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PUC BULLETIN

A Publication of the Public Utility Commission of Texas

Volume 15, No. 2 October 1989

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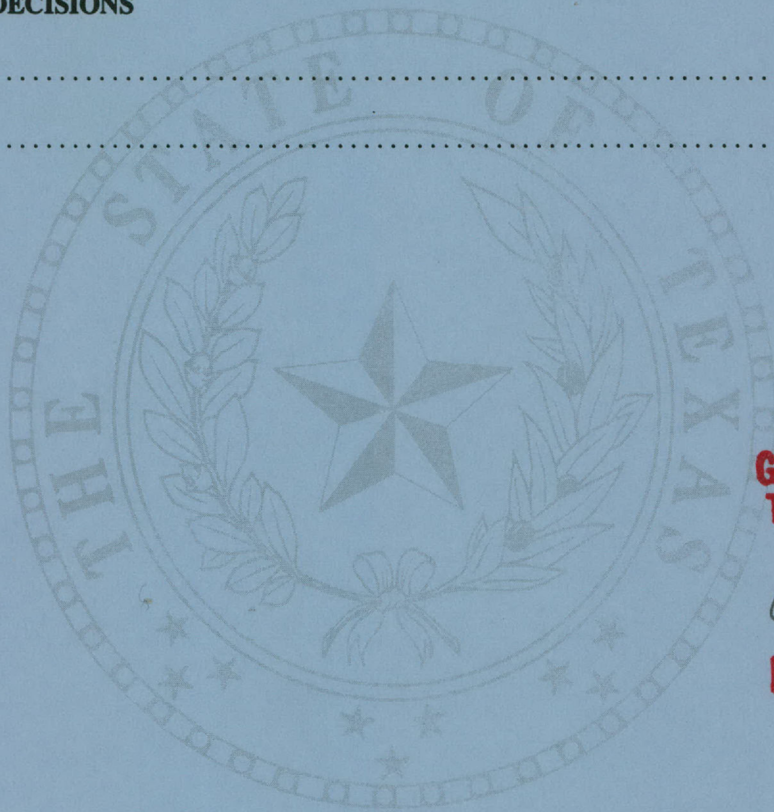

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APPLICATION OF LEA COUNTY ELECTRIC COOPERATIVE, INC. FOR APPROVAL OF A LEVELIZED FUEL AND PCRF CLAUSE § § §

DOCKET NO. 7161

May 13, 1987

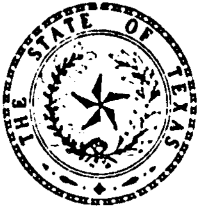
Commission approved Lea County Cooperative's request for levelized PCRF clause.

[1] PROCEDURE--NOTICE--NOTICE BY APPLICANT--WHEN REQUIRED
PROCEDURE--FUEL PROCEEDINGS

An application for a levelized PCRF clause was governed by § 43(g)(4) of PURA and not by § 43(a). As a result, it was not a rate case, the publication of notice requirements of § 43(a) were not applicable, and the filing of the application did not establish an effective date. Appropriate notice in the case consisted of direct notice to Texas ratepayers. (p. 275)

[2] RATEMAKING--RATE DESIGN--ELECTRIC--FUEL AND PURCHASED POWER

Levelized PCRF clause, previously approved for the applicant in New Mexico, was approved on a one-year trial basis. (p. 281)



Public Utility Commission of Texas

7800 Shoal Creek Boulevard · Suite 400N
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Dennis L. Thomas
Chairman

Peggy Rosson
Commissioner

Jo Campbell
Commissioner

April 30, 1987

TO ALL PARTIES OF RECORD

Re: Docket No. 7161--Application of Lea County Electric Cooperative, Inc. for Approval of a Levelized Fuel and PCRF Clause

Dear Madam or Sir:

Enclosed is a copy of my examiner's report and proposed final order in this case. The Commission will consider this case at an open meeting to begin at 9:00 a.m., Wednesday, May 13, 1987, at the Commission's offices, 7800 Shoal Creek Boulevard, Austin, Texas. Exceptions, if any, to the examiner's report must be filed by noon, May 7, 1987. Replies, if any, must be filed by noon, May 13, 1987. An original and 10 copies of all pleadings must be filed with the Commission filing clerk, and a copy must be served on the Commission general counsel. Requests for oral argument, if any, must be filed with the Commission and served on all parties by 5:00 p.m., May 7, 1987.

Summary of examiner's report. This case involves an application by the Lea County Co-op for approval of a levelized PCRF for a one-year trial period. The co-op operates principally in New Mexico and has received approval of the levelized PCRF from the New Mexico regulatory authority. According to the co-op, large variations in its monthly PCRF cause the bills to its customers to fluctuate over a wide range. The variations in the PCRF are apparently due to variations in the number of days between meter readings from one month to the next because of factors the co-op does not control. The levelized PCRF would eliminate the variations in the monthly PCRF and thereby reduce the variations in customer bills that are not due to variations in consumption or cost.

The staff noted that the proposed levelized PCRF is similar to the fixed fuel factor presently used in Texas: the levelized PCRF would be based on six months of historical data and six months of projected data. The co-op would submit a revised PCRF if it appears that significant deviations between PCRF costs and revenues would occur. Kelso King, the staff member who reviewed the application, recommended that the co-op be required to submit a revised PCRF whenever the deviations exceed the limits set forth in P.U.C. SUBST. R. 23.23(b)(3)(D). Mr. King noted that the Commission's rules require the co-op to

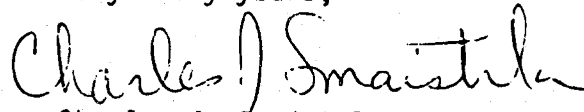
file monthly reports that will enable the staff to monitor the operation of the levelized PCRF.

According to Mr. King, the proposed plan complies with all the Commission's rules except P.U.C. SUBST. R. 23.23(b)(3)(B), which requires differences between actual PCRF costs and revenues for any month to be credited or charged to ratepayers in the second succeeding month. Under the co-op's proposal, deficit and surplus recoveries would not be offset, but would instead be carried forward and included in the calculation of the levelized PCRF for the succeeding six-month period. In Mr. King's opinion, the proposal would be unlikely to result in significant over- or undercollections within any six-month period.

Mr. King noted that since approval has been requested on a trial basis, the proposal offers an opportunity to evaluate this method of PCRF calculation. He recommended approval of the proposed levelized PCRF as a pilot program for a trial period of one year. Mr. King and the general counsel both emphasized, however, that the Commission should discourage other co-ops from seeking approval of similar PCRF clauses until the results of this pilot program can be evaluated. Lea County Co-op would have to apply for approval of a PCRF clause at the end of the one-year trial period and would have to be prepared to revert to a conventional PCRF clause.

I concur with the staff's recommendations and recommend that the Commission approve the proposed levelized PCRF clause with the conditions proposed by the staff.

Very truly yours,



Charles J. Smaistrla
Hearings Examiner

DOCKET NO. 7161

APPLICATION OF LEA COUNTY ELECTRIC COOPERATIVE, INC. FOR APPROVAL OF A LEVELIZED FUEL AND PCRF CLAUSE	§ § §	PUBLIC UTILITY COMMISSION OF TEXAS

EXAMINER'S REPORT

This case involves an application by the Lea County Electric Cooperative, Inc. (Lea County Co-op or the co-op) for approval of a "levelized" PCRF adjustment on an experimental basis. The levelized PCRF would reduce the current sizable variations in the co-op's PCRF from one month to the next.

Lea County Co-op operates principally in New Mexico, but provides electric service to about 2,275 Texas customers in the city of Plains and the counties of Gaines, Yoakum, and Cochran. The proposed levelized PCRF adjustment clause has been approved by the New Mexico Public Service Commission for a one-year trial. Although the proposed adjustment clause violates the two-month "true-up" requirement of P.U.C. SUBST. R. 23.23(b)(3)(B), the staff recommends that it be approved as requested on a trial basis, because of the large variations in Lea County Co-op's current monthly PCRF and because the New Mexico commission has approved the proposed clause. The examiner concurs.

I. Procedural History

On October 27, 1986, Lea County Co-op filed an application requesting approval of a "levelized fuel and purchased power cost recovery factor (PCRF) adjustment." The co-op requested that its application be approved pursuant to the Commission's reciprocity rule, P.U.C. PROC. R. 21.154, and section 43(g)(4)(B) of the Public Utility Regulatory Act, Tex. Rev. Civ. Stat. Ann. art. 1446c (Vernon Supp. 1987) (PURA).

Pursuant to examiner's order, Lea County Co-op filed a sworn statement affirming that (1) it serves a total of about 11,740 customers, of which about 2,275 are in Texas and (2) the proposed adjustment would not reflect changes in the cost of fuel, because the co-op purchases all of its power from Southwestern Public Service Company (Southwestern). In its application, Lea County Co-op

stated that it purchases its wholesale electric service at rates regulated by the Federal Energy Regulatory Commission (FERC).

By examiner's order on December 29, 1986, the examiner held that Lea County Co-op's levelized PCRF adjustment could not be reviewed and approved pursuant to P.U.C. PROC. R. 21.154, because that rule is restricted to utilities with fewer than 1,000 customers in Texas. In addition, the examiner noted the applicability to this case of section 43(g)(4)(B) of PURA and P.U.C. SUBST. R. 23.23(b), which govern the PCRF clauses of electric cooperatives. The examiner noted, however, that the levelized PCRF proposed by Lea County Co-op did not appear to comply with the requirements of Rule 23.23(b)(3). He directed the staff and the co-op to file legal briefs addressing the following issues: (1) the applicability of section 43(a) to this case; (2) the proper type of notice to be given; and (3) the appropriateness of reviewing and approving the proposed change administratively, without a hearing.

[1] On February 3 and 4, 1987, Lea County Co-op and the general counsel filed their respective legal briefs. On February 5, 1987, the examiner issued an order with the following rulings, which accorded with the conclusions of both the co-op and the general counsel:

1. This proceeding is governed by section 43(g)(4) of PURA and not by section 43(a). As a result, it is not a rate case, the publication of notice requirements of section 43(a) are not applicable, and the filing of an application did not establish an effective date.
2. Appropriate notice in this proceeding consists of direct notice to the affected Texas customers.
3. It would be proper to review the application administratively unless a hearing was requested or was otherwise determined necessary.
4. The Commission's final decision in this case can be based on the co-op's application and affidavits and the staff recommendation attached to the general counsel's brief.[1]

By the same order, Lea County Co-op was directed to mail individual notice to customers--containing the language prescribed by P.U.C. PROC. R. 21.24(c)(1)--and to file tariff sheets setting forth the proposed changes in conformance with the recommendations of the staff. The staff was directed to file any objections

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[1]The examiner agreed with the general counsel that the principles of comity provide additional support for the co-op's request.

or proposed revisions within 10 days after the tariff sheets were filed. In addition, unless an objection was filed within 20 days after direct notice was mailed, the following items were deemed to be admitted into evidence: (1) Lea County Co-op's application and affidavit affirming membership and purchase power, (2) the co-op's affidavit affirming notice, and (3) the memorandum of Staff Rate Design Analyst Kelso King. No objections were received and the items are therefore deemed admitted into evidence.

On February 24, 1987, Lea County Co-op filed an affidavit affirming that it had mailed individual direct notice of its application to all Texas customers on February 17, 1987. The notice explained the co-op's proposal and directed persons who wished to intervene or otherwise participate to file a request with the Commission within 15 days.

On February 26, 1987, Lea County Co-op filed proposed tariff sheets for review by the staff. The staff did not file objections or recommend revisions to the tariff sheets. The tariff sheets, which set forth the levelized PCRF clause, are attached to this report as Examiner's Exhibit No. 1.

On February 26, 1987, Fay Metz, a customer of Lea County Co-op, filed a letter requesting information about participating in the case to prevent approval of the proposed levelized PCRF. By letter on March 3, 1987, the examiner informed Ms. Metz that as a customer, she had the right to protest or to intervene in this case. The examiner recommended that Ms. Metz call or write Frank Davis, the assistant general counsel assigned to this case, for information and assistance. The examiner explained further that the staff had recommended approval of the application and that unless someone protested or intervened in the case, the examiner intended to write a report based on the information filed by the co-op and the recommendation filed by the staff. Finally, the examiner asked that if Ms. Metz were to decide to protest or intervene, she file her protest or motion no later than March 16, 1987.

Ms. Metz did not subsequently file a protest or any other correspondence with the Commission concerning this case. No protests or requests to intervene

have been filed by any other customer. Lea County Co-op's application is therefore unprotested.

II. Opinion

A. The Proposal

The Commission has jurisdiction and authority in this case pursuant to sections 16(a), 37, and 43(g)(4)(B) of PURA with respect to the service provided in Texas by Lea County Co-op. The Commission may review and approve the application in this case administratively, without a hearing, pursuant to section 13(e) of the Administrative Procedure and Texas Register Act, Tex. Rev. Civ. Stat. Ann. art. 6252-13a (Vernon Supp. 1987) (APTRA).

Section 43(g)(4)(B) of PURA grants the Commission liberal authority to approve PCRF clauses, which are the method by which electric utilities adjust their base rates to reflect changes in the cost of purchased electricity:

> [The commission] may utilize any appropriate method to provide for the adjustment of the cost of purchased electricity upon such terms and conditions as the commission may determine. Such purchased electricity costs may be recovered concurrently with the effective date of the changed costs to the purchasing utility or as soon thereafter as is reasonably practical.

Section 43(g)(4)(A) limits the PCRF clauses to apply only to changes in the cost of purchased electricity that have been approved by a federal regulatory authority or by the Commission. In this case, since Lea County Co-op purchases power from Southwestern at rates regulated by FERC, the co-op may use a PCRF to adjust its rates for changes in the cost of purchased power.

In its application, Lea County Co-op contends that large variations in its monthly purchased power cost factor cause the bills to its customers to fluctuate over a wide range from month to month. The co-op notes, for example, that in the period from January 1984 through March 1986, its PCRF varied from a low of $.0043 per kWh to a high of $.019. According to the co-op, the variations in the PCRF are not due to changes in the cost of purchased power; rather, the variation has been caused by differences in the number of days between monthly

meter readings, which have varied from 24 days to 37 days.[2] Southwestern bills the co-op for a relatively constant period of use each month, and the cost of purchased power is allocated to a greater or smaller number of kilowatt hours, depending in large part on the number of days between meter readings. The variation in the number of kilowatt hours causes the variation in the PCRF per kilowatt hour.

Lea County Co-op therefore proposes to implement a levelized PCRF as a pilot project for one year. Under the proposed clause, the co-op would file a new levelized PCRF every six months. The levelized PCRF would be based on the historical average cost of purchased power for the six-month period immediately preceding the filing. The historical cost would be adjusted, however, to reflect projected changes in purchased power cost expected to occur in the succeeding six-month period.[3] The adjusted historical cost would then be divided by the estimated kilowatt-hour sales for the six-month period in which the PCRF would be in effect. The levelized PCRF would be the difference between the adjusted historical cost and the co-op's base purchased power cost of $.0341.

The levelized PCRF would remain in effect for six months. Monthly deficits and surpluses would be carried forward in a balancing account and included in the cost of purchased power used to calculate the next period's levelized PCRF. Lea County Co-op would file with the Commission its projections and supporting materials. Whenever it appeared to Lea County Co-op that the levelized PCRF would produce a substantial under- or overcollection, the co-op would immediately file with the Commission an appropriate adjustment to the levelized PCRF consistent with both the order of the New Mexico commission and P.U.C. SUBST. R. 23.23(b)(3).

According to Lea County Co-op, the levelized PCRF would reduce the variation in the PCRF that occurs as it is currently determined. In addition, the co-op believes that its proposal would improve relations between it and its

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[2]The co-op contends that the variation in the meter reading cycle depends on such factors as weather, holidays, vacations, and sick leaves that are not entirely within its control.

[3]Lea County Co-op would determine the projected adjustments to cost with the assistance of Southwestern.

customers and stabilize the monthly bills of residential customers. Finally, Lea County Co-op notes that the levelized PCRF would make it easier to implement its plan to begin cycle billing in the near future.

With its application, Lea County Co-op filed a copy of the New Mexico commission order authorizing the co-op to implement the levelized PCRF on a trial basis for one year beginning October 1986. See In re Levelized Fuel and Purchased Power Cost Adjustment for Lea County Electric Cooperative, Inc., No. 2043 (P.S.C. N.M. Sept. 2, 1986).

B. Discussion

Staff Rate Design Analyst Kelso King reviewed Lea County Co-op's proposal. Mr. King noted a similarity between the co-op's levelized fuel factor and the fixed fuel factor currently used in Texas. The fixed fuel factor is determined by dividing the utility's known or reasonably predictable fuel cost by the corresponding estimated kilowatt-hour sales for the period during which the factor will be in effect. Similarly, Lea County Co-op has proposed to base its levelized PCRF on six months of historical data and six months of projected data.

Mr. King noted that the co-op intends to submit a revised PCRF if it appears that significant over- or undercollections would occur. He noted that P.U.C. SUBST. R. 23.23(b)(3)(D) specifies what constitutes a significant deviation between costs and collections. Under that rule, if PCRF revenue collections exceed PCRF costs by 10 percent in any given month and the total PCRF revenues have exceeded total PCRF costs by 5 percent for the most recent 12-month period, a cooperative-owned utility must report to the Commission the justification for the excess collections. Mr. King recommended that the guidelines of Rule 23.23(b)(3)(D) be applied in this case.

In addition, Mr. King noted that P.U.C. SUBST. R. 23.23(b)(3)(E) requires a utility to maintain and file with the Commission monthly reports containing all information required to monitor the costs recovered through the PCRF clause, including the total estimated PCRF cost for the month, the actual cumulative

PCRF cost, total PCRF revenue, and the calculation of the PCRF. Compliance with Rule 23.23(b)(3)(E) would enable the staff to monitor Lea County Co-op's collections and costs on a monthly basis.

Finally, P.U.C. SUBST. R. 23.23(b)(3)(B) provides that, unless otherwise approved by the Commission, the difference between actual PCRF costs and revenues for any month must be credited or charged to ratepayers in the second succeeding billing month. Under Lea County Co-op's proposal, deficit and surplus recoveries would not be offset, but would instead be carried forward and included in the calculation of the levelized PCRF for the succeeding six-month period. The proposal prevents the co-op from accumulating a long-term deficit or surplus; however, as the general counsel pointed out, the proposal does raise the possibility that an individual customer moving off the system may be denied part or all of the refund he is due. However, such overcollections (or undercollections) from individual customers leaving the system would be netted out by the collections from the general body of ratepayers, and the co-op itself would not be affected.

Mr. King noted that, with the exception of the two-month true-up requirement, the proposed method complies with the Commission's rules. In his opinion, the method would be unlikely to result in significant over- or undercollections by the co-op in any six-month period. In addition, since approval has been requested on a trial basis, the proposal offers an opportunity to evaluate this method of PCRF calculation.

The staff therefore recommended approval of the proposed method of PCRF calculation for use by Lea County Co-op as a pilot program for a trial period of one year. Mr. King and the general counsel both emphasized, however, that the Commission should discourage other co-ops from seeking approval of similar PCRF clauses, at least for the present time. The proposed calculation is a relatively untested, experimental method that is not typical for electric utilities in either New Mexico or Texas. Accordingly, the general counsel recommended that the Commission should make it clear that (1) the approval is granted only for the stated period of one year, (2) Lea County Co-op will have to seek approval for continued use, (3) Lea County Co-op must be prepared to revert to

the conventional PCRF clause after the trial period, and (4) no other applications for the proposed method will be granted pending an evaluation of Lea County Co-op's experience.

Lea County Co-op did not file a response to the staff's recommendations.

C. Examiner's Recommendation

[2] The examiner concurs with the reasoning and the recommendation of the staff and general counsel. He therefore recommends that the Commission approve the proposed levelized PCRF clause as a pilot program for a trial period of one year, with the requirement that Lea County Co-op submit a revised PCRF whenever it is apparent that the difference between collections and costs will exceed the limits set forth in P.U.C. SUBST. R. 23.23(b)(3)(D).

Moreover, as recommended by the staff, the Commission should make it clear that (1) it is expressly granting an exception only to the refund requirement of P.U.C. SUBST. R. 23.23(b)(3)(B), (2) all other rules of the Commission pertaining to the application of PCRF clauses remain in effect for Lea County Co-op, (3) the co-op must obtain approval of the Commission to use the levelized PCRF after the end of the one-year trial period, and (4) pending an evaluation by the Commission staff of the results of the pilot program, no other levelized PCRF proposals will be approved. In addition, the examiner recommends that the Commission order Lea County Co-op to file, ninety days before the expiration of the trial period, an application requesting either reinstatement of a conventional PCRF clause or an extension of the levelized PCRF clause.

With respect to the monthly reporting requirements of P.U.C. SUBST. R. 23.23(b)(3)(E), Lea County Co-op should be required to file its monthly reports with the Rate Design Section of the Electric Division, which would monitor the calculation and operation of the levelized PCRF during the trial period. In addition, the co-op should be required to file its initial PCRF calculation with the Hearings Division. The one-year trial period would begin the first day of the first billing period for which the levelized PCRF is in effect.

III. Findings of Fact and Conclusions of Law

A. Findings of Fact

1. Lea County Co-op is an electric distribution cooperative providing electric utility service in three Texas counties under Certificate No. 30101.

2. On October 27, 1986, Lea County Co-op filed an application requesting approval of a levelized PCRF clause, which is set forth in the tariff sheets attached to this report as Examiner's Exhibit No. 1.

3. Lea County Co-op mailed individual direct notice of the proposed levelized PCRF clause to all Texas customers, directing persons who wished to intervene or otherwise participate in this case to file a request with the Commission within 15 days; sufficient notice was given to all affected persons to provide them with a reasonable opportunity to protest the application or intervene in the case.

4. No protests or requests to intervene have been filed; the application is unprotested.

5. Lea County Co-op is a nongenerating electric utility and purchases all of its power from Southwestern at rates regulated by FERC.

6. Lea County Co-op experiences large variations in its monthly PCRF because of differences in the number of days between meter readings; stabilizing the PCRF would benefit both the co-op and its customers by reducing the variation in bills that is not related to changes in consumption or purchased power cost.

7. Under the proposed clause, Lea County Co-op would file a new levelized PCRF every six months, based on the adjusted historical cost of the co-op's purchased power as described in section II(A) of this report.

8. To avoid the possibility of significant deviations between collections and costs, it will be necessary for Lea County Co-op to file a revised PCRF whenever

it is apparent that the difference between PCRF collections and costs will exceed the limits set forth in P.U.C. SUBST. R. 23.23(b)(3)(D).

9. An exemption from the requirements of P.U.C. SUBST. R. 23.23(b)(3)(B) is necessary for the implementation of the levelized PCRF clause and would not, in this case, result in an unreasonable delay in rectifying differences between PCRF collections and costs.

