taken directly from the ALJs' PFD, summarizes the parties' recommended ranges for CEHE's ROE.

ALJs' Summary of ROE Recommendations[7]

WITNESS	ROE RANGE		ROE RECOMMENDATION
	LOW	HIGH	
Jorge Ordonez (Staff)	8.34%	9.79%	9.45%
Anjuli Winker (OPUC)	6.76%	9.92%	9.15%
Michael Gorman (TIEC)	9.00%	9.50%	9.25%
J. Randall Woolridge (TCUC)	7.30%	8.65%	9.00%
Robert Hevert (CenterPoint)	10.00%	10.75%	10.40%

Thus, the ALJs statement that mathematically the credible range of ROEs for CEHE is between 9.0% and 10.0% is incorrect. The credible evidence in the record establishes a range of ROEs from 7.30% to 9.92%, which mathematically produces an average ROE of 8.61%. An average return on equity of 8.61% is much closer to Dr. Woolridge's recommended ROE of 8.65% before his adjustment for gradualism, and likewise, closer to his recommendation of a specific percentage of 9.00%.

Therefore, TCUC respectfully urges the Commission to adopt a return on equity of 9.00% with a corresponding capital structure of 60% debt and 40% equity.[8]

B. Cost of Debt [PO Issue 8]

TCUC excepts to the ALJs' recommendation to exclude the cost of short-term debt in determining CEHE's overall cost of capital.[9] They reach their conclusion primarily based on the

[6] *See* TCUC Initial Brief at 9.

[7] *See* PFD at 116.

[8] *See* TCUC Initial Brief at 9-13.

[9] Docket No. 43695, *Application of Southwestern Public Service Company for Authority to Change Rates*, Order on Rehearing (Feb. 23, 2016) ("Docket No. 43695").

Commission's decision in Docket No. 43695[10] and their conclusion that "TCUC has presented no evidence supporting a change in that *long-standing practice*."[11]

First, the ALJs provide no citations to the "long-standing practice" they may have in mind; they cite only to Docket No. 43695. Oddly, the ALJs discard years of Commission precedent with regard to the appropriate capital structure to employ in setting CEHE's cost of capital.[12] Nonetheless, the ALJs on the Commission's decision in a single, contested case to reject TCUC's alternative recommendation to include the cost of short-term debt in determining CEHE's overall cost of capital.[13] More importantly, not only does a single case not establish "long-standing precedent," but the Commission decides issues of fact – including whether to include the cost of short-term debt in a utility's capital structure – based on the evidence in each case. Consequently, the Commission's findings of fact in Docket No. 43695 do not control the Commission's findings in setting CEHE's rates.

Second, with regard to the ALJs' statement that TCUC has presented no evidence supporting inclusion of CEHE's cost of short-term debt in CEHE's capital structure, the record establishes, as the ALJs noted, that:

- CenterPoint employs short-term debt to finance its operations, including financing of its capital expenditures;[14]

- As recently as March 28, 2019, CenterPoint employed $590 million in short-term borrowings from the money pool in which CNP subsidiaries participate for short-term borrowings;[15]

- Dr. Woolridge's analysis established that CenterPoint's use of short-term financing requirements and debt varies by the day, and it had short-term debt outstanding for 225 of the 365 days in 2018;[16]

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[10] *See* PFD at 171.

[11] *See* PFD at 173 [emphasis added].

[12] *See* PFD at 188 (citing to the Staff's testimony, which cites to Docket No. 22344, *Generic Issues Associated with Applications for Approval of Unbundled Cost of Service Rate Pursuant to PURA § 39.201 and Public Utility Commission Substantive Rule § 25.244*, Order No. 42, (Dec. 22, 2000).

[13] *See* PFD at 171.

[14] *See* PFD at 171; *see also* TCUC Initial Brief at 32-33.

[15] *See* PFD at 171; *see also* TCUC Initial Brief at 33.

[16] *See* PFD at 171; *see also* TCUC Initial Brief at 36.

- Dr. Woolridge calculated CenterPoint's average daily balance of short-term-debt to be $52.1 million in 2018;[17]

- When CenterPoint reports its finances to the investment community, it makes clear that it is reporting the entirety of its debt and is not limiting its financial reporting only to long-term debt.[18]

Thus, the ALJs' statement that TCUC presented no evidence to support its proposal is simply incorrect. The preponderance of the evidence establishes that CEHE employs short-term debt in every aspect of its operations, as it should.

And crucially, although the ALJs note that CenterPoint "initially funds its capital investments with a combination of internally-generated funds, short-term debt, long-term debt, and common equity investments from CNP,"[19] and that "short-term debt initially used to fund operations and capital investments is converted to long-term debt, similar to when a utility asset is removed from CWIP and placed in service,"[20] they ignore the fungibility of CEHE's sources of cash.

The record establishes, and CEHE's cost-of-capital witness agreed, that CEHE cannot trace a dollar secured through short-term debt, long-term debt, equity, or internally generated cash, to any particular use. CEHE's – as is any utility's – capital is fungible and CEHE cannot trace short-term debt, long-term debt, or equity cash to a particular project. This is precisely what CEHE's 10Ks and 10Qs show: CEHE uses cash funds from short-term debt, long-term debt, or equity to finance capital projects and its operations.[21]

The effect of the fungibility of CEHE's funds is that each and every expenditure CEHE makes – whether an expense or a capital item – is financed with a mix of CEHE's sources of capital: short-term debt, long-term debt, equity, and internally-generated cash. This means that in establishing CEHE's cost of capital, the cost of short-term debt plays a key role. Irrespective of CEHE's practice for accounting for its assets, the fact remains that CEHE acquires each asset through a mix of indistinguishable dollars.

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17 *See* PFD at 171; *see also* TCUC Initial Brief at 36.

18 *See* PFD at 171-72; *see also* TCUC Initial Brief at 33.

19 *See* PFD at 172.

20 *See* PFD at 172.

21 *See* TCUC Initial Brief at 13.

Moreover, Mr. McRae, CEHE's principal witness on capital-structure issues, in a rate case in Minnesota, requested, "the [Minnesota] Commission to approve a capital structure composed of 52.18% common equity, 43.67% long-term debt, and 4.15% short-term debt," and testified that the "primary sources of capital are short-term debt, long-term debt, and common equity. *Capital structure is typically expressed in terms of the ratio of a particular type of capital to total capital.*"[22] But the Commission will search the PFD in vain either for the ALJs' dialogue of the fungibility of capital, or their discussion of the position CEHE advocated in Minnesota to include short-term debt in CenterPoint's capital structure. Instead, the PFD simply ignores the inconsistent positions CenterPoint takes in Texas versus Minnesota.

