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analysis by Sargent & Lundy, LLC, with SWEPCO's overall net salvage value for Production Plant being a smaller negative number than negative 5%.⁴²⁵

Mr. Watson also listed 23 cases in which the Commission approved a negative 5% net salvage value.⁴²⁶ Many were settled cases. Mr. Pous suggested that if there is a precedent, it is the positive 5% net salvage value approved in SPS's last four rate cases,⁴²⁷ which were all settled. The ALJs conclude that settled cases have no precedential value. Their outcomes are negotiated tradeoffs among various issues and should not be used to set SPS's net salvage value for Production Plant in this case.⁴²⁸

Staff witness Katie Rich supported SPS's proposed negative 5% net salvage value, for three reasons.⁴²⁹ First, she noted that SPS is not expected to divest its generation in order to transition its territory to retail competition in the foreseeable future. The ALJs agree. Second, Ms. Rich cited the prefiled testimony in two older SPS rate cases by Staff witnesses who recommended a negative 5% net salvage value for SPS's Production Plant: Nara Srinivasa in Docket No. 32766 and Jolie Mathis in Docket No. 35763. The ALJs find that their prefiled testimony does not support setting a negative 5% net salvage value in this case. Mr. Srinivasa and Ms. Mathis recommended no change to SPS's *then-current* net salvage value of negative 5%, after concluding that SPS did not meet its burden to prove that even larger negative numbers should be approved.⁴³⁰ Both cases ultimately settled. Third, Ms. Rich observed that the Commission approved a net salvage value of negative 5% in Docket No. 37744 for ETI and in

⁴²⁵ See, e.g., Docket No. 40443, PFD at 177 ("SWEPCO requested an overall production plant net salvage rate of negative 3.4%."). Mr. Pous testified that the Commission adopted a negative 2.6% value, or negative 1.4% "when placed on a comparable basis to that proposed by the Company." AXM Ex. 3, Pous direct at 14-15. He did not explain why he considered negative 1.4% to be comparable.

⁴²⁶ SPS Ex. 44, Watson rebuttal at 14.

⁴²⁷ AXM Ex. 3, Pous direct at 14-15.

⁴²⁸ For the same reason, and because for years SPS's average service life and net salvage value for the various FERC accounts have been set in settled cases, the ALJs do not find the amount of a proposed change to such numbers to be particularly informative. Those arguments are not further discussed in this PFD.

⁴²⁹ Staff Ex. 4, Rich direct at 5-9. Ms. Rich adopted the prefiled testimony of Christine L. Wright.

⁴³⁰ TIEC Ex. 47 at 16; TIEC Ex. 48 at 29.

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Docket No. 40094 for El Paso Electric Company (EPE).⁴³¹ The ALJs note that both of those were settled cases.

The ALJs conclude that the Commission has approved a negative 5% net salvage value in numerous rate cases. Many were settled cases with no precedential value; in others the Commission simply did not change the utility's previously approved net salvage value. The ALJs have considered Commission orders adopting a negative net salvage value in recent cases involving other utilities in which the issue was litigated. Given differences in facts among utilities and rate cases, however, the ALJs find such determinations insufficient to meet SPS's burden to prove that its net salvage value is negative 5%.

d. ALJs' Recommended Net Salvage Value for Production Plant

SPS's existing positive 5% net salvage value was set in non-precedential settled SPS rate cases and is not supported by the evidence in this case. Taking into account all matters discussed above, SPS met its burden to prove that its net salvage value for Production Plant is negative. The more difficult question is what negative value should be set in this case. All parties that addressed the issue proposed net salvage values that were based on past settled SPS rate cases or Commission orders involving other utilities. The ALJs recommend a net salvage value for Production Plant of negative 2%. That number was not proposed by any party or witness and—like the parties' proposed values—is not based on a precise calculation based on SPS's facts. The ALJs conclude, however, that the evidence in this case better supports a value of negative 2% than either negative 5% or positive 5%. The ALJs' recommended value is within the range proposed by the parties and expert witnesses and reflects the ALJs' consideration of the weight that should be given to all evidence presented on this issue, the facts that were proven, and application of the burden of proof to SPS.

⁴³¹ Staff Ex. 4, Rich direct at 8, citing *Application of Entergy Texas, Inc. for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 37744, Order (Dec. 13, 2010) and *Application of El Paso Electric Company to Change Rates and to Reconcile Fuel Costs*, Docket No. 40094, Order (May 23, 2012).

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Regarding the remaining disputed issues involving depreciation expense, discussed below, only AXM challenged SPS's proposals.

2. Transmission and Related General Plant

a. Account 350.2–Land Rights

For Land Rights, SPS witness Mr. Watson recommended a life-curve combination of 80R4,⁴³² and AXM witness Mr. Pous recommended 100R4.⁴³³ The ALJs recommend SPS's proposal.

Noting that land rights are generally usable until the assets are removed from the land covered by the easement, Mr. Watson proposed an 80-year average service life to reflect the lives of such assets. Mr. Pous testified that land rights should be in place for at least one complete life cycle of the assets that rest on the land rights. Mr. Pous calculated the complete life cycle as at least 114 years for some of the investment added in any one year, but he recommended 100 years for reasons of gradualism. Mr. Watson responded that Mr. Pous's calculation of 114 years is based on when the last dollar of the Transmission Pole account will retire and, combined with an R4 dispersion curve, would result in land rights lasting up to 154 years. He objected: "Even though these assets have long lives, there must be a reasonable period of recovery assigned to them."⁴³⁴ Finding Mr. Watson's approach to be more reasonable, the ALJs recommend SPS's proposal.

⁴³² SPS Ex. 44, Watson rebuttal at 20-23.

⁴³³ AXM Ex. 3, Pous direct at 32-34.

⁴³⁴ SPS Ex. 44, Watson rebuttal at 22.

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b. Account 353–Transmission Substation Equipment

i. Average Service Life

For this account, Mr. Watson recommended 57R2.5⁴³⁵ and Mr. Pous recommended 62R2.⁴³⁶ The ALJs recommend SPS's proposal.

Mr. Watson based his recommendation on historical data and feedback from SPS personnel. He said that SPS personnel indicated the mix of assets in this account is changing toward assets with shorter lives, such as more electronics in the substations, which supports giving greater weight to shorter bands that more closely reflect the impact of the newer technology and asset types.⁴³⁷ Mr. Pous based his recommendation on analysis of SPS's data and practices, and said Mr. Watson chose an average service life significantly longer than most of the lives estimated by the SPS personnel. Each witness presented graphs to indicate that his recommendations better fit the data. The ALJs find Mr. Watson's reasoning to be more persuasive.

ii. Net Salvage Value

For Transmission Substation Equipment, Mr. Watson recommended a net salvage value of negative 20%⁴³⁸ and Mr. Pous recommended negative 10%.⁴³⁹ The ALJs recommend SPS's proposal.

⁴³⁵ SPS Ex. 44, Watson rebuttal at 23-30.

⁴³⁶ AXM Ex. 3, Pous direct at 35-40.

⁴³⁷ SPS Ex. 44, Watson rebuttal at 25. Mr. Watson analyzed the net salvage values for various bands (combinations) of years. He testified that using averages, such as the 5-year average band, smooths timing differences and that review of successive average bands reveals trends in the data. SPS Ex. 13, Watson direct at 28.

⁴³⁸ SPS Ex. 44, Watson rebuttal at 73-75.

⁴³⁹ AXM Ex. 3, Pous direct at 75-77.

Mr. Pous compared Mr. Watson's recommendations for SPS in this case and for SPS affiliate PSCo in a recent case. Mr. Watson identified net salvage values for the 5-year and 10-year bands of negative 27.25% and negative 22.61% for PSCo and only negative 23% and negative 20% for SPS, but recommended negative 15% for PSCo and negative 20% for SPS. Mr. Watson responded that his proposals reflect differences in facts relating to the utilities' historical data, including that PSCo's net salvage values have been more volatile than those of SPS. The ALJs find such comparisons of little value absent evidence showing that SPS's situation is comparable to that of the other utility.⁴⁴⁰

Mr. Pous also opined that in SPS's historical database, the retirement of transformers is not representative of the investment level, distorting the results. He calculated that historical data associated with transformer retirements indicate an approximate negative 12% net salvage value, and a much larger more negative net salvage value in years in which transformer retirement was underrepresented. He expressed concern that SPS's historical recording of gross salvage has not been consistent, noting that SPS retired the largest annual number of transformers in 2005 but reported no gross salvage in 2005 or 2006. He pointed out that transformers contain large quantities of copper, for which scrap prices have increased several hundred percent in the past 10 years.

Mr. Watson questioned Mr. Pous's assertion that transformers have a less negative net salvage value than other assets in this account. Mr. Watson explained that transformers are bulky and heavy; cranes must be used to remove them; and they are filled with significant quantities of oil that must be drained, tested, and disposed of, whereas smaller items in this account, such as switches, require significantly less effort to remove. He also testified that, despite the high copper prices, SPS has experienced a negative 23% net salvage value for the five-year average. He calculated gross salvage would have to be over 150% of its already record high levels just to move the 5-year moving average to his recommended net salvage value of negative 20%. The ALJs find Mr. Watson's explanation to be more convincing.

⁴⁴⁰ For the same reason, absent such evidence, arguments comparing SPS's average service life or net salvage value for the various FERC accounts to those of another utility are not further discussed in this PFD.

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c. Account 355–Transmission Poles and Fixtures

i. Average Service Life

For this account, Mr. Watson recommended 53R2.5⁴⁴¹ and Mr. Pous recommended 62R2.⁴⁴² The ALJs recommend SPS's proposal.

Mr. Watson's recommendation is based on actuarial analysis and information from SPS personnel. Mr. Pous responded by noting factors that he expected to increase life expectations, including SPS's increased use of steel poles over wood poles, more advanced chemical treatment of poles, and SPS's pole inspection program. Mr. Watson responded that his recommendation reflects these factors, including SPS's move to steel poles, which are expected to have a longer life than wood poles, and SPS's pole inspection program, which has been in place for 10 years and is reflected in the data. He observed that SPS's pole inspection program will lengthen the life of some poles but shorten the life of others, which will be replaced before they break. He also noted that 60% to 65% of existing wood poles are old-growth, but SPS must use more newer-growth trees, which have a shorter life expectancy than old-growth trees.⁴⁴³ Each witness presented graphs to indicate that his recommendation better fit the data. Finding Mr. Watson's explanation to be more persuasive, the ALJs recommend SPS's proposal.

ii. Net Salvage Value

For Transmission Poles and Fixtures, Mr. Watson recommended a negative 60% net salvage value⁴⁴⁴ and Mr. Pous recommended negative 35%.⁴⁴⁵ Mr. Pous also recommended that the Commission order SPS to investigate why its recorded net salvage values have been much

⁴⁴¹ SPS Ex. 44, Watson rebuttal at 31-40.

⁴⁴² AXM Ex. 3, Pous direct at 40-45.

⁴⁴³ SPS Ex. 13, Watson direct, Att. DAW-RR-2 at 29; SPS Ex. 44, Watson rebuttal at 35.

⁴⁴⁴ SPS Ex. 44, Watson rebuttal at 75-80.

⁴⁴⁵ AXM Ex. 3, Pous direct at 78-80.

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larger negative numbers than those of other utilities.⁴⁴⁶ The ALJs agree with AXM's proposed net salvage value, but not AXM's request to order SPS to conduct an investigation.

Mr. Watson performed a historical averaging analysis that resulted in net salvage values of negative 307% and negative 310% for the five-year and 10-year bands, respectively.⁴⁴⁷ He stated: "Given the large negative net salvage value exhibited by SPS, I have been conservative and reflected a gradual move toward the indications."⁴⁴⁸ Noting that SPS's historical five-year average changed from negative 483% to negative 307% between Docket No. 40824 and this case, Mr. Pous faulted Mr. Watson for not investigating why SPS's recorded values are unrealistic. Mr. Pous opined that SPS's practice of including cross arms as a separate property record unit has most likely skewed the historical data and should be investigated. Noting that cross arms have been a separate retirement unit for many years, Mr. Watson responded: "A more logical reason for the high negative net salvage is that removing transmission poles requires heavy equipment (e.g. cranes) and increasing levels of regulation, making them expensive to remove."⁴⁴⁹ The problem may be with SPS's data, but given the very large negative net salvage values and very large changes in net salvage values Mr. Watson's historical analyses have produced, the ALJs find that his analysis does not provide a reliable basis for setting SPS's net salvage value for this account. Although they do not recommend ordering SPS to investigate this matter, the ALJs expect that, to meet its burden of proof in future proceedings, SPS will need to provide either an analysis that produces less anomalous results or a sufficient explanation of the anomalous results.

⁴⁴⁶ AXM Ex. 3, Pous direct at 79-80.

⁴⁴⁷ SPS Ex. 13, Watson direct, Att. DAW-RR-2 at 57.

⁴⁴⁸ SPS Ex. 44, Watson rebuttal at 76.

⁴⁴⁹ SPS Ex. 44, Watson rebuttal at 76.

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d. Account 356–Transmission Overhead Conductors and Devices

For this account, Mr. Watson recommended 47R2⁴⁵⁰ and Mr. Pous recommended 55S0.5.⁴⁵¹ The ALJs recommend SPS's proposal.

Mr. Watson based his recommendation on actuarial analysis and input from SPS personnel. Objecting that Mr. Watson recommended the lowest average service life produced by his 24 curve-fitting analyses, Mr. Pous presented a recommendation based on the average, median, and mode values. He also argued that, to the extent the lack of dampers was causing shattering problems at insulators and thus early retirements, SPS's installation of dampers 25 years ago will cause historical life indications to be understated compared to future expectations. Mr. Watson responded that Mr. Pous did not take into account the life-shortening effect of reconductoring and input from SPS personnel, who told Mr. Watson they were "still seeing residual effects of not using dampers for many years."⁴⁵² Mr. Watson testified that, consistent with input from SPS personnel, he recommended a shorter life for conductors (47 years) than for poles (53 years). He said he is not aware of any authoritative text that indicates Mr. Pous's approach of averaging lives is valid. According to Mr. Watson, Mr. Pous calculated a median and mode value based on only 12 of the 82 different fits in Mr. Watson's analysis. Each witness presented graphs to indicate that his recommendation better matches the data. Finding Mr. Watson's explanation to be more persuasive, the ALJs recommend SPS's proposal.

⁴⁵⁰ SPS Ex. 44, Watson rebuttal at 41-48.

⁴⁵¹ AXM Ex. 3, Pous direct at 46-49.

⁴⁵² SPS Ex. 44, Watson rebuttal at 42-43.

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3. Distribution and Related General Plant

a. Account 365–Distribution Overhead Conductors and Devices

Regarding this account, Mr. Watson recommended 47R0.5⁴⁵³ and Mr. Pous recommended 50R0.5.⁴⁵⁴ The ALJs recommend SPS's proposal.

Mr. Watson based his recommendation on a Simulated Plant Record analysis and input from SPS personnel. According to Mr. Pous, Mr. Watson's Simulated Plant Record analysis indicated an average service life of between 49 and 51 years, and Mr. Watson did not take into account SPS's recently implemented pole inspection program. Mr. Watson responded that there is no evidence the pole inspection program will lengthen the service lives; in fact it could shorten them. He also cited input from SPS personnel indicating that small cable is deteriorating at about 35 to 40 years. Mr. Watson provided tables showing that historical information supports his proposal. The ALJs recommend SPS's proposal.

b. Account 368–Distribution Line Transformers

Regarding this account, Mr. Watson recommended 45R1⁴⁵⁵ and Mr. Pous recommended 48R0.5.⁴⁵⁶ The ALJs recommend SPS's proposal.

Mr. Watson based his recommendation on historical data and input from SPS personnel, who expect shorter lives due to discontinuation of a transformer repair process and lower quality of available materials.⁴⁵⁷ Mr. Pous observed that the repair process was discontinued 10 years

⁴⁵³ SPS Ex. 44, Watson rebuttal at 50-52.

⁴⁵⁴ AXM Ex. 3, Pous direct at 49-52.

⁴⁵⁵ SPS Ex. 44, Watson rebuttal at 54-56.

⁴⁵⁶ AXM Ex. 3, Pous direct at 53-55. Mr. Pous's testimony describing his recommendation is inconsistent. He stated at 53-54 that he recommended 48R0.5, but at 57-58 that he recommended 47R0.5, unless the Commission considers that recommendation too conservative and instead wants to adopt 48R0.5 or 49R0.5.

⁴⁵⁷ SPS Ex. 13, Watson direct, Att. DAW-RR-2 at 41; SPS Ex. 44, Watson rebuttal at 54-55.

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ago yet the lives are lengthening. He calculated that the historical data show a small but continuous increase in the average service life, from 45.2 to 45.7 years for the 20-year band and from 44.7 to 45.1 years for the 50-year band, and even longer lives for the shorter experience bands. Mr. Watson observed that the historical data Mr. Pous used indicate only a four to six-month increase in service lives. Mr. Watson testified that, when looking at all of the best-fitting lives for the curves across all the bands, Mr. Pous's recommendation is an outlier that is not a good fit for the assets. The ALJs find that Mr. Watson adequately supported the reasonableness of his proposal.

c. Account 369—Distribution Services

Regarding this account, Mr. Watson recommended a life-curve combination of 47R1.5⁴⁵⁸ and Mr. Pous recommended 51R1.⁴⁵⁹ The ALJs recommend SPS's proposal.

Mr. Watson based his recommendation on input from SPS personnel and historical data. Mr. Pous testified that Mr. Watson placed too much reliance on unsupported input from SPS personnel that they "expect the life to be lower than" the existing 48 years.⁴⁶⁰ Mr. Pous testified that his recommendation fits the data better than does Mr. Watson's recommendation. Mr. Watson responded that the 30-year, 35-year, and 40-year bands in the Simulated Plant Record analysis indicate that 79% of the life-curve combinations have lives less than or equal to his recommendation, and in the 45-year, 50-year, 55-year, and 60-year bands, 82% of the life-curve combinations have lives less than or equal to his recommendation. The ALJs find that Mr. Watson demonstrated that his recommendation should be accepted.

⁴⁵⁸ SPS Ex. 44, Watson rebuttal at 57-58.

⁴⁵⁹ AXM Ex. 3, Pous direct at 58-60.

⁴⁶⁰ AXM Ex. 3, Pous direct at 58-59.

4. General Plant Related to Information Technology and Software

a. Account 303—Miscellaneous Intangible Plant

The disputed issues regarding this account relate to software. Mr. Watson's Depreciation Study did not analyze assets in Account 303, including software.⁴⁶¹ Instead, for reasons explained by SPS witness Ms. Perkett, SPS proposes that its software investment be amortized over the life of the software assets.⁴⁶² She recommended average service lives of five years for Routine Software and 10 years for Large Software Systems. Mr. Pous recommended average service lives of six years for Routine Software and 15 years for Large Software Systems.⁴⁶³ He also recommended that SPS be ordered to conduct a detailed and well-supported study of amortization periods for software systems, to be presented in SPS's next rate case. The ALJs agree with SPS, except that they agree with AXM that software systems that are fully amortized by the end of the Test Year should be removed from rate base.

Mr. Pous explained that SPS provided no studies in response to discovery requesting "each separate study, analysis, report, etc. relied upon . . . to support its current five year and 10-year amortization periods" for its software systems.⁴⁶⁴ He testified that SPS identified 137 software systems that have been fully recovered and retired for accounting purposes, but were still in use during the past eight years. Ms. Perkett responded that:

- *Each new software release typically replaces part of the previous version. Because SPS cannot determine what part of previous software versions has been replaced, it cannot measure an accurate life for each version. In addition, the life of each version is much less than the life of the software system as a whole.*

⁴⁶¹ SPS Ex. 13, Watson direct, Att. DAW-RR-2 at 4.

⁴⁶² SPS Ex. 42, Perkett rebuttal at 14-20.

⁴⁶³ AXM Ex. 3, Pous direct at 17-24.

⁴⁶⁴ AXM Ex. 3, Pous direct at 21.

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- *Software systems serving the same purpose often have overlapping lives due to record retention and other business needs.* For example, SPS plans at the end of 2015 to stop using the JD Edwards general ledger system and to start using new software. One year of historical accounting data will be transferred to the new software, but because FERC requires SPS to keep plant records for 25 years after the plant is removed from service, the JD Edwards software will be preserved. Establishing an amortization period based on the amount of time all versions of software are used for any purpose would result in absurdly long amortization periods, simultaneous depreciation of systems that perform the same function, and intergenerational inequities.
- *SPS customers pay for software only during the amortization period in which the software is serving its primary purpose.* Although SPS does not retire software systems immediately when they are no longer used and useful, SPS amortizes expense only over the authorized period. Once it is fully amortized, SPS stops recording the expense and stops including any return on net investment rate base in its revenue requirement calculations. When SPS includes a fully amortized asset in rate base, base rates do not include any amortization expense or rate base attributable to that asset.⁴⁶⁵

Mr. Pous also recommended that three software systems with an identifiable fully accrued date of June 30, 2014, be removed from rate base.⁴⁶⁶ He observed that the software system with the largest single investment (\$10.8 million) became fully accrued on June 30, 2014, the last day of the Test Year. Ms. Perkett opined that including in the revenue requirement an amortizable asset that finishes its amortization in the Test Year is appropriate ratemaking. She reasoned that SPS's approach "provides balance to the overall effect on rates between rate cases" because other amortizable assets will be placed in service after the Test Year that have not been included in revenue requirement.⁴⁶⁷

Finding Ms. Perkett's reasoning on that point to be flawed, the ALJs agree with AXM that software systems that are fully amortized on or before June 30, 2014, should be removed from rate base. Finding Ms. Perkett's other testimony summarized above to be persuasive, the ALJs recommend rejecting Mr. Pous's other proposals.

⁴⁶⁵ SPS Ex. 42, Perkett rebuttal at 15-20.

⁴⁶⁶ AXM Ex. 3, Pous direct at 22.

⁴⁶⁷ SPS Ex. 42, Perkett rebuttal at 20.

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b. Account 391.004—Computer Equipment

For this account, Mr. Watson recommended 5SQ⁴⁶⁸ and Mr. Pous recommended 6SQ.⁴⁶⁹ The ALJs recommend SPS's proposal.

As explained by Mr. Watson, pursuant to the settlement in Docket No. 35763, the Commission authorized SPS to use amortization accounting for this account. For General Plant assets in Accounts 391 to 398, SPS uses a vintage year accounting method approved by FERC in Accounting Release No. 15. Accounting Release No. 15 allows utilities to use a simplified method of accounting for general plant assets, excluding structures and improvements. Assets in this account are characterized by rapid technological change and obsolescence, and because SPS uses Accounting Release No. 15 accounting, it does not keep detailed records of these assets but simply records a vintage with an amount. Mr. Watson based his recommended five-year life on historical data and input from SPS personnel.⁴⁷⁰ While acknowledging that SPS personnel indicated they expect a four-year life on newer technology and networking technology, Mr. Pous objected that SPS did not indicate the level of investment associated with such equipment. Mr. Pous based his recommended six-year life on SPS having proposed that life in Docket No. 42004 and his conclusion that the actuarial data supports a six-year life. Mr. Watson responded that the current Depreciation Study indicates that a five-year life is more appropriate. The ALJs find that Mr. Watson adequately supported his proposed five-year life for these assets.

⁴⁶⁸ SPS Ex. 44, Watson rebuttal at 59-60.

⁴⁶⁹ AXM Ex. 3, Pous direct at 61-69.

⁴⁷⁰ SPS Ex. 13, Watson direct at 32-33; SPS Ex. 44, Watson rebuttal at 60. FERC's Accounting Release No. 15 allows high-volume, low-cost assets to be amortized over the asset's useful life, eliminates the need to track individual assets, and allows retirement to be booked at the end of the asset's depreciable life. Under this method (often referred to as amortization of general plant), depreciation is calculated using a useful life applied to a vintage rather than to an entire account. Depreciation recovery ends when the vintage-accumulated depreciation equals the vintage plant adjusted for estimated salvage and removal costs.

5. General Plant Related to Equipment, Facilities, and Property Services

a. Account 390—General Plant Structures and Improvements

For this account, Mr. Watson recommended a negative 10% net salvage value⁴⁷¹ and Mr. Pous recommended positive 15%.⁴⁷² The ALJs recommend SPS's proposal.