10. In addition to allowing Lea County Co-op to recover changes in the cost of purchased power in an accurate and timely manner, the levelized PCRF proposal has the potential for reducing the variation in the co-op's PCRF, improving relations between the co-op and its customers, and stabilizing the bills of residential customers.

B. Conclusions of Law

1. Pursuant to sections 16(a), 37, and 43(g) of PURA, the Commission has jurisdiction and authority in this case with respect to the service provided in Texas by Lea County Co-op.

2. Proper notice was given to all affected persons in compliance with P.U.C. PROC. R. 21.25.

3. For the purposes of a trial program, Lea County Co-op has demonstrated that there is good cause to exempt it from the requirements of P.U.C. SUBST. R. 23.23(b)(3)(B) pertaining to rectifying differences between PCRF collections and costs; accordingly, the co-op should be granted an exemption pursuant to P.U.C. SUBST. R. 23.2.

4. With the exception noted in Conclusion of Law No. 3, Lea County Co-op's proposed levelized PCRF clause complies with P.U.C. SUBST. R. 23.23(b)(3), and the co-op should remain subject to the other requirements of that rule.

5. For the reason stated in Finding of Fact No. 6, Lea County Co-op should be required to file a revised PCRF whenever it is apparent that the difference

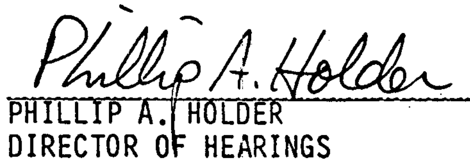
between PCRF costs and collections will exceed the limits set forth in P.U.C. SUBST. R. 23.23(b)(3)(D).

6. For the reasons stated in Finding of Fact No. 10, Lea County Co-op's proposed levelized PCRF clause would establish an appropriate method to provide for the adjustment of the cost of purchased electricity, as required by section 43(g)(4)(B) of PURA; accordingly, it should be approved for a one-year trial.

Respectfully submitted,

CHARLES J. SMAISTRLA
HEARINGS EXAMINER

APPROVED on the 30th day of April 1987.



PHILLIP A. HOLDER
DIRECTOR OF HEARINGS

EXAMINER'S EXHIBIT NO. 1

Lea County Elect . Cooperative, Inc.
Name of Issuing Corporation

Original T.P.U.C. Sheet No. 21

Cochran, Gaines & Yoakum Counties, Texas
Community, Town or City

CANCELLING T.P.U.C. Sheet No.

FOR COMMISSION USE ONLY

LEVELIZED FUEL AND PURCHASED POWER
COST ADJUSTMENT

AVAILABILITY AND APPLICABILITY

Applies to all rate schedules.

METHOD OF CALCULATION

(A) Determine the cost of fuel and purchased power per KWH sold for the projected six month period as follows:

(1) Calculate the actual average cost of fuel and purchased power per KWH sold over a six month period immediately prior to filing a new levelized fuel and purchased power cost adjustment (PCRF),

(2) Add or deduct from this average any apparent changes for the projected six month period in purchased power cost per KWH sold as determined by the Cooperative (LCEC) after consulting with its power supplier.

(B) Determine the levelized fuel and PCRF by subtracting LCEC's base cost of fuel and purchased power of $.0341 per KWH sold included in its rates from the projected cost of fuel and purchased power per KWH sold for the six month period as calculated in (A) above.

(C) LCEC will roll over into a balancing account any over-or under-recoveries that occur and will incorporate that amount into the purchased power cost for the next six month period.

(D) LCEC will furnish the Commission it's projections with supportive documentation and comments.

ADVICE NO.

Case Order No.

Issued by

286

Executive Vice President and General Mr

Date Filed February 24, 198

Effective

FOR COMMISSION USE ONLY

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16	21	Oil Well Pumping Service
17	22	Oil Well Pumping Service
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20	30	Large Primary Power Service
21		Levelized Fuel and Purchased Power Cost Adjustment

DOCKET NO. 7161

APPLICATION OF LEA COUNTY ELECTRIC COOPERATIVE, INC. FOR APPROVAL OF A LEVELIZED FUEL AND PCRF CLAUSE	§ § §	PUBLIC UTILITY COMMISSION OF TEXAS

ORDER

In public meeting at its offices in Austin, Texas, the Public Utility Commission of Texas finds that after statutory notice was provided, the application in this proceeding was processed in accordance with applicable statutes and rules by an examiner who prepared and filed a report containing findings of fact and conclusions of law. The Examiner's Report is ADOPTED and incorporated by reference into this Order. Accordingly, the Commission issues the following orders:

1. The application of Lea County Electric Cooperative, Inc. (the co-op) is APPROVED for a trial period of one year.

2. The proposed tariff sheets, attached to the Examiner's Report as Examiner's Exhibit No. 1, are APPROVED, effective the date of this Order.

3. The co-op is exempt from the refund requirement of P.U.C. SUBST. R. 23.23(b)(3)(B); the co-op remains subject to all other rules of the Commission pertaining to the application of PCRF clauses; the co-op shall submit a revised PCRF consistent with P.U.C. SUBST. R. 23.23(b)(3) whenever it is apparent that the difference between PCRF collections and costs will exceed the limits set forth in P.U.C. SUBST. R. 23.23(b)(3)(D).

4. With respect to the reports required by P.U.C. SUBST. R. 23.23(b)(3)(E), the co-op shall file monthly reports with the Rate Design Section of the Electric Division, which shall monitor the calculation and operation of the levelized PCRF. In addition, the co-op shall file its first levelized PCRF with the Hearings Division, and the trial period will begin on the first day of the first billing period for which the levelized PCRF is effective. The co-op shall file, 90 days before the expiration of the one-year trial period, an application requesting either reinstatement of a conventional PCRF clause or extension of the levelized PCRF clause.

5. The application in this case is approved as an experiment, based on a consideration of the circumstances causing the variation in the co-op's PCRF and the approval of the proposed clause by the New Mexico Public Service

Commission. Pending an evaluation of the trial program approved in this case, the Commission will not approve additional proposed levelized PCRF clauses.

SIGNED IN AUSTIN, TEXAS, on the 13th of May 1987.

PUBLIC UTILITY COMMISSION OF TEXAS

SIGNED: Dennis L. Thomas
DENNIS L. THOMAS

SIGNED: ______________________
PEGGY ROSSON

SIGNED: Jo Campbell
JO CAMPBELL

ATTEST:

Phillip A. Holder
PHILLIP A. HOLDER
SECRETARY OF THE COMMISSION

PETITION OF WEST TEXAS UTILITIES CO. FOR DEFERRED ACCOUNTING TREATMENT OF CERTAIN OKLAUNION-RELATED COSTS § § § § DOCKET NO. 7289

September 11, 1987

Commission approved deferred accounting treatment for certain costs associated with the Oklaunion Power Plant. Impairment of financial integrity and measurable harm were adopted as standards of review, but in later Docket Nos. 7560 and 8230 the standard of measurable harm was rejected.

[1] RATEMAKING--INVESTED CAPITAL--DEFERRED ACCOUNTING TREATMENT

Generally Accepted Accounting Principles (GCAP) requires that in order for a company's financial reports to reflect the deferred accounting treatment proposed by WTU, the company must receive reasonable assurance from its regulatory authority that it will eventually be allowed to recover in rates the expenses it defers. (p. 300)

[2] Paragraph 9 of Statement 71 of the Financial Accounting Standards promulgated by the Financial Accounting Standards Board (FASB) provides that rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise may capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:

a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for ratemaking purposes, and
b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. (p. 303)

[3] Paragraphs 8 and 12 of FASB statement No. 92 provide that if specified criteria are met, paragraph 9 of Statement 71 requires capitalization of an incurred cost that would otherwise be charged to expenses. An allowance for earnings on shareholders' investment is not "an incurred cost that would otherwise be charged to expense." Accordingly, such an allowance shall not be capitalized pursuant to paragraph 9 of Statement 71. The nature and amounts of any allowance for earnings on shareholders' investment capitalized for ratemaking purposes but not capitalized for financial reporting shall be disclosed. (p. 304)

[4] Deferred accounting treatment is a bifurcated process. The first decision is whether a company should be allowed to defer expenses and continue to accrue carrying costs. That decision does not involve the amount of costs the company will defer in the amount of costs the company will be allowed to recover. The amounts to be deferred and recovered will be determined in the company's next rate case. (p. 308)

[5] The limited scope of relief granted by the Commission in deferred accounting treatment cases does not warrant the extensive review usually provided by a rate case. (p. 321)

[6] The timing of the request for deferred accounting treatment does not affect the timing of the impact of the relief on the company's rates. Approval of deferral treatment affects only the company's financial statements during the deferral period. The company's rates are not affected until after rate base treatment is considered in the rate case. Whether the requested treatment is approved before or after the plant-in-service date, rates would be affected prospectively only. (p. 322)

[7] Financial integrity is the ability of a company to raise capital at reasonable terms. The "financial condition" of a company is a broader concept. It encompasses long-term factors such as the company's earning power--the sustainable ability of the company to generate net income over the years. (p. 323)

[8] Financial harm occurs if a company's financial condition is impaired. (p. 324)

[9] The consequences of allowing deferral treatment are significantly less than the consequences of including CWIP in rate base. The CWIP standard of harm to financial integrity should not be used in deferred accounting cases. (p. 326)

[10] There is the possibility of financial harm to a company that may occur if deferral treatment is denied, but which would not threaten the financial integrity of the company. (p. 326)

[11] The review in a deferred accounting treatment case consists of two steps. First, an analysis of the financial integrity of the company is made and if financial integrity is not threatened, then the review should proceed to the second step--a determination of whether the company's financial condition will be measurably harmed during the deferral period if deferral treatment is denied. (p. 327)

[12] A company requesting deferred accounting treatment must show that (1) it will suffer measurable financial harm by not being able to recover the costs that it seeks to defer and (2) deferral treatment will mitigate that harm. (p. 328)

[13] If the amount of costs to be recovered is significant enough to affect the company's bond rating or cause it to miss a common dividend payment, it would normally be undeniable that measurable financial harm would result. (p. 328)

[14] The standard for approving deferred accounting treatment is tied to the necessity for a rate case: deferral treatment is properly granted only as a result of a plant addition relatively large enough that it would require a utility to request a major rate change to include the additional plant in rate base. (p. 329)

[15] WTU would continue to have access to capital, albeit at considerably higher costs, even if deferral treatment is denied. (p. 339)

[16] Cash-flow financial ratios do not determine whether a company will suffer financial harm as a result of denying deferral treatment. (p. 339)

[17] WTU would suffer more than measurable harm to its financial condition if its request for deferred accounting treatment were denied. (p. 340)

[18] The capitalized costs are subject to review by the Commission in WTU's rate case (Docket No. 7510), and will be included in invested capital to the extent and only to the extent that the Commission determines that they are prudent, reasonable, and necessary expenses and that they are related to property that is used and useful in providing service. (pp. 343, 355)

[19] The scope of deferred accounting cases is limited to three issues:

1. Whether the company's current financial integrity is so fragile that it would not have access to the capital markets on reasonable terms unless it is allowed to continue to accrue AFUDC and defer the expenses associated with a new plant during the period of operation before rates are in effect that reflect the cost of the plant.

2. Whether the company's financial condition will be measurably harmed during the deferral period if it is not allowed to continue to accrue AFUDC and defer and capitalize the expenses related to the plant.

3. Whether the accounting treatment proposed by the company accrues with GAAP. (p. 343)

Public Utility Commission of Texas

7800 Shoal Creek Boulevard, Suite 400N
Austin, Texas 78757 · 512/458-0100

Dennis L. Thomas
Chairman

Peggy Rosson
Commissioner

Jo Campbell
Commissioner

August 21, 1987

TO ALL PARTIES OF RECORD

Re: Docket No. 7289--Petition of West Texas Utilities Co. for Deferred Accounting Treatment of Certain Oklaunion-Related Costs

Dear Madam or Sir:

Enclosed is a copy of my examiner's report and proposed final order in this case. The Commission will consider this case at an open meeting to begin at 9:00 a.m., Friday, September 11, 1987, at the Commission's offices in Austin, Texas. Exceptions, if any, to the examiner's report must be filed with the Commission and served on all parties by 4:00 p.m., September 1, 1987. Replies, if any, must be filed and served by noon, September 8, 1987. Requests for oral argument, if any, must be filed and served by 5:00 p.m., September 8, 1987. An original and 10 copies of all pleadings must be filed with the Commission filing clerk, and a copy must be served on the Commission general counsel.

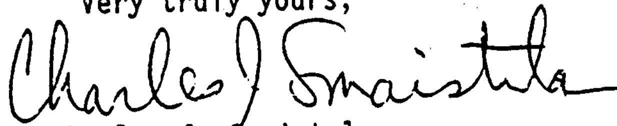
Summary of the examiner's report. This case involves a petition by West Texas Utilities Company (WTU) for deferred accounting treatment for certain costs related to Oklaunion Power Station Unit No. 1 (Oklaunion). According to WTU, the requested accounting treatment would allow it to seek recovery, in its rate case, of about $28.4 million of costs--incurred to provide service--that it would otherwise never be able to recover. Granting the petition would not affect any current rate or service of the company.

Oklaunion went into operation in December 1986, and pursuant to normal accounting procedures, WTU ceased accruing AFUDC and began charging the expenses of the plant against income as they were incurred. The petition, if granted, would allow the company instead to capitalize these items as an asset on its balance sheet until rates are in effect that reflect the cost of Oklaunion. The deferred costs would therefore not be charged against net income. In addition, WTU would be able to seek inclusion of the deferred-costs asset in its rate base to earn a return and be amortized over the life of the plant.

The intervenors and the Commission staff urge that the petition be denied on several grounds, including the failure of WTU to show that the requested

treatment is necessary to prevent material harm to the company's financial integrity. On the basis of the Commission's previous cases, I applied a lesser standard and recommend that the petition be granted, on the grounds that otherwise the financial condition of the company would be harmed.

Very truly yours,



Charles J. Smaistrla
Hearings Examiner

DOCKET NO. 7289

PETITION OF WEST TEXAS UTILITIES COMPANY FOR DEFERRED ACCOUNTING TREATMENT OF CERTAIN OKLAUNION-RELATED COSTS	§ § § §	PUBLIC UTILITY COMMISSION OF TEXAS

EXAMINER'S REPORT

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DOCKET NO. 7289

PETITION OF WEST TEXAS UTILITIES COMPANY FOR DEFERRED ACCOUNTING TREATMENT OF CERTAIN OKLAUNION-RELATED COSTS	§ § § §	PUBLIC UTILITY COMMISSION OF TEXAS

EXAMINER'S REPORT

I. Introduction

This case involves a petition by West Texas Utilities Company (WTU) for deferred accounting treatment for certain costs related to Oklaunion Power Station Unit No. 1 (Oklaunion). According to WTU, the requested accounting treatment would allow it to seek recovery, in its rate case, of about $28.4 million of costs--incurred to provide service--that it would otherwise never be able to recover. Granting the petition would not affect any current rate or service of the company.

Oklaunion went into operation in December 1986, and pursuant to normal accounting procedures, WTU ceased accruing AFUDC and began charging the expenses of the plant against income as they were incurred. The petition, if granted, would allow the company instead to capitalize these items as an asset on its balance sheet until rates are in effect that reflect the cost of Oklaunion. The deferred costs would therefore not be charged against net income. In addition, WTU would be able to seek inclusion of the deferred-costs asset in its rate base to earn a return and be amortized over the life of the plant.

The intervenors and the Commission staff urge that the petition be denied on several grounds, including the failure of WTU to show that the requested treatment is necessary to prevent material harm to the company's financial integrity. On the basis of the Commission's previous cases, the examiner has applied a lesser standard and recommends that the petition be granted, on the grounds that otherwise the financial condition of the company would be measurably harmed.

II. Procedural History

On December 23, 1986, WTU filed a petition seeking approval of deferred accounting treatment for certain costs related to Oklaunion Power Station Unit

No. 1 (Oklaunion). The petition seeks a Commission order that would allow it to accrue AFUDC and defer depreciation, operation and maintenance expenses, and taxes associated with Oklaunion. Supporting testimony was included with the petition.

Notice of WTU's petition was published once in newspapers of general circulation throughout the area served by WTU. The company served notice of its petition on all municipalities in its service area, the Office of Public Utility Counsel (Public Counsel), and on the counsels for the cities served by WTU, the Air Force, the State Agencies, and the State Treasurer. In the examiner's opinion, the notice satisfied the requirements of P.U.C. PROC. R. 21.25, and no additional notice was ordered.

Motions to intervene were filed by Public Counsel and by the Texas State Agencies. The motions were granted with no objection by WTU.

On February 2, 1987, Public Counsel filed a motion to dismiss, contending that the company's petition constituted a request for a rate increase that therefore required a statement of intent to change rates, a full rate filing package, notice to customers, and publication of notice as required by section 43(a) of the Public Utility Regulatory Act, Tex. Rev. Civ. Stat. Ann. art. 1446c (Vernon Supp. 1987) (PURA). Public Counsel's motion was supported by the State Agencies. On February 17, 1987, the examiner issued Order No. 3, denying the motion to dismiss and holding that the petition did not constitute a request for a rate increase, because granting the relief sought by WTU would not involve changing its tariff. Public Counsel appealed the order on February 20, 1987, and the order was deemed approved by operation of P.U.C. PROC. R. 21.106(a) when the Commission did not act on the appeal within 15 days.

Pursuant to the examiner's order, WTU filed a statement of the relief it seeks in this case and a list of the issues raised by its request. In response, the other parties, including the general counsel, filed their statements of the issues. On March 18, 1987, the examiner issued Order No. 5, delimiting the scope of this case and sustaining objections to certain requests for information (RFIs) filed by Public Counsel. In the order, the examiner ruled that this case is limited to the three issues identified by WTU, namely:

1. Whether WTU will suffer financial harm by not being able to recover the costs associated with the operation of Oklaunion during the period of its commercial operation and before rates that include Oklaunion in WTU's invested capital as plant in service are put into effect.

2. Whether the accounting treatment requested by WTU will decrease the effect of the investment in Oklaunion on the company's financial integrity.

3. Whether the accounting treatment proposed by WTU accords with Generally Accepted Accounting Principles (GAAP).

In addition, the examiner sustained WTU's objections to RFIs seeking projected financial data pertaining to WTU's parent company, Central and South West Corporation (CSW) and forecasted data for WTU beyond 1988. On March 27, 1987, Public Counsel appealed the order, which was deemed approved when the Commission did not act on the appeal within 15 days.

On March 27, 1987, WTU requested leave to file supplemental testimony addressing: (1) recent activities of the Financial Accounting Standards Board (FASB) and their potential effect on WTU's request; (2) additional cost data; and (3) the effect on deferred costs of assuming a March 1987, instead of a December 1986, test year for the company's next rate case. In response, the general counsel and Public Counsel filed motions requesting changes in the procedural schedule. By examiner's order, WTU was allowed to file the supplemental testimony, and the hearing--originally scheduled for April 20--was rescheduled for May 11. In response to a second motion by Public Counsel, the hearing was again rescheduled for May 14 to alleviate conflicts with the Gulf States Utilities hearing.

On May 11, 1987, WTU filed a correction to its accountant's testimony and a revised RFI response, which dealt with the company's ability to pay a fourth-quarter common dividend if its request for deferred accounting treatment were denied. In response, the general counsel filed a motion for continuance on the grounds that the new testimony was the first indication by the company that denial of deferral treatment would affect its ability to pay dividends. After argument was heard on May 14, the hearing was continued until May 18 and the staff and Public Counsel were granted leave to file supplemental testimony on May 19. The hearing was reconvened on May 18 and adjourned on May 20, and the parties filed their closing arguments by written briefs and replies.

II. Summary of Case

A. Introduction and Summary of Relief Requested

WTU operates entirely within Texas, providing electric utility service to about 178,000 customers in a 53,000-square-mile area of West Texas that includes all or part of 52 counties. The company is a wholly owned subsidiary of CSW and provides service under Certificate No. 30170. It is a public utility as that term is defined by section 3(c)(1) of PURA and is therefore subject to the general jurisdiction of this Commission pursuant to section 16(a) of PURA. The Commission has specific jurisdiction in this case pursuant to the authority granted by section 27 of PURA to prescribe the forms and methods of accounts and depreciation for public utilities.

Before Oklaunion went into operation, WTU operated 12 widely dispersed generating plants with a net generating capacity of about 1,070 megawatts (MW). Its system peak demand in the summer of 1986 was 1,120 MW. Oklaunion is a jointly owned 665-MW coal-fired generating unit owned by WTU, Central Power and Light Company (CPL), Public Service Company of Oklahoma (PSO), Oklahoma Municipal Power Authority (OMPA), and the Public Utilities Board of the City of Brownsville (PUB). The unit was certified by the Commission in 1981 (Docket No. 3879). It is the first coal-fired unit for WTU, which owns 54.69 percent, or 364 MW, of the unit. WTU invested about $270 million in Oklaunion, an amount equal to about 75 percent of its previous plant in service.

Oklaunion went into commercial operation on December 24, 1986, and it replaced firm-power-purchase commitments that were in effect through 1986. It provides WTU with a capacity margin in 1987 of about 23 percent and in 1988 of about 18 percent. The cost of the unit is expected to be about $610 per net MW. The company estimates that total operations and maintenance expenses for 1987 will be $13,118,000, of which WTU's share is $7,175,000.[1] WTU's estimated depreciation cost for the plant is $6,861,000 for the deferral period. The company estimates that the total cost that it will defer (carrying cost, depreciation, and O&M expenses including taxes) is about $28.4 million. *See* WTU Exhibit No. 3B at Exh. LBC-12S.

---

[1]WTU does not seek to defer the entire amount of its share of the O&M expenses, but rather only the O&M expenses net of the capacity payments for firm purchased power currently included in rates. From December 1986 through November 1987, the net O&M is estimated to be $360,400.

Briefly stated, WTU seeks relief in the form of a variance from normal accounting procedures. When Oklaunion was placed into commercial operation, the company began to incur O&M expenses and taxes associated with the plant. In addition, WTU began booking depreciation expenses and stopped booking AFUDC on its investment in the plant. As explained below, under normal accounting procedures, these income and expense items are reflected in the calculation of the company's net income, and in this case, the net effect of the items is to reduce net income by about $28.4 million during the period before the plant is reflected in rates. Under WTU's proposed accounting procedure, the expenses would be not be charged against net income; rather, the expenses would be deferred and capitalized (*i.e.,* they would be posted to the company's balance sheet as part of its investment in Oklaunion). In addition, WTU would continue to accrue AFUDC on its investment, which would be included in its net income. By this procedure the company seeks (1) to avoid the negative impact of the increased expenses and loss of AFUDC on its financial statements and (2) to provide a method by which the deferred expenses and AFUDC accrued during the deferral period may be recovered in rates after Oklaunion is recognized in rate base.