When given proper weight, the ALJs' error to reject inclusion of the cost of short-term debt in determining CEHE's overall cost of capital, is evident. Thus, should the Commission not accept Dr. Woolridge's primary recommendation of a capital structure of 60% long-term debt and an equity ratio of 40%, with a corresponding cost of equity of 9.00%, then alternatively, TCUC respectfully urges the Commission to include the cost of short-term debt in determining CEHE's overall cost of capital.

C. Capital Structure [PO Issue 7]

1. The preponderance of the evidence and Commission precedent support a capital structure comprised of 60% debt and 40% equity.

While the ALJs rightly rejected CEHE's proposed capital structure, the ALJs erred in recommending a capital structure of 55% long-term debt and 45% equity. As the Commission is well aware, the cost of debt is usually lower than the cost of equity, and certainly, that is the case today;[23] and the higher the equity ratio in CEHE's capital structure, the higher its revenue requirement as affected by its cost of capital. In reality, CEHE's overall cost of capital is lower than would be reflected in rates were the Commission to adopt the ALJs' proposed capital structure, with the difference flowing to the shareholders in unearned returns, leading to artificially inflated rates for the services CEHE provides,[24] and providing CEHE's shareholders with a bonus return.

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[22] *See* TCUC Reply Brief at 14 [emphasis added].

[23] *See* TCUC Initial Brief at 11-12.

[24] *See Id.* at 34.

The evidence establishes that CEHE's average common equity ratios for CenterPoint Energy, Inc. and CEHE are 33.4% and 42.9%, respectively,[25] and that CEHE's common equity ratio has been in the 38% to 45% range over the three-year time period from January, 2016 through December 31, 2018.[26] Crucially, at this level of equity, CEHE has not only raised capital at reasonable costs, but maintained its credit ratings.[27]

Additionally, these ratios ignore CEHE's use of short-term debt. Including short-term debt in determining the overall debt CEHE uses to fund its operations, its total use of debt for the 13-quarter period January 1, 2016 through March 31, 2019, ranged from a low of 54.2% to a high of 61.3%. Over this same 13-quarter period, including short-term debt, CEHE had an average of 56.9% total debt in its capital structure.[28]

Likewise, for the same 13-quarter period, *excluding* short-term debt, CEHE's debt ratio ranged from a low of 54.2% to a high of 58.5%, for an average of 56% long-term debt in its capital structure.[29] For the calendar year 2018, CEHE's use of debt to finance its operations – *including* and *excluding* short-term debt – ranged from 54.5% to 57.2%, and on average CEHE's total debt comprised about 56% of its capital structure. Its corresponding equity ratio for this period ranged from 42.8% to 45.5%.[30]

There is no credible basis for ratepayers in Texas to pay rates based on a higher equity ratio, or capital structure that excludes short-term debt in calculating CEHE's revenue requirement and rates, than ratepayers pay in other states in which CEHE's affiliates provide service. Each are wholly-owned subsidiaries of CenterPoint Energy.

But with only passing explanation,[31] the ALJs jettison the Commission's long-standing precedent from Docket No. 22344, which found that a uniform capital structure consisting of 60% long-term debt and 40% common equity was appropriate for ratemaking purposes for all TDUs operating in Texas.[32] Instead, the ALJs simply "split the baby" between CEHE's proposal

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[25] *See Id.* at 37.

[26] *See Id.* at 31.

[27] *See Id.*

[28] *See Id.* at 34.

[29] *See Id.* at 35.

[30] *See Id.*

[31] *See* PFD at 190-191.

[32] *See Id.* at 187-188.

and the intervenors' recommendation regarding the appropriate capital structure, excluding OPUC, and proposed adoption of a capital structure close to OPUC's recommended capital structure of 55.48% debt and 43.62% equity.[33]

Consistent with the preponderance of the credible evidence and Commission precedent, TCUC respectfully urges the Commission to adopt a capital structure of 60% debt and 40% equity.

2. If the Commission rejects TCUC's primary recommendation of a 60% debt and 40% equity capital structure, TCUC urges the Commission to adopt TCUC's alternative recommendation to include short-term debt and adjust the ROE accordingly.

TCUC alternatively recommended that, if the ALJs rejected a capital structure of 60% debt and 40% equity and a cost of equity of 9.00%, that they include short-term debt in determining CEHE's overall rate of return. But instead the ALJs proposed a higher equity ratio than TCUC recommended and excluded short-term debt from CEHE's capital structure. Thus, TCUC excepts to the ALJs' recommendation and urges the Commission to include short-term debt in CEHE's capital structure and that the Commission add the following findings of fact:

> **XXX.** A return on equity (ROE) of 8.65% will allow CenterPoint a reasonable opportunity to earn a reasonable return on its invested capital.
>
> **XXX.** The results of the discounted cash flow model, the risk premium approach, and the capital asset pricing model support an ROE of 8.65%.
>
> **XXX.** An 8.65% ROE is consistent with CenterPoint's business and regulatory risk.
>
> **XXX.** A capital structure composed of 0.90% short-term debt, 55.48% long-term debt, and 43.62% equity is reasonable in light of CenterPoint's business and regulatory risks.
>
> **XXX.** A capital structure composed of 0.90% short-term debt, 55.48% long-term debt, and 43.62% equity provides CenterPoint the ability to attract capital from investors at reasonable costs.
>
> **XXX.** CenterPoint's reasonable overall rate of return is as follows:

[33] *See Id.* at 191.

COMPONENT	CAPITAL STRUCTURE	COST OF CAPITAL	WEIGHTED AVERAGE COST OF CAPITAL
SHORT-TERM DEBT	0.90%	2.27%	0.02%
LONG-TERM DEBT	55.48%	4.38%	2.43%
COMMON EQUITY	43.62%	8.62%[34]	3.76%
TOTAL	100.00%		6.21%

For the reasons noted in Section III.B. – Cost of Debt, above, if the Commission does not adopt Dr. Woolridge's primary recommendation of a capital structure of 60% long-term debt and an equity ratio of 40%, with a corresponding cost of equity of 9.00%, then alternatively, TCUC respectfully urges the Commission to include the cost of short-term debt in determining CEHE's overall cost of capital and adopt the capital structure shown in the table immediately above.

Additionally, because Dr. Woolridge's alternative recommended capital structure, which includes short-term debt, contains a higher equity ratio, if the Commission adopts Dr. Woolridge's alternative recommended capital structure, then TCUC urges the Commission to adopt Dr. Woolridge's alternative recommended ROE of 8.65%.