Mr. Watson based his recommendation on historical and current data and on information from SPS personnel. He stated that the most recent five-year and 10-year moving averages indicate net salvage values of negative 17% and negative 22%. Mr. Pous observed that most of the investment in this account is associated with the nine largest facilities that SPS owns, which are in metropolitan areas and thus more likely to have a positive net salvage value when retired (sold). He stated that SPS's historical data for retirement of facilities other than entire office facilities, distribution centers, or service centers support a negative 22% net salvage value, which he considered more indicative of retirement of leasehold improvements or components of buildings SPS owned, such as roofs and air conditioning systems. He concluded that the database Mr. Watson relied on is not representative of most of the assets in the account. Mr. Watson stated that most sales proceeds will be in the land value; SPS does not sell buildings on an ongoing basis. The main retirements over time will be replacement of parking lots, roofs, heating, ventilation, and air conditioning, and periodic building remodeling. Mr. Pous's recommendation was based on data that included the positive 41% net salvage value achieved in 2003 associated with a consolidation of facilities. Mr. Watson testified that the 2003 facilities consolidation was a one-time event related to merger activities and SPS cost reduction initiatives and that it is not anticipated to recur. The ALJs find that SPS showed it is unlikely to sell the assets in this account for a positive net salvage value. Finding Mr. Watson's reasoning to be persuasive, the ALJs recommend SPS's proposal.

⁴⁷¹ SPS Ex. 44, Watson rebuttal at 77-78; SPS Ex. 13, Watson direct, Att. DAW-RR-2 at 63.

⁴⁷² AXM Ex. 3, Pous direct at 80-82.

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**b. Accounts 392.02–Transportation Equipment–Light Trucks and
392.04–Transportation Equipment–Heavy Trucks**

i. Average Service Life

Mr. Watson recommended 10SQ for Transportation Equipment–Light Trucks and 12SQ for Transportation Equipment–Heavy Trucks.⁴⁷³ Mr. Pous recommended 12SQ and 14SQ respectively.⁴⁷⁴ The ALJs recommend AXM's proposals.

Mr. Watson based his recommendations on input from SPS personnel and historical data. Mr. Pous objected that Mr. Watson's notes of interviews with SPS personnel do not state their estimated life expectancies, whereas the interview notes from SPS's last rate case state that "12 years is reasonable" for Light Trucks and "14 years matches their [Heavy Trucks] internal analysis and is what funding is based on."⁴⁷⁵ In his 2013 study, Mr. Watson presented 32 curve fits associated with actuarial results, which Mr. Pous stated support an average service life of 13 to 14 years. Mr. Pous also argued that advancements in transportation manufacturing and problem warning systems support a longer service life. Finally, Mr. Pous complained that Mr. Watson inconsistently recommended both short average service lives and low positive net salvage values. Mr. Watson considered Mr. Pous's comparison of SPS's trucks to the vehicles of average consumers inapt, because SPS puts much more wear and tear on its vehicles than the average consumer. Mr. Watson also cited a recent J.D. Power article indicating that increased problems involving newer model cars are being reported. Finding that the most recent notes of interviews with SPS personnel support AXM's proposal, and not that of SPS, the ALJs recommend AXM's proposal.

⁴⁷³ SPS Ex. 44, Watson rebuttal at 61-63.

⁴⁷⁴ AXM Ex. 3, Pous direct at 66-68.

⁴⁷⁵ AXM Ex. 3, Pous direct at 66-67.

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ii. Net Salvage Value

Mr. Watson recommended a net salvage value of positive 7% for Transportation Equipment–Light Trucks and positive 6% for Transportation Equipment–Heavy Trucks.⁴⁷⁶ Mr. Pous recommended positive 15% for both.⁴⁷⁷ The ALJs recommend SPS's proposals.

Mr. Watson's recommendations were based on SPS's discontinuation of a like-kind exchange program and his estimated proceeds from the sale of assets, using the database of a national auction house geared toward equipment used in the utility business. Using data from the National Automobile Dealers Association, Mr. Pous based his recommendation on the trade-in value in Amarillo, Texas, of a 2002 Ford F-150 4-wheel-drive Supercab Lariat truck with 180,000 miles. Mr. Watson complained that Mr. Pous based his recommendation on one brand of personal-use truck that is not representative of SPS's transportation equipment. Mr. Watson testified that, compared to personal-use trucks, SPS's work trucks are costlier to purchase, because they require customizations, and have a lower trade-in value, because they are used in extreme and demanding conditions and their specialized equipment is not in demand by the general public. Mr. Watson also criticized Mr. Pous for relying on historical data that do not reflect SPS's discontinuation in 2014 of a like-kind exchange program that SPS implemented in 2006. Finding Mr. Watson's reasoning persuasive, the ALJs recommend SPS's proposal.

c. Account 397–Communication Equipment

For this account, Mr. Watson recommended 15SQ⁴⁷⁸ and Mr. Pous recommended 20SQ.⁴⁷⁹ The ALJs recommend SPS's proposal.

⁴⁷⁶ SPS Ex. 44, Watson rebuttal at 79-81.

⁴⁷⁷ AXM Ex. 3, Pous direct at 82-84.

⁴⁷⁸ SPS Ex. 44, Watson rebuttal at 64-67; SPS Ex. 13, Watson direct, Att. DAW-RR-2 at 53.

⁴⁷⁹ AXM Ex. 3, Pous direct at 68-69.

This account consists of equipment that provides an overall data collection network to monitor and manage load demand on the energy grid, technology that Mr. Watson said is changing rapidly. He based his recommendation on input from historical data and information from SPS personnel. Mr. Pous observed that Mr. Watson undertook no new interviews with SPS personnel but relied on “previous interviews.”⁴⁸⁰ Based in part on those interview notes, in Docket No. 42004 Mr. Watson recommended a 23-year average service life. Mr. Pous quoted notes from previous interviews that reference lives of four years to 20 years for different assets in the account and state: “9 years for the overall account seems reasonable—the mix of shorter life and longer.”⁴⁸¹ Mr. Watson stated that his recommendation reflects the nine-year life recommended by SPS personnel while accounting for the impact of technology on the assets. The ALJs find that the interview notes and other evidence better support Mr. Watson’s proposal.

E. Affiliate Charges

1. Applicable Case Law and Background

PURA § 36.058 provides specific standards for the recovery of payments made for goods or services by a utility to an affiliated entity. In order to recover affiliate costs, SPS must demonstrate that:

1. The goods and services purchased from the affiliate were reasonable and necessary;
2. The cost of the goods and services purchased was reasonable and necessary;
3. SPS was charged no more than other entities for the same or similar goods and services; and
4. The charges to SPS reasonably approximated its affiliate’s cost to provide the goods and services.⁴⁸²

⁴⁸⁰ SPS Ex. 13, Watson direct, Att. DAW-RR-3 (workpapers compact disc at “Interview Notes”).

⁴⁸¹ AXM Ex. 3, Pous direct at 68-69.

⁴⁸² PURA § 36.058(b), (c).

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If the Commission finds a particular affiliate cost to be unreasonable, it must determine the reasonable level of the expense in question and include that sum in the utility's cost of service.⁴⁸³

SPS grouped Test Year affiliate charges into 47 affiliate classes. Fifteen witnesses testified concerning the scope, necessity, and beneficial nature of the services provided to SPS by its affiliates. SPS notes that, for the most part, Intervenor and Staff did not challenge affiliate charges.⁴⁸⁴

SPS witness Janet S. Schmidt-Petree provided background information concerning SPS's affiliate charges. She explained that, under the Public Utility Holding Company Act of 1935 (PUHCA), registered holding companies, such as Xcel Energy, were permitted to form and operate centralized service companies to provide common administrative and management services "at cost" to the utility operating companies and affiliates. As noted previously, XES is the service company subsidiary of Xcel Energy. At a minimum, XES provides executive management; accounting and financial reporting; finance; treasury; corporate communications; property services; human resources; information technology; environmental; legal; regulatory; customer services; engineering, distribution, and transmission management and support; and energy supply management and support to its affiliates. Ms. Schmidt-Petree testified that, during the Test Year, XES provided its services to SPS "at cost" as was required by the regulations adopted by the SEC under PUHCA.⁴⁸⁵

During the test year, XES billed \$1.08 billion to all Xcel Energy entities; 12.98% of those billings (\$139,778,574) were to SPS. Other affiliates also billed SPS during the test year: the total amount of affiliate O&M charges SPS initially sought to recover was \$86,844,330 (total

⁴⁸³ PURA § 36.058(f).

⁴⁸⁴ See SPS initial brief (RR), App. A.

⁴⁸⁵ SPS Ex. 14, Schmidt-Petree direct at 44. Ms. Schmidt-Petree testified that, although PUHCA was repealed in 2005, XES continues to provide its services to SPS "at cost." SPS Ex. 14, Schmidt-Petree direct at 44.

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company). However, SPS does not contest certain challenged affiliate costs, which total \$2,579.⁴⁸⁶ The contested and agreed-to issues are set out below.

2. External Affairs Class

The External Affairs Class of service focuses on SPS's participation in the legislative and policy areas. PURA § 36.062 provides that the Commission may not consider for ratemaking purposes an expenditure for legislative advocacy, made directly or indirectly, including legislative advocacy expenses included in trade association dues. Thus, SPS is required to exclude legislative advocacy costs. SPS witness Mr. Evans testified that the services grouped into this class are related to: tracking and providing analysis related to federal regulations and laws, developing programming for the involvement of stakeholders in electric utility issues, and providing executive leadership for the External Affairs business area.⁴⁸⁷ SPS requests recovery of \$115,562 (total company) for the services provided to it by the External Affairs business area of XES.⁴⁸⁸

OPUC recommends disallowance of these costs. OPUC contends that SPS applied an incorrect standard in determining which of its expenses are legislative advocacy costs. OPUC witness Dr. Szerszen testified that the External Affairs department engages in both lobbying and non-lobbying activities at the federal and state level and interfaces with trade associations to understand and shape policies important to SPS. Because SPS uses the Lobbying Disclosure Act to define lobbying activities, Dr. Szerszen expressed concern that SPS can avoid classifying its pre-lobbying as lobbying activities because a broad reading of the Lobbying Disclosure Act defines activities and research as lobbying only if, *at the time they are performed*, they are

⁴⁸⁶ SPS Ex. 14, Schmidt-Petree direct at 35-36, Att. JSSP-RR-4.

⁴⁸⁷ SPS excluded the costs of this class related to federal lobbying activities, Xcel Energy's civic and political engagement programs, and the costs related to administration of the Xcel Energy Foundation and corporate giving. SPS Ex. 6, Evans direct at 79.

⁴⁸⁸ SPS Ex. 6, Evans direct at 79. In its initial brief (RR), SPS indicates this amount is \$155,562.

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lobbying. Thus, SPS could classify a pre-lobbying activity or research as a non-lobbying expense even though it is clearly research for lobbying, but not at the time it was performed.⁴⁸⁹

In response, SPS witness Mr. Evans noted that, out of the total amount allocated to SPS for the services of the External Affairs class during the Test Year (\$921,047), SPS is seeking recovery of \$115,562. SPS excluded \$391,945 of the costs because they were related to the Xcel Energy Foundation, were corporate giving, or were costs of the Political/Grass Roots department within External Affairs, whose costs are all deemed related to advocacy. There are three additional departments within External Affairs that provide both lobbying and non-lobbying services: External Affairs Vice President, Federal Government Affairs, and Corporate and State External Affairs. SPS excluded the legislative advocacy costs of those departments, but is seeking recovery of the costs for non-lobbying services.⁴⁹⁰ Mr. Evans indicated that:

- The External Affairs Vice President is responsible for oversight and administration of the business area, including budgeting, and managing employees. In addition, he advises the Xcel Energy and SPS Boards of Directors, works on Xcel Energy's executive management team, and works with SPS to understand and comply with its regulatory environment and the overall-all policies of Xcel Energy. Of the \$164,768 allocated to SPS from the External Affairs Vice President department, SPS is seeking recovery of \$59,839 for the non-lobbying services provided.
- The Federal Affairs department collects and provides information to SPS and Xcel Energy regarding federal laws and regulations, and interfaces with many different organizations and entities at the federal level for purposes other than legislative advocacy. Of the \$312,743 allocated to SPS by the Federal Affairs department, SPS is seeking recovery of \$31,847 for these non-lobbying services.
- The Corporate and State Affairs department has informational and public relations responsibilities that are not lobbying-related. Of the \$44,077 allocated to SPS by this department, SPS is requesting \$23,876 for these activities.⁴⁹¹

⁴⁸⁹ OPUC Ex. 7, Szerszen direct at 29-30.

⁴⁹⁰ SPS Ex. 38, Evans rebuttal at 69.

⁴⁹¹ SPS Ex. 38, Evans rebuttal at 70.

According to Mr. Evans, the activities for which SPS seeks recovery were not pre-lobbying or the first step in lobbying efforts. Rather, they were a necessary function of providing service to SPS's customers, because legislation, regulations, and policies impact SPS's operations, customer costs, and the reliability of the SPS system. Mr. Evans also stated that SPS identifies expenses related to analysis, research, policy development, and regulatory contacts as legislative advocacy when the activities are preparatory to or part of lobbying activities, as guided by the Lobbying Disclosure Act and Texas Ethics Commission Rules, 1 TAC §§ 34.1 and 34.3.⁴⁹²

The ALJs find that SPS did not incorrectly include lobbying expenses in its External Affairs class of billing. Dr. Szerszen expressed concern that SPS may be using a standard that would allow SPS to improperly recover its lobbying costs, but offered no evidence that it had done so. The ALJs note that SPS must track legislation, regulations, and policies that impact or may impact its customers. There is no evidence showing that such actions are a "first step" towards lobbying, as Dr. Szerszen suggested.⁴⁹³ Moreover, even if they were a "first step," OPUC has not proved that they are, therefore, unrecoverable expenses. Mr. Evans testified that SPS had reviewed all work orders and had been careful to exclude costs if the description suggested that they were related to legislative advocacy or were otherwise not eligible for recovery. Accordingly, the ALJs recommend no adjustment to External Affairs affiliate costs.

3. General Counsel Class

The General Counsel Legal Services Class applies to legal services for Xcel Energy, its Board of Directors, officers, subsidiaries, business areas, and corporate operations areas. Personnel in this class provide services related to labor and employment law, litigation, contracts, rates and regulation, environmental matters, real estate, and other legal matters. SPS witness James L. Altman testified that XES bills the majority of its expenses for the General

⁴⁹² SPS Ex. 38, Evans rebuttal at 71-72, *citing* Texas Ethics Commission, *Lobbying in Texas, A Guide to the Texas Law*, https://www.ethics.state.tx.us/guides/LOBBY_guide.htm.

⁴⁹³ OPUC Ex. 7, Szerszen direct at 30-31.

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Counsel Legal Services class to affiliates other than SPS. SPS receives approximately 13.1% of total XES billings for this class. The services grouped in this class are necessary to ensure that SPS can deal with complex legal issues such as corporate governance, business transactions, employee benefits, and liability claims.⁴⁹⁴

Mr. Altman testified that, for fiscal years 2011, 2012, and 2013 and for the Test Year, the actual per book affiliate charges from XES to SPS for the General Counsel Legal Services affiliate class were:⁴⁹⁵

	Actual (Per Book) Charges Over Time			
Class of Services	2011	2012	2013	Test Year
GC Legal Services	\$2,276,065	\$1,884,847	\$2,284,201	\$2,305,611

OPUC witness Cynthia L. Zamora recommended a disallowance of \$70,048 (total company) for outside legal expenses incurred for nine discrimination actions involving eight employees.⁴⁹⁶ Ms. Zamora indicated that SPS was not a named defendant or party to the matters. Based on Commission precedent, the last contested ETI rate case, she suggested that such costs be excluded.⁴⁹⁷ In that case, the Commission disallowed litigation expenses because ETI failed to explain why its service affiliate and other sister operating companies were named in the lawsuit, but ETI was not. Thus, noted Ms. Zamora, the ALJs, and ultimately the Commission, found that ETI failed to meet its burden of proving the litigation was a cost of doing business.⁴⁹⁸

⁴⁹⁴ SPS Ex. 27, Altman direct at 50-52.

⁴⁹⁵ SPS Ex. 27, Altman direct at 56. He further explained, “The decrease in costs between 2011 and 2012 was primarily related to a reduction in labor costs due to vacant positions which were offset by a slight increase associated with merit increases and outside legal costs, including regulatory and litigation matters. The increase in costs between 2012 and 2013 was primarily the result of filling vacant positions, merit increases, and outside legal costs including litigation, employment, and commercial/transactional matters. The slight increase in costs between 2013 and the Test Year was primarily the result of labor costs associated with merit increases.” SPS Ex. 27, Altman direct at 57.

⁴⁹⁶ OPUC Ex. 4, Zamora direct at 7; Tr. at 266.

⁴⁹⁷ OPUC Ex. 4, Zamora direct at 7-8, *citing* Docket No. 39896, Order on Rehearing, FF 168.

⁴⁹⁸ Docket No. 39896, PFD at 230, Order on Rehearing, FF 168.

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SPS argues that the facts in this case are different. SPS witness Mr. Altman testified that the allegations were employment-related claims, and XES, the service company, was the employer, not SPS. None of the Xcel Energy Operating Companies, including SPS, were named as parties. The claims were asserted against XES, the service company, and in one instance, a claim was against Xcel Energy, the parent company.⁴⁹⁹ As of June 30, 2014, XES employed 3,517 persons. SPS is not requesting recovery of actual settlements relating to these lawsuits.⁵⁰⁰

Mr. Altman explained that there are two types of legal expenses at issue. The first type of legal expenses is for outside legal counsel. During the Test Year, legal costs were incurred in defending XES against filed claims or demand letters involving eight XES employees who alleged some kind of employment discrimination. In two of these eight situations, outside legal counsel were hired. SPS was allocated \$70,048 of the outside legal expenses incurred in those two matters. The portion of this expense allocated to the Texas retail jurisdiction was \$41,027. The second type of legal expense proposed for disallowance is the cost of XES's internal attorneys working on these matters. SPS was allocated \$9,243 of these labor costs and the Texas retail portion of this expense was \$5,416.⁵⁰¹

Mr. Altman also testified that, because XES operates at cost, any legal expenses XES incurs, whether to negotiate and draft contracts, prosecute warranty claims, or defend employment claims, must be billed to the Xcel Energy operating entities. XES has no profit from which it could pay legal expenses. In rebuttal, Mr. Altman detailed the work activities of each of the eight litigants at issue and concluded that the jobs these former employees performed benefited Xcel Energy Operating Companies, including SPS.⁵⁰²

OPUC also recommends disallowance because the number of discrimination claims and related costs in this Test Year may not be representative of future conditions. Indeed,

⁴⁹⁹ SPS Ex. 47, Altman rebuttal at 6-7.

⁵⁰⁰ SPS Ex. 47, Altman rebuttal at 6-7; OPUC Ex. 5, Zamora workpapers at 6.

⁵⁰¹ SPS Ex. 47, Altman rebuttal at 6.

⁵⁰² SPS Ex. 47, Altman rebuttal at 8; SPS reply brief (RR) at 117, fn. 635.

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Mr. Altman was unable to testify as to how many similar claims SPS has had in the past, but he stated that employment litigation, as do all legal matters, fluctuates, and he did not believe there was a consistent pattern.⁵⁰³ SPS responds by noting that discrimination claims are one of many different types of legal expenses incurred by XES and are a relatively small part of the service company's total legal costs. Specifically, during the Test Year, XES's legal costs directly charged or allocated to SPS totaled \$2,305,611 (total company). SPS estimates that the discrimination claim costs were 3.4% of the affiliate class's costs.⁵⁰⁴

Finally, OPUC also argues that SPS failed to meet its burden of proving that the employment discrimination claim costs were actually incurred during the Test Year or were reasonable and necessary. On the stand, Mr. Altman was able to recall that one of the discrimination claims occurred before the Test Year, but he stated all requested expenses were legal expenses incurred during the Test Year. However, he was unable to recall each claim, and the list he provided in his direct testimony failed to include a date on two matters. Mr. Altman thought that two dates may have been inadvertently left off from the information provided to OPUC during discovery.⁵⁰⁵

The ALJs concur with SPS that its request to include expenses relating to its service company's litigation expenses is not precluded by Commission precedent. The facts in the ETI rate case can be distinguished here. SPS proved that the eight employees involved in the discrimination claims were employed by XES and undertaking tasks that should be allocated to XES operating companies, such as SPS. No operating company or companies were named in the legal actions; SPS would not be expected to be named because SPS did not employ the litigants. At the end of the Test Year, XES employed 3,517 persons. It follows, unfortunately, that employment claims will arise when a business employs thousands of people. As Mr. Altman testified, the actual per book affiliate charges from XES to SPS for the General Counsel Legal

⁵⁰³ Tr. at 266.

⁵⁰⁴ SPS Ex. 27, Altman direct at 56.

⁵⁰⁵ Tr. at 265, 267-268, 271; SPS Ex. 27, Altman direct, Att. JLA-RR-R1.

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Services affiliate class from 2011 to 2013 were in line with that of the Test Year. Overall, SPS met its burden of proving that the legal expenses were just and reasonable.

A tougher question is whether SPS met its burden of proving that two of the nine matters were legitimately included in the Test Year legal costs because SPS failed to list dates on a discovery response and because SPS's witness could not state whether nine employment claims were representative of the number of claims that could be expected in a test year. Stated another way, how much detail must SPS furnish for each charge? SPS clarified during discovery that it was seeking a total amount of \$70,048 (\$41,027 Texas retail) for outside legal expenses and \$9,243 (\$5,416 Texas retail) for in-house legal expenses associated with the discrimination lawsuits for expenses incurred during the Test Year. It provided further detail about the lawsuits (the cause number, entity involved, jurisdiction (if applicable), type of case, and status). Two of the status updates failed to include dates. The list provided during discovery did not include additional details such as the job the employee held, when the demand letter or lawsuit was received or filed, etc. (although Mr. Altman provided some additional details in his rebuttal testimony, such as the jobs the employees held at XES).⁵⁰⁶ However, the list provided to OPUC was for "XES's Employment Matters for Which Test Year Legal Costs Were Allocated to SPS."⁵⁰⁷ This is evidence, albeit general, that SPS did incur these legal costs in the Test Year. The fact that two matters in the list failed to include dates did not negate this general evidence that the expenses were incurred during the Test Year.

Ultimately, the ALJs are not persuaded that SPS should be disallowed cost recovery for two claims because the status report failed to include dates or because SPS's witness, Mr. Altman, a supervising witness, could not provide detailed information at the hearing. Moreover, the ALJs are not persuaded that Mr. Altman needed to know whether nine employment claims were typical. SPS provided testimony that the overall General Counsel costs were roughly the same from year to year. Of note, OPUC witness Ms. Zamora did not

⁵⁰⁶ See OPUC Ex. 6 at 7 and highly sensitive workpapers; SPS Ex. 47, Altman rebuttal, Att. JLA-RR-R1; Tr. at 267-268.

⁵⁰⁷ SPS Ex. 47, Altman rebuttal, Att. JLA-RR-R1.

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recommend disallowance because she believed the work occurred outside the Test Year or that it was non-representative of a typical year. Rather, her concern was that the inclusion of the legal expenses was precluded by precedent. As indicated above, the ALJs find that the precedent does not apply to the facts in this case. The ALJs further find that SPS provided sufficient evidence that the costs were incurred in during the Test Year and were reasonable and necessary.