[1] As explained below, GAAP requires that in order for a company's financial reports to reflect the deferred accounting treatment proposed by WTU, the company must receive reasonable assurance from its regulatory authority that it will eventually be allowed to recover in rates the expenses that it defers. According to WTU, if it receives such assurance, the deferral of costs would be reflected as an asset on the company's balance sheet. The company would then seek recovery of the deferred costs in its next rate case by requesting that the deferred-costs asset be included in rate base. If at that time the Commission determines that the deferred costs were prudent, reasonable, and necessary expenses, the depreciation of the asset would be part of its cost of service, and the company would earn a return on the unamortized portion of the asset that is in rate base. According to the company, if the Commission in the next rate case allows the deferred costs to be reflected in rates, it would increase the company's cost of service by an estimated $0.46 per 1,000 kWh (kilowatt hours), assuming that the deferred costs are amortized over the life of the plant.

B. Deferred Accounting Treatment

1. Accounting Procedures

Lawrence Conners, the Secretary and Director of Accounting and Finance of WTU, explained the deferred accounting treatment as proposed by the company. According to Mr. Conners, the Uniform System of Accounts required WTU to cease accruing AFUDC and begin recording depreciation, operation and maintenance, and tax expenses on Oklaunion when the plant went into commercial operation. With the proper order from the Commission, the company would be able to accrue AFUDC and book its actual costs to deferred charges until rates reflecting the plant are put into effect.

As described by Mr. Conners, the proposed treatment would be implemented as follows. Because WTU has been recording these expenses as they were incurred, "reversing entries" would be made to the various accounts so that the amount in each account would be equal to the amount it would have been had the company been deferring the expenses and accruing AFUDC since the plant was placed in service. The past financial records of the company would not, however, be revised. The entire cumulative effect of the deferred accounting treatment up to the date of the revision would be reflected in one month's books. From then on, as expenses and accruals related to Oklaunion are incurred, they would be posted in accordance with the deferral treatment, so that at the end of the deferral period, the accounts would show all the accruals and expenses as deferred and capitalized.

With the exception of deferred federal income tax expenses, the deferred expenses would be identified for Oklaunion in WTU's accounting system. The deferred federal income tax expenses would be determined by calculating the tax effect of the deferred items. Each month, the sum of these amounts would be decreased by one-twelfth of the annual firm capacity payments that are included in WTU's current rates, and the net amount would be transferred to FERC Account 186--Miscellaneous Deferred Debts. The deduction for the firm capacity payments is necessary because Oklaunion's capacity replaced the company's former firm capacity commitments. That is, since Oklaunion capacity is replacing capacity that was formerly purchased, the Oklaunion capacity is already reflected in rates, and that portion of the cost is being recovered and should not be included in deferred costs for future recovery.

Second, AFUDC would continue to accrue on the Oklaunion construction balance during the deferral period. WTU proposes that the rate of 11.97 percent be used, which it determined by using the FERC Uniform System of Accounts instructions for AFUDC as adopted by this Commission. The proposed AFUDC rate uses a 16-percent cost of common equity, which was approved in WTU's last retail rate case. The company proposes that the AFUDC method be used to record the carrying costs during the deferral period because the procedure recognizes the total cost of equity and debt financing that is actually incurred by the company in financing Oklaunion. Also, the FERC AFUDC procedure has been allowed by this Commission in two cases, El Paso Electric Co., Docket No. 6350 (Jan. 31, 1986), and Gulf States Utilities Co., Docket No. 6525 (June 25, 1986).

2. **The** Controlling Accounting Principles

As a result of deferring the costs associated with Oklaunion and continuing to accrue AFUDC on the plant until it is reflected in rates, WTU would create on its books an asset, aptly named "Deferred Oklaunion Charges." This asset would be the tangible result of the "capitalization" of the expenses and carrying costs incurred during the deferral period. The creation and recognition of such assets in financial reports is governed by specific accounting statements issued by the Financial Accounting Standards Board (FASB). It is at this point that these accounting requirements need to be discussed. In the discussion, it must be remembered that the FASB accounting requirements govern only the accounting for a company's financial reports, they do not control accounting for other purposes, such as ratemaking. The discussion is complicated by the fact that while this case has been pending, FASB was considering amendments to the accounting requirements for financial reporting.

John Jeter, a partner with the firm of Arthur Andersen & Co., testified for WTU as an authority on regulated industries accounting practices. Mr. Jeter testified generally about the compliance of WTU's proposal with GAAP and the accounting principles set forth in statements of FASB. Mr. Jeter noted, as a general controlling principle, that GAAP requires regulatory actions to be reflected in the financial statements of regulated utilities. He explained the specific GAAP requirements as follows.

At the time WTU filed its petition, the deferral of costs and continued accrual of AFUDC beyond a plant's in-service date were allowed under certain conditions set forth in Statement of Financial Accounting Standards No. 71. (Statement 71). Paragraph 9 of Statement 71 provides,

> [2] Rate actions of a regulator can provide *reasonable assurance* of the existence of an asset. An enterprise shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:
>
> a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for ratemaking purposes.
>
> b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. . . .

(Emphasis added.) Mr. Jeter stated that in his opinion, WTU's proposed deferred accounting treatment complied with the requirements of Statement 71. At the time, however, FASB had distributed an "exposure draft" of proposed amendments to Statement 71 that would have placed additional restrictions on both the continued accrual of AFUDC and the deferral of cost past the in-service date.[2] The status of the proposed additional restrictions--which would have specifically governed phase-in plans and short-term deferrals--was uncertain at the time Mr. Jeter's testimony was filed.

In supplemental testimony filed in March 1987, Mr. Jeter explained that, based on the discussion at the FASB meeting in March 1987, it appeared that the Board would require that the deferred amounts be recovered in rates within 10 years of the date the deferrals began. That is, if the amortization period was longer than 10 years, no deferral would be allowed.

The proposed 10-year limitation, however, was later eliminated. In cross-examination at the hearing, Mr. Jeter testified that at its meeting in May 1987, FASB decided to allow, for financial reporting, the deferral of all the costs under consideration in this case except the return on equity. Equity return could be capitalized as a balance sheet adjustment, but it could not be included in income. Most important, FASB decided not to limit the amortization to 10 years; rather, the costs could be recovered over the life of the plant.

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[2]The proposed amendment was issued in December 1985 as an Exposure Draft, "Regulated Enterprises--Accounting for Phase-in Plans, Abandonments, and Disallowances of Plant Costs (An Amendment of FASB Statement No. 71)."

Although FASB had not published its statement of financial accounting standards as of the hearing, Mr. Jeter was of the opinion that FASB would allow deferral with amortization over the remaining life of the plant.[3]

[3] In August 1987, FASB issued Statement 92. Although the statement amends Statement 71 to specify the accounting for phase-in plans, it contains several provisions and an example that are relevant to deferral of costs. In particular, paragraphs 8 and 12 of Statement 92 provide,

> 8. If specified criteria are met, paragraph 9 of Statement 71 requires capitalization of an incurred cost that would otherwise be charged to expense. An allowance for earnings on shareholders' investment is not "an incurred cost that would otherwise be charged to expense." Accordingly, such an allowance shall not be capitalized pursuant to paragraph 9 of Statement 71.
>
> 12. The nature and amounts of any allowance for earnings on shareholders' investment capitalized for rate-making purposes but not capitalized for financial reporting shall be disclosed.

(Footnote omitted.)

In addition, Appendix A of Statement 92 presents an example which reviews the proper accounting treatment for a hypothetical utility that is ordered by its regulator to capitalize its net cost of operating a new plant during the period before rates are adjusted to reflect the plant. The order in the example defers essentially the same costs for which WTU is seeking deferred treatment in this case.[4] Paragraphs 39, 40, and 41 in Appendix A provide,

> 39. The resulting deferral is not a phase-in plan. The regulator's order to capitalize an amount pending completion of a rate hearing is designed to protect the utility from the effects of regulatory lag in the absence of a rate order--a routine procedure on the part of regulators. . . .
>
> 40. Under paragraph 9 of Statement 71, [the utility] should capitalize that portion of the amount capitalized for rate-making purposes that represents incurred costs that would otherwise be charged to expense . . . .

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[3]Upon order of the examiner with the agreement of the parties, the record was left open for the company to file the expected statement from FASB as soon as it became available.

[4]The deferred net costs in the example include operating costs, depreciation, allocable interest cost, and an allowance for earnings on shareholders' investment, all net of savings that result from operation of the new plant.

> 41. [In this example], Statement 71 does not permit capitalization of an allowance for earnings on shareholders' investment. Accordingly, [the utility] should not capitalize, for financial reporting, the portion of the amount capitalized for rate-making purposes that represents an allowance for earnings on shareholders' investment. If recovery of that allowance subsequently occurs, increased earnings during the recovery period will result.

(Footnote omitted.)

The foregoing language in Statement 92 will apparently allow WTU, for the financial reporting purposes, to defer and capitalize the costs associated with Oklaunion if it receives an order from the Commission that satisfies the criteria of paragraph 9 of Statement 71. The deferrals would be reflected in an asset for which WTU could seek--in its rate case--to have included in its invested capital. Furthermore, it appears that pursuant to paragraph 9 of Statement 71, WTU would be able to amortize over the life of Oklaunion any costs included in rate base.

Statement 92 apparently prevents a company from including in its financial statements a capitalized allowance for earnings on shareholder equity, but at the same time requires that such amounts be disclosed in the company's financial reports. In its financial statements, therefore, WTU could not capitalize or include in net income the AFUDC accrued on equity funds that it has invested in Oklaunion. But paragraph 12 of Statement 92 would require WTU to disclose in its reports any AFUDC accrued on equity funds for ratemaking purposes.

3. The Bifurcated Approval Process

WTU contends that the necessity for deferred accounting treatment arises as a result of the Commission's current policy barring a plant from being included in rate base unless it was in commercial operation at the end of the test year. WTU's witness Mr. Conners noted that the company does not challenge that policy, but he maintained that in cases where a plant represents a large increase in investment, the effect of the policy on the company and its stockholders can be staggering.

Mr. Conners explained the problem from the company's point of view as follows. The policy creates a lag of at least nine months between the time a plant goes into operation and the time it is reflected in rates. During that time, while the customers obtain the electricity produced by the plant, the

company cannot recover the carrying costs or the cost of producing the electricity.

Mr. Conners contended that there is nothing that a company can do to avoid the substantial delay in the inclusion of new Electric Plant in Service in rate base. Under the Commission's rules, a company is not allowed to make post-test-year adjustments for plant in service, because plant in service is a rate base item, not a cost of service item (for which "known and measurable" changes are allowed).

In the case of Oklaunion, the earliest the company could include its Oklaunion investment in rate base is a test year ending December 1986. Absent a stipulated agreement, the earliest that any company can get rates into effect after the end of a test period is about nine months. Thus, with a test year ending December 1986, the earliest effective date for new rates would be around October 1987.[5] With the exception of fuel expenses, which are recovered through the fixed fuel factor during this period, any expenses incurred on the unit are unrecoverable. Most important, the company does not even have the opportunity to recover these costs or, because AFUDC ceases, the carrying costs of its investment during the period. And there is no way to time the rate case differently to eliminate the inability to recover the costs actually incurred.

In analyzing the interaction of deferred accounting treatment with the Commission's policies pertaining to post-test-year changes to plant in service, it is useful to diagram the events associated with putting a plant into service and recognizing it in rate base. Among other things, a diagram helps one to understand exactly what relief is being requested in a "deferred-accounting-treatment" case and what decisions should be postponed to the rate case. As is noted in the discussion below, the approval of the proposed treatment and the recovery of the deferred costs in rates is a two-part process, and an apropriate bifurcation of the regulatory review process is essential for the Commission to properly consider deferred-accounting-treatment requests.

The diagram below, labeled Figure 1, presents on a time line the important events from the time a plant is placed into service to the time it is recognized

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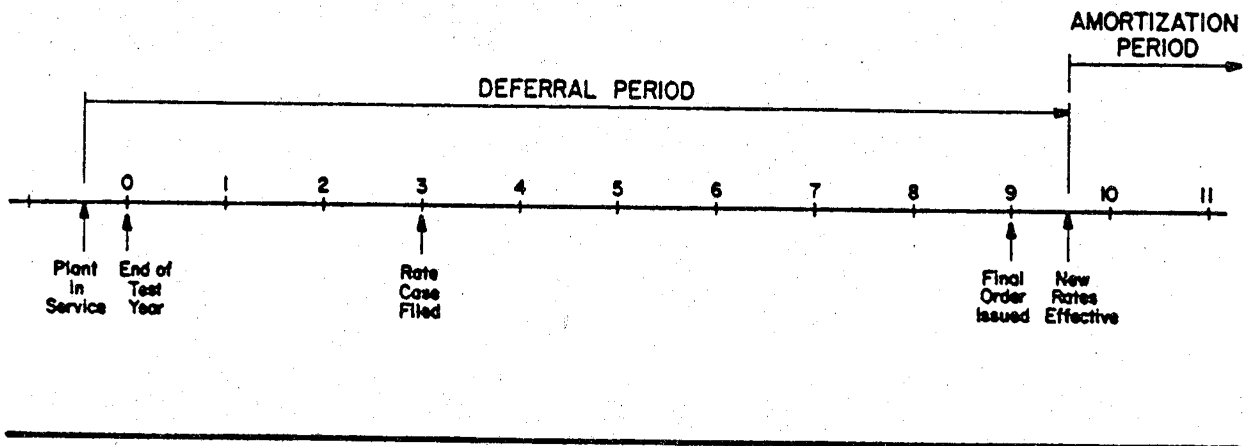
[5]For unstated reasons, WTU delayed its rate filing until May 1987 so that it could use a test year ending March 1987. As a result, the company expects new rates to go into effect in November, resulting in a lag of about 11 months. The extra delay increased the deferred costs by about $6 million.

in new rates. Each interval on the time line represents 1 month. The plant-in-service date is indicated on the line to the left of zero; the plant is assumed to go into service at a time favorable to reducing the lag in its recognition: near the end of the last month in a calendar quarter. As a result, the utility can assemble a rate filing package based on a test year ending the month the plant goes into service, which is labeled zero.[6] According to Mr. Conners, a rate filing package will generally require about 3 months to prepare, so the rate case filing is indicated on the line at the end of the third month. If the case is contested and not settled, the final order would not be expected earlier than the end of the statutory time limit of 6 months. The final order is therefore indicated at the end of the ninth month, with tariffs approved and the new

FIGURE I



[6]Since a test year must end in a calendar-year quarter, one would therefore expect utilities to attempt to place plants into service near the end of calendar quarters. If a plant were placed into service near the beginning of a quarter, the utility would have to wait that much longer for the end-of-quarter accounting information to prepare its rate filing package.

The foregoing consideration raises an interesting question: What is the profit-maximizing decision for the utility if an unexpected event delays the plant from going into commercial operation until just after a new quarter begins? Without deferred accounting treatment, the utility would lose three months' AFUDC if it placed the plant into operation at the beginning on a quarter. A policy barring deferred accounting treatment would thus provide inducement to a utility to further delay putting the plant into service even though the customers would benefit from its earlier operation.

rates effective some time during the following month. In the diagram, the utility would thus begin sending out bills based in part on the new rates about 9 to 10 months after the plant goes into service.

On the diagram, the period from when the plant goes into service until the new rates go into effect is labeled the deferral period. It is the operating expenses, depreciation, and carrying costs incurred during this period that WTU seeks to defer. If WTU is allowed in this case to defer and capitalize the expenses and carrying costs, it would create an asset on its balance sheet to reflect the amounts deferred. In its rate case, WTU would seek to have the asset included in its invested capital. To the extent it is recognized as invested capital, the asset would be depreciated during the period labeled on the diagram as the amortization period. As discussed above, FASB statements appear to allow the asset to be amortized over the life of the plant. During the amortization period, the asset would create rate revenue for WTU just as any other asset does: depreciation expense and return on the unamortized balance.

[4] The process leading to the recovery of the deferred costs in rates is thus a bifurcated decision. What must be understood about deferred accounting treatment is that the first decision--the decision in this case--concerns only whether the company will be allowed to defer the expenses and continue to accrue carrying costs. Most important, the decision in this case does not involve the *amount* of costs the company will defer or the *amount* of costs the company will be allowed to recover. Rather, the decision in this case has two "non-quantitative" purposes: (1) to provide the company "reasonable assurance" that it will eventually recover the deferred costs, so that the deferred accounting treatment can be reflected on the company's financial statements, and (2) to preserve, for the company's next rate case, the determination of the amount of the costs to be recovered.

It was noted above that deferred accounting treatment results in the creation of an asset on the company's balance sheet. This asset is reviewed in the rate case for inclusion in rate base, and the review is essentially the same as that for any company asset: Were the costs reasonable, necessary, and prudently incurred, and is the asset used and useful for the provision of utility service? The main issues raised in the rate case are those involving the *amount* that is properly includible in rate base. It is therefore in the rate case that the Commission would resolve issues such as those involving the amount of costs

deferred, the calculation of the costs, what costs are properly deferrable, and whether there are offsetting changes in expenses or revenues. These issues are essentially identical to the rate case issue of how much of the asset created by the deferrals should be included in rate base. They are inherently rate case issues, not deferred-accounting-treatment issues.

On the diagram, the time after the plant is placed in service is divided into the deferral period and the amortization period. This case, the deferred accounting treatment case, is limited to determining what will happen during the deferral period: primarily, whether the company's income statements will reflect the cost associated with the new plant. The approval of the requested treatment cannot affect rates or service during the deferral period. And absent a favorable review of the deferred costs in the rate case, the rates during the amortization period will not be affected either. This case therefore does not by itself affect any rates or produce a transfer of funds between the deferral period and the amortization period.

In addition, the diagram helps one to understand the relationship between deferred accounting treatment and the Commission's current policy barring post-test-year changes to plant in service. There is no inconsistency between deferral treatment and that policy. If a rate case is filed--as shown on the diagram--at the end of the third month, the Commission's policy precludes the recognition in rate base of any plant that is not in service before the end of the test year. It is apparent from the diagram, however, that the plant is in service before the end of the test year, and allowing it into rate base would therefore not violate the Commission's policy. In the rate case, the question before the Commission would be the proper level of capital costs associated with the plant, and the amount of costs recognized as reasonable and necessary would determine the amount of the plant that is recognized in rate base.[7]

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[7]Section 41(a) limits the invested capital of a utility to original cost of property, and it defines "original cost" to be "the actual money cost . . . of the property at the time it shall have been dedicated to public use . . . ." The intervenors in this case contend that the deferred expenses cannot properly be included in invested capital, because they are not part of the original cost of the plant. Neither the issue of including the plant in rate base nor the issue of the proper definition of "original cost" is properly within the scope of this case.

One may note, however, that for purposes of section 41(a), the capitalized deferred expenses can be considered to be an asset apart from the plant itself or a "subsequent addition" to the plant. Including the asset in invested

C. *The Effect of Deferred Accounting Treatment on WTU*

1. Income Statements and Balance Sheets

The effect of allowing deferred accounting treatment can be assessed by comparing the financial condition of WTU during the deferral period with and without the deferral of Oklaunion costs. Since the deferral period in this case coincides with the calendar year 1987, the effec of deferring the costs can be assessed by comparing the financial statements of WTU showing the accounts for 1987 with and without the proposed treatment.

Table 1 presents accounts from WTU's income statement and statement of retained earnings for the years 1984 through 1987. Estimated data for 1987 is presented both with and without deferral treatment. Because the statement were prepared before FASB Statement 92 was issued, the deferrals include the AFUDC on shareholders' equity funds invested in Oklaunion.

Looking at the operating revenue and expense data over the years, one notes that while revenues have been declining, the expenses have declined enough to maintain the level of operating income.[8] Indeed, if the requested treatment were approved, the company would apparently have the highest operating income for the four years presented. One notes also that the company's total AFUDC has increased sharply since 1984, reflecting its investment in Oklaunion and a lower percentage of CWIP allowed in rate base.[9] Finally, the company has been able to post increasing amounts to retained earnings while maintaining the level of common stock dividends.

The figures in boldface are for the accounts that are most affected by deferred accounting treatment. These comparisons show how the treatment would increase WTU's net income by $28.4 million in 1987.

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capital would not therefore not run afoul of the "original cost" concept of section 41(a).

[8] The decline in expenses mainly reflects a decrease in the amounts spent on fuel and purchased power. *See* OPC Exhibit Nos. 2 and 3.

[9] WTU was allowed 100 percent of CWIP in rate base from 1982 through 1984, at which time allowable CWIP was reduced to 47.5 percent. *See* OPC Exhibit No. 8.

TABLE 1

WEST TEXAS UTILITIES
ANNUAL FINANCIAL STATEMENTS

(millions of dollars)

Income Statements

(years ending December 31)

Account	1984	1985	1986	est. 1987 w/o DAT	est. 1987 w/ DAT
Operating Revenue	$312.1	$317.8	$273.6	$270.7	$270.7
Operating Expenses	273.0	277.3	236.6	229.4	227.5
Operating Income	39.1	40.6	37.0	41.3	43.2
Other Income (incl. AFUDC--equity)	6.1	13.9	18.7	.7	17.4[a]
Total Income Before Interest Charges	45.2	54.4	55.8	42.0	60.6
Interest Charges (net of AFUDC--debt)	15.1	15.2	13.5	24.2	14.4[a]
Net Income	30.1	39.3	42.3	17.8	46.2
Preferred Dividends	2.8	2.8	4.3	4.6	4.6
Net Income Available for Common Stock	27.3	36.5	38.0	13.2	41.6
Common Dividends	15.7	18.8	16.1	15.6	21.7
Balance Retained	$11.6	$17.6	$21.9	$(2.5)	$19.9

Statements of Retained Earnings

(as of December 31)

Account	1984	1985	1986	est. 1987 w/o DAT	est. 1987 w/ DAT
Retained Earnings--Beginning of Year	$43.3	$54.8	$72.5	$94.3	$94.3
Net Income for Common	27.3	36.5	38.0	13.2	41.6
Deduct: Common Dividends	(15.7)	(18.8)	(16.1)	(15.6)	(21.7)
Retained Earnings--End of Year	$54.8	$72.5	$94.3	$91.9	$114.2
[a]Total AFUDC	$9.4	$21.6	$28.8	$0.4	$26.9

Source: OPC Exhibit Nos. 2 and 3.
Note: Components may not add up to totals because of rounding.

What may be surprising at first is the relatively small decrease in operating expenses that results from deferred accounting treatment. One reason is that, as noted above, the purchased power costs already in rates are deducted from deferred operating expenses. In addition, the more detailed financial reports in the record, which present other components of operating expenses, reveal that a large ($6.9 million) decline in depreciation expense is more than offset by a larger ($7.8 million) increase in deferred income taxes. Declines in other operating expenses produce the net $1.9 million decline in the account. As a result, almost all of the effect of the deferral treatment is produced by the change in AFUDC, which totals $26.5 million.[10]

To facilitate understanding of the relationship among the accounts, the most significant of them are presented in graph form in Figure 2. As can be seen there, deferred accounting treatment does not greatly affect operating income; its major impact on net income is through AFUDC. The effect on net income then flows through to retained earnings.