Dr. Woolridge's alternative rate-of-return recommendation uses *CEHE's actual 2018 capital structure.* With respect to the ROE, Dr. Woolridge's range of return on equity of 7.30% to 8.65%, accurately reflects current capital market data.[35] As Dr. Woolridge testified:

> Capital costs in the U.S. remain low, with low inflation and interest rates and very modest economic growth. To reflect these low capital costs, my alternative ROE recommendation is 8.65%, which is at the high end of my equity cost rate range. Given my recommended capitalization ratios and senior capital cost rates, my alternative rate of return or cost of capital recommendation for the Company is 6.22%.[36]

Dr. Woolridge's *alternative* recommendation to expressly include short-term debt in establishing CEHE's overall rate of return is fully supported by the evidence, is consistent with CEHE's historical use of debt, is premised on what the credit agencies review and with the data

[34] TCUC's alternative recommendation includes a return on equity of 8.65%. Taking into account the ALJs' proposed adjustment to CEHE's return on equity produces a return on equity of 8.62%, which results in an overall rate of return of 6.21%.

[35] TCUC Exh. 1 – Woolridge Dir. at 5.

[36] TCUC Exh. 1 – Woolridge Dir. at 5. TCUC's alternative recommendation includes a return on equity of 8.65%. Taking into account the ALJs' proposed adjustment to CEHE's return on equity produces a return on equity of 8.62%, which results in an overall rate of return of 6.21%.

CEHE reports to the SEC, and tracks CEHE's actual capitalization. Should the Commission not adopt Dr. Woolridge's primary recommendation of a capital structure of 60% long-term debt and an equity ratio of 40%, with a corresponding cost of equity of 9.00%, then alternatively, TCUC respectfully urges the Commission to adopt Dr. Woolridge's alternative cost-of-capital recommendation.

D. Overall Rate of Return [PO Issue 8]

For the reasons noted above, TCUC excepts to the ALJs' proposed overall rate of return of 6.65% and urges the Commission to adopt an overall rate of return of 6.22% as shown in the table below:

Primary Recommendation Regarding Capital Structure, Return on Equity, and Rate of Return[37]

COMPONENT	CAPITAL STRUCTURE	COST OF CAPITAL	WEIGHTED AVERAGE COST OF CAPITAL
LONG-TERM DEBT	60%	4.38%	2.63%
COMMON EQUITY	40%	8.97%	3.59%
TOTAL	100.00%		6.22%

Alternatively, TCUC urges the Commission to adopt an overall rate of return of 6.21% as shown in the table below:

Alternative Recommendation Regarding Capital Structure, Return on Equity, and Rate of Return

COMPONENT	CAPITAL STRUCTURE	COST OF CAPITAL	WEIGHTED AVERAGE COST OF CAPITAL
SHORT-TERM DEBT	0.90%	2.27%	0.02%
LONG-TERM DEBT	55.48%	4.38%	2.43%
COMMON EQUITY	43.62%	8.62%[38]	3.76%
TOTAL	100.00%		6.21%

[37] TCUC's primary recommendation includes a return on equity of 9.00%. Taking into account the ALJs' proposed adjustment to CEHE's return on equity produces a return on equity of 8.97%, which results in an overall rate of return of 6.22%.

[38] TCUC's alternative recommendation includes a return on equity of 8.65%. Taking into account the ALJs' proposed adjustment to CEHE's return on equity produces a return on equity of 8.62%, which results in an overall rate of return of 6.21%.

IV. Operating and Maintenance Expenses [PO Issues 4, 5, 21, 22, 25, 26, 28, 29, 33, 35, 36, 38, 39, 54, 55]

C. Depreciation and Amortization Expense [PO Issue 25]

1. Study Methodology

TCUC excepts to the ALJs' findings of fact regarding the appropriate depreciation rates to use in setting CEHE's rates, and more specifically, to the ALJs' proposed findings of fact numbers 251, 255, and 257 - 266.

For the reasons noted below, TCUC respectfully urges the Commission to reject the ALJs' recommended depreciation rates and corresponding findings of facts, and to approve TCUC witness David Garrett's proposed depreciation rates and further urges that the Commission modify FOF Nos. 251, 255 and 257-266 to read as follows:

> 251. The effect of applying the depreciation rates approved in this proceeding to the December 31, 2018 depreciable plant balances is an annualized depreciation expense of approximately ~~$378~~ 341.5 million, which represents an overall ~~increase~~ decrease of approximately ~~$2.5~~ 36.5 million compared to CenterPoint's annualized depreciation and amortization expense as ~~at prior depreciation rates~~ proposed.
>
> 255. The reserve reallocation and resulting service lives and net salvage rates proposed by ~~CenterPoint~~ TCUC are reasonable, and the Commission should use these service lives and net salvage rates in calculating depreciation rates for CenterPoint's transmission, distribution, and general plant assets.
>
> 257. The appropriate service life for CenterPoint's transmission station equipment (FERC Account 353) is ~~53~~ 56 years with a dispersion curve of R0.5.
>
> 258. The appropriate service life for CenterPoint's transmission towers and fixtures (FERC Account 354) is ~~59~~66 years with a dispersion curve of R2~~.5~~.
>
> 259. The appropriate service life for CenterPoint's distribution station equipment (FERC Account 362) is ~~48~~55 years with a dispersion curve of R~~1~~0.5.
>
> 260. The appropriate service life for CenterPoint's distribution poles, towers, and fixtures (FERC Account 364) is ~~35~~ 45 years with a dispersion curve of R0.5.
>
> 261. The appropriate service life for CenterPoint's distribution overhead conductors and devices (FERC Account 365) is ~~38~~ 40 years with a dispersion curve of R0.5.
>
> 262. The appropriate service life for CenterPoint's distribution underground conduit (FERC Account 366) is ~~25~~ 65 years with a dispersion curve of ~~R2.5~~ S1.

263. The appropriate service life for CenterPoint's distribution underground conductor and devices (FERC Account 367) is ~~38~~ 42 years with a dispersion curve of ~~R0.5~~L0.

264. The appropriate service life for CenterPoint's distribution line transformers (FERC Account 368) is ~~28~~ 32 years with a dispersion curve of ~~R1~~ L0.

265. The appropriate service life for CenterPoint's general plant structures and improvements station equipment (FERC Account 390) is ~~50~~ 58 years with a dispersion curve of R42.

266. The depreciation rates CenterPoint filed with the application as Appendix A Exhibit DAW-1, as modified by TCUC's recommended depreciation rates, are just and reasonable.

The ALJs conclude that TCUC's critique of CEHE's method of developing depreciation rates using the Simulated Plant Record ("SPR") method is not supported by the credible evidence nor by Commission precedent.[39] Their conclusion is incorrect.