4. Charges to New Mexico Work Orders

SPS uses six-digit work orders to bill direct charges for services from XES or to another operating company or affiliate when the provider of the services knows the specific operating company or affiliate that should be billed for those services. According to SPS witness Ms. Schmidt-Petree, a six-digit work order generally represents a managerial department within XES or an Operating Company. All charges billed using a six-digit work order are direct charges. The six-digit work orders can be used for both labor and non-labor charges. Such orders are generally established for managerial budgeting and reporting and are often assigned to a manager or director.⁵⁰⁸

OPUC witness Dr. Szerszen recommended that all such work orders with “New Mexico” in the title should be disallowed because they did not benefit Texas retail customers. Dr. Szerszen recommends a disallowance of \$203,474. These are charges for customer service, marketing and communications, business system, accounting, general counsel, legal service, financial, and other costs.⁵⁰⁹

Ms. Schmidt-Petree disagreed with Dr. Szerszen. She testified that SPS reviewed total company charges from XES without reviewing the title of the work order because, although some may appear to be directed at New Mexico, those charges are primarily related to the costs of managers or directors in managing that department, which provides services to all of SPS’s jurisdictions. As an example, Ms. Schmidt-Petree explained:

⁵⁰⁸ SPS Ex. 14, Schmidt-Petree direct at 50; SPS Ex. 45, Schmidt-Petree rebuttal at 7-8.

⁵⁰⁹ OPUC Ex. 7, Szerszen direct at 31-32.

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For instance, while an employee is working on a New Mexico rate matter, the employee determines that a spreadsheet could be reorganized to provide a clearer presentation of information and that the spreadsheet format could be used for Texas rate matters. Therefore, the costs recorded in the New Mexico titled work order benefit the total SPS system.⁵¹⁰

According to Ms. Schmidt-Petree, these charges generally benefit customers in all of SPS's jurisdictions and were appropriately allocated among SPS's three jurisdictions.⁵¹¹

Ms. Schmidt-Petree suggested that, if Dr. Szerszen's approach is applied to include the six-digit work orders that contain a reference to "Texas" or a city in Texas, \$1,068,644 should be direct assigned to SPS's Texas retail jurisdiction, rather than allocated in SPS's jurisdictional cost of service study. This amount reflects the \$772,510 already allocated to Texas, plus an additional \$296,138 of "Texas" costs being directly assigned to Texas retail that were previously allocated to New Mexico retail. Because Ms. Szerszen's proposed disallowance is to remove the \$203,374 that was allocated to Texas retail from costs recorded in the New Mexico work orders, the overall revenue requirement impact of applying Dr. Szerszen's proposal would be a reduction of the \$203,374 for "New Mexico" work orders and an increase of \$296,138 for "Texas" work orders. The net effect would be an increase of \$92,764 to SPS's Texas retail jurisdiction.

OPUC points out that Ms. Schmidt-Petree's explanation that New Mexico-specific work has a benefit to other jurisdictions would be true of most services provided by XES employees to the Xcel Energy subsidiaries. The fact that both Texas and New Mexico benefit from carry-over knowledge and experience is not sufficient justification for charging New Mexico-specific costs to Texas rate payers, argues OPUC. XES has a well-defined system of direct-charging and allocating its service costs, argues OPUC, citing Ms. Schmidt-Petree.⁵¹² OPUC questions why SPS cannot explain the same direct charging of services between Texas and New Mexico for the six-digit work orders.

⁵¹⁰ SPS Ex. 45, Schmidt-Petree rebuttal at 9.

⁵¹¹ SPS Ex. 45, Schmidt-Petree rebuttal at 9.

⁵¹² See SPS Ex. 14, Schmidt-Petree direct at 14.

OPUC further contends that there is no evidence to support “Ms. Schmidt-Petree’s unverifiable contention that direct assigning state specific costs would result in an increase in the costs assigned to Texas retail.”⁵¹³ OPUC argues that the methodology SPS used to separate out the Texas and New Mexico affiliate costs is not explained or supported. In support of its argument, OPUC notes that SPS failed to explain the methodology Ms. Schmidt-Petree used to assign the costs to the correct jurisdiction.⁵¹⁴

At the outset, the ALJs note that Ms. Schmidt-Petree’s testimony about direct assignment of state specific costs (*e.g.*, Texas-titled work orders to Texas and New Mexico-titled work orders to that jurisdiction) was not refuted. One could argue that much of the sworn testimony in this case is unverifiable, which is why witness experience and credibility must be considered. The ALJs found Ms. Schmidt-Petree to be a credible witness. Moreover, the ALJs take note of her testimony that SPS did not look at the title of the work orders in allocating costs, which appears to be the source of the disconnect between OPUC’s concerns and SPS’s explanations. The ALJs further note that the costs in these workpapers were directly assigned by managerial-level employees. On the face of it, the ALJs found some evidence that the direct assignment of some costs during an activity that related to New Mexico should be allocated to Texas retail.

However, the ALJs concur with OPUC that OPUC’s concern was not addressed. SPS provided only general information concerning the direct assignment of certain costs. SPS failed to explain, in detail, why the titles of the worksheets in question are not assigned to the jurisdiction in the title. Moreover, Ms. Schmidt-Petree’s one example—that a spread sheet made for New Mexico might be used for Texas—is not convincing, particularly for amounts totaling \$203,474 (total company). In this instance, given that the title of the work order itself suggests that the work was done for New Mexico, SPS should have provided more detail about these work orders because Dr. Szerszen recommended that they be disallowed. SPS met its initial burden of providing evidence that the six-digit work orders were allocated properly to the

⁵¹³ OPUC initial brief (RR) at 52.

⁵¹⁴ OPUC cites to OPUC Ex. 30 and 30A. Ex. 30 and 30A are SPS’s responses to an RFI requesting supporting documentation for Ms. Schmidt-Petree’s allocation of costs to Texas and New Mexico in her rebuttal testimony.

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appropriate jurisdictions.⁵¹⁵ But once Dr. Szerszen took issue with particular work orders, SPS needed to provide convincing evidence, such as a showing a sample of work orders that properly reflected costs that should be partially charged to Texas ratepayers.

OPUC asked SPS a series of questions during discovery concerning the allocation of costs to Texas and New Mexico in Ms. Schmidt-Petree's rebuttal testimony. SPS's responses reveal an extremely complicated jurisdictional allocation process.⁵¹⁶ It is possible that SPS provided support for Ms. Schmidt-Petree's testimony but the ALJs cannot, without further explanation, divine the particular allocation processes used for these work orders.

The ALJs understand SPS's argument that, if the directly assigned New Mexico orders are disallowed, there should be an increase of \$296,138 for "Texas" work orders. Those orders were allocated the same way, testified Ms. Schmidt-Petree. However, SPS bears the burden of proof on this issue. OPUC raised a concern about a set number of work orders and SPS did not meet its burden of showing that those work orders were an allowable expense. Accordingly, the ALJs recommend a disallowance of \$203,474.

5. Shared Facilities Charge

SPS witness Ms. Perkett explained that shared assets are assets used by an Xcel Energy affiliate (*e.g.*, XES) that are owned by one of the Xcel Energy Operating Companies. The shared asset is recorded on the books of the Xcel Energy Operating Company. Because the asset is owned by one of the Operating Companies, but used by, for example, XES employees performing work for all of the Operating Companies, the costs for that asset must be shared among all the Operating Companies. The costs that the owner incurs for these assets include book depreciation, tax depreciation, related deferred taxes, removal cost recovery, property taxes, and a return on investment. According to Ms. Perkett, the return on investment associated with the shared assets is included to ensure SPS customers, and the customers of the other

⁵¹⁵ SPS Ex. 37, Blair direct at 18-20.

⁵¹⁶ See OPUC Ex. 30, 30A; OPUC Ex. 8, Szerszen workpapers at 17-20.

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Operating Companies, are not subsidizing, or being subsidized by, other affiliates. The associated costs for the shared assets SPS owns are transferred from SPS to XES by crediting the SPS FERC Account 922, Administrative and General Transferred Credit, and debiting SPS inter-company receivables. The same entries are made on the books of the other Operating Companies for the shared assets they own.⁵¹⁷

Staff witness Ms. Givens recommends a decrease of \$1,564,659 to SPS's requested expenses to remove the carrying costs associated with the shared assets that have been charged to SPS. Under PURA § 36.058(a)(2) and (b), the Commission may not allow as a capital cost or expense a payment to an affiliate for interest expense unless the regulatory authority finds the payment is reasonable and necessary for each item or class of items as determined by the Commission. According to Ms. Givens, because SPS's Capital Asset Accounting Policy already makes the affiliates whole for the costs of the shared assets—by charging depreciation expense, tax expense, and removal costs—it is not reasonable and necessary to add a mark up to the shared costs in the form of a return on the asset. The cost of a profit to an affiliate is an unnecessary and unreasonable expense to Texas ratepayers and is inconsistent with case law which requires affiliate charges to be at actual cost.⁵¹⁸

Because SPS has also included in its revenue requirement \$1,187,726 that it received from other affiliates related to shared assets that SPS owns, Ms. Givens also recommends that this amount be removed from SPS's revenue requirement. This adjustment is found in FERC Account 922. The net impact of the amount charged to SPS and received by SPS is a disallowance of \$376,933.⁵¹⁹

SPS disagrees with Ms. Givens. SPS witness Ms. Perkett stated that the carrying cost component for the affiliate expense on a shared asset is a reasonable and necessary expense and

⁵¹⁷ SPS Ex. 42, Perkett rebuttal at 22-23; Staff Ex. 5A, Givens direct at 33.

⁵¹⁸ Staff Ex. 5A, Givens direct at 33-34, *citing Railroad Com'n of Texas v. Rio Grande Valley Gas Co.*, 683 S.W.2d 783 (Tex.App.-Austin 1984, no writ).

⁵¹⁹ Staff Ex. 5A, Givens direct at 34-35.

SPS should be allowed to recover it in its cost of service. She indicated that the charges for shared asset costs represent “rent” paid to the owning operating company for the XES employees’ use of the assets. The return on shared assets represents the after-tax WACC, based on a regulatory authority’s approved return and cost of capital. By including return in shared assets carrying costs, this represents the actual cost of service for the shared assets for the owning Operating Company, stated Ms. Perkett. And she noted that the relevant regulatory authorities have approved the return and weighted average cost of capital for each of the owning companies. Moreover, FERC considered SPS’s methodology for applying a return on shared assets and did not disagree with it.⁵²⁰

The ALJs concur with Staff. The cost of a profit to an affiliate is an unnecessary and unreasonable expense to Texas ratepayers and is inconsistent with case law. SPS’s shared facilities charge expense should be adjusted downward by \$1,564,659 to remove the carrying costs associated with the shared assets that have been charged to SPS. Additionally, SPS’s revenue requirement should be adjusted upward by \$4,487,726 to remove the return on assets that SPS received from other affiliates. As recommended by Ms. Givens, this adjustment should be made to FERC Account 922.

6. Life Events

For most affiliate classes, SPS included expenses for life events, which are costs incurred to improve employee morale by acknowledging specific events such as the birth of a child or death of a family member. Staff witness Ms. Givens testified that this gesture of “kindness and compassion” is not reasonable and necessary for the provision of electric utility service and recommended a disallowance of Life Event costs totaling \$2,475.⁵²¹ Although SPS believes these costs are reasonable and beneficial, it does not contest this proposed disallowance. Accordingly, the ALJs recommend that this expense be excluded from SPS’s affiliate expenses.

⁵²⁰ SPS Ex. 42, Perkett rebuttal at 24-26.

⁵²¹ Staff Ex. 5A, Givens direct at 35.

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7. Timekeeping Entry Error

During the discovery process, SPS identified a time-keeping entry error that resulted in additional expense. Based on this error, Staff witness Ms. Givens requested a disallowance in the amount of \$104 to FERC Account 920.⁵²² SPS agrees. Accordingly, the ALJs recommend a disallowance of \$104 to affiliate expenses.

F. Purchased Capacity Costs

SPS witness Jeffrey C. Klein testified that SPS purchases capacity and associated energy under long-term agreements and administers those agreements to provide its customers with the lowest reasonable cost of power available. He stated that all capacity-related costs that SPS incurred during July 1, 2013, through June 30, 2014, the Test Year, were incurred under contracts reviewed in previous base rate cases and fuel reconciliations. Given SPS's need for capacity in 2013-2014, it was reasonable to make these capacity purchases. Mr. Klein also testified that contractually authorized price increases, purchased power agreement terminations, and new purchased power agreements, necessitated pro forma adjustments to the Test Year data for these known and measurable changes. The total purchased power agreements' costs requested were \$125,243,289 (total company), consisting of \$118,824,909 in Test Year costs (total company) and \$6,418,380 in PTYAs.⁵²³

Specifically, Mr. Klein recommended the following adjustments:⁵²⁴

- Removal of the costs associated with the contract with Golden Spread that was in effect in the Test Year, but that will not be in effect in the rate year.

⁵²² Staff Ex. 5A, Givens direct at 35.

⁵²³ SPS Ex. 32, Klein direct at 32.

⁵²⁴ SPS Ex. 32, Klein direct at 16-17.

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- Removal of the costs associated with three contracts—City of Lubbock for the Brandon unit, City of Lubbock for the Massengale unit, and Orion Engineered Carbons, LLC—that were in effect in the Test Year, but will not have capacity-related costs in effect during the rate year.
- Addition of costs to reflect full rate year costs. SPS has two purchase power agreements with Calpine: “Calpine I” runs from January 1, 2012 through December 31, 2018; “Calpine II” runs from June 1, 2014 through May 31, 2019. However, the Calpine II contract had booked capacity-related costs during one month of the Test Year, June 2014, but will cause SPS to incur capacity-related costs during all twelve months of the rate year.
- Addition of costs related to changed contract provisions (capacity-related costs and variable O&M expenses) for Borger Energy Associates, L.P., Calpine I, and Sid Richardson.

AXM witness Mr. Dittmer recommended that these adjustments be denied. However, he proposed an adjustment to SPS’s proposed level of purchased power expenses that would “annualize” purchased power expense to capture price changes.⁵²⁵ Overall, AXM recommends an increase to SPS’s purchase power expense for this item in order to remain consistent with its position that the Commission should reject SPS’s PTYAs.

SPS rebuts AXM, citing 16 TAC § 25.236(a)(6). This rule prohibits the recovery of demand or capacity costs in fuel costs absent special circumstances, which makes it appropriate to recover these costs through base rates in a base rate proceeding. Also, 16 TAC § 25.231 specifically allows known and measurable changes to test year costs. SPS argues that its proposed known and measurable adjustments reflect costs that have begun or ended before the start of the rate year, the 12 months starting July 1, 2015, so that the amount requested is more representative of the expenses that will be incurred when the rates are put into effect. SPS cites to the testimony of another AXM witness, Steven Carver, who acknowledged that changes are known and measurable when they are fixed in time, known to occur, and measurable in amount.⁵²⁶

⁵²⁵ AXM Ex. 2, Dittmer direct at 28.

⁵²⁶ AXM Ex. 5, Carver direct at 9.

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The Commission's cost of service rule at 16 TAC § 25.231(a) provides that "rates are to be based upon an electric utility's cost of rendering service to the public during a historical test year, adjusted for known and measurable changes." The Commission further provides that capacity costs may be recovered in base rates, as they cannot be recovered as fuel costs.⁵²⁷ SPS adjusted its capacity costs to capture contractual changes in its capacity-related costs. No party contests that these contractual changes occurred. They are known and measurable. Thus, SPS met its burden of proof on this issue. The ALJs further note that SPS properly removed the costs associated with the Golden Spread ramp down. Even AXM witness Mr. Dittmer testified that, if the Commission accepts SPS's proposed change in jurisdictional allocations caused by the change in the Golden Spread wholesale load, it should also eliminate the costs of that contract.⁵²⁸

G. Coal Procurement Expenses

SPS witness H. Craig Romer testified that SPS procures coal from TUCO for its two coal-fueled electric generating facilities, Harrington and Tolk Stations, under a long-term, sole supplier contract for each station. Among other responsibilities, TUCO arranges for the purchase, receipt, transportation, unloading, handling, crushing, weighing, and delivery of coal to the bunkers to meet SPS's requirements. In the Test Year, the coal handling costs that are included in base rates include several projects that were undertaken at Tolk and Harrington Stations to improve safety and efficiency. SPS requested recovery of coal procurement costs in base rates. The total coal costs requested were \$40,658,533 (total company), consisting of \$40,598,847 in Test Year costs and a \$59,686 PTYA. The adjustment reflects a contractual increase in SPS's payment to TUCO in 2015.⁵²⁹

AXM recommends an increase to SPS's rate base for this item, consistent with its position that the Commission should reject all of SPS's PTYAs.

⁵²⁷ 16 TAC § 25.236(a)(6).

⁵²⁸ AXM Ex. 2, Dittmer direct at 29-30.

⁵²⁹ SPS Ex. 31, Rover direct at 31.

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The ALJs decline to adopt AXM's recommendation. SPS adjusted its costs to capture contractual changes in its payments to TUCO. No party contests that these contractual changes occurred, and they are known and measurable. Thus, SPS met its burden of proof on this issue. SPS's requested coal procurement costs, as adjusted, should be allowed.

H. SPP and Other Transmission Charges and Revenue

SPS incurs charges under SPP's Open Access Transmission Tariff (OATT) and other utilities' OATTs. SPS also receives revenues under SPP's OATT, which are offsets to expense in SPS's cost of service. In this case, AXM challenges SPS proposals relating to Schedule 1-A expenses, Lamar Direct Current Tie (Lamar tie) expenses, and point-to-point revenues. AXM, OPL, TIEC, and Staff also challenge SPS proposals relating to Schedule 11 expenses and revenues. For reasons discussed below, the ALJs recommend accepting SPS's proposals regarding Schedule 1-A and Lamar tie expenses, and point-to-point revenues, and rejecting SPS's proposals regarding Schedule 11 expenses and revenues.

1. Schedule 1-A and Lamar Tie Expenses, and Point-to-Point Revenues

SPS calculated its requested amounts for Schedule 1-A and Lamar tie expenses, and point-to-point transmission revenues, as described below.⁵³⁰

- ***Schedule 1-A expenses.*** Under the SPP OATT, Schedule 1-A charges are applied to all transmission service to cover SPP's expenses related to its administration of the OATT. SPS calculated its requested Schedule 1-A expenses as follows:

SPS's Test Year per book Schedule 1-A expenses	\$11,895,856
<i>Minus</i> Schedule 1-A expenses related to wholesale load	(\$3,294,127)
<i>Plus</i> amount reflecting increase in Schedule 1-A fee approved by SPP Board of Directors for 2015	<u>\$878,143</u>
SPS's requested Schedule 1-A expenses	\$9,479,871

⁵³⁰ SPS Ex. 36, Freitas direct at 12-13, 18-19, 23, Att. APF-RR-1 at 2, line 12; SPS Ex. 52, Freitas rebuttal at 42-46. All numbers are total company.

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- ***Lamar tie expenses.*** During the Test Year, SPS incurred \$8,475,178 in costs for transmission capacity across the Lamar tie, which is jointly owned by SPS and PSCO. SPS seeks an increase of \$390,182 to reflect a January 1, 2015 increase in PSCO's charges for capacity on the tie. The increased charges result from changes in PSCO's FERC-approved formula rate.
- ***Point-to-point transmission revenues.*** SPS's Test Year per book amounts of point-to-point transmission revenues were \$4,086,694 for firm service and \$782,943 for non-firm service. To reflect a change in FERC-approved rates, SPS proposes to increase the firm revenues by \$642,812 and the non-firm revenues by \$130,287.

AXM witness Mr. Dittmer proposed to annualize the expenses and revenues in effect at the end of the Test Year and include only the annualized amount in cost of service.⁵³¹ He explained that SPS "has reached approximately six months beyond the end of the historic test year to capture actual and anticipated price changes" and AXM supports a "more rigid cutoff for cost of service components that captures quantities and prices being experienced at the end of the historic test year to achieve a better 'match' for all cost of service components."⁵³² He did not specify how his proposal regarding these issues achieves a better match with cost of service components.

The ALJs recommend rejecting AXM's proposals. As SPS points out, nothing in PURA or the Commission's rules prohibits known and measurable adjustments to test year amounts more than six months beyond the test year. 16 TAC § 25.231(b) allows test year operating expenses to be adjusted for known and measurable changes. SPS's proposed changes to the Test Year amounts are known and measurable. The increase in Schedule 1-A charges was approved by the SPP Board of Directors in October 2014 and took effect on January 1, 2015, and FERC has approved the rates SPS used to make the adjustments to Lamar tie expenses and point-to-point transmission revenues.

⁵³¹ AXM Ex. 2, Dittmer direct at 36-37. Mr. Dittmer noted that the dollar amounts of these adjustments are not large. See also AXM Ex. 5, Carver direct, Att. SCC-3, Sch. C-13.

⁵³² AXM Ex. 2, Dittmer direct at 36-37.

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2. Schedule 11 Expenses and Revenues

Schedule 11 is the part of SPP's OATT that addresses charges and revenues for Base Plan Upgrade (BPU) projects, which are SPP-approved transmission projects.⁵³³ In calculating SPS's cost of service, Schedule 11 revenues are a credit that offsets Schedule 11 expenses.

SPS witness Arthur Freitas recommended two adjustments to SPS's Test Year Schedule 11 expenses and revenues:

- **RRR Adjustment:** Instead of Test Year numbers, start with data from the Revenue Requirement and Rates (RRR) file that SPP issued on October 1, 2014; but
- **Return on equity adjustment:** Regarding certain Schedule 11 revenues and expenses, change the FERC-approved return on equity in the 2014 FERC-approved transmission formula rate to the Commission-approved return on equity (for which, as a proxy, Mr. Freitas's calculations used the 10.25% return on equity requested by SPS in this case).⁵³⁴

SPS provided a modified calculation of its Schedule 11 expenses and revenues, which incorporates the RRR and return on equity adjustments but assumes that (as the ALJs recommend but SPS opposes) SPS's proposed PTYAs to rate base are rejected.⁵³⁵ That modified calculation (on a total company basis) is set forth below.⁵³⁶

⁵³³ SPS Ex. 36, Freitas direct at 16, 25. The PFD includes only very high-level summaries of the detailed explanations of Schedule 11 expenses and revenues that are in evidence. *See, e.g.*, SPS Ex. 36, Freitas direct at 16-17, 25-38.

⁵³⁴ SPS Ex. 36, Freitas direct at 16-17, 25-26, 40; Tr. at 305-306. Mr. Freitas testified that, compared to his calculations, Commission approval of a return on equity lower than 10.25% would reduce Schedule 11 revenues more than Schedule 11 expenses, increasing the net revenue requirement. Tr. at 306.

⁵³⁵ As discussed previously, the PFD does not include numbers SPS proposed with respect to various issues in the event its rate base PTYAs are accepted.

⁵³⁶ SPS Ex. 36, Freitas direct at 16; SPS Ex. 52, Freitas rebuttal at 8-9, 41, Atts. APF-RR-R3, APF-RR-R4; *see also* Tr. at 277-278, 291, 719-721. Mr. Freitas explained:

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	Test Year	SPS Request if Rate Base PTYAs Are Rejected
Schedule 11 expenses	\$54,595,476	\$77,593,999
Schedule 11 revenues	\$60,836,135	\$60,251,331

SPS's RRR adjustment is contested by AXM, OPL, TIEC, and Staff. SPS's return on equity adjustment is contested by AXM, OPL, and TIEC. For reasons discussed below, the ALJs recommend rejecting both SPS proposals and instead using SPS's Schedule 11 expenses and revenues for the Test Year.

a. Schedule 11 RRR Adjustment

i. Evidence Regarding Variability of RRR File Data

SPP uses the RRR files to calculate Schedule 11 expenses and revenues, which are invoiced monthly to SPP members, including SPS.⁵³⁷ SPP issues new RRR files often. Six RRR files were in place during the Test Year.⁵³⁸ SPS proposes using the October 1, 2014 RRR file to calculate the Schedule 11 revenues and expenses included in cost of service. SPP, however, has revised the RRR file since October 1, 2014, and will continue to do so.⁵³⁹

If RRR files were used to calculate the Schedule 11 expenses and revenues included in

If the Commission does not allow SPS to include in rate base the plant placed in service between June 30, 2014, and December 31, 2014, the Commission should use the revenues and expenses set forth in the October 2014 RRR file with three adjustments: (1) the amounts should be adjusted so that the ROE used to calculate Schedule 11 expenses and revenues matches the ROE [return on equity] used to calculate the Texas retail jurisdictional revenue requirement; (2) the Schedule 11 expenses and revenues associated with plant placed in service after June 30, 2014 should be removed; and (3) the Schedule 11 expenses and revenues associated with plant placed in service before June 30, 2014 should be annualized. My Attachments APF-RR-R3 and APF-RR-R4 set forth those calculations.