The final significant effect presented in Table 1 is the increase in dividends to common stock if deferred accounting treatment is approved. According to WTU's witness Mr. Conners, unless the treatment is approved by September 30, 1987, the company will be unable to declare a fourth-quarter dividend.[11] In his rebuttal testimony and on cross-examination, Mr. Conners explained that a requirement in a first mortgage bond indenture limits common dividends to net income earned in the 12 months preceding the dividend. Without deferral treatment, WTU would not have enough earned income to pay another dividend in 1987. As discussed below, the company's position is that the forgone dividend demonstrates that its financial condition would be adversely affected by denial of the proposed treatment.

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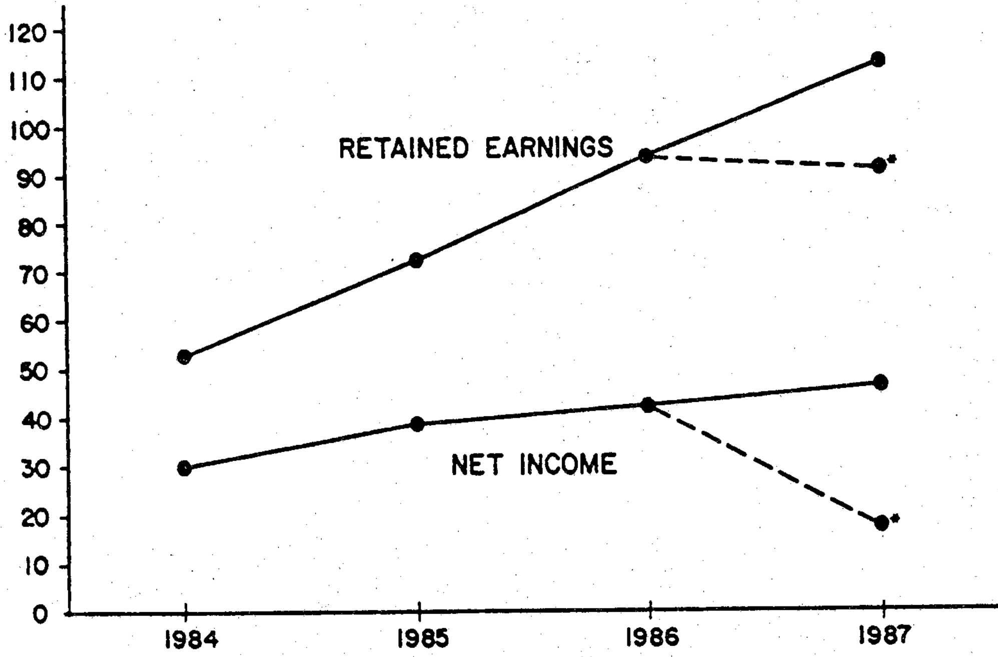
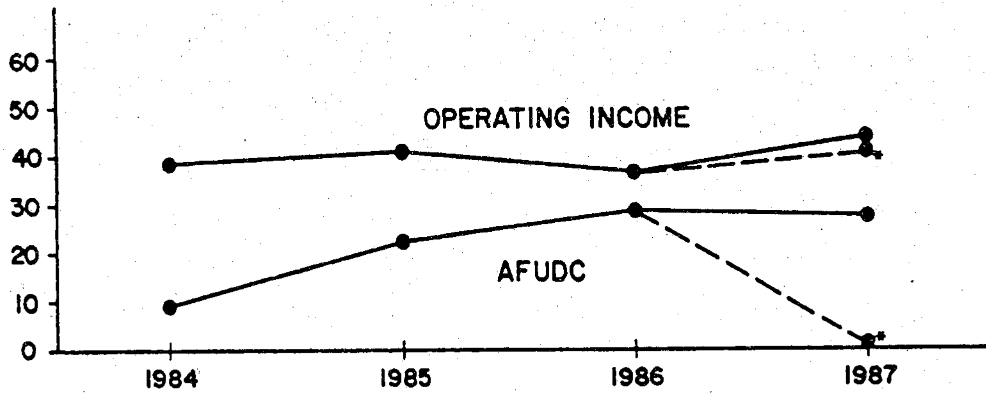
[10]Of the total change in AFUDC, the allowance for equity funds changes $16.8 million, and the allowance for borrowed funds changes $9.8 million. As explained above, Statement 92 would not allow the allowance for equity funds to be capitalized for financial reporting purposes, but would require WTU to disclose the capitalization of the allowance for equity funds for rate-making purposes.

[11]The dividend, if declared, would be $6.0 million.

FIGURE 2





**without deferred accounting treatment.*

2. Financial Indicators

Table 2 presents three of WTU's financial ratios for the years 1984 through 1987: pretax interest coverage, return on equity, and AFUDC as a percentage of net income. The first two ratios are presented both with and without AFUDC; the ratios that exclude AFUDC are considered cash-flow ratios. As noted by both WTU's witness Mr. Conners and Staff Financial Analyst Patricia Scheuer, the ratios reveal a cash flow strain resulting from the financing of Oklaunion construction. Ms. Scheuer observed that when a utility is involved in a major construction program such as a generating plant, its cash flow ratios are likely to decline until the plant is operational and is included in rate base.

TABLE 2
WEST TEXAS UTILITIES
FINANCIAL RATIOS
HISTORICAL AND PROJECTED

Ratio	1984	1985	1986	1987 (est.) w/o DAT	1987 (est.) w/ DAT[a]
Pretax Interest Coverage--					
Excluding AFUDC[b]	3.10	2.70	2.37	2.16	2.16
Including AFUDC	3.61	3.59	3.57	2.17	3.65
Return on Equity--					
Excluding AFUDC[b]	10.8%	7.5%	4.1%	5.5%	5.2%
Including AFUDC	16.4%	18.4%	17.0%	5.7%	17.0%
AFUDC as % of Net Income	34.6%	59.3%	75.7%	2.8%	64.8%

[a]Assumes approval of deferred accounting treatment by September 30, 1987.
[b]For 1987, the figures exclude both AFUDC and deferred expenses.
Source: Staff Exhibit Nos. 3A and 3B, Sched. I, II.

WTU's cash-flow ratios--pretax interest coverage and return on equity, excluding AFUDC--declined significantly from 1984 through 1986. By contrast, the ratios that include AFUDC remained more or less stable. The increased amount of AFUDC as a percentage of net income explains the difference in behavior of the cash and noncash ratios.

As can be seen from Table 2, deferred accounting treatment would have a significant effect only on the noncash ratios. Without deferral treatment, pretax interest coverage would decline from 3.57 in 1986 to 2.17 in 1987. Return on equity would decline from 17.0 percent to 5.7 percent. AFUDC would fall from 75.7 percent of net income to only 2.8 percent. If deferral treatment were approved, the noncash ratios would be maintained at or near their previous levels. The ratios that reflect the cash flow of the company would not be significantly affected by deferral treatment, because AFUDC and the requested deferred expenses are noncash accruals not included in these ratios.

IV. Standard of Review

A. Previous Commission Cases

The Commission has considered deferred accounting treatment for utilities in three previous cases, all of which were major rate cases: Houston Lighting & Power Co., Docket No. 6765 (Nov. 14, 1986) (HL&P); Gulf States Utilities Co., Docket No. 6525 (June 25, 1986) (GSU); El Paso Electric Co., Docket No. 6350 (Jan. 31, 1986) (EPEC). Deferred accounting treatment was approved in the EPEC and GSU cases; it was denied in the HL&P case.

1. El Paso Electric Co.

In EPEC, the company requested permission to defer the costs associated with Palo Verde Unit No. 1 after that unit went into commercial operation. According to the company's testimony, the lag between the unit's in-service date and rate base treatment would have caused its financial indicators to deteriorate seriously and made long-term capital unavailable to the company. The staff concurred, testifying that without the deferred accounting treatment, the company's financial viability would have been seriously diminished. There was no opposition to deferral treatment; however, one of the intervenors suggested a modification to the language of the order requested by the company.

According to the examiner's report, because EPEC's commitment to Palo Verde was so massive relative to the size of the company, the lag in regulatory recognition of the unit would have had a very detrimental effect on the company's financial integrity. The examiner attributed the problem, however, to poor management of EPEC.

Significantly, the examiner's report in the <u>EPEC</u> case noted that approval of deferred accounting treatment affects neither the outcome of the rate case nor the total book cost of the unit. In addition, it noted that approval of deferral treatment does not limit the Commission's review of the prudence of the capitalized expenses or of the unit itself. As a result, the examiner concluded,

> Under the circumstances, the examiner agrees with EPEC's position that the proposed request for capitalization of PVNGS Unit No. 1 expenses will do no more than preserve the Company's financial position until the rate case in which PVNGS Unit No. 1 is considered for in-service treatment by the Commission.
>
> It appears to the examiner that the Commission can prevent some financial difficulties for EPEC without harming the ratepayer or circumscribing the Commission's freedom of action concerning future rate base treatment of PVNGS Unit No. 1, by permitting deferral of PVNGS Unit No. 1 expenses.

By adopting the examiner's report in the <u>EPEC</u> case, the Commission adopted the above language.

2. Gulf States Utilities Co.

Deferred accounting treatment of costs associated with the River Bend nuclear power station was approved by the Commission in the GSU case as part of the parties' stipulated settlement of the case. The examiner simply noted that the circumstances supporting approval of deferral treatment were similar to those in the <u>EPEC</u> case and recovery of the costs in rates would not occur unless they were found to have been appropriate. Since it was settled by stipulation, the <u>GSU</u> case does not serve as precedent for Commission action.

3. Houston Lighting & Power Co.

As part of its last major rate case, HL&P requested both deferred accounting treatment and rate base treatment of costs associated with Limestone Unit 1. The question before the Commission was therefore not only whether to allow the deferral and capitalization of the costs, but also whether to include the costs in rates. The Commission denied both deferred accounting treatment and rate base treatment.

Judging from the examiner's report, it appears that most of the testimony concerned the inclusion of the costs in rate base and cost of service. HL&P had requested rate base treatment for about $65 million of costs and an amortization expense of about $7 million included in cost of service. As grounds for its request, the company noted the regulatory lag that made it impossible to recover the cost associated with a plant from the time it goes on line to the time it is recognized in rates. Because of the larger size of plants, the financial effect of the lag was becoming more significant. To conform with the FASB Exposure Draft amending Statement 71, the company requested a 10-year amortization period.

The intervenors opposed recognizing the costs in rates. The Cities argued that regulatory lag is an inherent risk for a utility and is not sufficient reason to warrant "extraordinary treatment." Moreover, the requested expenditures had not been incurred by test-year end, and no consideration had been given to the proper rate of return to allow on the costs or to an offsetting effect of deferred federal income taxes. The Cities argued also that the size of Limestone 1 relative to HL&P's total plant was only 19 percent, which was much smaller than the massive figure in the EPEC case.

The Cities recommended an alternative treatment: that HL&P receive a return on its investment plus compensation for reasonable expenses incurred during the first year. In addition, the Cities recommended that deferred accounting treatment be approved for Limestone 2, with reservation of the right to exclude from rate base or other recovery any expenditure not found reasonable.

Public Counsel recommended denial of the requested cost-of-service treatment of the costs for several reasons. The recovery of the costs would shift all the risk of a new plant to the ratepayers, causing rates to rise at a time they should decrease. In addition, there were offsetting decreases in expenses that had been ignored.

One staff witness recommended approval of recognizing the costs in rates, while another recommended denial. Mark Young testified that it would be fair and equitable to allow recovery of the costs: because of fuel savings experienced by the company as a result of the new plant, its fuel factor would be lower to reflect the savings. In his opinion, allowing recovery of the costs was consistent with adopting the lower fuel factor. In further testimony, Mr.

Young recommended several adjustments to the amount of costs receiving deferred accounting treatment and several modifications to the company's proposed procedure. Candice Kever recommended denying the inclusion of the unamortized portion of the costs in rate base. In her view, the requested deferral was not related to rate shock, and a sharing of the burden between shareholders and ratepayers would be appropriate.

A third witness, Bob Reilley, testified that approval of deferred accounting treatment would not have a major effect on HL&P's financial indicators for the calendar year of the deferral period, regardless of whether the company was granted rate relief. He concluded that approval of deferral treatment was not necessary to maintain the company's financial integrity.

The examiners recommended denial of HL&P's request. In their opinion, regulatory lag--the fundamental reason for the company's request--did not by itself warrant "exceptional treatment." In HL&P's case, there was no "massive commitment" that made deferral treatment necessary to the financial integrity of the company, as there was in EPEC's case. In addition, EPEC's plant had not yet been in rate base, and since it was a nuclear plant, there could be a long lag between its operational date and recognition in rate base. Finally, the examiners noted that the EPEC case did not involve a request to include a portion of the deferred costs in the company's current cost of service.

4. The Parties' Interpretation of the Cases

Public Counsel. Public Counsel argues that the foregoing cases have several significant characteristics that distinguish them from this case. One, each of them was a rate case, so that the decision about deferral was made after an analysis of all factors affecting the company's financial condition. All cost elements were reviewed for a year that coincided with the deferral period. Public Counsel maintains that the thorough examinations were necessary and contrast sharply with the limited scope of this case.

Two, GSU and EPEC requested and obtained approval of deferred accounting treatment before the plants went into service, so the Commission was granting prospective relief. By contrast, both the HL&P case and this case involve retroactive relief. According to Public Counsel, this was one of the reasons deferral treatment was denied in the HL&P case.

In addition, Public Counsel contends that in the HL&P case, the Commission established that deferred accounting treatment constitutes "extraordinary" treatment to be applied in "unusual" cases, because the Commission upheld the examiners' language that characterized it as such. Finally, Public Counsel notes that while the examiners in the HL&P case did not evaluate the benefits of the plant in question, it was unnecessary to do so in that case because deferral treatment was denied on a threshold issue.

General Counsel. The general counsel contends that the foregoing cases establish that in order to obtain approval of deferred accounting treatment, a utility must establish that the treatment is necessary to avoid a *material* adverse effect on its financial integrity. To support his position, the general counsel notes the examiners' language in the HL&P case: "[T]here must be demonstrated sufficient reasons to warrant the granting of the extraordinary treatment." The key determinant in that case and the EPEC case, according to the general counsel, was the effect the regulatory lag would have on the company's financial integrity. The general counsel notes that where the staff had found there would be a material adverse effect, the relief was granted, and where the staff had found there would be no significant effect, the relief was denied. Accordingly, the general counsel's position is that there must be material damage to the company's financial integrity before the Commission should grant this extraordinary treatment.

WTU. The company argues that the fact that the previous deferred-accounting-treatment cases were rate cases is irrelevant to whether WTU's request should be granted. WTU notes that the granting of the request in the EPEC case had no effect on the rates set in that case, just as granting the request in this case would not affect WTU's rates.

WTU points out that with regard to determining the benefits that the customers receive from the plant, the Commission found that EPEC had failed to show that its decision to participate in the Palo Verde plant was a prudent one--yet the company's request for deferred accounting treatment was granted. WTU notes also that in the HL&P case, the examiners discussed the Commission's criteria for granting deferral treatment, but did not mention that a finding of benefits from the plant was required. According to WTU, the sole reason for denying HL&P's request was that the company's financial condition would not be suffi-

ciently affected by the denial of deferral treatment, because of the small size of the plant relative to the company's existing plant in service.

With respect to the timing of its request for deferred accounting treatment, WTU contends that the request was filed outside of and before a rate case because relief was needed much earlier than it could be obtained in a rate case. The company notes that its last rate case was filed three years ago, and it is not relevant that its request for deferral treatment was not included in that rate case or the one that is presently pending.

Finally, WTU contends that it is seeking the same treatment that EPEC and GSU received, for the same reason: to avoid harm to its financial condition by the end of the deferral period.

B. Discussion

1. The Issue of Extraordinary Treatment

The examiner's report as adopted by the Commission in the EPEC case does not characterize deferred accounting treatment as constituting "extraordinary" treatment. Rather, it presents the treatment as an opportunity to "prevent some financial difficulties for EPEC without harming the ratepayer." Thus, the report's recommendation to approve deferral treatment is based in part on the absence of any reasons not to grant the request: (1) Deferred accounting treatment simply preserves a company's financial condition until the next rate case, (2) it does not limit the Commission's review of the costs in the next rate case, and (3) it does not affect rates or service in the case in which it is approved.

The interpretation of the HL&P case is complicated by its simultaneous consideration of whether to approve deferred accounting treatment for certain costs *and* whether to include the deferred costs in rate base. Moreover, the testimony of the parties and the discussion in the examiners' report do not draw a clear distinction between the initial approval of deferral treatment and the subsequent review of the costs for rate base treatment. Thus, while Public Counsel and the State Agencies have cited the HL&P case as establishing that the proposed treatment is an "extraordinary treatment," it is unclear from the report in the HL&P case whether it was deferral treatment or rate base treatment that the examiners considered to be extraordinary relief.

In the examiner's opinion, it would not be useful to attempt to determine whether deferred accounting treatment is extraordinary treatment for utilities solely on the basis of the language in the HL&P case. Rather, it would be more appropriate to examine the issues raised by the parties in this case and to review the nature of the requested treatment. On the basis of that review and the previous decisions of the Commission, the appropriate criteria for approving deferred accounting treatment may be established.

2. The Rate Case Issue

Public Counsel argues that it is highly significant that each of the cases in which deferred accounting treatment was reviewed was a rate case. With respect to the implied principle that deferral treatment can be properly reviewed only in a rate case, the examiner notes first that the Commission did not suggest that principle in any of the previous cases.

Moreover, a rule limiting review of deferred-accounting-treatment requests to rate cases would pose problems for the timely review of such requests. In the HL&P case, one of the reasons for denying deferral treatment was that the company was also requesting rate base treatment for the plant associated with the deferred costs. On the basis of the HL&P case, therefore, a company should not wait until the rate case after the plant is put into service to request deferred accounting treatment. According to Public Counsel's argument, a company would therefore have to request deferral treatment in an earlier rate case. But WTU's last rate case was filed in mid-1984, which would have been much too early to consider the treatment for Oklaunion. To comply with Public Counsel's proposed rule, WTU would have had to file a full rate case, at considerable expense to it, the intervenors, and the Commission, simply to consider a request for deferred accounting treatment that would not affect any rate it is charging.[12] And after the deferred-accounting-treatment case, the company would have to immediately file a second rate case, for a second complete review, to have [5] the plant placed in rate base. In the examiner's opinion, the limited scope of relief granted by the Commission in deferred-accounting-treatment cases does not warrant such an extensive review.

[12]The rate case could not be restricted to a review of the request for deferred accounting treatment. All of the company's rates and costs could be challenged by the Commission and intervenors for reasonableness.

3. The Retroactive Regulation Issue

Public Counsel argues also that the relief granted in the GSU and EPEC cases was prospective, but the relief requested in the HL&P case--as in this case--was retrospective and for that reason was denied. However, the examiners' report in the HL&P case does not indicate that the relief was denied on the ground that it was retrospective. And in this examiner's opinion, that would [6] not have been a proper ground for denying the relief: the timing of the request for deferred accounting treatment does not affect the timing of the impact of the relief on the company's rates. Approval of deferral treatment affects only the company's financial statements during the deferral period. The company's rates are not affected until after rate base treatment is considered in the rate case. Therefore, whether the requested treatment is approved before or after the plant in-service date, rates would be affected prospectively only.

In a sense, the financial reports are retroactively revised if deferred accounting treatment is approved after the plant is in service. According to Mr. Conners' testimony, upon receiving approval of deferral treatment, he would make "reversing entries" in WTU's accounts so that the expenses and accruals associated with Oklaunion since it went into operation would be reflected in the accounts as deferred charges. While the past financial statements would not be retroactively revised, the cumulative effect of the deferral treatment would be reflected in the accounts as if the company had been deferring the expenses and accruing AFUDC from the date the plant was placed in service.

Therefore, the issue raised by Public Counsel is whether allowing such reversing entries to be made to the financial records of a utility violates the specific prohibition against retroactive ratemaking or the broader prohibitions against retroactive legislation. See Southwestern Bell Telephone Co. v. PUC, 615 S.W.2d 947 (Tex. Civ. App.--Austin), writ ref'd n.r.e. per curiam, 622 S.W.2d 82 (Tex. 1981); Tex. Const. art. II, § 16. One may observe first that in order for deferred accounting treatment to be retroactive ratemaking, it must at least be ratemaking. In this case, Order No. 3 (Denying Motion to Dismiss) held that, contrary to the contentions of Public Counsel and the State Agencies, approval of the requested treatment would not involve changing any of WTU's

legal rates and therefore this is not a rate case.[13] It thus does not specifically involve retroactive ratemaking.

With respect to the broader prohibition against retroactive legislation, the Texas Supreme Court has held that a retroactive statute is not prohibited by the constitution unless it takes away or impairs vested rights acquired under existing law. McCain v. Yost, 155 Tex. 174, 284 S.W.2d 898 (1955).[14] No party in this case has identified a vested right of any person that would be impaired by the approval of WTU's request for deferred accounting treatment. In the examiner's opinion, no vested right would be impaired and the approval of deferral treatment would therefore not violate even the broad prohibitions against retroactive legislation.

4. **The** Issue of Material Adverse Financial Impact

As noted above, the general counsel's interpretation of the previous deferred-accounting-treatment cases is that to obtain approval of the treatment, a company must demonstrate that it would otherwise suffer "material damage to its financial integrity." According to the general counsel, it is not sufficient for a company to show mere "financial harm."

[7] It is useful to define terms at the outset. As presented in staff financial analysis, "financial integrity" is the ability of the company to raise capital at reasonable terms. Financial integrity depends primarily on short-term factors, such as the liquidity or cash flow of the company. By contrast, the "financial condition" of a company is a broader concept, which depends on more factors than the ability of the company to raise capital. Generally speaking, financial condition encompasses long-term factors such as the company's earnings power--the sustainable ability of the company to generate net income over the years. For example, financial condition considers the long-term rate

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[13]The order was appealed by Public Counsel and was deemed approved when the Commission declined to consider the appeal.

[14]In Southwestern Bell, the court noted three criteria that determine whether a retroactive statute impairs or destroys existing vested rights: (1) whether the public interest is advanced or retarded, (2) whether the bona fide intentions or reasonable expectations of affected persons are fulfilled or defeated, and (3) whether persons who have long relied on a contrary state of law are surprised. 615 S.W.2d 956-57. Even if one assumes that there is a vested right involved in this case, it is difficult to see how it would be impaired by the approval of deferred accounting treatment.

of growth of variables such as earnings, dividends, and book value, which are not especially significant to financial integrity. Another important consideration determining financial condition is the regulatory environment in which the utility operates. In short, financial condition considers the overall well-being of company as an operating entity; financial integrity focuses on the company's ability to raise more capital.