First, the credible evidence reinforces TCUC witness Mr. David Garrett's criticism of CEHE's calculation of its depreciation rates based on the SPR method.[40] Mr. Dane Watson, CEHE's depreciation witness, based his estimates of depreciation rates for CEHE's transmission and distribution accounts on the Simulated Plant Record ("SPR") method. The SPR method of developing depreciation rates differs from the actuarial method in that the actuarial method uses what is known as "aged" data whereas the SPR method does not.[41] Aged data shows not only the age of the asset in the year the utility retired the asset, but also when the utility placed the asset into service, known as the "vintage" year.[42]

Because the actuarial method uses "aged" data this method provides the analyst more data upon which the analyst can estimate depreciation rates. No party disputes the fact, and Mr. Watson indeed concedes, that "aged" data is more robust in comparison to "unaged" data.[43] CEHE's witness Mr. Watson further acknowledged that other utilities track aged data for transmission and distribution accounts and that it is not uncommon in the industry for aged data

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[39] PFD at 265.

[40] Mr. Garrett addressed CEHE's proposed depreciation rates for eight accounts where CEHE's proposed rates are based on the SPR method; these accounts are Account Numbers 353, 354, 362, 364, 365, 366, 367 and 368.

[41] *See* PFD at 261 and 263; TCUC Exh. 2, Direct Testimony of David Garrett ("Garrett Dir.") at 8-9.

[42] *Id.* at 261; TCUC Exh. 2 – Garrett Dir. at 8.

[43] HOM Tr. at 325; CEHE Exh. 41 – Rebuttal Testimony of Dane Watson ("Watson Reb.") at 14.

to be maintained for these accounts.[44] Thus, the record establishes that, relative to the actuarial method of estimating depreciation rates, because the SPR method lacks "aged" data, it produces less reliable results than the actuarial method.[45]

The ALJs do not dispute that aged data is more "robust," but in a conclusory fashion do no more than to state that the SPR method, which uses unaged data, is just as reliable as the actuarial method, which uses aged data.[46] However, the ALJs' conclusion is inconsistent with the credible record evidence. As noted above, the record establishes that because the SPR method does not rely on aged data, it is less reliable than the actuarial method to estimate depreciation rates.

To test Mr. Watson's analysis, and because the SPR method lacks aged data, Mr. Garrett considered the service lives for transmission and distribution accounts for other utilities that do maintain aged data for such assets and for which the Commission had approved depreciation rates.[47] Mr. Garrett's analysis showed that Mr. Watson's proposed depreciation rates were materially shorter for the eight accounts in question, that the lives of those same accounts for other utilities. The results of Mr. Garrett's analysis are depicted in the chart below:

Figure 3: Peer Group Comparison[48]

			Peer Group					
Acct	Description	CEHE	SWEPCO	OG&E	PSO	Peer Avg	Peer Avg less CEHE	TCUC
	TRANSMISSION PLANT							
353	STATION EQUIPMENT	53	60	63	60	61	8	56
354	TOWERS & FIXTURES	59	60	75	75	70	11	66
	DISTRIBUTION PLANT							
362	STATION EQUIPMENT	48	55	68	75	66	18	55
364	POLES,TOWERS,FIXTURE	35	55	55	53	54	19	45
365	O/H CONDUCT DEVICES	38	44	54	46	48	10	40
366	UNDERGROUND CONDUIT	62	70	65	78	71	9	65
367	U/G CONDUCT/DEVICES	38	45	64	65	58	20	42
368	LINE TRANSFORMERS	28	50	44	36	43	15	32
	Average	**45**	**55**	**61**	**61**	**59**	**14**	**50**

[44] HOM Tr. at 327.

[45] TCUC Exh. 2 – Garrett Dir. at 8.

[46] PFD at 265.

[47] TCUC Exh. 2 – Garrett Dir. at 18-20.

[48] *Id.* at 20.

To be clear, Mr. Garrett did not simply take the other utilities' depreciation lives and propose that the Commission adopt those same lengths of lives for CEHE's assets. Instead what the evidence establishes, as shown in the chart above, is that TCUC's proposed service lives are generally closer to CEHE's proposals than they are to the peer-group service lives. This demonstrates that Mr. Garrett's recommendations are conservative in nature. Further, the ALJs' summary of Mr. Garrett's testimony establishes that the other companies in Mr. Garrett's peer group are demonstrably similar to CEHE such as to allow for an apples-to-apples comparison of service lives of the assets in question.[49]

Thus, the credible evidence in the record establishes that:

- As between the actuarial method for determining depreciation rates, and the SPR method for estimating depreciation rates, the actuarial method is superior;
- The actuarial method, in part, is superior because it relies on "aged" data, whereas the SPR method lacks such data;
- Mr. Watson agreed that having aged data provides the analyst with a more robust set of data points, and concomitantly, more accurate results;
- Mr. Watson used the SPR method for estimating CEHE's depreciation rates;
- Mr. Watson's proposed lives for the eight accounts at issue are markedly shorter than the lives for the same accounts for other utilities for which the Commission has recently approved depreciation rates; and
- Mr. Garrett's proposed lives for the assets in the eight accounts in question are consistent with the lives the Commission recently approved for these accounts.

With regard to the ALJs' second conclusion – that Mr. Garrett's analysis is inconsistent with the Commission's precedent – that too is not supported by the record.

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[49] PFD at 263-264:

- They are electric utilities, which means they all utilize similar types of assets.
- The service lives of the assets at issue in this proceeding, for the utilities in the peer group of utilities, were approved within the past two years, demonstrating that any recent trends in the service lives of the assets for the accounts at issue are taken into account.
- One of the utilities, SWEPCO, is an electric utility located in Texas, and its service area is adjacent to CenterPoint's service area. The other utilities in the study, OG&E and PSO, are located in Oklahoma, relatively close to CenterPoint's service area. (citations omitted).

As explained below, a comparison of utilities' service lives such as this is a valid means establishing depreciation, rates when the underlying data is relatively unreliable. The ALJs did not give Mr. Garrett's comparative analysis sufficient weight even though the ALJs acknowledge that the service lives that result from the SPR method are derived from relatively unreliable unaged data. The purpose of accounting for the approved service lives of other utilities is to serve as a check on the reasonableness of CEHE's proposed service lives given the relative unreliability of un-aged data that Mr. Watson's SPR method utilizes.

With regard to the ALJs' second conclusion – that Mr. Garrett's analysis is not supported by Commission precedent – that conclusion, too, is wrong.[50] Indeed, the first case the ALJs cite – Docket No. 28840[51] – actually supports Mr. Garrett's position.

In Docket No. 28840, AEP Texas Central Company's ("AEP") general rate case, the ALJs approved the cities' witness' recommendations to lengthen the service lives of certain accounts because based on the results of a survey of other utilities' service lives for the similar assets, AEP's proposed service lives were longer than the service lives of similar assets held by those other utilities.[52]

In Docket No. 28840 the cities' witness reviewed AEP's historical data and concluded that the data were not consistent with the survey results for the other utilities. This is the same process Mr. Garrett followed in this case. Although in Docket No. 28840 the Commission expressed a preference for a utility's historical data to set its depreciation rates, those data must be reliable, and if they are not, as is the case in this proceeding, the precedent the Commission established in Docket No. 28840 is that it is permissible to consider other utility's data to set depreciation rates.[53]

In this proceeding, Mr. Garrett's testimony established that CEHE's data were questionable first because of the material disparity between Mr. Watson's proposed services lives for the eight accounts at issue, and also because Mr. Watson based his analysis on the SPR method, which lacks aged data. Taken together – the materially shorter lives Mr. Watson presented and lacking aged data – makes the results of Mr. Watson's analysis suspect. As the

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[50] PFD at 278.