SPS Ex. 52, Freitas rebuttal at 41.

⁵³⁷ Tr. at 296.

⁵³⁸ Tr. at 730-731; OPL Ex. 13 (SPP Documents and Filings Webpage).

⁵³⁹ Tr. at 296-297, 716.

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cost of service, the outcome would vary widely, depending on which RRR file is used. For example, SPP's January 1, 2015 RRR file was in place at the time of the hearing.⁵⁴⁰ In response to discovery by OPL, Mr. Freitas indicated that the following values are correct:⁵⁴¹

	October 1, 2014 RRR File	January 1, 2015 RRR File
Total Schedule 11 Charges	\$86,026,223	\$96,985,999
Total Schedule 11 Revenues	\$80,076,975	\$104,581,927
Net Expense	\$5,949,248	(\$7,595,928)

Mr. Freitas agreed that the above data show an approximate \$13.5 million swing in net Schedule 11 expense between using the two RRR files.⁵⁴²

A variety of events contribute to the variability of the RRR file data. For example, a change in transmission revenue requirement for any of the roughly 20 SPP members triggers an RRR file update.⁵⁴³ Allocation of expenses and revenues among SPP members also changes.⁵⁴⁴ For instance, the percentage of Schedule 11 expenses assigned to SPS declined from the 13.8% share SPS used in its Application to approximately 12.5% in the January 1, 2015 update.⁵⁴⁵ New members will join SPP this year, which will impact revenues and expenses in a manner that Mr. Freitas described as “complicated.”⁵⁴⁶

Mr. Freitas testified that he used the October 1, 2014 RRR file as the starting point for calculating Schedule 11 revenues and expenses because that file calculates revenue requirement for plant in service through December 31, 2014, and SPS is requesting PTYAs for rate base through December 31, 2014.⁵⁴⁷ In his rebuttal testimony, he proposed using the October 1, 2014

⁵⁴⁰ Tr. at 734.

⁵⁴¹ OPL Ex. 14 at 2; Tr. at 735-736.

⁵⁴² Tr. at 736.

⁵⁴³ Tr. at 292-295.

⁵⁴⁴ Tr. at 294, 297.

⁵⁴⁵ Tr. at 298-302.

⁵⁴⁶ Tr. at 311-313; *see also* Tr. at 292, 294-296, 298-299.

⁵⁴⁷ Tr. at 733, 741.

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RRR file for that purpose even if SPS's rate base PTYAs are rejected.⁵⁴⁸

Mr. Freitas opined that the October 1, 2014 RRR file represents a known and measurable change to the Test Year numbers and should be accepted because *at the time SPS filed its application* SPS was paying the rates and revenue requirements contained in the October 1, 2014 RRR file.⁵⁴⁹ Whether a change was in effect when the Application was filed, however, is not the issue. A Commission rule requires that “[i]n computing an electric utility’s allowable expenses, only the electric utility’s historical test year expenses as adjusted for known and measurable changes will be considered”⁵⁵⁰ The Texas Supreme Court has stated: “[c]hanges occurring after the test period, if known, may be taken into consideration . . . in order to make the test year data as representative as possible of the cost situation that is *apt to prevail in the future*.”⁵⁵¹ As Mr. Freitas acknowledged, SPS’s payments are no longer based on the October 1, 2014 RRR file.⁵⁵² The ALJs conclude that the October 1, 2014 RRR file is not representative of the cost situation apt to prevail in the future. Because the RRR files change often, and using different RRR files produces very different net Schedule 11 expenses for SPS, the ALJs find that none of the RRR files qualifies as a known and measurable change to the Test Year.

ii. Commission Precedent on Use of RRR Files

In a recent transmission cost recovery factor (TCRF) case,⁵⁵³ the Commission rejected

⁵⁴⁸ Tr. at 733.

⁵⁴⁹ SPS Ex. 52, Freitas rebuttal at 9, 31.

⁵⁵⁰ 16 TAC § 25.231(b).

⁵⁵¹ *Suburban Util. Corp.*, 652 S.W.2d at 366.

⁵⁵² Tr. at 317, 715.

⁵⁵³ *Application of Southwestern Electric Power Company for Approval of a Transmission Cost Recovery Factor*, Docket No. 42448, PFD at 15-16 (Oct. 10, 2014), adopted in Docket No. 42448, Order (Nov. 24, 2014) at 1-2, FFs 32-45.

SWEPCO's proposal to use RRR files SPP issued after the test year. SPS argues that the Commission's holding was limited to TCRF cases. The ALJs disagree. SWEPCO's RRR adjustment was rejected on two grounds. One ground—that the adjustment was not appropriate to the limited scope of a TCRF proceeding—does not apply to this case, but the other ground—that the adjustment was not known and measurable—does apply. That is clear from the PFD (which the Commission adopted), which concludes:

The use of adjustments to historical test year figures potentially eviscerates the benefits of providing a streamlined process. *Added to that is the fact that the adjustments proposed by SWEPCO do not satisfy the known and measurable standard.* For example, the changes to the Rates and Revenue Requirement (RRR) file that took place in April 2014 are likely no longer in place as of the date of this hearing. The RRR files change frequently. As a consequence, there is no way to say with certainty that the revised figures are “known.” . . . Because the RRR file changes with great frequency and because the changes can go either direction, it is not possible to point to the RRR file at any given time and say that it is known that the changes represented by the file will remain in effect throughout the time a rate will be in effect.⁵⁵⁴

iii. ALJs' Recommendation

Post-hearing briefs indicate that the parties opposing the RRR adjustment support using Test Year numbers to calculate SPS's Schedule 11 revenues and expenses.⁵⁵⁵ The ALJs agree.

⁵⁵⁴ Docket No. 42448, PFD at 15-16 (*italics added*); *see also* Docket No. 42448, Order, FFs 37-38, 40-41:

37. SWEPCO's charges under SPP's schedule 9 and schedule 11 can change as often as every month.
38. SWEPCO used the charges from the April 2014 version of SPP's schedules 9 and 11 to calculate its proposed TCRF. The amount of these charges will change during the pendency of this proceeding.
40. SWEPCO does not know what its charges under SPP's schedules 1A, 9, and 11 will be for the period during which the TCRF set in this proceeding will be in effect.
41. SWEPCO's proposed post-test-year and pro-forma adjustments to its SPP charges are not known and measurable.⁵⁵⁴

⁵⁵⁵ *See also* TIEC Ex. 1, Pollock direct at 25, 27 and OPL Ex. 1, Griffey direct at 35 (recommending use of the Test Year amounts for Schedule 11 expenses and revenues).

Finding that the October 1, 2014 RRR file cannot be considered a known and measurable change, the ALJs recommend using the Test Year Schedule 11 expenses and revenues.

b. Schedule 11 Return on Equity Adjustment

i. SPS's Evidence and Argument Regarding Its Return on Equity Adjustment

As explained by SPS witness Mr. Freitas,⁵⁵⁶ BPU transmission projects can be built anywhere in the SPP footprint, which covers all or parts of nine states. When SPS builds a transmission project, it includes that project in its regulated rate base even when the project is constructed pursuant to an SPP-issued Notification to Construct and will be regionally funded, in whole or in part. Texas retail customers thus pay for BPU projects through base rates, including a return of and on SPS's investment in BPU projects. The Texas retail portion of the plant balance of the BPU projects is included in SPS's Texas retail rate base and earns a return at the Texas retail weighted average cost of capital (WACC), of which one component is return on equity.

Each SPP transmission owner, including SPS, has either a FERC-approved transmission formula or a FERC-approved transmission revenue requirement. SPP takes each transmission owner's revenue requirement for all of its BPU projects and allocates those costs to the transmission owner's zonal revenue requirement or to the region-wide revenue requirement. Through this process:

- *SPS is invoiced for Schedule 11 charges* (expenses) resulting from: (1) BPU projects SPS constructs in the SPS zone; and (2) a share of the BPU project charges allocated region-wide (which includes costs for BPU projects built by all SPP transmission owners that have region-wide recovery, including SPS); and
- *SPS receives Schedule 11 revenues* for BPU projects it constructs and owns from SPS zone transmission customers, all transmission customers in SPP (including

⁵⁵⁶ SPS Ex. 36, Freitas direct at 27-28, 37, 41, 44-48; SPS Ex. 52, Freitas rebuttal at 10, 22; Tr. at 280.

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SPS), or both, depending on the project's cost allocation methodology.

Although the amounts are netted on the invoice SPP sends to SPS, SPP's settlement statement shows the entire calculation of Schedule 11 expenses and revenues.

Texas retail customers pay a portion of the Schedule 11 charges attributable to each BPU project in the SPS zone, but do not pay all of the Schedule 11 charges attributable to BPU projects of 100 kV or higher. SPS receives from customers in other zones Schedule 11 revenues that, depending on the project's size, may total as much as 87% of the costs of a BPU project in the SPS zone. These revenue credits arise only in connection with BPU projects that SPS constructs in the SPS zone.

Schedule 11 revenues that SPS *receives from transmission customers in the SPS zone* are returned dollar-for-dollar to SPS's retail customers in the form of Schedule 11 revenues, as reimbursement for BPU project costs that Texas retail customers bear through retail base rates. Mr. Freitas said there is no mismatch for Schedule 11 expenses collected from SPS zone transmission customers; those customers pay Schedule 11 charges at the FERC-approved WACC and receive that same amount of Schedule 11 revenues back at the same WACC.

In contrast, Mr. Freitas testified, the Schedule 11 revenues SPS *receives from transmission customers in SPP zones other than the SPS zone* are unrelated to the Schedule 11 expenses SPS pays to all these other zones through the Schedule 11 region-wide charge. According to him, this mismatch occurs because the revenues SPS receives are supposed to reimburse SPS's retail customers for the portion of BPU projects in rate base, but are higher than the amounts Texas retail customers pay for those projects if the FERC-approved WACC is higher than the Commission-approved WACC.⁵⁵⁷ Mr. Freitas stated that SPS's return on equity adjustment is needed to synchronize that mismatch. For consistency, the return on equity

⁵⁵⁷ SPS Ex. 36, Freitas direct at 45. SPS's FERC-approved return on equity is currently 11.27%, which is higher than SPS's current Commission-approved return on equity. OPL Ex. 1, Griffey direct at 33; Tr. at 307-308. A complaint is pending at FERC regarding the return on equity used in the SPS transmission formula rate. SPS Ex. 36, Freitas direct at 38-39.

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adjustment also uses the Commission-approved return on equity to calculate Schedule 11 expenses.

Mr. Freitas described a simplified example which assumes that: (1) costs and revenues are allocated 50% to Texas retail and 50% to FERC; (2) a transmission project is placed in rate base at a Commission-approved Texas retail WACC of 9%; and (3) SPS receives Schedule 11 payments from other SPP members based on a FERC-approved WACC of 10%.⁵⁵⁸ According to Mr. Freitas, if SPS's retail customers are credited with the actual revenues SPS receives from FERC jurisdictional customers, in essence SPS receives a 9% WACC for all of its investment, even though it is entitled to a 9.5% WACC (50% at the Commission-approved 9% WACC and 50% at the FERC-approved 10% WACC).⁵⁵⁹ He opined that "giving the entire revenue credit to Texas retail customers lowers the 10% WACC approved by FERC to the 9% approved by the Texas commission because SPS ultimately earns only the amount recovered in Texas retail rates for all of its investment, even that allocated to the wholesale jurisdiction."⁵⁶⁰

ii. Opponents' Evidence and Argument Regarding the Return on Equity Adjustment

TIEC witness Mr. Pollock disagreed with SPS's Schedule 11 return on equity adjustment, explaining:

Texas ratepayers are being asked to bear 100% of the costs of SPS's BPU projects allocated to Texas. This includes providing a return on investment, depreciation and all other plant-related expenses. Accordingly, Texas retail customers should also receive the full benefits from the revenues generated from the costs for which they are being asked to support in rates.⁵⁶¹

Mr. Pollock analogized a utility's Schedule 11 revenue credits from transmission projects to a

⁵⁵⁸ SPS Ex. 36, Freitas direct at 45-46.

⁵⁵⁹ SPS Ex. 36, Freitas direct at 46.

⁵⁶⁰ SPS Ex. 36, Freitas direct at 48.

⁵⁶¹ TIEC Ex. 1, Pollock direct at 27.

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utility's off-system sales from generation facilities. He testified that in both cases: (1) the utility constructed plant for the benefit, and at the expense, of its ratepayers; (2) the utility can use the plant to generate revenues from customers other than its ratepayers; and (3) the revenues should flow back to the ratepayers who pay for the plant. TIEC notes that, although a Commission rule⁵⁶² allows a utility to retain 10% of the margins for off-system sales if certain criteria are met (including a finding that the transaction is not detrimental to ratepayers), there is no such rule regarding Schedule 11 revenues.

Mr. Freitas responded that: (1) retail customers pay only their jurisdictional share of the plant-related costs and operating expenses; and (2) as long as the returns on equity are mismatched, SPS's customers are not bearing 100% of the costs of the SPS BPU projects allocated to Texas.⁵⁶³ Opponents of the return on equity adjustment, however, cited his testimony that, even without the return on equity adjustment, SPS will earn its Commission-authorized WACC on 100% of the transmission plant in its Texas retail rate base.⁵⁶⁴ These parties argue that SPS's return on equity adjustment would amount to earning the FERC-approved return on equity on net Schedule 11 expenses, which are under the jurisdiction of the Commission, not FERC.

AXM witness Mr. Dittmer also questioned the consistency of trying to allocate return on equity between jurisdictions while assuming the revenue credit developed with broad formula weights is adequate for assignment or allocation of all other elements that would be included in a jurisdictional cost of service study.⁵⁶⁵ Similarly, OPL witness Mr. Griffey testified that adjusting the return on equity would be insufficient to align the FERC and Commission approaches to rate determination for transmission, "because so many other factors from which return is calculated are different."⁵⁶⁶ Other regulatory differences include test-year expenses, regulatory liabilities,

⁵⁶² 16 TAC § 25.236(a)(9).

⁵⁶³ SPS Ex. 52, Freitas rebuttal at 27-28.

⁵⁶⁴ Tr. at 322-323, 326-327.

⁵⁶⁵ AXM Ex. 2, Dittmer direct at 18.

⁵⁶⁶ OPL Ex. 1, Griffey direct at 34.

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ADIT, income taxes, allocation factors, and capital structures.⁵⁶⁷ OPL contends that SPS's return on equity adjustment seeks to cherry-pick one difference that increases SPS's revenue requirement.

OPL further argues that, although other SPP participants pay part of the cost of SPS's transmission projects, SPS has chosen to include the projects' full cost in Texas rate base. In another SPS case, Mr. Freitas agreed that a simpler approach could be used: "the BPU plant in the SPS Zone could be excluded from rate base, the Schedule 11 revenues could be disregarded, and the costs associated with the BPU projects would be recovered solely through Schedule 11 expenses."⁵⁶⁸

iii. ALJs' Recommendation

The parties' debate over the Schedule 11 return on equity adjustment includes disagreement over the likelihood that SPS's FERC-approved returns on equity will remain higher than its Commission-approved returns on equity; *i.e.*, whether SPS or its Texas customers would benefit from the adjustment in future. The PFD does not summarize evidence and argument on that point because, rather than try to predict what return on equity the Commission and FERC will adopt, the ALJs focused on whether SPS's return on equity adjustment is appropriate. For reasons discussed below, the ALJs conclude that it is not and recommend using Test Year Schedule 11 expenses and revenues.

SPS argues that it is entitled to receive the FERC-approved WACC on BPU projects under FERC jurisdiction. SPS does receive Schedule 11 revenue credits calculated using the FERC-approved WACC; SPS simply does not want its Texas retail rates set in a way that passes the full value of the credits on to its Texas retail ratepayers. In short, there is not a jurisdictional

⁵⁶⁷ OPL Ex. 16 (SPS RFI response).

⁵⁶⁸ OPL Ex. 1, Griffey direct at 35, n. 46 (quoting Mr. Freitas's testimony in *Application of Southwestern Public Service Company for Approval of a Transmission Cost Recovery Factor*, Docket No. 42042 (Nov. 25, 2013)).

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issue—the Commission, not FERC, has authority to set SPS's Texas retail rates. Moreover, SPS is not asking that the Commission flow through FERC-set Schedule 11 expenses and revenues to Texas retail customers; SPS is asking that the Commission *not* do that but instead adjust the FERC-set Schedule 11 expenses and revenues when setting Texas retail rates.

PURA § 36.051 requires the Commission to “establish the utility’s overall revenues at an amount that will [1] permit the utility a reasonable opportunity to earn a reasonable return on the utility’s invested capital used and useful in providing service to the public [2] in excess of the utility’s reasonable and necessary operating expenses.” Regarding that statutory language, the Commission-approved return on equity is a component of [1]; and the Schedule 11 expenses and revenues credit offset are components of [2]. SPS’s argument that, without the Schedule 11 return on equity adjustment, SPS will earn less than the Commission-approved return on equity on invested capital confuses [1] and [2]. Whether the Schedule 11 return on equity adjustment is accepted does not affect the Commission’s setting of rates that “permit the utility a reasonable opportunity to earn a reasonable return on the utility’s invested capital used and useful in providing service to the public.” The Commission-approved return on equity applies to SPS’s invested capital, not its expenses, and the Schedule 11 revenue credits are an offset to expenses, not a mechanism to add to SPS’s return. The ALJs find that in this case, the reasonable and necessary standard applicable to [2] is met by using SPS’s actual Test Year Schedule 11 expenses and revenues.

Another requirement applicable to [2], 16 TAC § 25.231(b), requires that “[i]n computing an electric utility’s allowable expenses, only the electric utility’s historical test year expenses as adjusted for known and measurable changes will be considered” The return on equity adjustment is not a known and measurable change to SPS’s Test Year Schedule 11 expenses and revenues.

Nor are the ALJs convinced that simply substituting the Commission-approved return on equity for the FERC-approved return on equity in the manner described for SPS’s return on equity adjustment produces an outcome that is reasonable and consistent. SPP’s process for calculating Schedule 11 revenues and expenses is complex, and the timing and methodology for

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calculating SPP members' transmission revenue requirements and SPS's Texas retail revenue requirement are quite different. In addition, SPS's return on equity adjustment introduces substantial complexity to the determination of Schedule 11 amounts to include in Texas retail rates.

The ALJs find that determining SPS's reasonable and necessary operating expenses using its actual Schedule 11 revenues and expenses is reasonable and fair. SPS's return on equity adjustment would instead use hypothetical Schedule 11 revenues calculated to address SPS's real concern: that its Commission-approved return on equity is lower than its FERC-approved return on equity.⁵⁶⁹ As discussed above, SPS's argument confuses return on investment with expenses. It also assumes that the Commission should adjust actual Schedule 11 expense and revenue amounts in order to provide SPS a different return on equity than the one the Commission determined provides SPS a reasonable opportunity to earn a reasonable return on SPS's invested capital. Moreover, SPS argues that the return on equity adjustment corrects a mismatch arising from the difference in the FERC-approved return on equity and the Commission-approved return on equity, but the ALJs recommend using Test Year Schedule 11 expenses and revenues, and during the Test Year the Commission-approved return on equity was set by negotiated settlement, with SPS's consent.

SPS argues that, because of the difference in returns on equity, without the return on equity adjustment Texas retail ratepayers are not paying their share of the full cost of the BPU projects. For reasons discussed above, the ALJs disagree. SPS cites no rule or precedent supporting its return on equity adjustment. Absent an exception (like the Commission rule allowing a utility to retain 10% of off-system power sales if certain criteria are met), the ALJs conclude that Texas retail ratepayers pay a reasonable return on and of SPS's investment in the BPU projects in rate base, as well as Schedule 11 and other BPU project-related expenses, and should receive the benefit of the Schedule 11 revenue credits that SPS actually receives.

⁵⁶⁹ Under SPS's theory, if FERC and the Commission approved the same WACC, there would be no mismatch and no reason for the return on equity adjustment.

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I. O&M Cost Containment

SPS's direct case includes a benchmarking study sponsored by SPS witness Richard D. Starkweather of ScottMadden, Inc. Based on his own benchmarking study, DOE witness Dwight D. Etheridge of Exeter Associates, Inc., recommended disallowing \$17.2 million of administrative and general O&M (A&G) expense and \$3.2 million of distribution O&M expense (total company).

Based on the evidence presented, the ALJs (1) do not recommend DOE's proposed disallowances, but (2) find that DOE has identified areas of comparatively high cost growth that warrant further investigation, and (3) for that reason, recommend ordering SPS to investigate and to detail in its next rate case the reasons for the substantial cost increases, the steps being taken to address them, and the timing and cost impacts of those steps. SPS's and DOE's evidence and arguments about each other's study methodologies and conclusions, SPS's performance relative to its peers, and factors affecting that performance, and the ALJs' recommendations, are discussed below.

1. Methodologies Used in SPS and DOE Benchmarking Studies

After considering all of the evidence and arguments summarized below, the ALJs find that (1) both benchmarking studies are reliable, and (2) because SPS's study focused on comparative *costs* while DOE's study focused on comparative *cost growth rates*, they provide different types of relevant and useful information.

a. Time Periods Used

Mr. Starkweather's benchmarking study was based on operational and financial data from publicly-available FERC Form 1 filings by regulated energy and utility companies for the

five-year period 2009 through 2013.⁵⁷⁰ Mr. Etheridge calculated compound annual growth rates (CAGRs) starting with data averaged for the years 2006-2009 and ending with data averaged for the years 2012-2014, effectively reviewing a 5½-year period.⁵⁷¹

b. Compound Annual Growth Rate Analysis

Whereas Mr. Starkweather compared SPS's O&M costs to those of its peers, Mr. Etheridge compared SPS's A&G and distribution O&M cost growth rates to those of its peers, using a CAGR analysis.⁵⁷² In Mr. Etheridge's opinion, such growth rate trends better reflect a utility's ability to manage costs. Mr. Starkweather agreed that utilities should look at expense growth rate trends to identify where costs can be trimmed.⁵⁷³

Mr. Starkweather testified that a CAGR analysis can be a useful tool for benchmarking studies, but the results depend heavily on the calculation's starting and ending points.⁵⁷⁴ He said, however, that he did not necessarily challenge the starting and ending points Mr. Etheridge selected, and he agreed a sensitivity analysis is a tool used to ensure selection of starting and ending points that do not skew the results.⁵⁷⁵ Mr. Etheridge testified that he performed such a sensitivity analysis and determined that using other starting and ending points showed worse performance by SPS.⁵⁷⁶

In his benchmarking study, Mr. Etheridge averaged the starting and ending points in order to smooth out potential data issues for other utilities in the peer group.⁵⁷⁷ Mr. Starkweather agreed that an analyst can smooth data anomalies by averaging several years when selecting

⁵⁷⁰ SPS Ex. 10, Starkweather direct at 11.

⁵⁷¹ DOE Ex. 2, Etheridge direct at 16, 28-29.

⁵⁷² DOE Ex. 2, Etheridge direct at 4, 17-18; Tr. at 192.

⁵⁷³ Tr. at 197-198.

⁵⁷⁴ SPS Ex. 41, Starkweather rebuttal at 23-24.

⁵⁷⁵ Tr. at 199-201.

⁵⁷⁶ DOE Ex. 2, Etheridge direct at 33.

⁵⁷⁷ DOE Ex. 2, Etheridge direct at 14.

starting and ending points; he used that approach in his own study.⁵⁷⁸ He opined, however, that using a simple three-year rolling average analysis would address any potential anomalies in the data.⁵⁷⁹ According to Mr. Starkweather, Mr. Etheridge instead provided an asymmetrical CAGR analysis of four years' average data for the starting point and three years' average data for the ending point, and selected the four-year and three-year averaging periods for starting and ending points that accommodate his perceived concerns about SPS's O&M cost levels in 2005, 2010, and 2011. The ALJs find Mr. Starkweather's brief testimony on that point to be unconvincing.

c. Metrics Evaluated

Mr. Etheridge examined five performance metrics for A&G expense, including two used by Mr. Starkweather.⁵⁸⁰ Mr. Starkweather questioned Mr. Etheridge's use of two of the five metrics: A&G expense per total plant in service; and A&G expense per total megawatt-hour (MWh) sold, including both retail and wholesale sales.⁵⁸¹ Mr. Starkweather stated that he saw no correlation between A&G expense and total plant in service. Mr. Etheridge presented correlation coefficients in his study showing the correlation between O&M expense and each selected measure (*e.g.*, retail sales or total plant in service) of SPS's operations.⁵⁸² For the period 2006 through 2009, the correlation between A&G expense and total plant in service (81.3%) exceeded the correlation between A&G expense and either retail sales (78.7%) or retail customers (79.2%), two metrics that Mr. Starkweather and Mr. Etheridge both endorse. The correlation between A&G expense and total sales was also relatively strong, ranging between 75.4% and 76.9% for the periods 2006 through 2009 and 2012 through 2014, respectively.

d. Peer Groups Used

⁵⁷⁸ Tr. at 200.