[8] "Financial harm" occurs if a company's financial condition is impaired. More precisely, financial harm is an adverse *change* in a company's financial condition. To determine whether denial of deferred accounting treatment would cause financial harm to a company, one must determine whether it would cause a change in the company's financial condition. If a change is large enough that the company's cost of capital would significantly rise or that the company's financial integrity would be impaired, one may say that there would be "material financial harm."

From the examiner's report in the EPEC case, it is clear that EPEC's reason for requesting deferred accounting treatment and the Commission's reason for granting it were the same: to avoid the substantial harm to the company's financial integrity that would have occurred without deferral treatment. The report does not discuss, however, how much harm a company must show that it will suffer in order to demonstrate a need for deferral treatment. Nor does the report suggest that the treatment should be allowed only if the company's financial condition is poor. It simply concludes that under the circumstances of the case (which included substantial financial harm to the company if deferred accounting treatment were denied), the treatment was appropriate.

The report in the EPEC case does not suggest that the showing of substantial damage was a *necessary* condition to obtaining approval of deferred accounting treatment.[15] Nor does the report suggest that such a showing is the *only* reason for approving the treatment. It is therefore not correct to infer from the EPEC case that a company must show substantial financial damage in order to obtain approval of deferral treatment.

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[15] Strictly speaking, the examiner's discussion of deferred accounting treatment in the EPEC case presented the showing of substantial financial damage as a *sufficient* condition for approving deferred accounting treatment, not a *necessary* condition.

In the HL&P case, the Commission found that its approval of deferred accounting treatment in the EPEC case was "based upon the financial impact on the utility which would have resulted from denial of the requested relief." *See* HL&P at 421, Conclusion of Law No. 26. Thus, one of the grounds for denying HL&P's request for deferral treatment to HL&P was that the finding that "HL&P's financial integrity will not be harmed financially by the Commission's denial of the requested deferral . . . ."[16] *See* id. at 399, Finding of Fact No. 66. In their discussion, the examiners noted that the staff financial analyst had concluded that "HL&P's financial integrity would not suffer should the deferral request be denied." By this conclusion, the examiners distinguished HL&P's circumstances from those in the EPEC case.

The denial of deferred accounting treatment in the HL&P case was therefore based on the absence of harm to the financial integrity of the utility. The report discussed factors that indicated, in the opinion of the examiners, that there would be little harm: for example, the company's construction was only 19 percent of its total net investment. And the examiners rejected regulatory lag per se as a sufficient reason to approve deferral treatment. They did not, however, otherwise discuss what other considerations would warrant approval of the treatment. Significantly, nowhere does the report or the order of the Commission state that in order to obtain approval of deferred accounting treatment, a utility must demonstrate that it would otherwise suffer *material* damage to its financial condition. In this examiner's opinion, it would be incorrect to infer from the HL&P case that such a showing is necessary.

It is tempting to infer that principle from the case because of the way that the staff's financial integrity analysis was (and has continued to be) interpreted in the case. The staff financial analyst had set target levels for several of the company's financial indicators in order to determine how much CWIP[17] to allow in rate base. The target levels were set with the objective of

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[16]As noted above, the interpretation of the HL&P case is complicated by the fact that the case included requests both for deferral of costs and for inclusion of the costs in rate base. Moreover, there was not a clear distinction made in the case between approving the deferred accounting treatment and including the deferred costs in rate base. See, for example, at 398, Finding of Fact No. 65, which refers to not letting the company "defer recovery of operating costs and depreciation," thereby mixing together the concepts of cost deferral and cost recovery.

[17]Construction work in progress.

maintaining HL&P's financial integrity at the same general level that it experienced in the test year. Further analysis indicated that the denial of deferred accounting treatment would not cause the financial indicators to drop below the target levels, and the analyst therefore concluded that the denial would not cause significant impairment of HL&P's financial condition. By this reasoning, the same standards that were used to demonstrate that "exceptional circumstances" warranted the inclusion of CWIP in rate base were also used to determine whether to grant the company's request for deferral treatment. It is thus easy to conclude incorrectly that unless exceptional circumstances exist (*i.e.*, material damage to financial integrity would result), a request for deferred accounting treatment should be denied.

5. The Standard of Review

[9] There are at least two distinct reasons that one should not infer from the HL&P case that, in order to obtain approval of deferred accounting treatment, a utility must demonstrate that it would otherwise suffer material damage to its financial integrity. One, the consequences of allowing deferral treatment are significantly less than the consequences of including CWIP in rate base; the Commission should therefore not use the same standard of harm to financial integrity to determine whether to allow the treatment. Two, the report did not discuss--and did not reject--other criteria that are relevant to the issue of [10] allowing deferred accounting treatment. For example, there is the possibility of financial harm to a company that may occur if deferral treatment is denied, but which would not threaten the financial integrity of the company. Each of these reasons is discussed in the remainder of this section, which then concludes with a proposed approach for evaluating requests for deferred accounting treatment.

From the foregoing discussion of the financial integrity analysis in the HL&P case, it is apparent that taken by itself, the analysis would effectively impose the same standard for allowing deferred accounting treatment as for including CWIP in rate base. The steps would be as follows: The financial analyst establishes target levels for the several financial ratios to determine how much CWIP has to be included in rate base to maintain the company's financial condition at its test-year level. Further analysis may show that the same

level of financial integrity could be maintained without granting the company's request for deferred accounting treatment, and on the basis of that analysis, the treatment is determined to be unnecessary. By such reasoning, deferred accounting treatment would be allowed on the same basis as CWIP is included in rate base.

The question is whether there are reasons to impose the same financial integrity standard for approving deferred accounting treatment and for including CWIP in rate base. In the examiner's opinion, the financial integrity standard for deferral treatment should be much less than that for CWIP. First, section 41(a) of PURA establishes a financial integrity standard for CWIP. Section 27 gives the Commission the authority to establish the forms and methods of accounts and depreciation for utilities. There is no provision in PURA that expressly and specifically governs deferred accounting treatment or prescribes standards for its approval. The Act thus impliedly leaves the determination of a standard within the discretion of the Commission. The standard is most appropriately determined by the deferral treatment's effect.

From the discussion of deferred accounting treatment presented earlier in this Report, it is apparent that unlike CWIP in rate base, the deferral treatment has no immediate effect on the rates paid by the customers of the utility. Approval of the treatment does not even determine the amount of costs that the company will defer. Rather, it reserves for the company's subsequent rate case the question of the amount of the costs (in the form of the deferred-costs asset) that will be allowed in rate base.

The significance of the deferred-accounting-treatment case for the company's customers and the Commission is that the Commission commits itself to allowing in rate base--subject to challenge--the deferred costs that it finds in the next rate case to be prudent, reasonable, necessary, and associated with an asset that is used and useful in the provision of service. To the extent that the costs and the associated plant do not withstand the scrutiny of the Commission in the rate case, the deferred accounting treatment will not enable the company to recover the deferred costs from the ratepayers. The standard required for approving deferral treatment should therefore be much less stringent than that required for including CWIP in rate base.

[11] In the examiner's opinion, the review in a deferred-accounting-treatment case properly consists of two steps. The first step is an analysis of the

financial integrity of the company. If, as in the EPEC and GSU cases, a company's continued financial integrity (*i.e.*, its ability to obtain capital on reasonable terms) depends on approval of deferred accounting treatment, no further analysis is necessary; the treatment can properly be allowed. If, however, the company's financial integrity is not at stake, the review should proceed to the second step: a determination of whether the company's financial condition will be measurably harmed during the deferral period if deferral treatment is denied.[18] That is, the Commission should require a company [12] requesting deferred accounting treatment to show that (1) it will suffer measurable financial harm by not being able to recover the costs that it seeks to defer and (2) deferral treatment will mitigate that harm.

There are several criteria that can be properly considered in determining whether to allow deferred accounting treatment. For example, without deferral treatment, the utility may permanently lose the opportunity to recover costs [13] associated with an addition to plant that does not result in additional revenue. If the amount of the costs is significant enough to affect the company's bond rating or cause it to miss a common dividend payment, it would normally be undeniable that measurable financial harm would result. There is also the consideration of consistency: for example, if the fuel savings made possible by a new plant are expected to be incorporated in the calculation of the company's fuel factor in the next rate case, it would be proper to allow deferred accounting treatment. Other considerations may be offered in future cases, and the Commission may determine that they form a proper basis for allowing deferral treatment.

Utilities should not, however, expect to obtain approval of deferral treatment for all or even a small portion of the costs associated with incremental additions to plant between rate cases that are associated with incremental growth in demand and revenues. There is no precedent or tradition for allowing recovery of all such costs. Moreover, if an addition to plant is not large

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[18]The term "measurable" is used in this Report with its general meaning as given in Webster's Third New International Dictionary (1976): "capable of being measured . . . *specif:* large or small enough to be measured . . . great enough to be worth consideration: significant." This Report would thus require showing less harm than "material" harm (the standard recommended by general counsel), and deferred accounting treatment would not be considered an "exceptional" form of relief.

enough that it would by itself cause the utility to request a rate increase, Commission policy has not eliminated the opportunity to recover the cost.

By setting the appropriate standard, however, the Commission can enable utilities to avoid unnecessary damage to their financial condition when relatively large additions to plant occur. [14] The examiner recommends that the Commission tie the standard for approving deferred accounting treatment to the necessity for a rate case: deferral treatment is properly granted only as a result of a plant addition relatively large enough that it would require a utility to request a major rate change to include the additional plant in rate base. The connection is an appropriate one, because it is the necessity of the rate case and the inability of a company to obtain timely recognition of the plant in rate base that create the need for deferral treatment. By imposing such a standard, the Commission would reserve deferred accounting treatment for major projects such as generating stations. The incremental additions to rate base that accumulate between major rate cases would not constitute grounds for allowing deferral treatment.

V. Applying the Standard of Review to WTU

A. *Effect on Financial Condition of WTU*

1. Public Counsel's Position

Public Counsel has taken the position that WTU's financial integrity will not be significantly affected by the denial of deferred accounting treatment. Public Counsel offers the following contentions to support its position: One, deferral treatment is not necessary for financial reporting purposes. Two, investor perceptions will not be significantly affected by the denial of the treatment. Three, denial will not significantly affect WTU's financial integrity. Four, a missed dividend is not sufficient grounds for granting deferral treatment. Five, the company has reduced costs in other areas that offset the costs associated with Oklaunion. Six, the company's financial projections are inaccurate.

<u>Financial reporting</u>. Public Counsel notes that WTU's interim financial reports have been issued without the requested deferral. Public Counsel concludes that the company therefore did not need to show deferred accounting on the interim reports in order to maintain its financial integrity.

Investor perceptions. Public Counsel's witness Dr. Carol Szerszen, an economist, testified about the effect on stockholders of delay in recognizing Oklaunion in rate base. According to Dr. Szerszen, the delay will not have the "staggering effect" claimed by the company. She calculated that WTU's rate of return on equity was 16.28 percent in 1984; 18.31 percent in 1985, and 17.21 percent in 1986. Its allowed rate of return was 16.25 percent in 1984 and 16 percent since then, so Dr. Szerszen concluded that the company has experienced excessive returns. In addition, she believed that stockholders are fully aware that there may be a lag in recognizing the plant in rate base and they therefore took any decline in the financial indicators into consideration when they purchased the stock. Thus, any such future events would be accounted for in the price of the stock. In her opinion, ". . . there is no reason to believe that stockholders would be concerned about short-term aberrations in financial ratios."

Financial integrity. According to Dr. Szerszen, "[t]here is absolutely no reason to believe that the Company's long-term financial condition will be affected by denial of Oklaunion accounting treatment . . . ." She points out that deferred accounting treatment would have no effect on the company's cash-based financial indicators in 1987. Rather, it will increase the AFUDC-derived coverage ratios and equity returns. Based on her experience, Dr. Szerszen believed that investors would not consider such increases to indicate an improved financial condition. She noted that recently, financial experts in rate cases have been discussing the need to reduce the AFUDC-derived indicators. Moreover, she noted that the company's internal cash ratio and AFUDC-to-income ratio have improved as a result of the completion of Oklaunion, so the company's financial condition is not as desperate as it claims.

Missed dividend payment. Public Counsel notes the confusion that resulted in this case from the late revisions to testimony and discovery responses filed by WTU with regard to its ability to pay a common dividend in the fourth quarter of this year. The original testimony indicated that the company would pay the same amount of dividends in 1987--about $15.6 million--whether or not deferred accounting treatment is approved. The revised testimony and responses indicated that unless deferral treatment is approved by September 30, 1987, the company will be forced to forgo its fourth-quarter dividend. With deferral, the company would pay an extra $6.0 million in dividends, or about $21.7 million for the

year. The problem arises because of a provision in a mortgage indenture (as amended by an SEC order) that limits dividends to amounts earned in the 12 calendar months immediately preceding the payment of the dividend.

Public Counsel challenges WTU's interpretation of the SEC order. According to Public Counsel, the company has neglected to consider earnings for November, which would be included in the 12-month period immediately preceding the payment of a fourth quarter dividend. Moreover, Public Counsel argues that WTU's dividend policy appears to be extremely flexible. The parent company, CSW, has a stated policy of basing dividends on a 9.0-percent yield on common stock equity. According to Dr. Szerszen, the policy creates a situation in which CSW subsidiary yields range from 7.5 to 22.0 percent. Public Counsel notes also that while WTU's witness Mr. Conners testified that the cash earnings to dividends figure is too low, the company would pay dividends even though deferred accounting treatment will not affect cash-based ratios.

Public Counsel also challenges the significance of a missed dividend. The primary test of financial integrity, according to Dr. Szerszen, is the ability to attract capital on reasonable terms. All of WTU's common stock is held by CSW, and Dr. Szerszen did not believe that an omission, delay, or reduction in WTU's dividend payment to CSW will affect its access to capital markets. In her opinion, WTU cannot credibly claim that CSW will not continue to make equity infusions and cash advances as necessary to support its subsidiary.

Cost offsets. Public Counsel notes that the order in WTU's last rate case was entered in November 1984 and since that time, the company's expenses in various areas have decreased and it is thus overcollecting for some items. Dr. Szerszen testified that the company has overearned its allowed return on equity, has had a lower federal income tax rate since July 1987, and has paid less in capacity payments. Public Counsel contends that since WTU's request fails to take these offsets completely into account, it fails to balance the interest of the investors with those of the ratepayers.

Accuracy of financial projections. Public Counsel notes that WTU has based its request for relief on its projected financial condition, so the accuracy of its projections is a proper area of inquiry. According to Dr. Szerszen, WTU's budgets since 1984 have consistently underprojected returns on equity and other financial ratios. In her opinion, the dollar amount of the projection errors is significant. She notes that in 1986, for example, the company overprojected

total operating expense by almost 18 percent, or $51.3 million, and under-projected net income by over 26 percent, or $4.7 million. In addition, she points out that in January and February 1987, total operations and maintenance expenses for Oklaunion were negative (*i.e.*, the company has been incurring substantial net savings rather than the net expenses it expected).

2. Staff's Position

Staff Financial Analyst Patricia Scheuer testified about the effect of deferred accounting treatment on WTU. The purpose of her analysis was to determine whether WTU's financial integrity would be materially damaged if deferral treatment were denied. She noted that although the appropriateness of the treatment can be evaluated on the basis of other criteria, her analysis was based strictly on financial integrity considerations. In order to determine whether WTU would suffer material financial harm if its request is denied, Ms. Scheuer analyzed the effect of deferral on WTU's financial ratios and credit-worthiness.

Ms. Scheuer noted that since CSW owns all of WTU's common stock, it is not publicly traded. WTU does, however, issue its own preferred stock and bonds. Its current bond rating is AA, which indicates a very strong capacity to pay interest and repay principal. In 1986, the company issued $75 million of first mortgage bonds and $25 million of preferred stock, but it does not expect to require additional long-term financing this year or in 1988. Because WTU is the smallest of CSW's subsidiaries, contributing just 10 percent to CSW's operating revenues and 11 percent to its net income, its effect on the perceptions of CSW equity shareholders is probably less than that of the other subsidiaries. While Ms. Scheuer did not analyze the effect of deferred accounting treatment on CSW, she agreed that the proper focus of this case is WTU's financial condition and the impact of deferral treatment on it during 1987, the year in which the expenses are being accrued.

The basic financial ratios that make up Ms. Scheuer's financial analysis appear in Table 2. She concentrated on three financial ratios: pretax interest coverage, return on equity, and AFUDC as a percentage of net income. The first two were calculated with and without AFUDC and deferred expenses. Ms. Scheuer noted that the ratios that reflect only the cash flow of the utility are not

affected by deferred accounting treatment, because AFUDC and the requested deferred expenses are noncash accruals.

In addition to the financial-ratio analysis, Ms. Scheuer reviewed investment advisory and rating agency reports on WTU. She focused on the reports of the rating agencies because they extensively analyze WTU for fixed-income investors. According to Ms. Scheuer, these reports focus on its cash-flow ratios. She concluded that the cash-flow ratios are more significant to investors than the ratios that include noncash items. In her opinion, therefore, even though WTU projects a $24 million decrease in net income from 1986 to 1987 if it is denied deferred accounting treatment, the decrease would not be important to fixed-income investors because it consists of noncash income. As support for her opinion, Ms. Scheuer noted that Standard & Poor's changed one of its financial benchmarks to exclude AFUDC and other noncash accruals because of doubts that the AFUDC would be realized in the future.

Ms. Scheuer observed that it is difficult to assess the effect of deferred accounting treatment on WTU's creditworthiness. While the rating agencies use many criteria to determine a utility's bond rating, deferral treatment per se would not affect many of these criteria, such as cash flow adequacy, fuel mix, operating efficiency, and management.

Ms. Scheuer compared several WTU financial ratios with Standard & Poor's financial benchmarks for a AA rating. These benchmarks and ratios are presented in Table 3. Ms. Scheuer noted that WTU's pretax interest coverage (excluding noncash items) has been below the AA benchmark since 1982 and is projected to decline this year. Also, she observed that the net cash flow to permanent capital ratio would fall below the AA benchmark in 1987 whether or not deferred accounting treatment is approved. This ratio would not be affected by deferral treatment except that if the treatment is approved, the company will be able to pay its fourth-quarter dividend.[19] Payment of the dividend would lower the cash flow ratio. According to Ms. Scheuer, without the deferral treatment, the cash flow ratio would be within the A category; if the treatment is approved, the ratio would fall to the BBB category.

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[19]Payment of the fourth-quarter dividend would increase the company's common dividends in 1987 from $15.6 million to $21.7 million.

TABLE 3

WEST TEXAS UTILITIES COMPANY
FINANCIAL RATIOS

STANDARD & POOR'S
BOND-RATING BENCHMARKS

Ratio	S&P AA Benchmark	1986	1987 (est.) w/o DAT	1987 (est.) w/ DAT
Pretax interest coverage[a]	3.5-5.0	2.37	2.16	2.16
Net cash flow/permanent capital	7-11%	7.0%	4.96%	6.35%
Debt leverage	39-46%	43.5%	41.99%	43.83%

[a]Excludes AFUDC and other noncash accruals.
Source: Staff Exhibit No. 3B, Rev. Sched. III.

Ms. Scheuer also considered the implications of missing the fourth-quarter dividend. She did not discover any facts that demonstrate that the company's financial integrity would be damaged if it forgoes a dividend payment. She noted that in 1986, WTU missed a quarterly dividend payment because of a clerical error by CSW that prevented the parent company from making a scheduled capital contribution to WTU. In lieu of the capital contribution, WTU skipped the dividend payment, and there were no apparent repercussions. In Ms. Scheuer's judgment, although the situation in the fourth quarter would be different because of the bond indenture restriction, WTU's experience last year indicates that the effect of a subsidiary's missing a dividend may be less than the effect of a "stand-alone" company's missing a dividend. In light of these considerations, Ms. Scheuer testified that her recommendation is not affected by the prospect of the company's missing a dividend.

Finally, Ms. Scheuer conceded that regulatory environment is taken into consideration by rating agencies. Thus, she believed that the decision in this case could affect the investment community's assessment of WTU's future regulatory treatment. Approval of deferred accounting treatment would likely be interpreted as a positive signal for the future recovery of expenses related to

Oklaunion, while denial could cause concerns about WTU's prospects in its rate case.

Overall, however, Ms. Scheuer did not believe that the decision in this case will have a significant impact on WTU's creditworthiness. In her opinion, the investment community is much more concerned about WTU's earning a cash return on Oklaunion. She believed that if the company's bond rating is adjusted, it would occur after the rate case. Ms. Scheuer recommended denying WTU's request for deferral treatment because in her opinion, the treatment is not necessary to maintain the company's financial integrity.

3. WTU's Position

According to WTU, the construction of Oklaunion has taken its toll on the company's financial condition. WTU noted first the large decline in its financial indicators that began in 1982 as a result of the construction program. According to the company, these indicators have fallen considerably below the benchmarks for a AA-rated company such as WTU. During the construction, WTU was able to earn a return on some of the construction in the form of CWIP, but most of the construction expenses have earned only AFUDC. The company argued that because of the Commission's policy barring post-test-year adjustments to rate base, it now faces a situation in which it has no opportunity to recover costs and earn a reasonable return on its investment in Oklaunion. According to the company, the estimated financial indicators will be at levels that clearly indicate a materially damaged financial condition if deferred accounting treatment is not allowed.

WTU's accountant, Mr. Conners, argued that the company would be severely affected by the inability to recover the estimated $28 million of costs that it will incur during the deferral period. To put this amount of money in perspective, Mr. Conners noted that $28 million is

1. equal to two-thirds of WTU's net income for 1986;
2. almost one-third of the company's total retained earnings at the end of 1986;
3. greater than the common dividends ever paid in any one year by the company;
4. greater than all but two of the company's first mortgage bond or preferred stock issues; and

5. more than 80 percent of the company's 1986 payroll.

In Mr. Conners' opinion, the loss of $28 million of earnings constitutes a significant and material harm to WTU's financial condition. He believed that it would be inequitable to require the common equity holders of the company to absorb the loss.

Mr. Conners observed that the effect of WTU's inability to recover its costs has already been reflected in its first-quarter Form 10Q report to the SEC. Net income for common stock for the first quarter of 1987 was only $999,000; for the first quarter of 1986, the net income to common was $5,856,000.

WTU noted that without deferred accounting treatment, its projected rate of return in 1987 would be 5.7 percent. The company's witness Dr. Hadaway observed that a 5.7-percent rate of return in 1986 would have distinguished WTU as the second lowest among all major investor-owned utilities in the country. Dr. Hadaway's further analysis of utilities showed that in 1986, there were four companies that reported returns below 8 percent, and each of them is considered to be a "troubled" utility, in the sense of having very serious financial problems. He noted that none of the four companies is rated higher than BBB.