[51] *Application of AEP Texas Central Company for Authority to Change Rates*, Docket No. 28840, PFD on Remand at 63-66 (Nov. 16, 2004).

[52] *Id.* at 64-66. In fact, in Docket No. 28840, the utility itself relied on the survey results.

[53] *Id.* at 66.

record established a study premised on "unaged" data is not as reliable as aged data. So, Mr. Garrett correctly developed his peer-group study and relied on the results of that study in developing his proposed depreciation rates. Mr. Garret's proposed depreciation rates are based on sound data and the method he relied upon to estimate CEHE's depreciation rates is consistent with Commission precedent.

In addition, the ALJs also cite *City of Amarillo v. Railroad Commission*;[54] however, that case is not on point. In *City of Amarillo*, a party contended that the utility had a duty to demonstrate the continuing reasonableness of previously approved depreciation rates that the utility did not seek to change, and because the utility did not provide such proof, the Commission should not approve those rates.[55] In upholding the Commission's decision, the court rejected that argument because it concluded that the Commission is generally bound by its prior holdings unless there are changed circumstances.[56]

In contrast to *City of Amarillo*, the majority of the depreciation rates that TCUC contests in this proceeding involve depreciation rates that CEHE seeks to change, and as to the other depreciation rates that CEHE does not seek to change, TCUC contests those rates for reasons other than by arguing that CEHE has the burden of proof to show the continued reasonableness of its pre-exiting depreciation rates. So *City of Amarillo* is not relevant in this proceeding, and does not serve to justify CEHE's proposed depreciation rates.

Further undermining the ALJs' conclusion that Mr. Garrett's proposed depreciation rates are not supported by credible evidence or Commission precedent is that the ALJs in part based their recommendation to approve Mr. Watson's proposed depreciation rates on his interviews with CEHE's employees. Contrary to the ALJs' findings, the record establishes that Mr. Watson's interviews with company employees cannot serve as the basis for establishing CEHE's depreciation rates.[57] Nonetheless the ALJs either ignore or play down these shortcomings in Mr. Watson's analysis.[58]

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[54] *City of Amarillo v. Railroad Commission*, 894 S.W.2d 491, 501 (Tex. App.—Austin 1995, writ denied) ("*City of Amarillo*").

[55] *Id.*

[56] *Id.*

[57] PFD at 264-265 ("1.The Company's employees are by definition not capable of rendering an independent, objective opinion regarding the expected service lives of the Company's assets based on personal experience. None of the employees that Mr. Watson interviewed are witnesses in this case, and therefore none of their opinions can be challenged by means of cross-examination. 2. The record is devoid of what the employees

First, Mr. Watson described in only the most general terms with very little explanation how he validated the comments he received in interviews with CEHE employees in developing his depreciation study.[59]

Second, Mr. Watson's proposed service lives for the eight accounts in question are significantly different when compared to the approved service lives for similar assets of the other utilities in Mr. Garrett's peer group. This calls into question the soundness of Mr. Watson's validation process and the ALJs' acceptance of that process.

Finally, the ALJs' reliance on the fact the Mr. Watson testified that he cannot recall a CEHE ever fabricating information does not prove that these things do not happen. An employee, cognizably or not, may be incented to proffer skewed information to improve the company's financial performance, which may impact the amount of incentive compensation the employee receives, even though such information may not rise to the level of an outright fabrication.[60] Moreover, Mr. Watson acknowledges that employees provide information that may have been tainted by "unintended bias," but for whatever reason, this appears to not give the ALJs pause.

TCUC urges the Commission to reject the ALJs' findings that TCUC's proposed depreciation rates for the eight disputed depreciation rates based on the SPR method are not based on the credible evidence and precedent. TCUC's recommendations are based on Mr. Garrett's well-founded criticisms of the results of CEHE reliance on the SPR method and with the approach the Commission approved in Docket No. 28840.

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communicated to Mr. Watson. Nor does the record reveal how much experience the interviewees had on the job or the details of their job duties. 3. Many of the interviews were conducted in groups sessions where Mr. Watson divulged his own preliminary findings to the group, impairing the independence of the opinions. 4. Some of the information may have been tainted by "unintended bias" where for example an employee may have inordinate experience with faltering equipment and may have a skewed notion of how a particular piece of equipment lasts." (citations omitted.)).

[58] PFD at 265.

[59] HOM Tr. at 351-353.

[60] HOM Tr. at 340-341.

2. Specific Account Challenges

a. Account 390 – Structures and Improvements (Actuarial)

The ALJs recommend that the Commission approve the use of the R4-50 curve for Account 390 as proposed by CEHE's witness Mr. Watson and reject TCUC's recommended R2-58 curve to set the depreciation rates for this account.[61] TCUC urges the Commission to reject the ALJs' recommendation and approve TCUC's recommended curve for this account.

The ALJs' principal reason for rejecting TCUC's recommendation is because the ALJs conclude that Mr. Garrett omitted "significant portions" of the assets from this account.[62] What Mr. Garrett did was to omit from consideration the tail end of the Observed Life Table ("OLT") curve from his analysis, which is entirely permissible.[63] The authoritative treatise in the depreciation industry, Wolf & Fitch's "Depreciation Systems" states that "Points at the end of the curve are often based on fewer exposures and may be given less weight than points based on larger samples."[64]

With respect to Account 390, the data show that for the age interval of 49.5 to 50.5 years there is a substantial drop in the percentage of assets surviving from 74.09% to 56.67%.[65] At this age interval, the amount of exposures is far less ($3.6 million) than the amount of beginning exposures ($291.6 million).[66] Thus the dollar value of the assets that Mr. Garrett did not consider amounts to no more than "statistical noise" and is certainly not a "significant portion" of the assets in the account as the ALJs characterize it.

Additionally, the ALJs appear to agree with CEHE that Mr. Garrett relied entirely on mathematical curve-fitting instead of a combination of mathematical and visual curve-fitting.[67] The ALJs' assessment of Mr. Garrett's analysis is wrong. In fact, Mr. Garrett's direct testimony explains in numerous instances how his recommended R2-58 curve fits the data better than does

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61 PFD at 267.

62 *Id.*

63 TCUC Exh. 2 – Garrett Dir. at 11-16.

64 *Id.* at 12.