⁵⁷⁹ SPS Ex. 41, Starkweather rebuttal at 26.

⁵⁸⁰ DOE Ex. 2, Etheridge direct at 12.

⁵⁸¹ SPS Ex. 41, Starkweather rebuttal at 23, 31-32.

⁵⁸² DOE Ex. 2, Etheridge direct, Atts. DDE-3 at 1-2, DDE-4 at 1-2, 4-5.

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Mr. Starkweather's study considered a national peer group of 141 utility companies and a Texas peer group of 10 utility companies.⁵⁸³ The peer group included electric utilities that filed FERC Form 1 reports over the period of time studied, had at least 10,000 customers, and provided regulated electric service directly or indirectly to retail customers. Mr. Etheridge used as his peer group 41 electric utilities selected for a recent (updated in 2014) benchmarking study prepared by or for Xcel Energy.⁵⁸⁴ Mr. Starkweather objected that Mr. Etheridge's peer group included much larger utilities, some of which (unlike SPS) had service areas that included major metropolitan areas.⁵⁸⁵ At the hearing, however, Mr. Starkweather testified that he did not "necessarily fault Mr. Etheridge" for his sample selection.⁵⁸⁶

Mr. Starkweather questioned Mr. Etheridge's failure to include a comparison to a Texas-only peer group. In Mr. Starkweather's study:

- SPS was at or near the median of the Texas peer group for A&G expense per MWh sold and in the top (*i.e.*, best) quartile for the Texas peer group for A&G expense as a percent of revenues; and
- SPS was solidly in the top quartile of the Texas peer group for Distribution O&M cost per MWh sold, and at the Texas peer group median for distribution O&M expense per customer.⁵⁸⁷

Stating that he included the national peer group in his own study simply to provide another, broader perspective for the Commission, Mr. Starkweather opined that SPS's cost performance relative to other Texas electric utilities is the most relevant comparison in this case. DOE observes that he did not mention that opinion until his rebuttal testimony.

⁵⁸³ SPS Ex. 10, Starkweather direct at 13-14, Att. RDS-RR-2. Transmission-only utilities, and generation and transmission-only utilities, were excluded.

⁵⁸⁴ DOE Ex. 2, Etheridge direct at 13, Att. DDE-2.

⁵⁸⁵ SPS Ex. 41, Starkweather rebuttal at 28.

⁵⁸⁶ Tr. at 206.

⁵⁸⁷ SPS Ex. 41, Starkweather rebuttal at 29.

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DOE questions Mr. Starkweather's claim that his study presented benchmark comparisons of 10 Texas utilities, including SPS.⁵⁸⁸ Arguing that each of his A&G and distribution O&M metrics includes retail sales, retail customers, or retail revenues,⁵⁸⁹ DOE contends that "wires-only" utilities were not included in Mr. Starkweather's A&G and distribution O&M analyses and could not have been included in Mr. Etheridge's study.⁵⁹⁰ Regarding six of the nine Texas utilities (besides SPS) included in Mr. Starkweather's comparison, DOE argues that:

- AEP Texas Central Company, AEP Texas North Company, and Texas-New Mexico Power Company are wires-only companies and do not report retail sales, retail customers, or retail revenues;
- Mr. Starkweather expressed reluctance about having included in his own study CenterPoint and Oncor Electric Delivery Company (Oncor), which serve large metropolitan areas; and
- As Mr. Starkweather acknowledged, it would have been difficult for Mr. Etheridge's benchmarking study to include Sharyland Utilities, L.P. (Sharyland) in examining trends over time that began before 2010, which is when Sharyland began filing Form 1 reports.⁵⁹¹

DOE points out that Mr. Etheridge included four Texas utilities in his benchmarking study: SPS, SWEPCO, EPE, and ETI.⁵⁹² Out of those four Texas utilities, SPS was the worst or second worst performer for each metric he examined.⁵⁹³

The ALJs find that: (1) both witnesses performed benchmark comparisons with Texas utilities but were hampered by the limited number of vertically integrated utilities and differences between the service areas of some Texas utilities and that of SPS; and (2) made

⁵⁸⁸ SPS Ex. 10, Starkweather direct at 13-14.

⁵⁸⁹ SPS Ex. 10, Starkweather direct at 30-31, 34-36.

⁵⁹⁰ Tr. at 208.

⁵⁹¹ DOE Exs. 6, 7, 8; Tr. at 209-212.

⁵⁹² Mr. Etheridge combined ETI with Entergy Gulf States Louisiana, L.L.C. for reasons that he explained and Mr. Starkweather supported. DOE Ex. 2, Etheridge direct at 13, Att. DDE-2; Tr. at 210-211.

⁵⁹³ DOE Ex. 2, Etheridge direct, Att. DDE-3 at 4-6, Att. DDE-4 at 7-11.

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reasonable selections for their peer groups.

2. SPS's Overall O&M Costs

Based on his benchmarking study, Mr. Starkweather concluded that, for nearly every measure, SPS's O&M expenses were at or below the median for his national and Texas peer groups and in many cases in the top quartile during the 2009 to 2013 period, which he said indicates SPS has carefully managed its O&M costs over the past five years.⁵⁹⁴ He concluded that, on a total O&M basis and total non-fuel O&M cost basis, SPS is competitive when compared to either his national or Texas peer groups.⁵⁹⁵

Mr. Starkweather objected to DOE proposing disallowances for individual O&M components—A&G and distribution O&M—when SPS's *overall* O&M costs are reasonable compared to those of the national and Texas peer groups.⁵⁹⁶ Finding that objection unpersuasive, the ALJs conclude, as a matter of law, that a utility whose overall O&M costs are reasonable and necessary may nevertheless have particular O&M costs disallowed that do not meet that standard.⁵⁹⁷

3. Administrative and General O&M Expense

Based on his benchmarking study, Mr. Etheridge concluded that SPS's non-fuel O&M expenses per MWh sold increased 37% in four years, while the national median increase was only 8%.⁵⁹⁸ The largest component of SPS's non-fuel O&M costs is A&G expenses, of which a substantial portion is affiliate charges.⁵⁹⁹ DOE cites 2014 and 2015 presentations to investors by Xcel Energy indicating that Xcel Energy is taking steps to limit annual O&M cost growth to 0%

⁵⁹⁴ SPS Ex. 10, Starkweather direct at 8.

⁵⁹⁵ SPS Ex. 10, Starkweather direct at 25-26.

⁵⁹⁶ SPS Ex. 41, Starkweather rebuttal at 11-12.

⁵⁹⁷ *See, e.g.*, PURA §§ 36.051, 36.057, 36.058, 36.065; 16 TAC § 25.231(b).

⁵⁹⁸ DOE Ex. 2, Etheridge direct at 7.

⁵⁹⁹ DOE Ex. 2, Etheridge direct at 32-33.

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to 2%.⁶⁰⁰

As explained by Mr. Etheridge,⁶⁰¹ SPS seeks to include in cost of service \$104.6 million (total company) in A&G expense, a \$7.8 million increase over calendar year 2013 costs. The largest components of A&G expense are salaries and employee pension and benefit costs. Pension and benefits expenses and office supplies are major factors affecting SPS's A&G expense. Based on his benchmark study, Mr. Etheridge concluded that:

- SPS is significantly underperforming relative to its peers in controlling the escalation of A&G expenses.
- SPS “performed dismally” when benchmarked against the peer group with respect to managing A&G expense. For the five performance metrics, SPS's best ranking was 29th out of 41. For two of the five metrics, SPS placed in the bottom quintile and for the other three in the below-average fourth quintile.
- In order to be considered an average performer, SPS's A&G expense would have to be \$17.2 million lower (total company).⁶⁰²

Concluding that SPS's requested A&G expenses are not just and reasonable, Mr. Etheridge recommended a \$10.6 million (Texas retail) disallowance, which he said would merely bring SPS to the level of average cost growth management and the bottom level of the quintile for average performers.⁶⁰³

SPS argues that even Mr. Etheridge's analysis shows that, out of the five A&G expense metrics he analyzed, excluding pension and benefits expense, in only one case is SPS's cost management performance below average; for two of the metrics, SPS performance is average; and for the remaining two metrics, SPS's performance is above average compared to his

⁶⁰⁰ DOE Exs. 4, 5; TIEC Ex. 30 at 6, 13.

⁶⁰¹ DOE Ex. 2, Etheridge direct at 3, 28, 33.

⁶⁰² DOE Ex. 2, Etheridge direct at 4-5, 31-32, Table 2, Att. DDE-4.

⁶⁰³ DOE Ex. 2, Etheridge direct at 37.

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41-utility peer group.⁶⁰⁴

Mr. Starkweather opined that SPS's A&G expense trends were affected by the average energy consumption of SPS's customers, which differs substantially from the average energy consumption of customers of other Texas utilities.⁶⁰⁵ Other factors affecting major specific components of SPS's A&G expenses are discussed below.

a. Pension and Benefits Expense

As explained by SPS witness Mr. Schrubbe, because of the deep national recession in 2008 and accompanying stock market decrease, like almost every pension plan in the country, SPS's pension plans lost considerable asset value. They lost approximately 25% of their asset value, a 33.75% shortfall compared to the expected return for 2008. SPS phased in 20% of the asset loss each year from 2009 until 2013, when the entire amount of the 2008 asset loss was reflected in the calculation of annual pension cost. In addition, SPS suffered pension liability losses (the pension benefit obligation the pension plan must ultimately pay to the plan's beneficiaries). After the 2008 recession, to stimulate the economy the Federal Reserve began a sustained effort to drive down interest rates, which decreased discount rates from approximately 6.25% at the end of 2007 to approximately 5% at the end of 2011, causing SPS to suffer significant pension liability losses. The combination of pension asset losses and pension liability losses caused SPS's pension and benefit costs to increase as a percentage of overall A&G expenses from 2009 to 2014.⁶⁰⁶

Mr. Schrubbe concluded that the increase in pension and benefit expense from 2009 to 2014 occurred because of conditions in the national economy that were outside SPS's control. As DOE points out, Mr. Schrubbe did not explain why the recession and resulting financial crisis caused SPS's pension and benefits expense to increase to a greater extent than for other utilities.

⁶⁰⁴ DOE Ex. 2, Etheridge direct, Att. DDE-4.

⁶⁰⁵ SPS Ex. 41, Starkweather rebuttal at 21.

⁶⁰⁶ SPS Ex. 49, Schrubbe rebuttal at 53-54.

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b. Office Supplies Expense

SPS witness Gary O'Hara discussed XES's protocols for procuring office supplies.⁶⁰⁷ He stated that goods and services are procured through a competitive bidding process that evaluates not only price but also criteria such as a supplier's reliability and ability to meet the bid specifications. He cited a benchmarking study performed by the Center for Advanced Procurement and Supply indicating that the cost savings achieved by XES's supply chain function as a percentage of total company expenditures exceed the mean and median cost savings achieved by other utilities and have increased significantly over the past few years.

4. Distribution O&M Expense

SPS's request of \$38.7 million in distribution O&M expenses exceeds its total 2014 costs of \$36.2 million.⁶⁰⁸ Based on his benchmarking study, Mr. Etheridge concluded that:

- SPS lags well behind its peers in controlling escalating distribution O&M expenses.
- Only one of the sample 41 utilities performed worse than SPS at managing distribution O&M expense relative to retail customers.
- SPS was the worst performing utility when looking at O&M expense relative to plant in service.
- 2014 expense levels would need to be reduced by \$3.2 million (total company) or 8.9% just to place SPS in the middle quintile of the peer group.⁶⁰⁹

Concluding that SPS has not shown that its requested distribution O&M expense is reasonable, Mr. Etheridge recommended a \$2.3 million (Texas retail) disallowance.⁶¹⁰

⁶⁰⁷ SPS Ex. 24, O'Hara direct at 19-22.

⁶⁰⁸ DOE Ex. 2, Etheridge direct at 3.

⁶⁰⁹ DOE Ex. 2, Etheridge direct at 4-5, 21, Figs. 7-8.

⁶¹⁰ DOE Ex. 2, Etheridge direct at 6, 27.

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Mr. Starkweather testified that SPS provides reliable electric service.⁶¹¹ Noting that all regulated electric utilities are responsible for providing reasonable and adequate service, DOE responds that it is not challenging the quality of SPS's service, but rather the level of its distribution O&M expenses. The evidence does not show, and the ALJs find it unreasonable to assume, that the reason SPS's distribution O&M expenses are growing faster than those of its peers is that its peers have begun saving costs by providing inferior service.

Mr. Starkweather discussed factors affecting SPS's distribution O&M expense, including:

- SPS's unusual customer energy usage, *i.e.*, in 2013 (1) its residential class represented 79% of SPS's customers but only 19% of its retail energy sales, and (2) industrial and commercial energy usage, with their associated lower prices, represented about 78% of SPS's retail sales.
- Because SPS's service territory is primarily agricultural, its customers are located farther apart and require more distribution infrastructure.
- Oil and gas production growth in SPS's service territory over the last two to three years is unique relative to most of the country, and required SPS to construct more distribution infrastructure to serve oil and gas industry customers. From 2010 to June 30, 2014, SPS added 394 miles of new distribution lines.
- Temperature data show that for SPS's Texas service territory, the weather during July 2011 to June 2012 was the warmest on record in 117 years. Hotter weather can increase degradation of transformers and substation equipment, requiring additional distribution O&M work and higher monitoring and repair costs. System conditions were also affected by the particularly cold weather in February 2011.⁶¹²

In addition, Mr. Starkweather attributed the increase in SPS's distribution O&M expense per customer in 2011 to the loss of more than 34,000 retail customers due to the sale of the Lubbock

⁶¹¹ SPS Ex. 41, Starkweather rebuttal at 18. SPS's System Average Interruption Duration Index (average number of outage minutes per customer per year) during the Test Year was 77.65. SPS's System Average Interruption Frequency Index (average number of times a customer's service is interrupted) was 0.84.

⁶¹² SPS Ex. 10, Starkweather direct at 20, 35; SPS Ex. 41, Starkweather rebuttal at 14-17.

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distribution facilities in October 2010. DOE responds that is why Mr. Etheridge eliminated the 2010 and 2011 data from his analysis, an adjustment with which Mr. Starkweather agreed.⁶¹³

5. ALJs' Recommendation

Other challenges to specific O&M expenses (including affiliate expenses) that are within the scope of DOE's benchmark study are addressed elsewhere in this PFD. The issue here is whether to disallow A&G and distribution O&M expenses on the ground that, based on DOE's benchmark study, SPS's cost growth rates are unfavorable compared to those of its peers.

Although SPS is a vertically integrated utility, not a TDU, the ALJs agree with SPS⁶¹⁴ that it is instructive to consider the Commission's requirements relating to benchmark studies for TDUs that request recovery of affiliate expenses. The Commission's instructions for the TDU RFP include the following:

The following are examples of the types of evidence that may be presented to support the utility's burden of proof for the recovery of affiliate costs:

- a. historical cost trends; . . .
- c. benchmark data. It is acknowledged that benchmark comparisons may not be available for **all** transmission and/or distribution-related costs. To the extent that certain relevant costs are not included in the benchmark data used for comparison purposes, other evidence may be provided to address those costs.⁶¹⁵

Consistent with the Commission's TDU RFP, the ALJs find that evidence that may be presented to support a finding as to whether expenses are reasonable and necessary includes, but is not

⁶¹³ DOE Ex. 2 at 18; Tr. at 200-201.

⁶¹⁴ SPS Ex. 41, Starkweather rebuttal at 7.

⁶¹⁵ Commission, Investor-Owned Utility Transmission & Distribution Cost of Service Rate Filing Package at 63 (Apr. 2, 2003), http://www.puc.texas.gov/industry/electric/forms/rfp/iou_rfp_inst.pdf, last visited on September 28, 2015 (emphasis in original).

limited to, historical cost trends and costs compared to those incurred by peer utilities.

As DOE points out, the legal standard to include affiliate expenses in cost of service is more stringent than for non-affiliate expenses. The affiliate standard does not, however, require the growth rate of a utility's O&M expenses (which include but are not limited to affiliate expenses) to be comparable to that of peer utilities.⁶¹⁶ Moreover, DOE seeks disallowance of A&D and distribution O&M expenses on the same ground regardless of whether they are affiliate expenses.

Mr. Starkweather objected that, while acknowledging that many factors can affect A&D and distribution O&M expense growth rates, Mr. Etheridge never examined those factors, even though SPS presented witnesses who addressed them. Mr. Starkweather opined that higher costs may be reasonable if the utility has managed them prudently under the circumstances.⁶¹⁷ As a matter of law, the ALJs agree. For example, Docket No. 37162⁶¹⁸ involved proposed disallowances of increased fuel costs, which resulted from forced outages of SWEPCO power plants with lower fuel costs, on the basis that SWEPCO's forced outage rate was higher than that of its peers. The Commission adopted the PFD's recommendation to reject the disallowance. Findings of fact supporting that decision included the following:

39. The Commission has not adopted performance standards for SWEPCO's power plants but has instead used the prudence standard in evaluating the performance of SWEPCO's power plants.
40. Forced outages are unplanned outages resulting from equipment failure, which prevents units from operating. In general, low forced outage rates indicate prudent plant operation.
41. Forced outage rates are just one metric by which to evaluate power plant performance.

...

⁶¹⁶ See, e.g., PURA § 36.058.

⁶¹⁷ SPS Ex. 41, Starkweather rebuttal at 9, 11-12.

⁶¹⁸ *Application of Southwestern Electric Power Company for Authority to Reconcile Fuel Costs*, Docket No. 37162, PFD (Sep. 28, 2010) at 33-41; Order (Jan. 27, 2011) at 1, FFs 39-45, Conclusion of Law 8.

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44. SWEPCO's training programs and operating and maintenance procedures ensure the reliable and efficient operation of its generating units.
45. There was no evidence that SWEPCO imprudently operated or maintained its solid-fuel power plants during the reconciliation period.

Conclusion of Law No. 8 states the Commission's prudence standard: "The reasonableness of an action or decision must be judged in light of the circumstances, information, and available options existing at the time, without the benefit of hindsight."

Consistent with the Commission's reasoning in Docket No. 37162, the ALJs recommend that DOE's proposed disallowances be rejected. DOE does not allege, and the evidence does not show, that SPS's comparatively high growth rates for A&G and distribution O&M expenses resulted from imprudent cost control management. SPS presented sufficient evidence in this case to meet its burden of proof with respect to DOE's proposed disallowances. The ALJs find, however, that DOE's evidence presents enough cause for concern to justify further investigation of SPS's A&D and distribution O&M expenses. For that reason, the ALJs recommend that the Commission require SPS to investigate (including work with affiliates regarding their charges) and to detail in its next rate case the reasons for the substantial cost increases, steps being taken to reduce them, and the timing and cost impacts of those steps.

J. Fleet Fuel Expense

SPS incurred \$5,054,776 (total company) during the Test Year for the fuel required to operate the fleet of trucks and other vehicles used in providing services to customers and in its construction projects. By way of comparison, fuel costs for calendar year 2014 were \$4,934,584 (total company).⁶¹⁹ Staff witness Ms. Givens recommends a \$731,123 reduction to Test Year

⁶¹⁹ Fuel costs are direct costs for SPS; there no affiliate costs for fuel. Staff Ex. 5A, Givens direct, Att. AG-8 at 70.

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expense because the prices of gasoline and diesel have fallen. Ms. Givens replaced SPS's January 2014 gasoline expense of \$3.08 per gallon with a January 2015 average gasoline expense of \$1.91 per gallon. She also replaced SPS's January 2014 diesel expense of \$3.72 per gallon with a January 2015 average diesel expense of \$2.99 per gallon. Ms. Givens used the AAA Daily Fuel Gauge Report for the Amarillo metro area to determine her average price for gasoline and diesel. She applied this type of adjustment to six of the Test Year months, January through May 2014.⁶²⁰ Ms. Givens admitted that the prices of gasoline and diesel fuel can vary from month to month. She believes her adjustment was warranted because there was a significant downward trend in fuel prices by 20 to 25% per gallon.⁶²¹

SPS witness Ms. Blair took issue with Ms. Givens's adjustment because it is based on an estimate of the per-unit cost of fuel. Ms. Blair pointed out that fuel costs are notoriously volatile and future fuel costs cannot be calculated with reasonable certainty. Moreover, Ms. Givens used prices for fuel in the Amarillo area, but SPS often makes fleet fuel purchases hundreds of miles outside the city, in other urban areas, in rural areas, and even in New Mexico. Moreover, some vehicles are "wet-fueled," which means they are refilled from gas tankers, which is more expensive than using a refueling station in Amarillo. Finally, Ms. Blair noted that Ms. Givens's adjustment did not update for an increase or decrease of volumes of consumed fuel.⁶²²

The ALJs concur with SPS that Ms. Givens's adjustment fails to meet the known and measurable standard. It does not take into account different fuel costs for any refueling done outside Amarillo, fails to account for different types of refueling, fails to account for frequent fluctuations in fuel prices, and fails to consider any changes in volume that SPS may have had for the first six months of 2014. Indeed, SPS may have experienced higher gas usage, increasing its fuel costs during those same months. While fuel costs have decreased since the Test Year, Ms. Givens's recommendation is not persuasive evidence of SPS's future costs. Accordingly,

⁶²⁰ Tr. at 787; Staff Ex. 5A, Givens direct at 36-37.

⁶²¹ Tr. at 788-791. According to Ms. Givens, a material change, if it is known and measurable, can and should be made. Tr. at 792.

⁶²² SPS Ex. 53, Blair rebuttal at 42.

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the ALJs recommend that SPS's fleet fuel costs of \$5,054,776 (total company) be adopted.

K. Renewable Energy Credits

As explained by SPS witness Ruth Sakya, to meet Texas's renewable portfolio standard requirements, SPS obtains its renewable energy credits (RECs) through five long-term purchased power agreements.⁶²³ One of the five agreements is unbundled (the prices of energy and RECs are separately stated); the other four are bundled. The agreements provide that SPS takes possession of the energy and the RECs. Currently: (1) SPS's revenues from *REC sales* are a credit to eligible fuel expense; (2) for the *bundled contracts*, the imputed value of the RECs is deducted from the total contract price in eligible fuel expense; and (3) SPS's costs for *unbundled and bundled RECs* are included in base rates.⁶²⁴ "Margin" refers to sales revenues that exceed the cost of the RECs sold.⁶²⁵ The REC sales involve RECs incremental to those SPS needs to meet its renewable portfolio standard requirements each calendar year.⁶²⁶ Staff contested some of SPS's REC proposals; no other party did so.

SPS agreed to the recommendation by Staff witness Therese Harris that the imputed value of bundled RECs be set at \$0.64 per REC.⁶²⁷ That recommendation is undisputed, and the ALJs recommend its adoption.

SPS contests Ms. Harris's other two recommendations, which are:

⁶²³ SPS Ex. 35, Sakya direct at 9-10. SPS also buys power from a qualifying facility in New Mexico, receiving the RECs as part of its avoided cost payments to the facility.

⁶²⁴ SPS Ex. 35, Sakya direct at 11; SPS Ex. 51, Sakya rebuttal at 5-6, 8; Staff Ex. 2, Harris direct at 7-8. SPS calculates and imputes the value of the Texas retail jurisdictional share of RECs pursuant to a Commission-approved agreement. *See Application of Southwestern Public Service Company for: (1) Reconciliation of Its Fuel and Purchased Power Costs for 2002 and 2003; (2) a Special Circumstances Finding; and (3) Related Relief*, Docket No. 29801, Order (Dec. 19, 2005), FFs 38-41.