With respect to the financial ratios presented by Ms. Scheuer, Dr. Hadaway testified that the ratios as of the end of 1986 were not consistent with a AA bond rating. He noted that if the interest coverage and AFUDC ratios were the sole basis of bond ratings, WTU would be rated BBB at best.

Dr. Hadaway explained why WTU has maintained its AA bond rating with relatively poor cash financial indicators. Investors and rating analysts do not rely solely on financial ratios. He believed that in WTU's case, they recognize that the company has conducted a well-mananged, low-cost construction program with considerable participation and support from CSW. The plant is generally considered to be a needed, economic, and valuable addition to WTU's generating capacity. Based on this assessment and the Commission's previous regulatory treatment of WTU, the investment community continues to have confidence in the company's creditworthiness even though its financial ratios have fallen below industry norms.

Dr. Hadaway went on to observe, however, that key among the factors that have supported WTU's credit rating has been an investment community belief that

when a construction program is prudent and well managed, providers of capital will not be penalized by regulatory treatment that precludes an opportunity to recover and earn a fair return on the funds provided. In his opinion, the failure to provide a reasonable opportunity to recover reasonably incurred costs would be considered to be a punitive regulatory policy and would send a very negative signal to the investment community. While investment community views should not dictate regulatory policies, the views of rating agencies and their effect on the cost of capital borne by ratepayers cannot be ignored. Dr. Hadaway believed that the broad concern should be whether regulatory decisions reflect fair and equitable treatment of utility costs.

Missed dividend. WTU contended that its inability to pay a dividend in the fourth quarter if deferred accounting treatment is not allowed clearly demonstrates that its financial condition would be adversely affected. In Mr. Conners' opinion, the simple fact that dividends would be forgone should be adequate to support the company's claim of financial harm and its request for deferral treatment.

With respect to the missed dividend in 1986, Mr. Conners testified that the omission of the dividend was in lieu of a scheduled capital contribution by CSW. Since CSW did not make the capital contribution it had planned to make, WTU did not pay the dividend it had planned to pay. Since the result was a "wash," the investment community did not consider the missed dividend to be significant. The circumstances this year, however, are different. According to Mr. Conners, CSW does not plan to contribute capital in the fourth quarter of this year. The implications of an omitted dividend in 1987 would therefore be significantly different.

On cross-examination, Mr. Conners explained that he examines the company's books at the end of each quarter to determine whether there is sufficient earned income for the company to meet the requirement in its mortgage indenture. For the fourth-quarter dividend payment, the determination would be made at the end of the third quarter, September 30.

Accuracy of financial projections. WTU maintained that the overall accuracy and reliability of the projections are extremely good. In Mr. Conners opinion, Dr. Szerszen's own exhibit illustrates that the projections are reliable. He noted that the difference between the budgeted and actual return on equity ranged from 82 to 90 basis points (percentage differences of 5.1 to 5.3

percent) for the three years that Dr. Szerszen presented. For the fixed charge ratios, he noted that WTU's projections were within 3.7 percent for each year.

Investor perceptions. Dr. Hadaway disagreed with Dr. Szerszen's discussion of investors' perceptions of "normal" regulatory lag. He characterized the circumstances facing WTU if deferred accounting treatment is not allowed as "regulatory assurance that a utility has no opportunity to recover its expenses and earn a reasonable return on its investment." In his opinion, investors do not expect the type of regulatory lag that would result from Dr. Szerszen's recommendation to disallow deferral treatment.

With respect to the value of AFUDC in earnings, Dr. Hadaway noted that it is true that a large amount of AFUDC is viewed negatively. But he contended that no financial analyst would consider it to be of no value. Likewise, he said, no investor would prefer no earnings to deferred earnings.

Dr. Hadaway also responded to Dr. Szerszen's conclusion that investors would not favorably view the improvement in the AFUDC-derived coverage ratios and equity return. He noted that the decline in AFUDC as a percentage of net income, as calculated by Dr. Szerszen, results from a decline in AFUDC, not an improvement in earnings. And since a 5.7-percent return on equity would place WTU among the lowest utilities in the country, Dr. Hadaway rejected Dr. Szerszen's contention that such a comparatively poor return performance would not concern investors.

B. *Discussion*

1. The Issue of Financial Impact

The resolution of this case turns on the validity of the staff's financial integrity analysis. In the examiner's opinion, the financial integrity analysis contains a basic flaw. As explained below, the financial integrity analysis presented in this case may have properly assessed the "level" of the company's financial integrity, but it did not and could not assess the *change* in the company's financial condition that would result from denial of deferred accounting treatment. More succinctly, the analysis could not measure the effect of denying the treatment.

For the purpose of the first step in the review, determining whether WTU's continued financial integrity depends on approval of deferred accounting treatment, the examiner concludes on the basis of the staff's analysis that the [15] company would continue to have access to capital, albeit at considerably higher costs, even if deferral treatment is denied. The company's financial ratios are below its current AA rating, and it is difficult to expect that if the company sought additional funds in the capital market, it could maintain the AA rating unless it obtained deferral treatment.

The question therefore becomes whether WTU would be financially harmed if its request for deferred accounting treatment is denied. It is at this point that the flaw in the staff financial analysis becomes relevant, because it is the *change* in financial condition that must be assessed.

The financial analyst examined the values of three financial ratios: (1) pretax interest coverage, (2) return on equity, and (3) AFUDC as a percentage of net income. Throughout the analysis the analyst emphasized the importance of the first two ratios--measured on a cash-flow basis. Thus measured, the first two ratios are not affected by deferred accounting treatment, because they include only cash items. And because they are not affected by deferral treat- [16] ment, they cannot measure the effect of the treatment. The cash-flow financial ratios therefore do not determine whether a company will suffer financial harm as a result of denying deferral treatment. The cash-flow ratios measure a company's financial condition, but one cannot conclude on the basis of the ratios whether denying deferral treatment will *harm* the company's financial condition.[20]

The third ratio, AFUDC to net income, is larger if deferred accounting treatment is allowed. But one notes immediately that the interpretation of the change in the ratio is different for deferred accounting treatment than it is for CWIP. First for CWIP: a larger value of the ratio means that more of the company's return on construction is deferred to the future. Including CWIP in

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[20] More fundamentally, it is not necessary in a deferred-accounting-treatment case for the company to demonstrate that its financial integrity is so poor that it must be allowed deferral treatment in order to continue its operations; rather, the company may simply demonstrate that denial of deferral treatment would measurably harm its financial condition. The cash-flow ratios measure only the overall financial condition of the company, and they do so in a way that does not show the effect of deferred accounting treatment.

rate base allows the company to earn a current cash return, which lowers the ratio and improves the quality of its earnings.

For deferred accounting treatment, however, the interpretation of the ratio is exactly the opposite. Allowing deferral treatment means that the company can continue to accrue AFUDC and it will have an opportunity in the future to recover the carrying costs incurred during the deferral period. Denying the treatment means that the costs will never be recovered. A larger value of the ratio thus means that more of the costs will eventually be recovered and, in the context of deferral treatment, indicates a better financial integrity. The third ratio, like the cash-flow ratios, did not indicate whether deferred accounting treatment would result in financial harm to the company.[21]

[17] The examiner is persuaded by the testimony of Mr. Conners and Dr. Hadaway that WTU would suffer more than measurable harm to its financial condition if its request for deferred accounting treatment were denied. In the examiner's opinion, the harm shown far exceeds the harm necessary to obtain approval of deferral treatment, and the approval is warranted for any one of the following reasons: First, it is apparent that WTU's financial indicators would not maintain the company's current bond rating: the return on equity would be only 5.7 percent; interest coverage, 2.17X; and net cash flow to permanent capital, 4.96 percent. Second, the amount of the expenses WTU seeks to defer is a substantial amount for any company of its size. The testimony of Mr. Conners is impressive: the estimated deferred expenses are two-thirds of the company's 1986 net income and almost one-third of its retained earnings. Third, without deferral treatment, WTU will have to forgo paying a fourth-quarter common dividend. Fourth, according to the allegations of WTU, Oklaunion's fuel savings can be expected to lower the company's fuel factor in its rate case. It is not plausible to contend that a utility in these circumstances would not sustain material harm to its financial condition without deferral treatment.

2. Other Issues Raised Against WTU

Financial reports. While it is true that WTU has issued its interim financial reports without the requested deferral, it is incorrect to conclude that it

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[21]One may note that for purposes of determining the financial integrity of a company in a deferred-accounting-treatment case, one would examine the value of the AFUDC-to-income ratio, for the period preceding the deferral period.

would not be desirable that the interim reports reflect deferred accounting treatment. First, while WTU has not had to test its ability to obtain capital during the deferral period, that may not always be the case. Deferral treatment will normally substantially improve a company's reported financial condition, allowing it to obtain capital at lower interest rates--with the savings accruing to the ratepayers. Second, to the extent that a company expects to recover the expenses as being reasonable and necessary in its rate case, deferred accounting treatment enables it to issue financial reports consistent with the recovery of the expenses over the long term.

Investor perceptions. Public Counsel has employed a strained and incorrect construction of the rational expectations model of stock prices in this case. The fact that stockholders may anticipate the possibility that the company may not recover the expenses associated with a project such as a power plant does not imply that the Commission should not allow the company to recover those costs. There is a substantial difference between the anticipation of a potential loss and its actual realization. Public Counsel would apparently equate the two.

Cost offsets. Public Counsel contends that the amount of costs deferred by WTU should be offset, or reduced, by cost savings it has experienced since its last rate case. The issue is outside the scope of this case as determined by Examiner's Order No. 5. Public Counsel's argument addresses the amount of cost deferred; this case is concerned with whether the deferral will be allowed. In WTU's rate case, the company will request rate base treatment for the deferred expenses asset. That will be the appropriate time for intervenors to challenge the cost of that asset.

Accuracy of financial projections. The comparisons of actual and projected figures prepared by Dr. Szerszen establish that WTU has been able to estimate its financial ratios with a fairly high degree of accuracy. The company has estimated its realized rate of return within an average of 85 basis points for each of the last three years. The fixed-charge ratios have been estimated within 4 percent. The AFUDC-to-income ratio has been estimated within 10 percent. Moreover, the projected ratios on which the company bases its case fall far outside these small ranges of error.

On cross-examination, Dr. Szerszen contended that the amount of dollars involved in the 85-basis-point error for the rate-of-return projection was

significant. That average error pales in comparison with the projected decrease in return of over 1100 basis points. Yet Dr. Szerszen insisted that on the basis of the past projections and the estimate for 1987, one cannot confidently anticipate a sharp decline in return. She appeared to be utterly unaware of the relevance of a simple statistical concept, the confidence interval, and thereby materially damaged her own credibility as an expert.

3. Accordance with GAAP

As discussed in the procedural history section of this Report, the third issue to be resolved in a deferred-accounting-treatment case is whether the proposed treatment accords with GAAP. Mr. Conners and Mr. Jeter described the proposed treatment and testified that in their opinion, it accorded with GAAP. Their testimony was corroborated by Staff Accountant Mark Young.[22] Mr. Young recommended that the Commission order WTU to subaccount the components of the Oklaunion deferrals within FERC Account 186 to make them easily identifiable to various parties that may wish to analyze them in a major rate case.

In addition, Mr. Walter Meller, an engineer for WTU, testified that the estimated operations and maintenance expenses for Oklaunion were reasonable expenses. His testimony was corroborated by Staff Engineer Keith Rogas.

On the basis of the testimony, the examiner concludes that the requested treatment conforms with the requirements of GAAP. In addition, the examiner concludes that the estimates provided by the company form a reasonable basis for determining the appropriateness of deferred accounting treatment in this case.

VI. Recommendation

In the examiner's opinion, the preponderance of the evidence in this case supports the conclusion that WTU will suffer measurable financial harm if it is not allowed the opportunity to recover the costs associated with Oklaunion during the period of its commercial operation and before rates that include Oklaunion in the company's invested capital are put into effect. To enable the company to seek recovery of these costs in its rate case and thereby decrease

[22]Mr. Young recommended that certain language requested by WTU pertaining to the amortization period be modified. The issuance of FASB 92 has mooted the disagreement between Mr. Young and the WTU witnesses because the company agreed to accept the longest amortization period allowed by the FASB statements.

the measurable adverse effect of the investment on the company's financial condition, the examiner recommends that the Commission order WTU to continue to accrue AFUDC and to defer the costs pursuant to FASB Statement 71 and Statement 92 as discussed in section III.B.2 of this Report.

To enable WTU to defer and capitalize the expenses associated with Oklaunion, the examiner recommends that the Commission include the following language in its order:

[18] West Texas Utilities Company (WTU or the company) shall continue to accrue AFUDC on its investment in Oklaunion and to defer and capitalize the depreciation, operations and maintenance, insurance, and tax expenses associated with Oklaunion from December 24, 1986, until rates are in effect that reflect the cost of the plant. WTU shall subaccount the accruals and deferred expenses within FERC Account 186 in a manner that will enable the Commission to identify them as being related to Oklaunion, and the company shall otherwise employ the deferred account treatment in a manner consistent with its description in the Examiner's Report. The capitalized costs will be subject to review by the Commission in WTU's rate case (Docket No. 7510), and they will be included in invested capital to the extent and only to the extent that the Commission determines that they are prudent, reasonable, and necessary expenses and that they are related to property that is used and useful in providing service.

In addition, based on his evaluation of the issues, arguments, and the record in this case, the examiner recommends as a conclusion of law a restatement of the three issues that define the scope of the Commission's review of requests for deferred accounting treatment. By this restatement, the scope of these cases would be limited to three issues, namely:

[19] 1. Whether the company's current financial integrity is so fragile that it would not have access to the capital markets on reasonable terms unless it is allowed to continue to accrue AFUDC and defer the expenses associated with a new plant during the period of operation before rates are in effect that reflect the cost of the plant.

2. Whether the company's financial condition will be measurably harmed during the deferral period if it is not allowed to continue to accrue AFUDC and defer and capitalize the expenses related to the plant.

3. Whether the accounting treatment proposed by the company accords with GAAP.

The restatement would implement the two-stage review of financial integrity and effect on financial condition that has been recommended in this Report, as those terms have been defined in this Report. As indicated in the earlier discussion, the second issue would be reached only if the company's financial integrity is judged to be sufficiently strong in the first step.

VII. Findings of Fact and Conclusions of Law

A. Findings of Fact

1. On December 23, 1986, WTU filed a petition seeking approval of deferred accounting treatment for certain costs related to Oklaunion.

2. WTU is an investor-owned electric utility providing service in 52 Texas **counties** pursuant to Certificate No. 30170.

3. Notice of WTU's petition were published once in newspapers of general circulation throughout the area served by WTU, and the company served individual notice on all municipalities in its service area, the Public Counsel, the Air Force, the State Agencies, and the State Treasurer.

4. Motions to intervene were filed by Public Counsel and by the State Agencies; the motions were granted with no objection by WTU.

5. On February 5, 1987, Public Counsel filed a motion to dismiss WTU's petition on the grounds that (1) the requested deferred accounting treatment constitutes a change in rates governed by section 43(a) of PURA, (2) the petition requests rate base treatment of the costs, and (3) the Commission has not approved deferred accounting treatment outside a major rate case.

6. On February 18, 1987, Order No. 3 denied Public Counsel's motion to dismiss, rejecting all grounds; Public Counsel appealed the order, which was deemed approved by operation of P.U.C. PROC. R. 21.106(a) when the Commission did not act on the appeal within 15 days.

7. On March 18, 1987, Order No. 5 delimited the scope of this case to comprise three issues identified by WTU. On March 27, 1987, Public Counsel appealed the order, which was deemed approved when the Commission did not act on the appeal within 15 days.

8. The hearing on the merits began on May 14, reconvened on May 18, and adjourned on May 20, 1987.

9. Oklaunion is jointly owned by WTU and several other utilities; WTU owns about 55 percent, or 364 MW, of the plant.

10. Oklaunion was placed in commercial operation on December 24, 1986.

11. Pursuant to the FERC Uniform System of Accounts, adopted by P.U.C. SUBST. R. 23.12(a), WTU was required to cease accrual of AFUDC and to begin recording depreciation, operations and maintenance, insurance, and tax expenses associated with Oklaunion when the plant was placed in service.

12. The net effect of the items in Finding of Fact No. 11 would be to reduce WTU's net income by an estimated $28.4 million during the period before the plant is reflected in rates. The net effect is calculated by subtracting from the total of the items the capacity payments for firm purchased power currently included in WTU's rates.

13. Pursuant to the deferred accounting treatment proposed by WTU, the actual expenses in question would not be charged against net income; rather, the actual expenses would be charged to FERC Account No. 186--Miscellaneous Deferred Debts.

14. Upon order by the Commission to defer the actual expenses related to Oklaunion since the date it was placed in service, WTU would make reversing entries to its accounts that would make each account equal to the amount it would have been had the company been deferring the expenses and accruing AFUDC since the plant was in service.

15. WTU's financial condition would be measurably harmed if the company is not allowed to continue to accrue AFUDC and defer the expenses related to Oklaunion as requested in its petition and described in section II.B.1 of this Report.

16, The deferred accounting treatment proposed by WTU and described in section II.B.1 of this Report accords with the requirements of GAAP.

17. The deferred accounting treatment would change none of WTU's rates, as that term is defined in section 3(d) of PURA, and none of WTU's services, as that term is defined in section 3(s) of PURA.

18. The deferred accounting treatment would not result in the inclusion of CWIP in WTU's rate base.

B. Conclusions of Law

1. The Commission has jurisdiction and authority in this case pursuant to sections 16(a) and 27 of PURA and P.U.C. SUBST. R. 23.12(a) and 23.21.

2. WTU is a public utility as defined by section 3(c)(1) of PURA.

3. WTU provided proper notice to affected persons in accordance with the requirements of P.U.C. PROC. R. 21.25.

4. WTU's petition does not constitute a request to change rates governed by section 43(a) of PURA.

5. WTU's petition does not constitute a request to include CWIP in invested capital that would be characterized as an exceptional form of rate relief by section 41(a) of PURA.

6. Pursuant to section 27 of PURA, the Commission has authority to prescribe the forms and methods of accounts and depreciation for public utilities, which include the deferred accounting treatment at issue in this case.

7. The deferred accounting treatment described in section II.B.1 of this Report accords with the requirements of section 27 of PURA.

8. The scope of issues to be resolved by the Commission in reviewing a request for deferred accounting treatment comprises the following issues:

1. Whether the company's current financial integrity is so fragile that it would not have access to the capital markets on reasonable terms unless it is allowed to continue to accrue AFUDC and defer the expenses associated with a new plant during the period of operation before rates are in effect that reflect the cost of the plant.

2. Whether the company's financial condition will be measurably harmed during the deferral period if it is not allowed to continue to accrue AFUDC and defer and capitalize the expenses related to the plant.

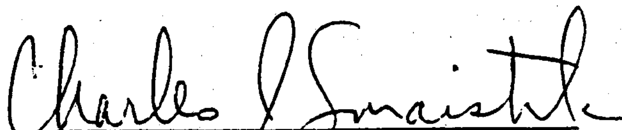
3. Whether the accounting treatment proposed by the company accords with GAAP.

9. For the reasons discussed in section IV.B.5 of this Report, deferred accounting treatment is properly granted only with respect to a plant addition so large relative to the size of the utility that it would normally require a utility to request a major rate change to include the additional plant in rate base.

10. Issues of law and fact that were ruled to be outside the scope of this case remained unresolved and may therefore be raised in WTU's rate case in connection

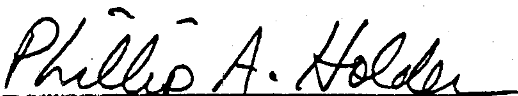
with the Commission's review of the deferrals for amortization and inclusion in rate base.

Respectfully submitted,



CHARLES J. SMAISTRLA
HEARINGS EXAMINER

APPROVED on the 21st day of August 1987.



PHILLIP A. HOLDER
DIRECTOR OF HEARINGS

DOCKET NO. 7289

PETITION OF WEST TEXAS UTILITIES COMPANY FOR DEFERRED ACCOUNTING TREATMENT OF CERTAIN OKLAUNION-RELATED COSTS	§ § § §	PUBLIC UTILITY COMMISSION OF TEXAS

SUPPLEMENTAL EXAMINER'S REPORT

I. Introduction

This Supplemental Examiner's Report is issued to correct the original report's interpretation of the accounting principles that control the reporting of capitalized allowances for earnings on equity. This Report deletes a paragraph from the body of the original report, but does not recommend any modifications to the proposed findings of fact and conclusions of law or to the proposed order.

II. Discussion

The examiner's report in this case was issued on August 21, 1987. The parties filed exceptions and comments on September 1, 1987, and replies to exceptions and comments on September 8, 1987. The comments filed by West Texas Utilities Company (WTU or the company) suggest a change that the examiner believes appropriate.

Section 15 of the Administrative Procedure and Texas Register Act provides, "The proposal for decision may be amended pursuant to exceptions, replies, or briefs submitted by the parties without again being served on the parties." Tex. Rev. Civ. Stat. Ann. art. 6252-13a (Vernon Supp. 1987). The Commission's procedural rules similarly provide for supplemental and amended examiner's reports. P.U.C. PROC. R. 21.141(c). The examiner accordingly issues this Supplemental Examiner's Report.

In its comments, WTU suggests that the examiner's report did not correctly interpret the provisions of Statement 92 of the Financial Accounting Standards Board (FASB) that control WTU's ability to report the deferral and capitalization of allowances for earnings on shareholder equity. In particular, the report stated, "Statement 92 apparently prevents a company from including in its financial statements a capitalized allowance for earnings on shareholder equity . . . . In its financial statements, therefore, WTU could not capitalize or include in net income the AFUDC [Allowance for Funds Used During Construction]

accrued on equity funds that it has invested in Oklaunion." Report at 10. Upon further review of Statement 92 in light of WTU's comments, the examiner concludes that the quoted statements are incorrect with respect to financial reports issued by WTU in its current fiscal year (calendar year 1987).

Deferred accounting treatment involves an interplay of the provisions of FASB Statement 71 and Statement 92. FASB Statement 71 broadly controls the accounting for cost deferrals in financial reports. Statement 92 modifies and restricts certain applications of Statement 71. Most important--for the purposes of this case--Statement 92 restricts the capitalizing of AFUDC for earnings on shareholder equity. As explained in the examiner's report, paragraph 8 of Statement 92 prohibits companies from reporting capitalized allowances for earnings on equity that were accrued other than during construction or as part of a phase-in plan.