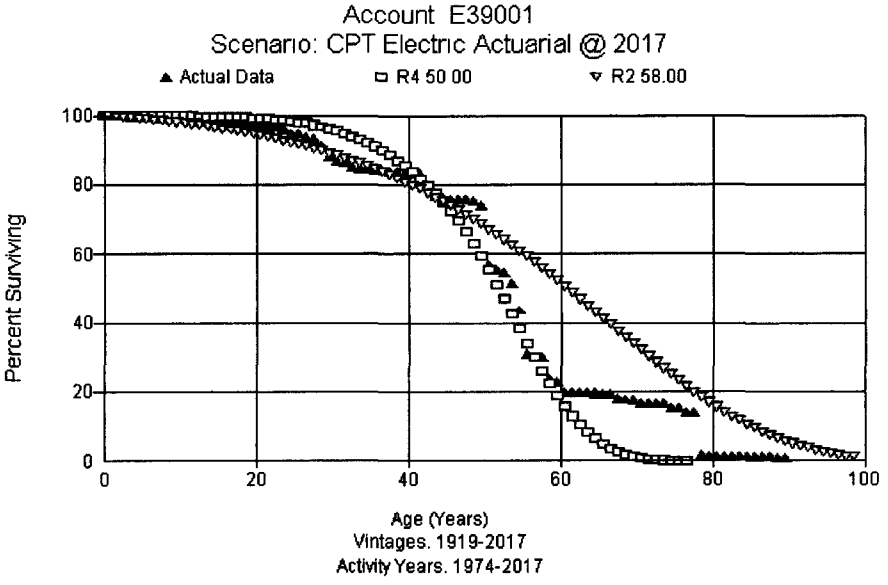
65 *Id.* at 14.

66 *Id.*

67 PFD at 267.

CEHE's R4-50 cure based on graphical depictions.[68] Indeed Mr. Garrett states that "it is visually clear that my curve provides a better visual fit to the observed data, which can be verified mathematically."[69]

Even accepting for the sake of argument CEHE's contention that the middle part of the curve – from 20% to 80% surviving – is a better gauge of the fitness of a curve, the evidence shows that Mr. Garrett's R2-58 curve is actually a better visual fit than is Mr. Watson's R4-50 curve. As shown in the diagram in Mr. Watson's rebuttal testimony,[70] the blue triangles depicting Mr. Garrett's R2-58 curve track the actual data more closely from age 20 to around age 50 than do the blue squares depicting Mr. Watson's R4-50 curve.[71]



So based on Mr. Watson's own standards, Mr. Garrett's R2-58 curve is a better visual fit. It is also a better mathematical fit based on its sum-of-squared-differences score of 58 versus 0.1442 in Mr. Watson's curve.[72] Therefore, TCUC urges the Commission to reject the ALJs' recommendation to approve a R4-50 curve for Account 390 and instead to approve TCUC's recommended R2-58 curve to set the depreciation rates for this account.

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[68] TCUC Exh. 2 – Garrett Dir. at 11-16.

[69] *Id.* at 16.

[70] *Id.* at 52.

[71] *Id.*

[72] *See* TCUC's Initial Brief at 42-43; TCUC Exh. 2 – Garrett Dir. at 16.

b. Account 353 – Transmission Station Equipment (SPR)

The ALJs recommend that the Commission approve the use of the R0.5-53 curve for Account 353 as proposed by CEHE's witness Mr. Watson and reject TCUC's recommended R0.5-56 curve to set the depreciation rates for this account.[73] TCUC urges the Commission to reject the ALJs' recommendation and approve TCUC's recommended curve for this account.

The ALJs assert that the principal reason for finding in favor of CEHE is that the property in this account is changing and that Mr. Garrett ignored that change.[74] The change in life characteristics can be evaluated on the basis of more limited bands, such as the 30- and 40-year bands that CEHE relied on to show that those bands exhibit good to excellent Conformance Index (CI) results.

As explained in TCUC's Initial and Reply Briefs, the CI is a mathematical measure of the fitness of a particular survivor curve.[75] However, as Mr. Garrett testified, focusing on only a single band, such as a 30- or 40-year band as CEHE did for Account 353, ignores the remainder of data in the overall band. To accept CEHE's position would ignore a substantial amount of data – 60 out of the total of 93 years of data for Account 353. This approach would deprive the Commission of an adequate basis to judge the reasonableness of a particular survivor curve.

Additionally, focusing on a single band allows for cherry-picking the CI of a band that best supports the analyst's position. Mr. Watson's reliance on the 30-year band, which has the highest CI of any of the bands, to support his choice of the R0.5-53 curve is an example of the flaw in this approach. Use of the overall band, as Mr. Garrett has done, avoids this cherry-picking problem.

TCUC's recommended R0.5-56 curve is superior to CEHE's proposed 0.5.-56 curve because the overall CI for CEHE's curve is merely 26 which rates as "poor."[76] Further a 53-year service life for this account is much lower than the average service life of 61 years of the other utilities in Mr. Garrett's study and is much lower than the 73 years than the Commission approved for SWEPCO.[77]

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[73] PFD at 267.

[74] *Id.* at 268.

[75] *See* TCUC's Initial Brief at 41.

[76] TCUC Exh. 2 – Garrett Dir. at 21.

[77] *Id.* at 23.

Therefore, TCUC urges the Commission to reject the ALJs' recommendation to approve a R0.5-53 curve for Account 353 and instead to approve TCUC's recommended R0.5-56 curve to set the depreciation rates for this account.

c. Account 354 – Transmission Towers and Fixtures (SPR)

The ALJs recommend that the Commission approve the use of the R2.5-59 curve for Account 354 as proposed by CEHE's witness Mr. Watson and reject TCUC's recommended R2-66 curve to set the depreciation rates for this account.[78] TCUC urges the Commission to reject the ALJs' recommendation and approve TCUC's recommended curve for this account.

The ALJs fault Mr. Garrett for ignoring the characteristics of the property included in this account as well as CHE's experience with this plant.[79] CEHE's own experience, as expressed through the opinions of its employees is not a reliable source of information.[80] Mr. Garrett was correct to ignore that subjective and unreliable evidence and account for only the objective numerical data in arriving at his recommendation.

TCUC urges the Commission to approve TCUC's proposed curve because it has a higher CI of 75 for the overall band compared to the 73 for CEHE's proposed curve.[81] TCUC's 59-year service life is lower than the average of 66 for the three utilities in Mr. Garrett's study and is much lower than PSO's own witnesses' recommendation of 75 years.[82] Further, the PFD refers to CEHE's contention that Mr. Garrett failed to justify the low REI for this account; the fact of the matter is that at a score of 86, it ranks "high."[83]

Therefore, TCUC urges the Commission to reject the ALJs' recommendation to approve an R2.5-59 curve for Account 354 and instead to approve TCUC's recommended R2-66 curve to set the depreciation rates for this account.