⁶²⁵ SPS Ex. 35, Sakya direct at 16.

⁶²⁶ SPS Ex. 51, Sakya rebuttal at 9.

⁶²⁷ SPS Ex. 51, Sakya rebuttal at 5; Staff Ex. 2, Harris direct at 5, 9.

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- Credit REC sales revenue in base rates, not in eligible fuel expense, for which she calculated a base rate credit of \$444,376; and
- Reject SPS's proposed 10%/90% sharing between SPS and its retail customers of margins generated from REC sales.⁶²⁸

For reasons discussed below, the ALJs agree with both Staff recommendations, except that the ALJs recommend using SPS's number (\$207,792) instead of Staff's number (\$444,376) for the amount of the base rate credit.

1. REC Sales Revenue Recognized in Base Rates or as a Credit to Eligible Fuel Expense

a. Legal and Policy Arguments

Under the Commission's fuel rule, SPS may flow through to its Texas retail ratepayers its eligible fuel expenses, calculated monthly.⁶²⁹ This procedure is an exception to the general requirement that utility costs are recovered through base rates.⁶³⁰ Ms. Harris opined that SPS's current practice of crediting REC sales revenue in eligible fuel expense rather than in base rates violates the fuel rule, which limits eligible fuel expenses to delivered costs of fuel for generation and purchased power energy costs.⁶³¹ The ALJs agree. SPS did not argue otherwise, but contends that policy considerations support allowing its current practice to continue.

As discussed previously, 16 TAC § 25.3(b) states that the Commission may grant good cause exceptions to its rules. Ms. Harris objects that SPS did not seek a good cause exception to the fuel rule.⁶³² SPS responds that her objection is inconsistent with its last two rate cases, in which the settlement agreements and the Commission orders approving them expressly allow

⁶²⁸ Staff Ex. 2, Harris direct at 11-12.

⁶²⁹ 16 TAC § 25.236.

⁶³⁰ See PURA §§ 36.201-.208.

⁶³¹ Staff Ex. 2, Harris direct at 7.

⁶³² Staff Ex. 2, Harris direct at 13.

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SPS to credit REC sales margins in eligible fuel expense.⁶³³ SPS notes that in those cases, it was not required to show good cause for an exception to the fuel rule. Given the past settled cases, the ALJs conclude that SPS did not waive the opportunity to show good cause for a fuel rule exception in this case by failing to explicitly request a good cause exception in its direct case. On the other hand, this is not a settled case, and the Commission orders in past settled SPS rate cases are not precedential. Staff timely recommended changing the current practice and showed that it violates the fuel rule, and for that practice to continue, SPS must show good cause for an exception to that rule.

To support SPS's request to continue the current practice, Ms. Sakya made several policy arguments. She testified that:

- Although REC retirement obligations are not tied to fuel, REC acquisitions and associated costs are directly tied to the energy component of purchased power expenses in that, for every MWh of renewable energy generated, one REC is also generated;
- Similar to fuel and purchased power costs, REC sales (volume) and associated revenues are variable and governed by a market in which SPS has no influence;
- The current practice provides accurate cost recovery and ensures that neither SPS nor its customers are unduly harmed or receive asymmetrical benefits; and
- That outcome is appropriate, because SPS procured its purchased power agreements to meet the state's renewable energy goals and policy and as economic system resources to reduce customer bills.⁶³⁴

The ALJs note that last year, in a rulemaking to amend the fuel rule, the Commission rejected the similar policy arguments of a utility requesting that REC costs be considered eligible fuel expense. As described in the rule's preamble, the utility argued that: (1) "compliance with government-mandated environmental standards should not create cost recovery risk for utilities"; (2) "RECs are intended to reduce emissions; exhibit a direct relationship to fuel and purchased

⁶³³ SPS Ex. 51, Sakya rebuttal at 13; *see also* Docket No. 42004, Order, FF 33(b); Docket No. 40824, Order, FF 23(b).

⁶³⁴ SPS Ex. 51, Sakya rebuttal at 6, 8-10, 13.

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energy; and present variable cost exposure for the utility”; and (3) “the cost of the REC is market-driven and subject to the forces of supply and demand that can cause price volatility.”⁶³⁵

The Commission declined to consider REC costs as eligible fuel expense, explaining that:

A utility’s fuel factor is designed to recover the utility’s Texas retail customer costs resulting from its fuel usage and energy purchases. In contrast, a utility’s RPS [renewable portfolio standard] requirement is not a direct function of its fuel usage or energy purchases. The number of RECs that a utility is obligated to purchase may decrease even as that utility’s fuel usage and energy purchases grow, or increase even as that utility’s fuel usage and energy purchases decrease. The commission therefore will not include REC costs as eligible fuel expenses, because these costs are not directly tied to a utility’s fuel use and energy purchases.⁶³⁶

Finding that REC sales revenues are, if anything, even less directly tied to a utility’s fuel use and energy purchases than are REC costs, the ALJs conclude that Ms. Sakya’s policy arguments do not support continuing SPS’s present practice.

Ms. Harris argued that SPS’s practice also creates a mismatch because SPS recovers REC costs in base rates but credits REC sales revenue in eligible fuel expense.⁶³⁷ The ALJs agree.

Ms. Sakya argued that because a Texas REC has a three-year life, although REC costs for a particular vintage year (such as 2016) are incurred in that calendar year, revenues received in that calendar year are likely from prior vintage RECs (2013, 2014, 2015, 2016, and possibly future years if SPS were to sell future RECs). According to her, although REC costs are reliably known and measurable, REC sales revenues are not known and measurable, which creates a timing mismatch. Noting that REC prices are expected to continue to decline, she also expressed concern that SPS’s REC sales will generate less revenue than is estimated for Test Year purposes.⁶³⁸

⁶³⁵ *Rulemaking Proceeding to Amend PUC Subst. R. 25.236 Relating to Recovery of Fuel Costs*, Project No. 41905, Order Adopting Amendments to § 25.236 as Approved at the May 16, 2014 Open Meeting (May 21, 2014) (Project No. 41905, Order) at 10-11.

⁶³⁶ Project No. 41905, Order at 13.

⁶³⁷ Staff Ex. 2, Harris direct at 12.

⁶³⁸ SPS Ex. 51, Sakya rebuttal at 10-12.

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The ALJs find that the timing concerns Ms. Sakya raised are inherent in the REC program and thus were already considered by the Commission in connection with the fuel rule, which does not allow REC sales revenues to be credited in eligible fuel expense. SPS presented no unusual facts or other persuasive reason to allow SPS to continue its current practice.

b. Quantification of Base Rate Credit for REC Sales Revenues

In the event the Commission adopts Staff's recommendation to credit REC sales revenue in base rates, Ms. Harris recommended a base rate credit of \$444,376,⁶³⁹ and Ms. Sakya recommended a base rate credit of \$207,792.⁶⁴⁰ The ALJs recommend using SPS's number.

Ms. Harris's number is based on the difference between the average number of RECs SPS required for renewable portfolio standard compliance in calendar years 2013 and 2014 (546,618 and 550,123, respectively, for an annual average of 548,371) and the number of RECs generated for the Test Year (1,242,708). Her calculation assumes that the difference (694,337) is the number of RECs SPS will have available to sell (694,337, multiplied by Ms. Harris's recommended imputed value of \$0.64, equals \$444,376).⁶⁴¹ Ms. Sakya challenged the REC quantity and price that Ms. Harris used in her calculations.

Regarding the quantity, Ms. Sakya objected that it is unrealistic to expect SPS to sell all incremental RECs before the end of the calendar year in which they are generated, especially because: (1) RECs have a three-year life; and (2) SPS does not know how many RECs were generated in a calendar year until at least one month after the end of the year (due to a delay for December metering and associated REC creation).⁶⁴² She noted that REC sales in any given year are likely for RECs generated in prior years, as well as the current year. She considered a

⁶³⁹ Staff Ex. 2, Harris direct at 14, 16; SPS Ex. 51, Sakya rebuttal at 18.

⁶⁴⁰ SPS Ex. 51, Sakya rebuttal at 18.

⁶⁴¹ Staff Ex. 2, Harris direct at 14; SPS Ex. 51, Sakya rebuttal at 16.

⁶⁴² SPS Ex. 51, Sakya rebuttal at 11.

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two-year average level of RECs that SPS actually sold to be more indicative of the annual level of sales going forward than Ms. Harris's assumption that SPS will sell or retire all RECs generated during the Test Year each year.⁶⁴³ SPS sold 566,275 RECs in 2013 and 621,105 RECs in 2014 (an average of 593,690).⁶⁴⁴

Regarding the price, Ms. Sakya testified that, because RECs have a three-year life, SPS will be selling RECs from at least three different years.⁶⁴⁵ The majority of RECs SPS sells will be from the two older years, due to SPS's practice of retiring RECs on a first-in first-out basis to maximize customer value and the ability to "bank" RECs for future use. She observed that the average price per REC sold will be lower than the current year's price because older vintage RECs typically sell at a discount. Given the steady decline in REC prices and the "older" mix of REC sales in any given year, she recommended using a REC price of \$0.35/REC. Multiplying that price by 593,690 RECs yields a base rate credit of \$207,792.

Finding Ms. Sakya's reasoning to be persuasive, the ALJs recommend using her proposed base rate credit of \$207,792.

2. SPS's 90%/10% REC Sales Margin Sharing Proposal

Ms. Sakya described SPS's margin sharing proposal as follows: (1) if sale of a Texas-generated incremental REC produces a positive margin, SPS would credit customers with sale revenues equal to the cost of the RECs sold plus 90% of the margin, with SPS retaining 10% of the margin; and (2) if a REC sale does not produce a margin, SPS would credit customers with 100% of the sale revenues.⁶⁴⁶ She argued that SPS's proposal is similar to other incentives the Commission has approved (such as the sharing of off-system sales margins), provides a small economic incentive that will help ensure REC sales margins are maximized, and is aligned with PURA goals encouraging development of renewable energy resources.

⁶⁴³ SPS Ex. 51, Sakya rebuttal at 18.

⁶⁴⁴ SPS Ex. 51, Sakya rebuttal at 17-18.

⁶⁴⁵ SPS Ex. 51, Sakya rebuttal at 17-18.

⁶⁴⁶ SPS Ex. 35, Sakya direct at 16-17; SPS Ex. 51, Sakya rebuttal at 20-23.

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Ms. Harris testified that the fuel rule provision allowing a utility to retain 10% of margins from off-system sales if certain criteria are met does not apply, because RECs are not an eligible fuel expense and REC sales are not off-system energy sales.⁶⁴⁷ The ALJs agree.

Ms. Harris opposed SPS's margin sharing proposal, noting that SPS already has a statutory obligation to serve customers at just and reasonable rates, which includes ensuring that unused RECs are sold before their expiration at the best possible sales price.⁶⁴⁸ She criticized the proposal as inequitable, because ratepayers do not decide the amount of RECs SPS purchases, must pay the full cost of RECs, and likely will never recover that full cost, much less any profit, because REC prices are declining. Finally, she expressed concern that the proposal would provide SPS an incentive to purchase numerous excess RECs that customers pay for, in the hope that the REC sales price might increase above the purchase price.

Ms. Sakya responded that Ms. Harris's arguments do not negate the effectiveness and desirability of an incentive. Under Ms. Harris's reasoning, Ms. Sakya argued, neither the Commission (*e.g.*, off-system sales margin sharing) nor the Legislature (*e.g.*, energy efficiency bonuses) would authorize incentives.⁶⁴⁹

The ALJs find that SPS did not prove its margin sharing proposal should be adopted. As Staff points out, SPS already has an obligation to manage its REC expenses and revenues prudently. SPS also has an incentive to do so, because a Commission finding to the contrary could result in adverse treatment in a rate case. As previously discussed regarding SPS's proposed Schedule 11 return on equity adjustment, with few exceptions utilities do not earn a return on revenue credits to expenses, only on investment in rate base. SPS has cited no law, rule, or precedent allowing utilities to keep 10% of the margins on REC sales. In addition, SPS's

⁶⁴⁷ Staff Ex. 2, Harris direct at 13-14, discussing 16 TAC § 25.236(9).

⁶⁴⁸ Staff Ex. 2, Harris direct at 13.

⁶⁴⁹ SPS Ex. 51, Sakya rebuttal at 20. PURA § 36.052 allows the Commission to consider a utility's energy conservation efforts and achievements in establishing a reasonable return on invested capital.

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evidence supporting its margin sharing proposal was vague and theoretical. SPS provided no evidence showing a net benefit to SPS's retail customers.

The ALJs also have concerns about Ms. Sakya's quantification of the modification that should be made to the base rate credit if SPS's margin sharing proposal were adopted. She testified that if the *margin* sharing proposal is adopted, the \$207,792 base rate REC sale *revenue* credit that she calculated (and the ALJs recommend) would need to be reduced by 10%, to \$187,013.⁶⁵⁰ It appears to the ALJs that Ms. Sakya's calculation: (1) would provide SPS 10% of the REC sale *revenues*, not 10% of the REC sale *margins* (which presumably is a much lower number), and (2) is inconsistent with her testimony that, under SPS's margin sharing proposal, customers will be credited with sales *revenues* equal to the cost of the RECs sold plus 90% of the *margin* earned in such sale and, if revenues are less than the cost of the RECs sold, ratepayers would be credited with 100% of the sales revenues.⁶⁵¹

For reasons described above, the ALJs recommend rejection of SPS's margin sharing proposal.

L. Advertising, Contributions, and Dues

The Commission allows recovery for ordinary advertising, contributions, and donations as a cost of service as long as the sum of such items does not exceed three-tenths of 1.0% of the gross receipts for services rendered to the public (a 0.3% cap).⁶⁵² Moreover, per Commission rule, the following expenses are not allowed in cost of service:

- (A) legislative advocacy expenses, whether made directly or indirectly, including, but not limited to, legislative advocacy expenses included in professional or trade association dues;
- (B) funds expended in support of political candidates;

⁶⁵⁰ SPS Ex. 51, Sakya rebuttal at 18-19.

⁶⁵¹ SPS Ex. 35, Sakya direct at 16-17.

⁶⁵² 16 TAC § 25.231(b)(1)(e); SPS Ex. 37, Blair direct at 67.

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- (C) funds expended in support of any political movement;
- (D) funds expended promoting political or religious causes;
- (E) funds expended in support of or membership in social, recreational, fraternal, or religious clubs or organizations;
-
- (J) any expenditure found by the commission to be unreasonable, unnecessary, or not in the public interest, including but not limited to executive salaries, advertising expenses, legal expenses, penalties and interest on overdue taxes, criminal penalties or fines, and civil penalties or fines.⁶⁵³

At the outset, the ALJs note that SPS claims, after exclusions, it incurred more than the 0.3% cap. Based on SPS's test year revenues of \$963,611,415, Ms. Blair calculated a \$2,890,834 cap.⁶⁵⁴ Because SPS's advertising, contributions, and dues exceed the cap by \$210,865, SPS is seeking the capped amount in its cost of service or \$2,890,834.⁶⁵⁵

1. OPUC Recommended Disallowances

OPUC witness Ms. Zamora recommended a disallowance of \$6,759 for certain professional dues SPS requested.⁶⁵⁶ Ms. Zamora testified that the following should be disallowed for rate making purposes: (1) various council dues because the organizations engage in lobbying activities on behalf of their members; (2) Plains Cotton Growers, Inc. dues because it engages in lobbying; (3) the Texas Ethics Commission expense because it was a lobbyist registration fee; (4) aviation association dues because they are not reasonable and necessary for the provision of electric utility service to Texas ratepayers; and (5) an MD Campbell and Associates LLC charge because, as SPS recognized in response to discovery, this charge should

⁶⁵³ 16 TAC § 25.231(b)(2).

⁶⁵⁴ SPS Ex. 37, Blair direct at 67-68. Ms. Blair's amounts were updated in Mr. Evans's rebuttal; this is the rebuttal amount. SPS Ex. 38, Evans rebuttal, Att. EDE-RR-R3 at 1.

⁶⁵⁵ SPS Ex. 38, Evans rebuttal, Att. EDE-RR-R3 at 1.

⁶⁵⁶ These expenses are found on Schedule G-4.3c of the RFP. OPUC Ex. 4, Zamora direct at 9. Ms. Zamora's recommended deductions are found at OPUC Ex. 5, Zamora workpapers at 1-16.

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never have been allocated to SPS.⁶⁵⁷

Overall, SPS does not contest Ms. Zamora's recommendations. However, SPS states that, in a future rate case, it may seek to include expenses for the Plains Cotton Growers, Inc., the American Benefits Council, the American Coal Council, and two charges from the Association of Corporate Council, if future invoices can segregate out the lobbying portions of dues. Concerning the aviation associate dues, SPS agrees to this adjustment to be consistent with its proposed aviation adjustment that replaced actual aviation business travel expenses facilitated through the use of two corporate jets with an estimate of commercial airline services.⁶⁵⁸

Based on the above discussion and 16 TAC § 25.231(b), the ALJs recommend approval of OPUC's recommended disallowance of \$6,759 to SPS's Test Year advertising, contribution, and dues expenses.

2. Staff Recommended Disallowances

Ms. Givens recommended disallowances totaling \$61,552 for payments to organizations that engage in legislative advocacy, professional registrations in certain states, and payments to organizations that do not provide a clear indication of the reasonableness and necessity for the provision of electric utility service. The description of the entities and Ms. Givens's deductions are detailed in her workpapers.⁶⁵⁹ Ms. Givens also recommended a separate adjustment of \$673,650⁶⁶⁰ in advertising expenses. In sum, her disallowances total \$735,205.⁶⁶¹ These are

⁶⁵⁷ OPUC Ex. 4, Zamora direct at 9-10.

⁶⁵⁸ SPS Ex. 38, Evans rebuttal at 62-64.

⁶⁵⁹ Staff Ex. 5A, Givens direct at 30, Att. AG-6. Ms. Givens's proposed adjustments relate to RFP Schedules G-4.3a, G-4.3c, and G-4.3d.

⁶⁶⁰ Staff Ex. 5A, Givens direct at 61.

⁶⁶¹ The ALJs recognize there may be a rounding error. This amount comes from Ms. Givens's workpapers. Staff Ex. 5A, Givens direct at 61.

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discussed below.

a. Advertising Expenses

SPS seeks reimbursement from Texas ratepayers for its sponsorship of Minnesota Wild Hockey Club, LP, and the naming rights to the St. Paul Arena Company, LLC and the St. Paul Facility Management, LLC. Ms. Givens testified that these expenses are extraordinary and do not represent the type of advertising the Texas ratepayer is likely to view. She noted that these three expenses, which total \$673,650, represent 50% of SPS's requested expenses for this FERC Account 930.11.⁶⁶²

SPS does not contest this adjustment.⁶⁶³ The ALJs concur with Staff that these expenses do not appear to be related to electric service provided to Texas customers. Therefore, the ALJs adopt Ms. Givens's recommended disallowance of \$673,650.

b. Organizational Expenses

Ms. Givens proposed an adjustment of \$43,376 for organization expenses for five organizations. SPS agrees to some of Ms. Givens's recommended disallowances: specifically, the adjustment for the Minnesota Municipal Utilities Association and the Colorado Mining Association. This is a total of \$214. However, for dues for the American Wind Energy Association, the Association of Electric Companies of Texas, and Edison Electric Institute, SPS contends that it is requesting recovery only of the portion of dues that are not related to lobbying. SPS witness Mr. Evans testified that invoices from American Wind Energy Association, the Association of Electric Companies of Texas, and Edison Electric Institute separately identify the portion of membership dues that are attributable to lobbying versus non-lobbying activities. According to Mr. Evans, SPS records all lobbying-related costs to FERC Account 426, which is

⁶⁶² Staff Ex. 5A, Givens direct at 30.

⁶⁶³ SPS reply brief (RR) at 152.

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a below-the-line account.⁶⁶⁴

The ALJs agree with SPS that the membership dues for American Wind Energy Association, the Association of Electric Companies of Texas, and Edison Electric Institute, which reflect segregated dues and are booked to FERC Account 930, should be included in the cost of service. Ms. Givens's workpapers indicate that membership dues related to these associations were booked to FERC Account 930.2. Accordingly, the ALJs do not adopt Ms. Givens's disallowance of \$43,736. Rather, the ALJs recommend a decrease in dues of \$214 to this category of expenses.

c. Professional Registrations/Association Payments

Ms. Givens also proposed several disallowances for expenses found on Schedule G-4.3a, which are related to professional registrations and association payments. For instance, she recommended disallowances for professional registrations in states such as Alaska, Kentucky, Indiana, and Montana, and countries such as the United Kingdom. Ms. Givens's recommended adjustment of \$17,706 contains some of the same disallowances recommended by OPUC witness Ms. Zamora.⁶⁶⁵ Ms. Givens also proposed a disallowance of \$109 in dues to the Amarillo Club, a place for social, business, and civic gatherings.⁶⁶⁶

SPS does not contest the recommended disallowance for Amarillo Club dues. However, Mr. Evans testified that SPS and XES employees maintain professional memberships in industry organizations and associations in many states, not just Texas, especially since many XES employees do not reside or work in Texas. He stated that Ms. Givens's disallowances appear to disallow expenses for memberships or certifications in other states that are reasonable, such as a registration fee for an XES tax services employee to take an exam to become a certified member

⁶⁶⁴ SPS Ex. 38, Evans rebuttal at 65-66. Mr. Evans also admitted that SPS had inadvertently failed to remove the portion of Edison Electric Institute dues recorded to FERC Account 426 from the allocation to Texas retail in Schedule G-4.3c. That correction has been reflected in SPS's rebuttal cost of service, stated Mr. Evans.

⁶⁶⁵ Compare Staff Ex. 5A, Givens direct at 30, Att. AG-6 to OPUC Ex. 5, Zamora workpapers at 1-16.

⁶⁶⁶ Staff Ex. 5A, Givens direct at 30. This expense is listed on Schedule G-4.3c.

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of the Institute for Professionals in Taxation. Mr. Evans opined that a registration fee is a reasonable expense that supports the continuing education and certification of an employee trained in a specialized field that provides services to all of Xcel Energy's operating companies, including SPS.⁶⁶⁷

Mr. Evans also took issue with disallowances for membership dues with various state bar associations. He noted that many XES attorneys are licensed to practice law in more than one state, and these attorneys provide legal services that benefit SPS's operations. For instance, he noted that XES attorneys who are licensed in other states assist SPS with debt issuances, personnel matters, contracts and other transactional issues, and federal environmental compliance issues.⁶⁶⁸

Mr. Evans admitted that "Ms. Givens could find it difficult to discern the direct benefit that SPS's Texas customers receive from certain memberships."⁶⁶⁹ In order to reduce the contested issues, SPS agreed to the following disallowances:⁶⁷⁰

Organization	Original Amount Requested (Texas Retail)
Association of Fundraising Professionals	\$ 20
Alaska Department of Commerce	26
Colorado Non-Profit Department	5
Kansas State University	10
Mid-Continent Compliance Forum	7
Minnesota Council for Quality	1,239
Minnesota Department of Health	19
Minnesota High Tech Association	75
Minnesota Lawyer	16
New Mexico Department of Agriculture	51
New Mexico Home Builders' Association	299

⁶⁶⁷ SPS Ex. 38, Evans rebuttal at 66-67.

⁶⁶⁸ SPS Ex. 38, Evans rebuttal at 67.

⁶⁶⁹ SPS Ex. 38, Evans rebuttal at 67.

⁶⁷⁰ SPS Ex. 38, Evans rebuttal at 68.