Paragraph 8's implications for WTU in this case depend, however, on the effective date of Statement 92. Paragraph 14 of Statement 92 establishes both an effective date and a transition period for implementing the Statement's provisions:

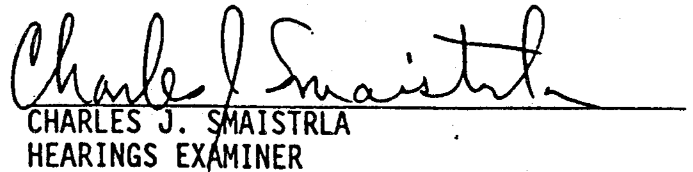
> [T]his Statement shall be effective for fiscal years beginning after December 15, 1987 . . . . Earlier application is encouraged. . . . The provisions of this Statement [in paragraphs 8 and 9] that address capitalization of an allowance for earnings on shareholders' investment . . . shall not be applied to amounts capitalized in fiscal years prior to the initial application of this Statement.

Paragraph 14 thus provides that the restrictions on capitalizing AFUDC accrued on shareholder equity are not to be applied to amounts capitalized before a company's initial application of Statement 92.

This case involves the deferral and capitalization of costs during WTU's current fiscal year, which began January 1, 1987. Upon approval by the Commission, the company would report the capitalization of the costs pursuant to Statement 71. The capitalization would not invoke the application of Statement 92. For WTU, Statement 92 thus becomes effective next year, on January 1, 1988, the beginning of the company's first fiscal year after December 15, 1987. And pursuant to the express provision of paragraph 14, the restrictions on the capitalization of AFUDC on shareholders' equity are not to be applied to amounts capitalized this year, WTU's current fiscal year.

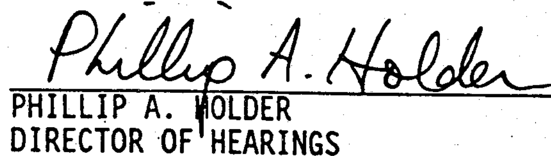
Therefore, contrary to the earlier-quoted statement from the examiner's report, WTU would be able to capitalize and include in its reported net income for 1987 the AFUDC accrued on equity funds that it has invested in Oklaunion. Accordingly, the last paragraph of section II.B.2 on page 10 of the examiner's report should be deleted. A revised page 10 of the report is attached to this Supplemental Report as Attachment A, and it is to be substituted for original page 10 of the report.

Respectfully submitted,



CHARLES J. SMAISTRLA
HEARINGS EXAMINER

APPROVED on the 9th day of September 1987.



PHILLIP A. HOLDER
DIRECTOR OF HEARINGS

ATTACHMENT A

> 41. [In this example], Statement 71 does not permit capitalization of an allowance for earnings on shareholders' investment. Accordingly, [the utility] should not capitalize, for financial reporting, the portion of the amount capitalized for rate-making purposes that represents an allowance for earnings on shareholders' investment. If recovery of that allowance subsequently occurs, increased earnings during the recovery period will result.

(Footnote omitted.)

The foregoing language in Statement 92 will apparently allow WTU, for the financial reporting purposes, to defer and capitalize the costs associated with Oklaunion if it receives an order from the Commission that satisfies the criteria of paragraph 9 of Statement 71. The deferrals would be reflected in an asset for which WTU could seek--in its rate case--to have included in its invested capital. Furthermore, it appears that pursuant to paragraph 9 of Statement 71, WTU would be able to amortize over the life of Oklaunion any costs included in rate base.

3. The Bifurcated Approval Process

WTU contends that the necessity for deferred accounting treatment arises as a result of the Commission's current policy barring a plant from being included in rate base unless it was in commercial operation at the end of the test year. WTU's witness Mr. Conners noted that the company does not challenge that policy, but he maintained that in cases where a plant represents a large increase in investment, the effect of the policy on the company and its stockholders can be staggering.

Mr. Conners explained the problem from the company's point of view as follows. The policy creates a lag of at least nine months between the time a plant goes into operation and the time it is reflected in rates. During that time, while the customers obtain the electricity produced by the plant, the

DOCKET NO. 7289

PETITION OF WEST TEXAS UTILITIES COMPANY FOR DEFERRED ACCOUNTING TREATMENT OF CERTAIN OKLAUNION-RELATED COSTS	§ § § §	PUBLIC UTILITY COMMISSION OF TEXAS

ORDER

In public meeting at its offices in Austin, Texas, the Public Utility Commission of Texas finds that after statutory notice was provided, the application in this proceeding was processed in accordance with applicable statutes and rules by an examiner who prepared and filed a report containing findings of fact and conclusions of law and a supplemental report amending the original report. The Examiner's Report and Supplemental Examiner's Report are ADOPTED and incorporated by reference into this Order with the following modifications to the Examiner's Report:

1. On page 5, paragraph 1, amend the fifth sentence to read:

   Under WTU's proposed accounting procedure, the expenses would not be charged against net income; rather, the expenses would be deferred and capitalized (*i.e.*, they would be posted to the company's balance sheet as an asset separate from its investment in Oklaunion).

2. On page 13, paragraph 1, amend the fifth sentence to read:

   To the extent it is recognized as invested capital, the asset would be amortized during the period labeled on the diagram as the amortization period.

3. On page 17, note 10, strike the second sentence, which reads:

   As explained above, Statement 92 would not allow the allowance for equity funds to be capitalized for financial reporting purposes, but would require WTU to disclose the capitalization of the allowance for equity funds for rate-making purposes.

4. On page 45, paragraph 2, strike the seventh sentence, which reads:

   Fourth, according to the allegations of WTU, Oklaunion's fuel savings can be expected to lower the company's fuel factor in its rate case.

[18]Accordingly, the Commission issues the following orders:

1. West Texas Utilities Company (WTU or the company) shall continue to accrue AFUDC on its investment in Oklaunion and to defer and capitalize the depreciation, operations and maintenance, insurance, and tax expenses associated with Oklaunion from December 24, 1986, until rates are in effect that reflect the cost of the plant.

2. WTU shall subaccount the accruals and deferred expenses within FERC Account 186 in a manner that will enable the Commission to identify them as being related to Oklaunion, and the company shall otherwise employ the deferred account treatment in a manner consistent with its description in the Examiner's Report.

3. The capitalized costs will be subject to review by the Commission in WTU's rate case (Docket No. 7510), and they will be included in invested capital to the extent and only to the extent that the Commission determines that they are prudent, reasonable, and necessary expenses and that they are related to property that is used and useful in providing service.

SIGNED IN AUSTIN, TEXAS, on the 11th day of September 1987.

PUBLIC UTILITY COMMISSION OF TEXAS

SIGNED: Dennis L. Thomas
DENNIS L. THOMAS

SIGNED: Jo Campbell
JO CAMPBELL

SIGNED: Marta Greytok
MARTA GREYTOK

ATTEST:

Phillip A. Holder
PHILLIP A. HOLDER
SECRETARY OF THE COMMISSION

APPLICATION OF SABINE RIVER § DOCKET NO. 7870
AUTHORITY OF TEXAS FOR §
AUTHORITY TO CHANGE RATES §

February 23, 1989

Applicant's request to increase rates denied because SRAT (Sabine River Authority of Texas) failed in its burden of proof to show that the public interest required abrogation of a contract between SRAT and GSU.

[1] PROCEDURE--EVIDENCE AND BURDEN OF PROOF

The standard for abrogation of the Power Sales Agreement (PSA) is the public interest standard established by High Plains Natural Gas Company v. Railroad Commission of Texas, 467 S.W.2d 532 (Tex. Civ. App.--Austin 1971, writ ref'd. n.r.e.). (p. 360)

[2] The burden is on SRAT, as the party requesting a rate increase, to make the requisite showing under the High Plains public interest standard before the contract rates in the PSA may be reviewed or revised by the Commission. SRAT must show that continuance of the contract adversely affects the public interest in that it might impair the ability of the utility to continue service, cast upon other consumers an excessive burden, or be unduly discriminatory. (p. 361)

[3] Meeting the burden of proof under the threshold public interest test means that the contract then becomes subject to the review of and revision by the Commission. No entitlement to recovery of contractual expenses through rates is created when the threshold public interest test is met. The utility must then present evidence for a cost of service analysis. (p. 367)

DOCKET NO. 7870

APPLICATION OF SABINE RIVER AUTHORITY OF TEXAS FOR AUTHORITY TO CHANGE RATES	§ § §	PUBLIC UTILITY COMMISSION OF TEXAS

SUPPLEMENTAL EXAMINER'S REPORT

I. Procedural History

Sabine River Authority of Texas (SRAT or the authority) filed its application for a rate increase on December 17, 1987, requesting authority to increase the rates in the Power Sales Agreement (PSA) under which it sells electrical power to Gulf States Utilities Company (GSU), its only Texas customer. The case was assigned to Administrative Law Judge (ALJ) Paula Cyr.

Pursuant to P.U.C. PROC. R. 21.22(b), SRAT published once a week for four consecutive weeks in the Beaumont Enterprise, a newspaper of general circulation in Jefferson County, Texas, where GSU's headquarters is located. SRAT also provided GSU a copy of its application on or about the date of its filing. No municipalities were affected by the application.

The authority's application was first considered by the Commission during the Final Order Meeting on Wednesday, July 13, 1988. Oral argument regarding the application was heard. Appearances were entered by Mr. Allen King and Mr. Mark Witcher on behalf of SRAT, Mr. William C. Harrelson and Mr. Steven Feldman on behalf of GSU, and Ms. Paula Mueller of the Commission's General Counsel's Office on behalf of the public interest.

The Commission decided that the standard for abrogation of a contract, such as the PSA, was the public interest standard established by High Plains Natural Gas Company v. Railroad Commission of Texas, 467 S.W.2d 532 (Tex. Civ. App.--Austin 1971, writ. ref'd n.r.e.) (High Plains). Commissioners Campbell and Greytok voted to remand the application to the ALJ and, in the Order of Remand filed July 26, 1988, ordered that the record be reopened for the limited purpose of taking additional evidence to determine if SRAT could meet the public interest test for abrogation of a contract as articulated in High Plains.

On July 13, 1988, the authority filed its Second Motion to Extend Effective Date in which SRAT requested that its effective date be postponed such that the proposed rates would be implemented on July 21, 1988 at the latest. By order of July 14, 1988, the ALJ suspended the implementation date until July 21, 1988.

On July 18, 1988, SRAT filed its Third Motion to Extend Effective Date in which SRAT requested that its effective date be postponed such that the requested rates would be implemented on October 1, 1988 at the latest. Again, Judge Cyr, by order of July 21, 1988, suspended the implementation of rates from the otherwise effective date of January 21, 1988, until October 1, 1988.

On August 4, 1988, a prehearing conference was convened in this docket. During the prehearing conference, the parties discussed the public interest standard and agreed to brief several issues relating to the scope of remand and the application of the High Plains public interest test. Further, counsel for the authority agreed to a new implementation date of March 1, 1989. Following the prehearing conference, Judge Cyr issued Order No. 22, filed August 4, 1988, in which the briefing issues were enumerated. Judge Cyr further suspended the authority's date for implementation of rates from the otherwise effective date of January 21, 1988, until March 1, 1989, or superseding order of the Commission.

On August 23, 1988, SRAT filed its Motion to Terminate Proceedings and for Entry of Final Order. In its motion, the authority requested that no further evidentiary proceedings take place in this docket and that the ALJ determine whether SRAT had met the public interest standard for abrogation of the contract based upon the evidence in the record previous to the remand.

Due to the resignation of Judge Cyr, the docket was then reassigned to the undersigned hearings examiner.

On November 9, 1988, the Report on Proceedings After Remand was issued. The examiner recommended in the Report that the Commission deny SRAT's application for a rate increase because SRAT had failed to meet the public interest standard

for abrogation of the contract. This recommendation was based upon Judge Cyr's Examiner's Report, SRAT's decision not to present further evidence on the public interest issue during the first remand, and the examiner's inference that the Commission implicitly determined at the July 1988 open meeting that the public interest standard had not been met.

The case was considered during the Commission's final order meeting on November 22, 1988. The Commission remanded the case to the examiner and, by Second Order of Remand filed November 23, 1988, ordered the examiner to read the entire record and determine, based upon the record evidence, whether SRAT had met the public interest standard under High Plains.

On December 15, 1988, the examiner issued Examiner's Order No. 24, ordering SRAT to identify the information in the record upon which SRAT relied to argue that the public interest standard under High Plains had been met.

On December 30, 1988, SRAT filed the information in response to Examiner's Order No. 24. SRAT urged several arguments that based upon record evidence it had shown that the public interest required abrogation of the contract. On January 6, 1989, GSU filed its response to SRAT's letter of December 30, 1988.

II. Jurisdiction

SRAT is an electric utility as that term is defined in Section 3(c)(1) of the Public Utility Regulatory Act (PURA), Tex. Rev. Civ. Stat. Ann. art. 1446c (Vernon Supp. 1988). The Commission has jurisdiction over this application pursuant to Sections 16, 17, 37, and 43 of the PURA.

III. Recommendation

Based upon review of the entire record in this case, the examiner recommends that the Commission deny SRAT's application for authority to increase rates because SRAT has failed in its burden of proof under High Plains to show that the public interest required abrogation of the contract between SRAT and GSU.

Because the examiner has determined that SRAT has failed in its burden on this issue, this supplemental report does not include findings or conclusions regarding SRAT's reasonable operating expenses, original cost of the property used and useful by the authority in providing public utility service or a reasonable rate of return. Under High Plains, if the public interest standard has not been met, the contract cannot be abrogated. This would preclude the Commission from granting a rate increase as requested by SRAT.

If the Commission disagrees with the examiner and decides that SRAT has in fact carried its burden of proof on the required public interest finding, then the Commission should proceed to consider the findings and conclusions made by Judge Cyr regarding SRAT's cost of service, allowable expenses and other contested issues contained in her Examiner's Report. In that Report, Judge Cyr evaluated the record evidence in order to determine what rates would be appropriate using the just and reasonable standard and Article VI of PURA.

IV. Discussion

A. Introduction

1. The High Plains Public Interest Test

[1] The Commission in its first Order of Remand ordered that the appropriate standard for the abrogation of the contract between SRAT and GSU was the public interest standard as articulated in High Plains. In High Plains, the court stated that while the Texas Railroad Commission (RRC) had jurisdiction over avgas contract entered into between a utility and a municipal corporation, the RCC was required to determine that contract modification was in the public interest before the RCC could change the contract price. The court, relying on Federal Power Commission v. Sierra Pacific Power Company, 350 U.S. 348 (1956) (Sierra), held the following:

> We hold that in order to set the contract aside, the Appellant was charged with the burden of showing that a continuance of the contract would adversely affect the public interest in that it might impair the ability of the pipeline to continue its service, cast upon other consumers an excessive burden or be unduly

> discriminatory. At this point the contract would become subject to "review, revision and regulation by the Commission." It is not enough that the pipeline made a bad bargain. (Emphasis added).

(467 S.W. 2d at 537.)

[2] The burden is on SRAT as the party requesting relief to make the requisite showing under the High Plains public interest standard before the contract rates may be reviewed or revised by this Commission. SRAT must show that continuance of the contract adversely affects the public interest in that it might impair the ability of the utility to continue its service, cast upon other consumers an excessive burden or be unduly discriminatory. It is not enough if SRAT shows that it has made a bad bargain.

The examiner notes that several questions regarding the scope and application of the High Plains public interest standard were raised during the prehearing conference held subsequent to the first remand in this docket. The parties were ordered at that time to file briefs regarding these issues to assist the ALJ in determining the scope of the first remand. SRAT filed its Motion for Termination of Proceedings before the deadline for filing these briefs and the parties each informed the ALJ that they were not going to file briefs due to SRAT's pending motion.

The present examiner is therefore without comment or argument from the parties regarding: (1) whether, in determining the ability of the utility to continue service, the total operations of SRAT or SRAL, or mere components thereof, i.e., the electric division of SRAT or SRAL, or both, were relevant under the public interest standard; (2) whether the three criteria (ability to continue service, excessive burden on other consumers, or undue discrimination) established by High Plains were exclusive of any other factors alleged to demonstrate a public interest; and (3) whether, if the public interest did in fact require the abrogation of the contract, rates would then be set based upon a just and reasonable standard or under a public interest standard.

This supplemental report will focus on the three prong test established by High Plains. In addition, the examiner will discuss SRAT's miscellaneous

arguments that a public interest showing has been made although such arguments may not be properly classified within one of the three criteria of High Plains.

2. The State of the Record

It has been difficult to review and analyze the evidence in this case in terms of the High Plains public interest test because the party with the burden of proof on this issue, SRAT, did not allege the High Plains standard or attempt to litigate the issue directly, if at all. The majority of the evidence pertaining to whether the requisite showing that the public interest required modification of the contract had been made was found in GSU's direct case and GSU's cross-examination of SRAT's and the staff's witnesses.

The lack of direct evidence on the public interest standard is surprising given that, after reading the entire record, the examiner concludes that SRAT did indeed have sufficient notice prior to the hearing that the High Plains public interest standard would likely be an issue during the hearing on the merits.

Soon after SRAT filed its application for authority to increase rates in this docket, GSU filed a motion to dismiss alleging that, for various reasons, the Commission did not have the jurisdiction to grant relief to SRAT. Judge Cyr ultimately denied GSU's motion in Examiner's Order No. 11. In that order, Judge Cyr rejected GSU's interpretation that the contract could never be modified unless all of the parties to the contract agreed. She stated that "[a] regulatory authority empowered to determine that rates are just and reasonable must be able to modify rates, even though they were agreed to in a contract, if the public interest so requires." (Examiner's Order No. 11 at 23.)

After citing High Plains, Judge Cyr clearly stated that SRAT was not precluded from seeking relief from the Commission if it could meet the public interest test set forth in High Plains. Judge Cyr properly determined that the issue of whether the Commission could modify the contract, i.e., whether SRAT could meet the public interest standard, was a fact issue to be resolved at the hearing on the merits. (Examiner's Order No. 11 at 24.)

GSU argued in its direct testimony that, assuming the Commission had the jurisdiction to modify the contract absent mutual agreement of the parties, the public interest standard applied to the proceedings in this docket. GSU Ex. 14 at 5-6. See also GSU Ex. No. 21 at 2-3. GSU restated its position in its Opening Statement at the hearing that the High Plains test applied and that it believed that SRAT would continue as an ongoing concern regardless of whether SRAT received rate relief from this Commission. Tr. at 4.

The examiner concludes that SRAT had sufficient notice prior to the hearing that the public interest issue was to be litigated during the hearing.

B. Discussion of the Evidence under the High Plains Public Interest Test

As stated above in the Procedural History, SRAT provided the examiner with several arguments that the public interest showing had been made. Where appropriate, the examiner will indicate whether each of SRAT's arguments falls within one of the three categories of the High Plains test. Miscellaneous arguments which are not properly included within one of the three categories will be discussed below in Section IV.C. of this Report.

1. Whether Continuance of the Contract Would Adversely Affect the Public Interest in that It Might Impair the Ability of the Utility to Continue Service

If the public interest test requires evaluation of the total financial resources from every division of the authority in order to determine the authority's ability to continue service, then, as an initial matter, there is insuffcient evidence in the record to make the public interest showing under this part of the High Plains test. The authority's counsel, Mr. King, admitted as much during that first final order meeting when he contended that the record would need to be reopened in order to take further evidence regarding the entire Authority's financial position. See F.O.M. Tr. at 191, 202. SRAT did not present evidence of the financial position of the entire authority in order to show that under High Plains continuance of the contract would adversely affect

the public interest in that it might impair SRAT's ability to continue service--SRAT's pleading and evidence have always been focused upon obtaining a rate increase for the electric operations of the Toledo Bend Division of SRAT under a just and reasonable standard of review. See, generally, SRAT's Rate Filing Package, SRAT Ex. No. 1, and Jansen at 4.

Regardless of whether the High Plains public interest test requires a review of the financial position of the entire authority, the examiner's recommendation will not change--SRAT has not met its burden of proof either because SRAT did not produce evidence regarding the entire authority's ability to continue service, or because the evidence that SRAT did produce was not sufficient to meet its burden to show that the utility's ability to continue service would be impaired.

The record evidence that bore the most resemblance to the issue of the ability to continue service under High Plains focused on bond ratings and debt service coverage (DSC) ratios as indicators of financial integrity or viability.

SRAT maintained that its financial health and integrity depended upon the ability of the authority to earn a return, produce internally generated funds and accumulate retained earnings over time. SRAT's requested DSC ratio of 1.3X was intended to produce such results. SRAT Ex. No. 1, Heidebrecht at 20-33; Staff Ex. No. 14 at 20; Tr. at 1009-1010.

Judge Cyr agreed with the staff that a DSC of 1.3X was appropriate. She stated that "[t]his level of coverage would allow SRAT to meet its debt requirements while obtaining an amount sufficient to establish a reasonable level of reserve for unexpected outlays, planned outlays, and allow SRAT to attract capital and generate funds internally." Examiner's Report at 83.

The Commission staff also testified that "financial integrity" of a company was the ability of the company to approach the capital markets and obtain capital at reasonable rates. Tr. at 800. The examiner does not accept the staff's definition of financial integrity as determinative of a public interest showing under High Plains. However, if this definition of financial integrity

was one measure of the ability to continue service, it appears that SRAT was able to obtain such capital at reasonable rates in 1984. Tr. at 800-801. The examiner cannot find evidence in the record that SRAT has attempted and then failed to secure capital at a reasonable rate since 1984.

GSU's approach to these issues regarding financial integrity attempted to show that SRAT would be able to continue as a going concern. Tr. at 4, 39-40, 262, 798-806, 819-823. GSU's counsel repeatedly questioned SRAT's and the staff's witnesses regarding the financial integrity of SRAT and its ability to continue service. In fact, Mr. Collins, the Executive Vice President and General Manager for the Authority and Project Supervisor for Administration of the Toledo Bend Project, testified under cross-examination that he did not have any concerns at that time about the ability of SRAT--the total authority--to carry on as an entity. Tr. at 40.

While SRAT did prove to the satisfaction of the ALJ that it was entitled to relief under the just and reasonable standard, and based upon the record evidence the examiner agrees, the High Plains public interest test requires more. SRAT has failed in its burden to allege and prove that continuance of the contract adversely affects the public interest in that it might impair the ability of the utility to continue service.

The evidence shows that: (1) SRAT has continued to operate with a DSC ratio of less than 1.0X for at least the last eight years (Staff Ex. No. 14 at 19; GSU Ex. No. 10 and 11); (2) the requested DSC ratio of 1.3X which was recommended by the staff and adopted by the ALJ resulted in internal funds above and beyond the amount necessary to operate the facilities and service the debt (Tr. at 277); (3) Toledo Bend experienced a positive cash flow of $136,558 during the test year (SRAT Ex. No. 37; Tr. at 1092-1094); and (4) SRAT experienced a positive flow of funds from the sale of electric power in fiscal years 1986 and 1987 (Tr. at 159, SRAT Ex. No. 1, Collins at 20).

The evidence does not show that the public interest would be adversely affected by the continuance of the contract in that SRAT's ability to continue service would be impaired.