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78 PFD at 267.

79 *Id.* at 268-269.

80 *See supra*, pp. 17-18.

81 TCUC Exh. 2 – Garrett Dir. at 24.

82 *Id.* at 20 and 23-24.

83 PFD at 269; TCUC Exh. 2 – Garrett Dir. at 24.

d. Account 362 – Distribution Station Equipment

The ALJs recommend that the Commission approve the use of the R1-48 curve for Account 362 as proposed by CEHE's witness Mr. Watson and reject TCUC's recommended R0.5-55 curve to set the depreciation rates for this account.[84] TCUC urges the Commission to reject the ALJs' recommendation and approve TCUC's recommended curve for this account.

The ALJs' explanation for approving CEHE's proposed curve and rejecting TCUC's proposed is the same as the ALJs' rationale regarding Account 354.[85] CEHE's arguments are not persuasive for the reasons set out in the section of these exceptions regarding Account 354.

As to account 362 specifically, TCUC urges the Commission to approve TCUC's proposed curve because the service life of 55 years is much less than the average of 66 years in Mr. Garrett's comparative analysis and is identical to the 55 years that the Commission approved for SWEPCO.[86] Moreover, TCUC's recommended curve has a "good" CI score of 55 and an "excellent" REI score of 89.[87]

Therefore, TCUC urges the Commission to reject the ALJs' recommendation to approve a R1-48 curve for Account 362 and instead to approve TCUC's recommended R0.5-55 curve to set the depreciation rates for this account.

e. Account 364 – Distribution Poles, Towers, and Fixtures (SPR)

The ALJs recommend that the Commission approve the use of the R0.5-35 curve for Account 364 as proposed by CEHE's witness Mr. Watson and reject TCUC's recommended R0.5-45 curve to set the depreciation rates for this account.[88] TCUC urges the Commission to reject the ALJs' recommendation and approve TCUC's recommended curve for this account.

The ALJs justify their recommendation to approve CEHE's proposed curve because it better accounts for the changing conditions impacting the assets in the account.[89] However, the

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[84] PFD at 270.

[85] *Id.*

[86] TCUC Exh. 2 – Garrett. Dir. at 20 and 25.

[87] *Id.* at 25.

[88] PFD at 270.

[89] *Id.* at 271.

evidence of changed conditions is Mr. Watson's interviews with CEHE employees.[90] TCUC urges the Commission to afford that evidence very little weight as explained elsewhere in this brief and instead base its decision on the more reliable and objective numerical data. Those data show that TCUC's recommended curve is superior to CEHE's recommended curve because CEHE's CI is only 16 which under the applicable SPR method criteria is a "poor" fit.[91]

Further, the Commission approved a 55-year service life for this account for SWEPCO based on actuarial data, which is considerably longer than TCUC's recommendation of a 45-year service life in this case.[92] In addition, the mathematical Iowa curve analysis in SWEPCO's actuarial data showed that the service life could have been as high as 63 years.[93] OG&E also has a 55-year approved service life.[94]

Therefore, TCUC urges the Commission to reject the ALJs' recommendation to approve a R0.5-35 curve for Account 364 and instead to approve TCUC's recommended R0.5-45 curve to set the depreciation rates for this account.

f. Account 365 – Distribution Overhead Conductors and Devices (SPR)

The ALJs recommend that the Commission approve the use of the R0.5-38 curve for Account 365 as proposed by CEHE's witness Mr. Watson and reject TCUC's recommended R0.5-40 curve to set the depreciation rates for this account.[95] TCUC urges the Commission to reject the ALJs' recommendation and approve TCUC's recommended curve for this account.

The ALJs justify their recommendation to approve CEHE's proposed curve based on their conclusion that CEHE's proposed curve better accounts for the changing conditions impacting the assets in the account.[96] However, the evidence of changed conditions is comprised of Mr. Watson's interviews with CEHE employees.[97] TCUC urges that the Commission afford

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90 CEHE Exh. 25 - Watson Dir. at Exhibit DAW-1, Bates Page 2505.

91 TCUC Exh. 2 – Garrett Dir. at 26.

92 *Id.* at 26.

93 *Id.*

94 *Id.* at 28.

95 PFD at 272.

96 *Id.*

97 CEHE Exh. 25 – Watson Dir. at Exhibit DAW-1, Bates Page 2506.

that evidence very little weight as explained elsewhere in this brief and instead base its decision on the more reliable and objective numerical data.

The ALJs also contend that CEHE's proposed curve has better CI and REI results. However, the CI for CEHE's curve is only 21 which ranks as "poor."[98] Both CEHE's and TCUC's proposed curves have REI scores of 100 and so CEHE's proposed curve is no better than TCUC's curve on that basis.[99]

Additionally, CEHE's proposed 38-year service life is much shorter than the approved lives for SWEPCO, PSO and OG&E which are 44, 46 and 54 years respectively.[100] TCUC's proposed 40-year curve is a reasonable compromise between CEHE's proposal and the approved lives for other utilities.

Therefore, TCUC urges the Commission to reject the ALJs' recommendation to approve a R0.5-38 curve for Account 365 and instead to approve TCUC's recommended R0.5-40 curve to set the depreciation rates for this account.

g. Account 366 – Distribution Underground Cables (SPR)

The ALJs recommend that the Commission approve the use of the R2.5-62 curve for Account 366 as proposed by CEHE's witness Mr. Watson and reject TCUC's recommended S1-65 curve to set the depreciation rates for this account.[101] TCUC urges the Commission to reject the ALJs' recommendation and approve TCUC's recommended curve for this account.

The ALJs state that CEHE's proposed curve better reflects the actual conditions affecting CEHE's assets in this account whereas TCUC's proposed curve reflects only the experiences of other utilities.[102] For the reasons explained elsewhere in these exceptions, it is reasonable and appropriate to consider the experiences of other utilities when the approved depreciation rates for those other companies are based on more reliable actuarial data, which is not the case with the unaged data that CEHE maintained for its transmission and distribution accounts.

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98 TCUC Exh. 2 – Garrett Dir. at 28.

99 CEHE Exh. 41 at 38.

100 TCUC Exh. 2 – Garrett Dir. at 29.

101 PFD at 273.

102 *Id.*

A comparison to the approved service lives of other utilities for this account shows that CEHE's proposed curve is significantly shorter. For example, SWEPCO's own witness proposed a 70-year life which the Commission approved.[103] PSO has a much longer 78-year service life for this account. Both of these estimates were based on actuarial data.[104] Further, TCUC's curve ranks as "excellent" in both the CI and REI scales.[105] In addition, a 65-year life is a conservative recommendation given the longer approved lives for SWEPCO and PSO.