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Total	\$	1,767
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The ALJs agree with Ms. Givens that many of the professional dues and fees listed on Schedule G-4.3c do not appear to be related to electric service provided to Texas customers. Although SPS agreed with Ms. Givens's recommendation to exclude an additional number of fees, it failed to address the reason for expenses for others, such as the Minnesota High Tech Association and Geoscientists of British Columbia. These, and more, are also expenses for which, as Mr. Evans conceded, a direct benefit to Texas ratepayers is "difficult to discern." SPS bears the burden of proof on this issue. Therefore, the ALJs find that the following additional fees do not appear to be related to electric service provided to Texas customers and should be excluded:

Organization	Disallowed Amount (Texas Retail)
American Society for Training and Development Twin Cities Chapter	\$ 15
Associated Consultants International	14
Association of Corporate Council	514
AWS E-Commerce	30
Colorado Government Services	20
Colorado Non-Profit Department	7
Financial Executives	93
Minnesota High Tech Association	110
Minnesota Safety Council	2,121
Minnesota Women's Economic Roundtable	68
NSPW Xcellence	22 + 15 = 37
Professional Engineer Ontario	248
Association of Professional Engineers and Geoscientist of British Columbia	24
The Geological Society of London	89
Twin Cities Compensation Network	49 + 14 = 63
Twin Cities Diversity in Practice	637
Twin Cities Human Resource Association	30
Total ALJs' Disallowances	\$ 4,120

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Amount agreed to by SPS	+ \$ 1,767
Amarillo Club	+ \$109
TOTAL recommended disallowance	\$ 5,996

The ALJs, however, are persuaded that bar dues and professional associations that appear to be related to the provision of electric service should be allocated to Texas. Thus, in sum, the ALJs recommend a disallowance of \$5,996 for expenses associated with Professional Registrations/Association Payments.

d. Total Disallowance

Pursuant to 16 TAC § 25.231(b)(1)(E), the ALJs calculate that the total disallowance for advertising expense, contributions and donations, and membership dues expense (taking into account Ms. Zamora's and Ms. Givens's recommendation, as adjusted by the ALJs) is \$686,619. This amount should be removed from SPS's total adjusted Test Year expense, which is found in Mr. Evans's rebuttal testimony.⁶⁷¹

M. Pole Attachment Fee Revenue

In response to a recommendation by OPUC witness William Marcus,⁶⁷² SPS agrees that the pole attachment revenue amount should be normalized to reflect an average of the 2013 and 2014 amounts.⁶⁷³ This increases SPS's pole attachment revenues by \$413,379 (total company).⁶⁷⁴ The ALJs recommend accepting OPUC's adjustment.

N. Interest on Customer Deposits

⁶⁷¹ SPS Ex. 38, Evans rebuttal, Att. EDE-RR-R3 at 1. The ALJs believe that their recommended adjustment may be reduced by the amount SPS calculated was over the cap of \$210,865. Therefore, SPS's proposed advertising, contributions, and dues expense will be reduced by only \$475,754.

⁶⁷² OPUC Ex. 13, Marcus RR direct at 6.

⁶⁷³ SPS Ex. 53, Blair rebuttal at 47.

⁶⁷⁴ SPS Ex. 53, Blair rebuttal at 12.

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The Commission-approved interest rate on customer deposits was 0.09% per annum when the Application was filed but decreased to 0.07% per annum effective January 1, 2015.⁶⁷⁵ Staff witness Ms. Givens recommended using the 2015 rate to calculate the customer deposit interest amount included in cost of service.⁶⁷⁶ SPS has agreed to her recommendation, which the ALJs recommend be accepted.

O. Uncollectible Expense

SPS requested recovery of \$3,910,703 in uncollectible expense recorded in FERC Account 904, which was the Test Year per book amount of uncollectible expense. Staff witness Ms. Givens used SPS's proposed uncollectible expense and divided it by the total company requested revenue requirement, and calculated what she called the "effective rate." She then applied that amount to Staff's recommended revenue requirement to arrive at a recommended uncollectible accounts expense of \$3,444,710. This resulted in an adjustment of \$465,993 to Test Year expense. Ms. Givens did not explain why this adjustment is appropriate.⁶⁷⁷

SPS disagrees with both the amount of uncollectible expense recommended by Ms. Givens and the method that Ms. Givens used to arrive at her recommended amount of uncollectible expense. According to SPS, it used the Test Year per book amount of uncollectible expense, and that level of expense is representative of the amount of uncollectible expense that SPS is likely to experience in the future. SPS argues that Staff provides no explanation for how Ms. Givens's method produces a known and measurable change to the amount of uncollectible expense, or that uncollectible expense even varies with the dollar amount of the rate change.

Staff did not address this issue in briefs. As Staff did not explain why it is reasonable to adjust SPS's uncollectible accounts expense and SPS proffered evidence that its uncollectable expense was properly recorded, the ALJs do not recommend this adjustment.

⁶⁷⁵ SPS Ex. 53, Blair rebuttal at 4, 41.

⁶⁷⁶ Staff Ex. 5A, Givens direct at 35-36.

⁶⁷⁷ Staff Ex. 5A, Givens direct at 41.

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P. Taxes

As stated previously, except as otherwise stated in the PFD, the ALJs: (1) recommend accepting all SPS proposals (as revised by SPS in its rebuttal case) but do not separately discuss those proposals if they were not contested; and (2) recommend and intend that all flow-through impacts of the ALJs' decisions on other issues be incorporated in the numbers reflecting their recommendations, but do not separately discuss flow-through impacts. The only tax matters discussed below, therefore, are those for which a contested issue or adjustment to SPS's tax proposals as revised in its rebuttal case was raised.⁶⁷⁸

1. Federal Income Tax

The ALJs' understanding is that this issue is uncontested, although the parties dispute other issues for which the ALJs' recommendations may have flow-through impacts. In post-hearing briefs, SPS and AXM agreed that: (1) SPS inadvertently omitted the Research and Experimentation credit from the federal income tax calculation, and corrected that error in SPS's rebuttal case; and (2) SPS is allowed to deduct for federal income tax purposes the amounts paid for interest expense (quantified by multiplying the weighted cost of debt by SPS's rate base) and that flow-through impacts of decisions on other items will need to be made. The ALJs agree.

2. Property Tax

SPS agrees with the recommendations of AXM, OPUC, and Staff to use the actual amount of 2014 property tax, rather than partial projections, in determining the ratio used to calculate property tax on plant balances. The ALJs concur.

AXM, OPUC, and Staff propose to exclude property tax associated with post-Test Year

⁶⁷⁸ In its reply brief, Staff states: "SPS should pay the new rate for the Texas Margins Tax, which will be 0.75% of taxable margin, effective January 1, 2015." Staff reply brief (RR) at 8, n. 128, *citing* Act of June 15, 2015, 84th Leg. R.S., ch. 449 (to be codified at Tex. Tax Code § 171.002(a) and (b)). The ALJs have not addressed that proposal because Staff cited no evidence and raised the issue in its reply brief without mentioning it in its initial brief.

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plant. SPS describes those property tax amounts as an attendant impact of its proposed rate base PTYAs.⁶⁷⁹ SPS presented no other argument to include those amounts in property tax expense. Consistent with their recommendation to deny SPS's proposed rate base PTYAs, the ALJs recommend that property tax expense exclude property tax relating to post-Test Year plant.

The other contested property tax issue is whether property tax associated with CWIP should be included in O&M expense (SPS's position) or instead capitalized (AXM's and Staff's position). For reasons discussed below, the ALJs conclude that property tax associated with CWIP should be capitalized. SPS noted that in that event, adjustments to rate base to add capitalized property tax attributable to CWIP that was in service by the end of the Test Year and related depreciation adjustments should also be made. The ALJs agree. As discussed below, in its rebuttal case SPS provided calculations relating to various scenarios, including that reflecting the ALJs' recommendations on those issues.

AXM witness Mr. Dittmer and Staff witness Debi Loockerman testified that property tax identified exclusively with units of property that are not yet in service are properly included in CWIP; thus these expenditures should be capitalized and recovered through depreciation when the CWIP is placed in service.⁶⁸⁰ Mr. Dittmer stated that his recommendation results in proper matching, because current rates exclude property tax on plant not yet in service, and ratepayers who benefit from service from the plant are the ones who pay for property taxes relating to it.⁶⁸¹ He said that other utilities routinely capitalize property taxes associated with construction projects.⁶⁸²

According to Mr. Dittmer, "the FERC Uniform System of Accounts specifically requires that ad valorem taxes applicable to construction projects shall be included in the cost of

⁶⁷⁹ SPS Ex. 34, Arend direct at 21; *see also* SPS Ex. 50, Arend rebuttal at 8.

⁶⁸⁰ AXM Ex. 2, Dittmer direct at 33-36; Staff Ex. 7A, Loockerman direct (errata) at 6-9.

⁶⁸¹ AXM Ex. 2, Dittmer direct at 34-35.

⁶⁸² AXM Ex. 2, Dittmer direct at 35.

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construction.”⁶⁸³ Ms. Loockerman agreed, quoting the FERC Uniform System of Accounts definition of “Components of construction costs,” which includes “. . . taxes on physical property (including land) during the period of construction and other taxes properly includible in construction costs before the facilities become available for service.”⁶⁸⁴ She also quoted its definition of FERC Account 107, CWIP-Electric:

- A. This account shall include the total of the balances of work orders for electric plant in process of construction.
- B. Work orders shall be cleared from this account as soon as practicable after completion of the job. Further, if a project, such as a hydroelectric project, a steam station or a transmission line, is designed to consist of two or more units or circuits which may be placed in service at different dates, any expenditures which are common to and which will be used in the operation of the project as a whole shall be included in electric plant in service upon the completion and the readiness for service of the first unit. *Any expenditures that are identified exclusively with units of property not yet in service shall be included in this account.* (emphasis added)⁶⁸⁵

While acknowledging that FERC’s Uniform System of Accounts allows property taxes to be capitalized to CWIP, Ms. Perkett cited its definition of “Taxes,” which “includes taxes on physical property (including land) during the period of construction and other taxes properly includible in construction costs before the facilities become available for service.”⁶⁸⁶ In her opinion, “if the amount is *de minimis* or the process to assign the amount to the work orders is cost prohibitive (i.e. the cost to account for the item is more than the benefit received), one can choose to expense the cost instead of capitalizing it.”⁶⁸⁷

Finding Mr. Dittmer’s and Ms. Loockerman’s position to be more persuasive, the ALJs recommend that property taxes associated with CWIP be capitalized rather than expensed. Even

⁶⁸³ AXM Ex. 2, Dittmer direct at 35.

⁶⁸⁴ Staff Ex. 7A, Loockerman direct (errata) at 8.

⁶⁸⁵ Staff Ex. 7A, Loockerman direct (errata) at 8.

⁶⁸⁶ SPS Ex. 42, Perkett rebuttal at 30.

⁶⁸⁷ SPS Ex. 42, Perkett rebuttal at 30.

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if Ms. Perkett's interpretation of FERC's Uniform System of Accounts is correct, SPS did not prove that "the amount is *de minimis* or the process to assign the amount to the work orders is cost prohibitive." The ALJs' recommendation is consistent with the Commission's decision in a 2012 ETI rate case to include in property tax expense property taxes associated with test-year end plant in service.⁶⁸⁸

In his rebuttal testimony, Mr. Arend included property tax calculations under various scenarios. For the scenario recommended in this PFD—that actual, rather than projected, property tax amounts are used; the PTYA rate base adjustments are rejected; and all property taxes are expensed except those attributable to CWIP, which are capitalized—he calculated ad valorem tax of \$29,723,945.⁶⁸⁹ Ms. Perkett testified that if property taxes attributable to CWIP are removed from property tax expense, other revenue requirement adjustments would also need to be made.⁶⁹⁰ She indicated that \$116.3 million of CWIP was in service by the end of the Test Year (June 30, 2014), for which the capitalized property tax on CWIP would be \$689,732.⁶⁹¹ She noted that amount should be added to SPS's rate base and depreciation expense should be increased accordingly.⁶⁹² The ALJs agree.

3. PUC Assessment Tax

Staff witness Ms. Givens recommended that SPS change its accounting methods to record the PUC assessment tax in FERC Account 408 instead of FERC Account 928.⁶⁹³ SPS does not oppose that change, which the ALJs recommend be approved.

⁶⁸⁸ Docket No. 39896, Order, FF 150 ("Staff's recommendation to increase ETI's test-year property tax expenses by \$1,214,688 is based on the historical effective tax rate applied to the known test-year-end plant in service value, consistent with Commission precedent, and based upon known and measurable changes"), included in Staff Ex. 7A, Loockerman direct (errata) at 26.

⁶⁸⁹ SPS Ex. 50, Arend rebuttal at 10, Att. CAA-RR-R3.

⁶⁹⁰ SPS Ex. 42, Perkett rebuttal at 30-31.

⁶⁹¹ SPS Ex. 42, Perkett rebuttal at 31-32; SPS Ex. 50, Arend rebuttal at 10, Att. CAA-RR-R3.

⁶⁹² SPS Ex. 42, Perkett rebuttal at 31-32; *see also* SPS Ex. 50, Arend rebuttal, Att. CAA-RR-R3.

⁶⁹³ Staff Ex. 5A, Givens direct at 39.

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IX. BASELINES

The ALJs recommend using the following undisputed procedure to establish certain baselines provided for in PURA and Commission rules.⁶⁹⁴ After the Commission decides the issues on the merits, the final cost of service and class cost of service study that reflect the Commission's decisions would provide the values (the dollar amount and percentages) for the components in the baselines. To ensure that those baseline values are correct, the parties would be allowed an opportunity to comment in this proceeding on number-running information supporting the PFD and the Commission's order. In its initial revenue requirement brief, Staff comments that the establishment of baseline values should be done line by line and class by class using detailed information from the cost of service study developed to reflect the Commission's decisions on the issues in this case. Given that and the parties' opportunity to comment after that information is available, the ALJs have not discussed this issue further.

X. MISCELLANEOUS PRELIMINARY ORDER REVENUE REQUIREMENT ISSUES

The following issues listed in the Preliminary Order are not in dispute:

- *Preliminary Order Issue 26.* SPS does not own any nuclear plants and thus is not requesting any nuclear decommissioning expenses.
- *Preliminary Order Issue 27.* SPS is not requesting approval of or changes to any self-insurance plan.
- *Preliminary Order Issue 33.* SPS's requested level of fees for the letter of credit that SPS posts for participation in SPP's transmission congestion rights auction⁶⁹⁵ was not challenged by any party. The ALJs recommend its approval.

⁶⁹⁴ This procedure was proposed in SPS initial brief (RR) at 317-319; in reply briefs no party objected. The procedure would apply to the following types of baselines. PURA and Commission rules allow SPS to apply for periodic updates to certain transmission, distribution, and purchased power capacity costs. PURA §§ 36.205, 36.209, 36.210; 16 TAC §§ 25.238, 25.239, 25.243. These provisions require that baselines be set for use in comparisons to future cost balances. In addition, PURA § 36.065 allows a baseline to be set for use in tracking pension and OPEB costs and allows SPS to defer the resulting asset or liability for recovery or refund in a future rate case.

⁶⁹⁵ SPS Ex. 28, Imbler direct at 37-44; SPS Ex. 28A.

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- *Preliminary Order Issue 46.* At the December 19, 2014 prehearing conference, SPS withdrew its request for temporary rates as part of an overall agreement on a procedural schedule and establishing an effective date for new rates.
- *Preliminary Order Issue 47.* The ALJs recommend finding that SPS complied with all requirements of the Commission's final order in Docket No. 42004.⁶⁹⁶

XI. PRESENT REVENUE

A. Weather Normalization (Including Revenue Requirement Effect)

SPS contends that an adjustment to certain of its Test Year sales and reduction of its peak demand is warranted for calculating present revenues to account for the temperatures during the Test Year that were (a) warmer than the ten-year average in SPS's service area during the cooling season; and (b) cooler than the ten-year average during the warming season. No weather adjustment was made to the Primary General Service (PGS), Large General Service – Transmission (LGS-T), and Street Lighting classes, given SPS's determination that consumption by these classes was not affected by the abnormal Test Year weather.⁶⁹⁷ This proposed PTYA results in a lower number of billing units, which are the basis for SPS's recovery of its revenue requirement, therefore resulting in higher rates.⁶⁹⁸

SPS witness Jannell Marks and TIEC witness Mr. Pollock explained how SPS developed

⁶⁹⁶ SPS Ex. 6, Evans direct at 70-73; *Application of Southwestern Public Service Company for Authorization to Refund Amounts Received from Tri-County Electric Cooperative, Inc. Associated with Docket No. 42004*, Docket No. 44609, Order (July 2, 2015).

⁶⁹⁷ SPS Ex. 55, Marks direct at 17.

⁶⁹⁸ TIEC Ex. 1, Pollock RR direct at 35.

its proposed weather normalization adjustment for its Test Year retail sales in Texas. SPS used a ten-year average of heating degree days, cooling degree days, and precipitation data to determine normal daily weather. SPS calculated the number of heating degree days for each day by subtracting the average daily temperature from 65 degrees Fahrenheit and the number of cooling degree days for each day by subtracting 65 degrees from the average daily temperature.⁶⁹⁹ The temperature and precipitation data was obtained from two National Oceanic and Atmospheric Administration (NOAA) weather stations in Amarillo and Lubbock from January 2003 to December 2012. The weather data was aggregated to the state level by applying 74.5% weight to the Amarillo weather station and 25.5% to the Lubbock weather station. SPS did not use the Test Year weather data in calculating the ten-year average to avoid bias toward Test Year data and to be consistent with its weather normalization methodology used in prior rate cases as well as standard NOAA practice.⁷⁰⁰

According to Ms. Marks, the Test Year heating degree days were 9.7% above normal; the Test Year cooling degree days were 6.5% above normal; and the Test Year precipitation was 13.4% below normal. SPS used the following formula to calculate the percent difference from normal:

$$(Actual\ weather - Normal\ weather) / Normal\ weather.^{701}$$

These weather deviations, taken together, resulted in 70,090 more MWh being consumed in the Test Year than would have been consumed in the Test Year with normal weather, which amounts to 0.5% of total Texas retail sales.⁷⁰²

⁶⁹⁹ For example, for heating degree days, if the average daily temperature was 45 degrees Fahrenheit, then 20 heating degree days were recorded for that day; if the average daily temperature was greater than 65 degrees Fahrenheit, zero heating degree days were recorded. Likewise, for cooling degree days, if the average daily temperature was 75 degrees Fahrenheit, 10 cooling degree days were recorded for that day; if the average daily temperature was less than 65 degrees Fahrenheit, zero cooling degree days were recorded. Finally, the daily heating and cooling degree days are aggregated to monthly totals. SPS Ex. 55, Marks direct at 19-20.

⁷⁰⁰ SPS Ex. 55, Marks direct at 18-20; Tr. at 1,831-1,832.

⁷⁰¹ SPS Ex. 55, Marks direct at 20.

⁷⁰² SPS Ex. 55, Marks direct at 20, Att. JEM-RD-1 at 3.

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For its proposed weather normalization of the average monthly retail peak demand, Ms. Marks used three weather-related variables: (i) the accumulation of days when the high temperature was at least 95 degrees Fahrenheit, (ii) variation in the average peak day temperature, and (iii) the amount of precipitation occurring during the week prior to the system peak day. The same weighting percentages were applied between the Amarillo and Lubbock weather stations for the adjustment to peak demand that SPS used for the retail sales adjustment. Ms. Marks also used data from a third weather station in Roswell, New Mexico. The impact of weather on SPS's peak demand was measured by Ms. Marks using a weighted average of weather conditions in Amarillo, Lubbock, and Roswell.⁷⁰³

Applying this methodology, SPS proposes to reduce its Texas retail energy sales during the summer months by 35,300 MWh, or 0.7%, and to reduce its peak demand during the summer months by 50.3 MW, or 1.5%.⁷⁰⁴

As for the proposed adjustment for the winter months, SPS's methodology results in a reduction to Texas retail sales of 34,790 MWh, or 0.4%, and a reduction in peak demand of 31.99 MW, or 1.2%, as set out in Mr. Pollock's direct testimony.⁷⁰⁵

AXM agrees that a weather normalization adjustment is warranted, but contends that Test Year weather data should be used in calculating normal weather. According to AXM witness Mr. Brosch, using the most recent 10 years of weather data includes more relevant weather data and promotes the Commission's policy of capturing current weather trends.⁷⁰⁶ AXM notes that SPS used Test Year weather data in calculating normal weather in its last five rate cases, and argues that SPS provided no explanation or analysis to support its claim that use of Test Year

⁷⁰³ TIEC Ex. 1, Pollock RR direct at 35-36.

⁷⁰⁴ TIEC Ex. 1, Pollock RR direct at 35 (*citing* SPS Ex. 55, Marks direct, Atts. JEM-RD-1 and JEM-RD-1 at 08538-60).

⁷⁰⁵ TIEC Ex. 1, Pollock RR direct at 45-46 (*citing* SPS Ex. 55, Marks direct, Atts. JEM-RD-1 and JEM-RD-1 at 08538-60).

⁷⁰⁶ AXM Ex. 1, Brosch direct at 5.

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weather data would create a bias. Using its billing determinants through December 31, 2014, as updated in its rebuttal case, SPS concluded that including weather data for the 10-year period through the Test Year would increase its Test Year revenue under present rates by \$1,098,687.⁷⁰⁷ According to TIEC witness Mr. Pollock, the total impact of SPS's proposed weather normalization adjustment will increase SPS's claimed revenue deficiency by \$4.2 million, \$2.2 million of which results from adjustments to the summer months.⁷⁰⁸

TIEC contends that the Commission should reject SPS's proposed weather normalization adjustment in its entirety because SPS failed to prove its reliability. More specifically, TIEC argues that SPS used incomplete weather data that is not representative of its service area, because it only used data from two weather stations, one of which is located outside its service area. TIEC witness Mr. Pollock noted that SPS could have used weather data from the West Texas Mesonet project, which collects weather data at 90 stations in 61 counties across West Texas and Eastern New Mexico.⁷⁰⁹ TIEC also claims that SPS failed to prove that the weather-related variables affected its electricity sales in the way it asserts as grounds for the weather normalization adjustment sought. In that regard, Mr. Pollock contended that SPS should have but failed to consider moisture's effect on residential and consumer load, given the great percentage of that load attributable to air conditioning.⁷¹⁰ Mr. Pollock also asserted that using only two temperature readings per day cannot explain weather-related demand. Further, he opined that using the 95-degree threshold is improper for statistical reasons, considering that such threshold may only be reached for a few seconds and minutes and thus does not necessarily indicate a system peak.⁷¹¹ Finally, TIEC and Mr. Pollock took the position that the precipitation variables used by SPS are unreliable because (a) the precipitation data was not representative of rainfall across its service area; (b) they assume rainfall was uniform across its service area (especially problematic for irrigation load); and (c) they fail to adequately consider soil

⁷⁰⁷ AXM Ex. 45, Exh. SPS-AXM 32-3(e)-R, page 40, line 199.

⁷⁰⁸ TIEC Ex. 1, Pollock RR direct at 37.

⁷⁰⁹ TIEC Ex. 1, Pollock RR direct at 38.

⁷¹⁰ TIEC Ex. 1, Pollock RR direct at 41-42.

⁷¹¹ TIEC Ex. 1, Pollock RR direct at 42-43.

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saturation.⁷¹²

OPL takes a slightly different tack in its challenge to SPS's weather normalization, contending that its representations regarding its weather-adjusted retail sales to investors and to the Commission contradict each other. On rebuttal, according to OPL, SPS adjusted its data to include weather-adjusted sales data and revenue for a test year ending in December 2014. Effectively, SPS substituted revenue and sales data from July-December 2014 for the revenue and data from July-December 2013. OPL notes that, according to SPS's evidence, the effect of that substitution increased SPS's customer count; decreased sales to residential and small commercial classes (resulting in an overall reduction in revenue of \$1.08 million); increased Texas jurisdictional sales by 0.1%; and increased overall company retail sales by 0.5%.⁷¹³ According to OPL, these adjustments are inconsistent with a presentation made by SPS's parent company to investors in February 2015 in which SPS represented that weather-adjusted retail sales for SPS grew at a 2.3% rate in 2014 compared to 2013.⁷¹⁴ Finally, OPL witness Mr. Griffey asserted that SPS's weather adjustment for peak demand results in assigning demand reductions to residential and small commercial customers that should be assigned to irrigation customers, artificially reducing SPS's estimated retail revenue.⁷¹⁵

In rebuttal, SPS witness Ms. Marks explained that if the Test Year was used in developing the normal weather, it would be used twice in the same comparison. In other words, just as it would be nonsensical to compare the Test Year weather to itself in determining normal weather, Ms. Marks maintained it is not prudent to use the Test Year in calculating normal weather over a 10-year period because it gives the Test Year a 10% weighting in that determination.⁷¹⁶ Further, Ms. Marks opined that the weather data used by SPS in developing its proposed weather normalization adjustment adequately represents the weather in SPS's service

⁷¹² TIEC Ex. 1, Pollock RR direct at 40; SPS Ex. 58, Marks rebuttal at 18.