The ALJs also justify their recommendation to approve CEHE's proposed curve based on "CenterPoint input."[106] Seemingly the ALJs are referring to Mr. Watson's interviews with CEHE employees.[107] TCUC urges that Commission afford that evidence very little weight as explained elsewhere in this brief and instead base its decision on the more reliable and objective numerical data.

Therefore, TCUC urges the Commission to reject the ALJs' recommendation to approve an R2.5-62 curve for Account 366 and instead to approve TCUC's recommended S1-65 curve to set the depreciation rates for this account.

h. Account 367 – Distribution Underground Conductor and Devices (SPR)

The ALJs recommend that the Commission approve the use of the R0.5-38 curve for Account 367 as proposed by CEHE's witness Mr. Watson and reject TCUC's recommended L0-42 curve to set the depreciation rates for this account.[108] TCUC urges the Commission to reject the ALJs' recommendation and approve TCUC's recommended curve for this account.

The ALJs state that CEHE's proposed curve better reflects the actual factors affecting CEHE's assets in this account whereas TCUC's proposed curve is based principally on Mr. Garrett's peer group.[109] As noted above, it is reasonable and appropriate to consider the experiences of other utilities when the approved depreciation rates for those other companies are

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[103] TCUC Exh. 2 – Garrett Dir. at 29-30.

[104] *Id.* at 30.

[105] *Id.* at 31.

[106] PFD at 273.

[107] CEHE Exh. 41 – Watson Reb. at 42.

[108] PFD at 273.

[109] *Id.* at 274.

based on more reliable actuarial data, which is not the case with the unaged data that CEHE maintained for its transmission and distribution accounts.

A comparison to the approved service lives of other utilities for this account shows that the approved lives for SWEPCO, PSO and OG&E are 45, 65 and 64 years respectively, are based on actuarial data, and are much longer than the 38 years proposed by CEHE.[110] TCUC's proposed 42-year service life is derived from CEHE's SPR analysis, but moves CEHE's proposal closer to the range of reasonableness for this account and should be approved.

To the extent that the ALJs' understanding of the "actual factors" that affect CEHE's assets is based on Mr. Watson's interviews with CEHE employees, TCUC urges that the Commission afford that evidence very little weight as explained elsewhere in this brief and instead base its decision on the more reliable and objective numerical data.

Therefore, TCUC urges the Commission to reject the ALJs' recommendation to approve a R0.5-38 curve for Account 367 and instead to approve TCUC's recommended L0-42 curve to set the depreciation rates for this account.

i. Account 368 – Distribution Line Transformers (SPR)

The ALJs recommend that the Commission approve the use of the R1-28 curve for Account 368 as proposed by CEHE's witness Mr. Watson and reject TCUC's recommended L0-32 curve to set the depreciation rates for this account.[111] TCUC urges the Commission to reject the ALJs' recommendation and approve TCUC's recommended curve for this account.

To the extent that the ALJs reject TCUC's recommendation because it relies on the experiences of other utilities, for the reasons noted above, it is reasonable and appropriate to consider the experiences of other utilities when the approved depreciation rates for those other companies is based on more reliable actuarial data, which is not the case with the unaged data that CEHE maintained for all of its transmission and distribution accounts. That data show that CEHE's 28-year service life is much less than the approved service lives based on actuarial for SWEPCO, PSO and OG&E which are 50, 36 and 44 years respectively.[112] In fact, the Commission found that it would be reasonable to use a 55-year life in the case of SWEPCO.[113]

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[110] TCUC Exh. 2 – Garrett Dir. at 32.

[111] PFD at 275.

[112] TCUC Exh. 2 – Garrett Dir. at 33.

[113] *Id.*

In addition, to the extent that the ALJs' decision is based on CEHE's actual experience with the assets in this account, that evidence consists of Mr. Watson's interviews with CEHE employees. To reiterate arguments previously made, that evidence is unreliable which TCUC urges the Commission to not consider and instead based its decision on the more reliable and objective numerical data.

XII. Conclusion

For the reasons noted above, TCUC respectfully urges the Commission to grant TCUC's Exceptions to the Proposal for Decision and to adopt a revenue requirement that employs an overall rate of return of 6.22% based on the following cost of capital and capital structure:

Primary Recommendation Regarding Capital Structure, Return on Equity, and Rate of Return[114]

COMPONENT	CAPITAL STRUCTURE	COST OF CAPITAL	WEIGHTED AVERAGE COST OF CAPITAL
LONG-TERM DEBT	60%	4.38%	2.63%
COMMON EQUITY	40%	8.97%	3.59%
TOTAL	100.00%		6.22%

Alternatively, TCUC urges the Commission to adopt an overall rate of return of 6.21% as shown in the table below:

Alternative Recommendation Regarding Capital Structure, Return on Equity, and Rate of Return

COMPONENT	CAPITAL STRUCTURE	COST OF CAPITAL	WEIGHTED AVERAGE COST OF CAPITAL
SHORT-TERM DEBT	0.90%	2.27%	0.02%
LONG-TERM DEBT	55.48%	4.38%	2.43%
COMMON EQUITY	43.62%	8.62%[115]	3.76%
TOTAL	100.00%		6.21%

[114] TCUC's primary recommendation includes a return on equity of 9.00%. Taking into account the ALJs' proposed adjustment to CEHE's return on equity produces a return on equity of 8.97%, which results in an overall rate of return of 6.22%.

[115] TCUC's alternative recommendation includes a return on equity of 8.65%. Taking into account the ALJs' proposed adjustment to CEHE's return on equity produces a return on equity of 8.62%, which results in an overall rate of return of 6.21%.

Further, TCUC urges the Commission to adopt the depreciation rates and expenses Mr. David Garrett, TCUC's depreciation expert witness, recommends in his pre-filed direct testimony.[116] Compared to CEHE's depreciation expense, Mr. Garrett's testimony establishes that CEHE's depreciation expense should be reduced by a total of approximately $36.52 million. The effect of TCUC's proposed cost of capital and capital structure is shown in the table below:

DEPRECIATION EXPENSE ADJUSTMENTS[117]	Wholesale Transmission	Retail/Dist/Met/CS	TOTAL
Reduce Depreciation Expense Related to Rate Adjustments	(5.491)	(31.025)	(36.516)

Respectfully submitted,

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[116] *See* TCUC Exh. 2 – Garrett Dir.

[117] *See* GCCC Exh. 1 – Kollen Dir. at 14 at Table 1.

CERTIFICATE OF SERVICE

I hereby certify that on this the 10th day of October 2019, a true and correct copy of the ***Texas Coast Utilities Coalition's Exceptions to the Proposal for Decision*** was served upon all parties via electronic mail in compliance with SOAH Order No. 2.

By: _____
Leslie Lindsey