⁷¹³ *Compare* SPS Ex. 54, Luth direct, Att. RML-RD-2 with SPS Ex. 57, Luth rebuttal, Att. RML-RD-R1.

⁷¹⁴ OPL Ex. 1, Griffey RR direct at Bates 77, Exh. CSG-RR-3.

⁷¹⁵ OPL Ex. 4, Griffey direct at Bates 41, Figure RD7.

⁷¹⁶ SPS Ex. 58, Marks rebuttal at 8.

area. According to Ms. Marks, the stations from which SPS gathered its weather data cover over 61% of SPS's weather-sensitive sales in Texas. Although these stations only cover a fraction of the total square miles that SPS serves, many of those square miles that are not covered include land that represents very little of SPS's overall load.⁷¹⁷

The ALJs find that SPS's weather normalization adjustment is valid, reasonable, and should be adopted. Excluding the Test Year in the calculation of normal weather in the current rate case is standard practice and has been SPS's methodology for weather normalization adjustments in its past five rate cases before the instant docket.⁷¹⁸ NOAA uses this methodology in preparation of its development of 30-year normal weather statistics when comparing and analyzing the weather for a particular month. Ms. Marks's testimony was more credible than Mr. Brosch's testimony on this issue, and the ALJs determined that the factors included in the calculation of normal weather should be independent of the Test Year weather to which the normal weather is compared. Likewise, the ALJs concur with Ms. Marks that the weather data used to determine the proposed normalization adjustment was sufficiently representative of the weather in the SPS service area. There is no testimony or other evidence in the record that SPS's weather normalization adjustment was unreliable due to the weather data actually used; Mr. Pollock merely "questioned" whether the data was "sufficient and representative" of weather-related effects on SPS's sales. Further, TIEC offered no testimony or evidence showing that using additional data from a wider geographical area, or incorporating soil saturation or a moisture variable, would have improved the reliability of the weather normalization calculation.⁷¹⁹

SPS used regression analyses and Ms. Marks explained how the models used provide theoretically valid and statistically sound results which show the relationship between the weather variables and energy usage in the SPS service area.⁷²⁰ While TIEC raised issues and

⁷¹⁷ SPS Ex. 58, Marks rebuttal at 15.

⁷¹⁸ SPS Ex. 58, Marks rebuttal at 7.

⁷¹⁹ SPS Ex. 58, Marks rebuttal at 16-17.

⁷²⁰ SPS Ex. 58, Marks rebuttal at 21-24.

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questions with respect to SPS's methodology, its evidence fell short of rebutting SPS's evidence that the proposed adjustment is reasonable and reliable. Therefore, the ALJs recommend that the Commission approve SPS's proposed weather normalization adjustment.

B. Annualize Revenue for Transmission-Level Customer 8

In 2013, a transmission-level customer (Customer 8) added a transformer to provide service to additional processes at its facility. The amounts of incremental billing determinants attributable to Customer 8's additional power usage are 47,139 kW and 35,188,773 kWh for July 2013 through March 2014. Given the ALJs' recommendation that the Commission reject SPS's proposed PTYAs to plant, these amounts should be added to the Test Year billing determinants.

C. Adjustment to Post Test Year Billing Determinants

SPS provided adjusted billing determinants in its rebuttal case to match the period of PTYAs to plant it seeks in this case. However, since the ALJs recommended denial of the PTYAs, the post-Test Year billing determinants are irrelevant.

XII. COST ALLOCATION / RATE DESIGN INTRODUCTION

SPS conducted a class cost-of-service study (CCOSS) for this case which categorized embedded costs by the operating function (i.e., production, transmission, distribution); classified functional costs according to the methods (demand, energy, and customer) used to charge customers for utility service; defined the customer class cost responsibility; and allocated the requested revenue increase to classes of customers. The cost allocation is based on recovery of costs under present rates from each class, compared to the cost of providing service to each class. SPS's proposed revenue distribution is based in large part on its CCOSS, but is moderated by principles of gradualism. SPS then proposed a rate design intended to recover the revenue requirement through various combinations of demand charges, energy charges, and customer

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charges.⁷²¹

Various Intervenors and other parties have challenged SPS's CCOSS, revenue distribution, and rate design on numerous grounds. TIEC and OPL take issue with SPS's changes in methodology in its CCOSS, which resulted in an approximate 20% increase in the share of SPS's investment costs assigned to LGS-T customers from SPS's last rate case, and a finding that this class is currently paying rates substantially below its cost of service.⁷²² TIEC and OPL contend that this increase is improper, considering the lack of evidence of a shift in usage by these customers or a change in the type of costs incurred by SPS. Rather, they attribute the increase to SPS's change in how it defines what a cost is. These parties assert that if SPS had used a definition of cost more consistent with its prior CCOSSs, it would show that the LGS-T class is actually paying more than its cost of service.

State Agencies agree with TIEC and OPL, contending that the methodological changes proposed by SPS causes significant cost shifting among classes without sufficient evidence or justification. OPUC as well as OPL note the imprecision of CCOSSs in general and argue that other factors, including stability of rates and effectiveness in recovering the revenue requirement, should have been but were not properly considered by SPS in determining cost allocation.

Staff points to cost causation as the "guiding principle" for cost assignment between and within rate classes, and argues that each class's proposed revenue should equal that class's cost of service. Staff contends that SPS's proposals to pool capacity costs and re-allocate them on the basis of billing demands and to implement a gradualism adjustment to rates should be rejected because they are inconsistent with cost causation. Finally, Staff and Pioneer advocate for the Commission to reject all parties' recommendations to apply a gradualism adjustment to limit the amount of rate increase for any particular class, contending that no rate class would receive a rate increase under SPS's CCOSS that would cause "rate shock" so as to justify imposition of a

⁷²¹ SPS Ex. 54, Luth direct, Atts. RML-RD-4 and RML-RD-7; SPS Ex. 57, Luth rebuttal, Atts. RML-RD-R3 and RML-RD-R5.

⁷²² TIEC Ex. 66, Transcript of SPS witness Mr. Evans's deposition at 25.

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gradualism constraint. These issues are discussed in more detail below.

XIII. INTER-CLASS COST ALLOCATION

A. Demand Allocation

1. Determination of System Load Factor

The issue of which system load factor to use in demand allocation for purposes of allocating production and transmission costs among customer classes proved to be one of the most contentious at the hearing. No party takes issue with SPS's use of the Average and Excess Demand – 4 Coincident Peak (AED-4CP) demand allocation method to allocate these costs. SPS witness Mr. Evans testified that the AED-4CP methodology is a commonly-used, standard, and accepted way for a utility to allocate costs among classes.⁷²³ However, SPS, OPUC, AXM, and Wal-Mart advocate for the use of the average of the coincident peaks from the four summer months of June through September (4CP) to calculate the system load factor, which is used to weight the average and excess demand for each customer. TIEC, OPL, Staff, and State Agencies, on the other hand, propose the use of the actual annual system peak demand (1CP) as the system load factor. SPS's proposal is a change from its prior rate cases, in which it used the single annual system peak as the system load factor applied in the AED-4CP allocator. The change results in a greater allocation of production and transmission costs on the energy portion of the AED method. This change increased the allocation of these costs to LGS-T customers by approximately \$2.6 million.⁷²⁴

SPS used the demand production allocation factor (DPROD) to allocate production costs among customer classes, and the demand transmission allocator (DTRAN) to allocate most transmission costs among the classes.⁷²⁵ As explained by SPS witness Mr. Luth, he developed

⁷²³ SPS Ex. 61, Evans rebuttal at 17-18.

⁷²⁴ OPL Ex. 4, Griffey direct at Bates 21.

⁷²⁵ SPS Ex. 54, Luth direct at 41. Radial transmission facility costs and generation interconnection transmission

these allocators using the line-loss adjusted AED-4CP demands at the monthly peak for the four peak months of June through September.⁷²⁶ These factors are calculated as follows:

1. The contribution to the Texas retail production peak demand and system transmission peak demand by each Texas retail class for the four summer months is averaged to calculate 4CP demand by class;
2. The average demand of each class is then calculated by dividing the total test year kWh of that class by the total number of hours in the year;
3. The excess demand is calculated by subtracting the average demand from the 4CP demand by class (if the resulting value is negative, excess is set to zero);
4. System excess demand is the adjustment for imbalances resulting from class peak demands and the addition of average demands from customer classes that do not peak during the four summer months, and is calculated by multiplying each class's excess demand by the ratio of the total Texas system excess demand to the sum of the Texas class excess demands; and
5. Class AED-4CP weights average demand by the SPS system load factor, and system excess demand for each customer by the inverse factor (1 – SPS system load factor). The sum of the weighted average demand and excess demand represents the AED-4CP figure for each class, which is compared to the sum of the AED-4CP allocation factor to develop the percentage of costs allocated to each class through AED-4CP.⁷²⁷

a. 1CP v. 4CP

In this case, SPS calculated the system load factor by averaging the coincident peaks at the time of the SPS system peaks for the months of June, July, August, and September. Then it divided the average demand for the SPS system (calculated by dividing annual kWh usage, adjusted for losses, by 8,760 hours) by the 4CP demands.⁷²⁸ In at least some of SPS's previous

facilities are allocated using slightly different allocators. *Id.*

⁷²⁶ SPS Ex. 54, Luth direct at 41.

⁷²⁷ SPS Ex. 54, Luth direct at 41-42.

⁷²⁸ SPS Ex. 61, Evans rebuttal at 18.

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rate cases, and certainly in the most recent, SPS used the annual peak, or the single highest measured demand for the test year (1CP), to calculate the system load factor instead of the average of the peak demands in the four summer months (4CP).⁷²⁹ Using 4CP reduced the denominator in the system load factor calculation, thereby increasing the system load factor and concurrently the percentage of costs allocated on an average demand basis while decreasing the percentage of costs allocated on the basis of excess demand.⁷³⁰ OPUC and AXM agree with SPS's approach to the calculation of the system load factor; TIEC, OPL, State Agencies, and Staff disagree with SPS's use of 4CP to develop the system load factor.

OPL and TIEC take issue with SPS's change in demand allocation methodology, given that, on the production side, it resulted in allocation of millions more dollars in costs to the LGS-T customer class.⁷³¹ TIEC witness Mr. Pollock testified that, to be consistent with accepted practice and the Commission's decision in the last SWEPCO rate case, 1CP should be used to determine the system load factor.⁷³² Mr. Pollock stated that the NARUC Cost Allocation Manual calls for a calculation of the system load factor based on SPS's 1CP, and that even SPS calculated its system load factor for the Test Year in Schedule O-1.6 using the single test year coincident peak.⁷³³ Because SPS designs and builds its system to respond to the forecasted single annual system peak, as required by SPP, TIEC, Staff, and State Agencies maintain that the AED methodology should use a system load factor based on 1CP.⁷³⁴

Mr. Pollock indicated that each SPP member is obligated to provide a 12% capacity margin, which is measured relative to each utility's annual system peak, so that use of a 1CP load factor is consistent with system planning.⁷³⁵ State Agencies witness Kit Pevoto testified that SPS builds generation and transmission systems to handle the greatest single demand placed

⁷²⁹ SPS Ex. 61, Evans rebuttal at 18-19; Tr. at 893.

⁷³⁰ SPS Ex. 61, Evans rebuttal at 19.

⁷³¹ Tr. at 896-897.

⁷³² TIEC Ex. 3, Pollock rebuttal at 7.

⁷³³ TIEC Ex. 2, Pollock direct at 24; TIEC Ex. 70; Tr. at 931.

⁷³⁴ Staff Ex. 1A, Murphy direct at 36; Tr. at 937.

⁷³⁵ TIEC Ex. 2, Pollock direct at 27.

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upon them. She explained that the load factor is an expression of the proportion of time a customer uses the generation and transmission systems installed to serve them, and that using 4CP as a system load factor distorts how well the system is being utilized and overstates the average usage of the classes. She opined that it is more consistent with the AED-4CP methodology to use 1CP to determine the system load factor.⁷³⁶ OPL witness Mr. Griffey testified that resource planners use a 1CP criterion for building and buying resources to meet projected load.⁷³⁷

Consistent with TIEC, Staff witness Mr. Murphy also recommended that SPS's system load factor be calculated using SPS's 1CP.⁷³⁸ However, according to Mr. Pollock, Mr. Murphy derived the 1CP load factor using adjusted rather than actual system peak demands. Mr. Pollock testified that using the adjusted system peak demands is inconsistent with the Commission's decision in Docket No. 40443 (SWEPCO), and that actual demands are a better measure of SPS's system characteristics.⁷³⁹ Mr. Murphy also took the position that use of the single system peak to calculate the system load factor is more consistent with the cost causation principle. He opined that using the average of the system peaks in the four summer months to calculate the system load factor puts too much weight on the average demand component of the AED-4CP methodology and not enough on the excess. Therefore, keeping other variables constant, customers with higher load factors would be allocated some of the production and transmission capacity costs that were actually caused by other classes.⁷⁴⁰

On rebuttal, SPS witness Mr. Evans proposes using 4CP to calculate the system load factor because it is more consistent with the way costs are allocated. He explained that doing so is appropriate because the AED-4CP is developed based on average demands and on 4CP demands. According to Mr. Evans, reliance on a single peak hour is subject to greater variability

⁷³⁶ State Agencies Ex. 1, Pevoto direct at 8-9.

⁷³⁷ OPL Ex. 4, Griffey direct at Bates 25.

⁷³⁸ Staff Ex. 1A, Murphy direct at 36; Tr. at 1633.

⁷³⁹ TIEC Ex. 2, Pollock direct at 28; TIEC Ex. 3, Pollock rebuttal at 27.

⁷⁴⁰ Staff Ex. 1A, Murphy direct at 36.

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than the average of the four months which reflects SPS's system peak hours. He noted that SPS uses more than a single peak hour in planning and designing its generation resources and transmission systems.⁷⁴¹ Mr. Evans testified that SPS, like other utilities, build generation and transmission systems and acquire generation resources to reliably serve customers during all hours at the lowest reasonable cost. He stated that planning for the greatest demand expected on the system is only one consideration in that planning process. Mr. Evans disagreed with Ms. Pevoto's position regarding distortion of the average demand, contending that each class's average demand is fully reflected in its kWh usage, the "A" component of AED-4CP.⁷⁴² Finally, he disagreed that use of 1CP instead of 4CP to calculate the system load factor is more consistent with underlying assumptions of the AED-4CP, arguing that this would only be true if the allocation method was a AED-1CP. He testified that using 1CP "would create an unreasonable inconsistency between calculation of the system load factor used in developing the class allocators and the 4CP demands that is at the core of the AED-4CP allocator."⁷⁴³

Mr. Evans countered Mr. Pollock's position by noting that an SPP member can meet its system peak responsibility by purchasing short-term capacity, but that the short-term capacity purchase must be for a minimum of four months starting between May 1 and June 1. He stated that this criterion recognizes the importance of having adequate capacity to cover a four-month peak season, not just a single hourly peak.⁷⁴⁴ Mr. Evans testified that SPS's system planners consider significantly more than a single hourly peak load, and that focusing on the single hourly peak would result in construction of only peaking units.⁷⁴⁵ SPS witness Mr. Luth concurred. He stated that using 1CP puts too much emphasis on one hour in one month. He also testified that the peak season for SPS occurs from June to September, and that the peaks in those months are either the annual peak or within 5% of the annual peak. Given these facts, Mr. Luth took the

⁷⁴¹ SPS Ex. 61, Evans rebuttal at 20.

⁷⁴² SPS Ex. 61, Evans rebuttal at 24.

⁷⁴³ SPS Ex. 61, Evans rebuttal at 25.

⁷⁴⁴ SPS Ex. 61, Evans rebuttal at 21-22.

⁷⁴⁵ SPS Ex. 61, Evans rebuttal at 23.

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position that the 4CP weighting of excess demand is appropriate in determining the balance between average and excess demand.⁷⁴⁶

OPUC witness Mr. Marcus also testified that use of the 1CP load factor significantly and disproportionately increases the emphasis on one peak hour, when in reality SPS's system has significant year-round load and high generation costs in the winter months.⁷⁴⁷ Mr. Marcus explained that SPS's reserve margin is designed to ensure that it has adequate generation throughout the year regardless of the circumstances. He stated that SPS does not just experience unreliability and the need for capacity in one hour. Therefore, it must have capacity available in the event of significant forced outages (a) at high, but not peak, loads; (b) when loads are lower but units are on maintenance; and (c) when loads are at high cold winter peak levels but coal piles and pipes freeze or gas is unavailable. According to Mr. Marcus, the 1CP plus margin is a system method for handling all of these potential sources of unreliability, but does not mean that what happens outside the one peak hour is unimportant to system planning.⁷⁴⁸

Mr. Evans relied on the recent SWEPCO case as precedent for calculation of the system load factor based on 4CP.⁷⁴⁹ He and Mr. Luth both noted that Mr. Pollock testified in the SWEPCO case that 4CP should be used to calculate the system load factor.⁷⁵⁰ Mr. Luth pointed out that the NARUC manual does not set out a formula that applies to every utility, presents several different methods of demand cost allocation, and acknowledges that no single method is superior in every respect or in all cases.⁷⁵¹

OPL witness Mr. Griffey appears to acknowledge that the system load factor in the SWEPCO case was calculated using 4CP, but opined that such an approach is inappropriate here

⁷⁴⁶ SPS Ex. 57, Luth rebuttal at 17.

⁷⁴⁷ OPUC Ex. 14, Marcus direct at 13.

⁷⁴⁸ OPUC Ex. 14, Marcus direct at 12-13.

⁷⁴⁹ SPS Ex. 61, Evans rebuttal at 20.

⁷⁵⁰ SPS Ex. 61, Evans rebuttal at 22; Ex. 57, Luth rebuttal at 14-15.

⁷⁵¹ SPS Ex. 57, Luth rebuttal at 17.

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because SPS's industrial load is much larger than SWEPCO's. Therefore, according to Mr. Griffey, using this approach would not get SPS to a holistic outcome meeting the Bonbright criteria.⁷⁵² He also referenced the risk of large customer demand reduction, which he claimed would result from the change from 1CP to 4CP in calculating the system load factor. Mr. Griffey testified that using 4CP for the load factor does not promote the principle of cost causation, and that it inappropriately changes the meaning of the average and excess demand measurements.⁷⁵³

In response, Mr. Luth claimed that, although it is probably true that industrial customers have more access to alternative power sources, Mr. Griffey did not show that any such sources provide the same level of service as SPS, or that they become more economically favorable as a result of SPS's proposed 4CP weighting of average demand as compared to a 1CP weighting. Mr. Luth further testified that he sees no justification in further diluting the average demand weighting based on speculation that industrial customers may take advantage of alternative power supplies.⁷⁵⁴ Mr. Evans took the position that the calculation of appropriate allocation factors by a utility should be driven by the utility's system characteristics and not the types of customers they serve.⁷⁵⁵

On behalf of AXM, Mr. Johnson testified that the AED-4CP formula cancels most of the impact of average demand on the result, and that therefore it is primarily a peak demand responsibility method. He contended the AED-4CP allocator is ineffective in recognizing load duration aspects of generation cost causation. Mr. Johnson promoted the use of a 12CP methodology as more reasonable, but accepted SPS's methodology as reasonable given the Commission's prior approval of the AED-4CP formula.⁷⁵⁶ He noted that Mr. Luth's calculation

⁷⁵² OPL Ex. 4, Griffey direct at Bates 24-25. The Bonbright criteria are: (1) simplicity, acceptability, and feasibility; (2) effectiveness in yielding the revenue requirement; (3) stability from year to year; (4) minimization of changed adversely affecting existing customers; (5) fairness of apportionment among customer classes; (6) avoidance of undue discrimination; and (7) economic efficiency with respect to usage. OPL Ex. 4, Griffey direct at Bates 12.

⁷⁵³ OPL Ex. 4, Griffey direct at Bates 25.

⁷⁵⁴ SPS Ex. 57, Luth rebuttal at 16.

⁷⁵⁵ SPS Ex. 61, Evans rebuttal at 23.

⁷⁵⁶ AXM Ex. 6, Johnson direct at 14-15. 12CP is based on the average coincident peak for each month of the year

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of the system load factor is consistent with precedent from Docket No. 40443 (SWEPCO) and Docket No. 39896 (ETI). The 4CP system load factor was used in those cases, and Mr. Luth developed the same load factor in this case. Finally, Mr. Johnson testified that had SPS used the retail 1CP load factor it used in its previous rate case, the allocation to TIEC and OPL would have been even higher. Thus, according to Mr. Johnson, the 4CP system load factor is conservative compared to SPS's historical practice.⁷⁵⁷

b. ALJs' Analysis

It is undisputed that the Commission approved the use of 4CP to calculate the system load factor applied in the AED-4CP demand allocation methodology in Docket No. 40443, the most recent SWEPCO rate case. All of the parties who oppose this calculation of the system load factor in this case, with the exception of OPL, were parties in the SWEPCO case, and none of them asserted any objection to the calculation in that docket. To the contrary, TIEC, and its witness Mr. Pollock, actually proposed the 4CP system load factor in the SWEPCO matter. TIEC does not dispute this fact. No logical explanation is offered as to why the 4CP system load factor was appropriate and reasonable enough for TIEC to propose it in the SWEPCO case, but applying it here would be unreasonable, improper, and contrary to cost causation principles. The ALJs also note that Mr. Pollock used the 4CP system load factor in calculating his AED-4CP allocator in another rate case in Iowa just two years ago.⁷⁵⁸ Moreover, ETI used a 4CP system load factor to calculate the AED-4CP allocator, which the Commission approved without objection from TIEC or Staff. According to the uncontradicted testimony of OPUC witness Mr. Marcus, no other utility in Texas uses a 1CP system load factor in the AED-4CP allocator.

As for the arguments made by TIEC and OPL, the NARUC manual does not mandate the

and is used by SPS for its jurisdictional allocation. AXM Ex. 6, Johnson direct at 14.

⁷⁵⁷ AXM Ex. 6, Johnson direct at 15-16.

⁷⁵⁸ OPUC Ex. 17, Marcus rebuttal at 15-16.

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use of 1CP as the system load factor in AED-4CP allocation methodology. Rather, the manual is intended to be informational. It does not advocate for one particular method over another but discusses all methods and the pros and cons of each. While the illustrative example of application of AED-4CP in the NARUC manual uses 1CP to develop the system load factor, there is no evidence in the record as to why and what position, if any, the manual would take on use of a 4CP system load factor.

Moreover, there is very little explanation from any of the witnesses proposing the use of 1CP as to why using the single annual peak promotes the cost causation principle more than SPS's proposal to use a 4CP system load factor. In fact, neither Mr. Pollock nor Mr. Griffey testified to this effect. Staff witness Mr. Murphy does, yet he does not explain how, other than to make an unsupported and speculative assertion that if other variables are held constant, classes that have higher load factors will be allocated production and transmission capacity costs caused by other classes. Further, Staff did not object that the use of a 4CP system load factor by SWEPCO did not properly allocate costs based on causation.

While SPS must use 1CP to determine how much reserve energy it will need to meet its load, the evidence did not make a connection between how SPS's reserve requirement is calculated and the cost causation principle to justify the use of 1CP to calculate the system load factor used in the AED-4CP methodology. The preponderance of the evidence showed that many other factors go into SPS's planning of its production and transmission system. The ALJs agree that, given the characteristics of SPS's system, using 1CP in calculating the system load factor puts too much emphasis on one hour, and that using 4CP better balances the average and excess demand on the system for purposes of cost allocation. It is also consistent with cost causation principles. Therefore, the ALJs recommend that the Commission adopt the use of 4CP to calculate the system load factor to be used in calculating the AED-4CP allocation factor for production and most transmission investment costs.

Mr. Pollock's testimony that the Commission used actual demand, not adjusted demand, to calculate the system load factor in the SWEPCO case was unrefuted. Further, his testimony