2. Whether Continuance of the Contract Would Adversely Affect the Public Interest in that It Would Cast Upon Other Consumers an Excessive Burden

SRAT has argued that an excessive burden is created on the citizens of Texas because, without cost based revenues, continued cross-subsidization from SRAT's non-electric operations to the electric operation will occur. Therefore, SRAT contends, the citizens of Texas will lose the benefits which those funds could otherwise provide if they were used in fulfilling SRAT's other statutory obligations. According to SRAT, the "gross unfairness of the present rate" results in the cross-subsidization which leads to the excessive burden on the citizens of Texas.

As an initial matter, the examiner doubts whether "other consumers" can be stretched to encompass the entire citizenry of the State of Texas.

SRAT sought inclusion of interagency advances as a debt service obligation under its proposed revenue requirement. SRAT requested the inclusion in order to obtain through rates increased revenues with which to repay advances made by the Administrative and General Office (AGO) of SRAT to the Toledo Bend Division of SRAT from 1970 to 1987. SRAT alleged that when revenues from the electric operation were insufficient to meet operating expenses, the AGO provided the necessary funds to meet those expenses. SRAT Ex. No. 1, Jansen at 13-14. The Commission staff recommended inclusion of the advances using the staff's recommended allocation factor.

GSU contested the inclusion of the AGO advances in SRAT's debt service on two grounds: (1) that the inclusion would result in retroactive ratemaking; and (2) that SRAT kept inadequate accounting records and thus failed in its burden to show that the advances were a reasonable and necessary cost of providing electric service under PURA Section 41(c).

Judge Cyr found that SRAT did not keep accurate or reliable records for the advances and therefore recommended that the advances not be included in SRAT's debt service, although she did find that it was generally appropriate to include interagency funds in a company's debt service. Because she determined that

SRAT did not meet its burden under PURA Section 41(c), she did not make a finding as to the alleged retroactive ratemaking. Examiner's Report at 52-60, Findings of Fact Nos. 23-28, Conclusion of Law No. 11. Based upon the examiner's review of the record, the examiner agrees with Judge Cyr that the Commission could not be sure that the amount requested by SRAT for the AGO advances was accurate and reliable.

The examiner is left to determine whether the public interest requires abrogation of the contract (because the alleged cross-subsidization creates an excessive burden on the citizens of Texas) without accurate or credible evidence as to the total amount of such advances or the extent of the cross-subsidization. The examiner queries how such a determination can be made given that the record evidence did not establish a reliable or accurate account of the advances in the first place.

Further, SRAT's argument that the public interest requires that the citizens of Texas be relieved of this excessive burden caused by the cross-subsidization incorrectly assumes recovery through rates of the interagency advances after review by the Commission. In other words, if SRAT were to meet its burden under this part of the public interest test by proving that the public interest required abrogation of the contract because this cross-subsidization resulted in an excessive burden on "other consumers", that would not create an entitlement [3] to recovery through rates of those advances. Meeting the burden of proof under the threshold public interest test simply means that the contract then becomes subject to the review and revision by the Commission. SRAT then would have the burden to prove that the advances should be included under a cost of service analysis. As was discussed above, Judge Cyr recommmended denial of recovery through rates of the AGO advances.

Given the state of the record, the examiner cannot determine if the public interest will be adversely affected. Therefore, SRAT has not met its burden of proof that continuance of the contract would adversely affect the public interest in that the continuance of the contract would create an excessive burden on other consumers.

3. Whether Continuance of the Contract Would Adversely Affect the Public Interest in that It Would be Unduly Discriminatory

SRAT and GSU disagreed as to whether GSU was SRAT's only customer, SRAT maintaining that GSU was SRAT's sole customer and GSU taking the opposite position. Interestingly, now that the Commission has determined that the High Plains test applies in this docket, SRAT's argument that GSU was its only customer would appear to be directly contrary to what SRAT would be required to prove in order for SRAT to meet the third prong of the public interest test. It would be difficult for SRAT to show that the contract rates would be unduly discriminatory if there was only one customer.

GSU argued during the hearing and in brief that Louisiana Power and Light (LPL) and Central Louisiana Electric Company, Inc. (CLECO) as parties to the PSA were also customers of SRAT. According to GSU, any modification of the PSA would result in discrimination among the parties to the contract because the Commission did not have jurisdiction over the Louisiana companies and therefore only GSU's rate would change as a result of the Commission granting rate relief to SRAT in this docket. GSU contended that, pursuant to Section 8.03 of the PSA, it was obligated for one-half of the payment for the power attributable to SRAT and one-half of the payment for the power attributable to SRAL. Therefore, LPL and CLECO were also customers of both SRAT and SRAL to the extent of the utilities' respective one-fourth obligations under the PSA. Tr. at 625-631, GSU Ex. No. 18, GSU Exceptions at 24-26, GSU Brief at 23-29. GSU further pointed out that SRAT's vice president testified under cross-examination that LPL and CLECO were customers of SRAT. Tr. at 652-653.

SRAT contended that the contract did not specify to whom SRAT was delivering power nor to which authority, SRAT or SRAL, GSU's payment was attributable. According to SRAT, the contract merely specified that GSU was obligated to make payments for one-half of the power produced, and that CLECO and LPL were obligated for one-fourth each, respectively. SRAT Brief at 52-55.

Although Judge Cyr did not make a specific finding regarding whether LPL and CLECO were customers of SRAT, she found that GSU was SRAT's only Texas customer

and rejected GSU's position in her Examiner's Report. Examiner's Report, at 1, 99-101, Findings of Fact No. 1, 11. Based upon a review of the evidence, the examiner agrees that GSU is SRAT's only Texas customer.

Given SRAT's position during the hearing that GSU was its only customer, SRAT did not allege and did not prove that continuance of the contract would adversely affect the public interest because it would be unduly discriminatory. Therefore SRAT did not meet its burden of proof under the third part of the High Plains test.

C. Miscellaneous Arguments that the Public Interest Will be Adversely Affected and Therefore the Contract is Subject to Review and Revision by the Commission

In addition to the arguments previously discussed, SRAT presented four arguments which were intended to show an adverse effect on the public interest. At the outset the examiner notes that the four arguments do not fall within one of the three categories established by High Plains and are therefore outside the scope of this remand. An assertion or presumption of the existence of a general public interest in various aspects of SRAT's operations as a utility does not entitle SRAT to abrogation of the contract under High Plains. Even assuming that these arguments did fall within the scope of the High Plains public interest test, several of SRAT's contentions suffer from other flaws which would preclude a finding that the public interest standard had been met. However, for the sake of completeness, the positions will be presented and discussed below.

1. SRAT is a public entity charged with serving the public interest

SRAT, in response to Examiner's Order No. 24, argued that the public interest would be adversely affected if SRAT, as an public entity charged with serving the public interest pursuant to Tex. Rev. Civ. Stat. Ann. art. 8280-133 (Vernon Supp. 1988), was required to sell power below both its cost and its

reasonable value. According to SRAT, the doctrine established by the Federal Courts in Sierra and subsequent cases was designed to ensure that a utility and its shareholders would assume the risk of doing business, and that a negative impact on the value of the utility's shares was not sufficient grounds to modify a contract. Further, SRAT is a public entity and, therefore, does not serve shareholders, but serves the public interest. Therefore, SRAT contended that the logic behind requiring an investor-owned utility to abide by its contract did not apply with the same effect to a publicly-owned utility such as SRAT.

The examiner believes that this argument should be rejected for several reasons. First, GSU correctly identifies this argument as a legal argument; it is not within the scope of remand. Second, even if this argument were properly before this examiner, there is no evidence in the record upon which to base findings and conclusions that public entities such as SRAT should be treated differently than investor-owned utilities under the public interest standard of High Plains.

2. Repayment to the Texas Water Development Board (TWDB)

In order to finance the construction of the Toledo Bend Project, SRAT and the TWDB entered into the Toledo Bend Master Agreement on March 4, 1964. Under the agreement, SRAT sold water storage rights in the reservoir to the TWDB in the principal amount of $15,000,000 to finance its cost of constructing the project. Under the Master Agreement, SRAT agreed to ultimately repurchase the storage rights from the TWDB. SRAT Ex. No. 1, Exhibit H at 6. SRAT cannot sell water from behind the dam because that water is subject to the TWDB's storage rights until the entire amount of the obligation, principal and interest, is repurchased. SRAT admitted that it did not have a present need to sell that water. Tr. at 162-163.

SRAT argues that the public interest will be served if SRAT repays the obligation owed to the TWDB and that it cannot repay the TWDB without rate relief. Although it is not entirely clear from SRAT's written response to

Examiner's Order No. 24, it appears that SRAT is arguing that, if SRAT does not repay the TWDB, then the TWDB cannot use those funds in its statutory duty to assist and improve other water resource projects within the State of Texas, and therefore the public interest will be adversely affected.

SRAT's argument that there is a public interest in SRAT's repayment to the TWDB assumes that SRAT would recover through rates the funds with which to repurchase the water storage rights--SRAT argues that it cannot repay the TWDB without rate relief and that the public interest requires repayment. The High Plains test, however, is a threshold determination--meeting the burden of proof under the test does not create an entitlement of recovery or rate relief for that particular item. Meeting the burden of proof simply subjects the contract to review and possible revision by the Commission.

The issue of whether it was appropriate to include this obligation to the TWDB in SRAT's debt service was considered by Judge Cyr during the hearing on the merits. Judge Cyr discussed the TWDB obligation at length in her Examiner's Report, eventually determining that, although it was a "close judgment call", it was not appropriate to include this obligation in SRAT's debt service coverage. Judge Cyr's determination was based upon the finding that the obligation was not a debt for which regulatory rate relief was warranted. See Examiner's Report at 38-50, Findings of Fact Nos. 17-21.

There is no evidence in the record regarding the inability of the TWDB to assist or improve any water resource projects because SRAT has not repaid part or all of the obligation owed to the TWDB. The only evidence that SRAT can point to regarding this issue is the alleged "pressure" on SRAT to repurchase the obligation in the form of letters from the State Auditor and the TWDB recommending or suggesting that SRAT repurchase the obligation. SRAT Ex. No. 1, Collins at 22-23, and Exhibits I and J; Tr. at 166, 172-175. The evidence suggests that the TWDB and the State Auditor were responding to the existing financial crisis in the state, but there is no evidence that the TWDB had taken or expected to take action to enforce the repurchase obligation. SRAT Ex. No. 1, Exhibit J; Tr. at 172-173.

Even assuming that the public interest alleged here would fall within one of the three prongs of the High Plains test (an assumption with which the examiner would disagree) SRAT has not met its burden of proof that the public interest requires abrogation of the contract under that public interest test.

3. Safety of Downstream Residents

SRAT argues that there is a public interest associated with the safety of residents downstream from the Toledo Bend reservoir and that the ratefiling package establishes the inadequacy of the existing rates to generate sufficient funds for maintaining, operating and repairing the electric operations of the dam. SRAT contends that extraordinary repairs will increase as the dam ages and that certain capital improvements are required which if not completed could result in the dam becoming a safety hazard.

The examiner points out that while there is a general public interest in the safety of downstream residents, in order to abrogate the contract SRAT must meet its burden of proof under the High Plains public interest test.

The alleged potential safety hazard that SRAT is apparently referring to concerns the berm and drainage repairs to the dam. Tr. at 477-478, 662-663. While SRAT attempts to convey the idea that these repairs are critical and that the public interest requires rate relief in this docket to enable SRAT to make these repairs, Mr. Collins admitted that engineers discovered problems several years ago and that SRAT knew that it "had to do some work"; the repairs were not unusual; it would take between two and three years to complete the repairs; and FERC had not established a deadline for completion of the berm and drainage repairs. Tr. at 663-665. In addition, there is no evidence that SRAT has neglected to make repairs due to any financial position of the company. SRAT simply "hasn't been able to get it accomplished", although Mr. Collins did not give a reason for the delay in repairs. Tr. at 664. No party disputed SRAT's assertion that as the dam ages, repair expenses will likely increase.

It is far from evident how SRAT's assertions rise to the level of the requisite showing under the High Plains test. Merely asserting that failure to

complete certain repairs could constitute a safety hazard is not sufficient under High Plains to show that the public interest requires abrogation of the contract.

4. Public Interest in the Efficient Use of Natural Resources

Regarding the efficient use of natural resources, SRAT argued:

> A further public interest exists in the efficient use of natural resources. The uncontroverted testimony is that high levels of water are necessary for efficient generation at the hydroelectric projects. These high levels of water result in erosion to the banks of the lake well beyond the extent that would be suffered if lower lake levels could be efficiently maintained. If inadequate rates are provided to allow the utility to protect against such erosion or to reimburse shoreside property owners for damage from such erosion, the utility has less incentive to maintain higher levels. The inefficient generation results in an inefficient use of the resource. Once that resource is lost below the dam, it cannot be used again for generation. Further, if the utility is required to keep high lake levels for whatever reason, erosion control is required or the damaged property must be purchased. Inadequate revenue would endanger the property in question without any guarantee that its owners would be properly reimbursed. To the extent the high level of the lake is attributable to electric generation, electric generation should be responsible for the consequences.

Presumably, there is a general public interest in the efficient use of all natural resources, within and without the State of Texas, not just in the efficient use of water resources in the Toledo Bend Reservoir. However, such a general public interest is not part of the requisite showing under the High Plains public interest test.

SRAT's argument includes several contested issues regarding the level of the lake and the multi-purpose nature of the project, the appropriate cost and debt allocation between electric and non-electric operations of the authority, the consequences of erosion and property damage and the dispute as to which party, SRAT or GSU, should be financially responsible for that erosion and damage.

SRAT and GSU contested the issue of whether the level of the lake was maintained primarily for the purpose of hydroelectric generation or for the benefit of those persons desirous of using the facilities for recreational purposes. SRAT argued that the PSA and the need for efficient generation of hydroelctric power determined the level of the lake. Tr. at 131-132, 178-180, 217-224, 1087-1090; SRAT Ex. No. 1, Exhibit D at 26. GSU argued that the level of the lake was also determined by the recreational users' need for a lake level sufficient to allow them to dock their boats at the marinas and to utilize boat ramps. GSU Ex. No. 17 at 12-14 and Schedules AEN-5 and AEN-6; GSU Ex. 20 at 6-7.

Under Section 5.05 of the PSA, the elevation of the lake during normal operation would be maintained between 162.2 and 172.0 mean sea level and that "[i]nsofar as practicable, the reservoir will be maintained above elevation 169.0 mean sea level." SRAT Ex. No. 1, Exhibit D at 26. Further, SRAT's witnesses testified that hydroelectric generation at the project was more efficient at the higher water levels. However, there was contravening evidence that the level of the lake was also determined by the interests of the recreational users. Area residents had filed a lawsuit complaining of low water levels below 172 mean sea level. GSU Ex. No. 7 at 6-7, Exhibits AEN-5 and AEN-6. Judge Cyr rejected SRAT's contention that the level of the lake was determined solely by the hydroelectric generation. Examiner's Report at 66.

SRAT also asserts that, to the extent the level of the lake is attributable to electric generation, the electric utility customer (i.e., GSU) should be responsible for the consequences, (i.e., erosion and property damage). The evidence however is to the contrary. First, SRAT did not prove that the high level of the lake was due solely to hydroelectric generation. In addition, the authorities (SRAT and SRAL) and the three power companies entered into a letter agreement at the time of the above-mentioned lawsuit. The agreement prevents SRAT from recovering the costs of erosion from GSU through electric rates. SRAT did not attempt to recover erosion control costs from GSU in its cost of service because of that agreement. SRAT Ex. No. 1, Bryant at 11; GSU Ex. No. 17 at 12-13, Exhibits AEN-5 and AEN-6; Tr. at 63-64; Examiner's Report at 64-66, 84.

Although there is presumably a general public interest in the efficient use of natural resources, the examiner finds that SRAT has not met its burden under the High Plains public interest test for abrogation of the contract.

D. Summary

In summary, for the reasons stated above, the examiner concludes that SRAT has not met its burden of proof under the High Plains public interest test. It has not met its burden to show that continuance of the contract would adversely affect the public interest in that it might impair the ability of the utility to continue service, cast upon other consumers an excessive burden, or be unduly discriminatory. Therefore, the contract is not subject to review, revision or regulation by this Commission and the authority's application to change rates should be denied. Further, the existence of any general public interest in various aspects of SRAT's operations as a utility does not entitle SRAT to abrogation of the contract under High Plains.

If the Commission disagrees with the examiner and decides that SRAT has carried its burden of proof on the required public interest finding, then the Commission should proceed to consider and adopt the original Examiner's Report with modifications as appropriate.

V. Findings of Fact and Conclusions of Law

The examiner recommends that the Commission adopt the following Findings of Fact and Conclusions of Law.

A. Findings of Fact

1. On December 17, 1987, Sabine River Authority of Texas (SRAT) filed an application for authority to increase the rates in the Power Sales Agreement (PSA) under which it sells power to Gulf States Utilities Company (GSU), its only Texas customer.

2. SRAT published notice of the proposed rate change once a week for four consecutive weeks in the Beaumont Enterprise which is a newspaper of general circulation in Jefferson County where GSU's headquarters is located. Publisher's affidavits proving publication were filed with the Commission.

3. SRAT provided GSU with a copy of its application on or about the date SRAT filed its request with the Commission.

4. No municipalities were affected by SRAT's request.

5. The authority's application was considered during the Commission's final order meeting on Wednesday, July 13, 1988.

6. The application was remanded to Administrative Law Judge Cyr and the record reopened for the limited purpose of taking additional evidence to determine if SRAT could meet the public interest standard articulated in High Plains Natural Gas Company v. Railroad Commission of Texas, 467 S.W.2d 532 (Tex. Civ. App.--Austin 1971, writ. ref'd n.r.e.).

7. Pursuant to agreement by the Authority, Judge Cyr further suspended the implementation of requested rates until March 1, 1989.

8. On August 23, 1988, SRAT filed a Motion to Terminate Proceedings and for Entry of Final Order.

9. Due to the resignation of Judge Cyr, the docket was reassigned to the undersigned hearings examiner.

10. Pursuant to Second Order of Remand filed November 23, 1988, the case was remanded and the examiner was ordered to read the record and determine if SRAT had met the public interest standard under High Plains.

11. The hearings examiner read the entire record as ordered by the Commission in the Second Order of Remand.

12. SRAT did not present evidence of the financial position of the entire authority in order to show under High Plains that its ability to continue service would be impaired absent modification of the contract.

13. SRAT continued to operate with a DSC ratio of less than 1.0X for at least the last eight years.

14. The DSC ratio of 1.3X resulted in internal funds above and beyond the amount necessary to operate the facilities and service the debt.

15. The Toledo Bend Division experienced a positive cash flow of $136,558 during the test year.

16. SRAT experienced a positive flow of funds from the sale of electric power in fiscal years 1986 and 1987.

17. SRAT did not keep accurate or reliable records of the Administrative and General Office (AGO) advances made to the Toledo Bend Division of SRAT.

18. GSU is SRAT's only Texas customer.

B. Conclusions of Law

1. SRAT is an electric utility as that term is defined in Section 3(c)(1) of the Public Utility Regulatory Act (PURA), Tex. Rev. Civ. Stat. Ann. art. 1446c (Vernon Supp. 1988), and as such is subject to the jurisdiction of this Commission.

2. The Commission has jurisdiction over this application pursuant to Sections 16, 17, 37, and 43 of PURA.

3. On December 17, 1987, SRAT filed a statement of intent to change its rates in accordance with Section 43(a) of PURA.

4. SRAT published and mailed notice of its application as required by Section 43(a) of PURA and P.U.C. PROC. R. 21.22(b).

5. In compliance with Section 15 of the Administrative Procedure and Texas Register Act (APTRA), the Supplemental Examiner's Report was prepared by the undersigned examiner who has read the entire record.

6. The standard for abrogation of the contract is the public interest standard established by High Plains Natural Gas Company v. Railroad Commission of Texas, 467 S.W.2d 532 (Tex. Civ. App.--Austin 1971, writ ref'd n.r.e.) (High Plains).

7. SRAT had sufficient notice prior to the hearing that the High Plains public interest standard would be an issue during the hearing on the merits.

8. Before the Commission may review the application, SRAT has the burden to show that the continuance of the contract adversely affects public interest in that it might impair SRAT's ability to continue its service, cast upon other consumers an excessive burden or be unduly discriminatory.

9. SRAT failed in its burden to allege and prove that continuance of the contract adversely affects the public interest in that it might impair SRAT's ability to continue its service.

10. SRAT failed in its burden to allege and prove that continuance of the contract adversely affects the public interest in that it would cast upon other consumers an excessive burden.

11. SRAT failed in its burden to allege and prove that continuance of the contract adversely affects the public interest in that it would be unduly discriminatory.

12. The existence of a general public interest in various aspects of SRAT's operations as a utility does not entitle SRAT to abrogation of the contract under High Plains.

13. The contract is not subject to review, revision or regulation by the Commission.

14. SRAT's application for authority to increase rates should be denied.

Respectfully submitted,

Beth Bierman
BETH BIERMAN
HEARINGS EXAMINER

APPROVED on this the 3rd day of February 1989.

Elizabeth Hagan Drews for
PHILLIP A. HOLDER
DIRECTOR OF HEARINGS

DOCKET NO. 7870

APPLICATION OF SABINE RIVER AUTHORITY OF TEXAS FOR AUTHORITY TO CHANGE RATES	§ § §	PUBLIC UTILITY COMMISSION OF TEXAS

ORDER

In public meeting at its offices in Austin, Texas, the Public Utility Commission of Texas finds that, after statutory notice was provided to the affected interested persons, the application in this case was processed by a hearings examiner in accordance with Commission rules and applicable statutes. A Supplemental Examiner's Report containing Findings of Fact and Conclusions of Law was submitted, which report is adopted. The Commission further issues the following Order:

Docket No. 7870, Application of Sabine River Authority of Texas for Authority to Change Rates is hereby DENIED.

SIGNED AT AUSTIN, TEXAS on this the 23rd day of February 1989.

PUBLIC UTILITY COMMISSION OF TEXAS

SIGNED: Marta Greytok
MARTA GREYTOK

SIGNED: Jo Campbell
JO CAMPBELL

SIGNED: William B. Cassin
WILLIAM B. CASSIN

ATTEST:
Elizabeth Nagan Drews for
PHILLIP A. HOLDER
SECRETARY OF THE COMMISSION

MEMORANDUM DECISIONS

TELEPHONE

Southwestern Bell Telephone Company and AT&T Communications of the Southwest, Inc., Docket Nos. 5502/5559. Revised Examiner's Report adopted August 16, 1989. Request for transfer of facilities and certificate rights from SWB to AT&T granted.

GTE Southwest, Inc., Docket Nos. 7489 and 8221. Examiner's Report adopted August 2, 1989. Applicant's request for an amendment to its 976 service tariff implementing special prefix Dial It service granted.

Southwestern Bell Telephone Company, Docket No. 8565. Examiner's Report adopted August 30, 1989. Applicant's request to extend emergency number (911) service to rural areas granted.

Cumby Telephone Cooperative, Inc., Docket No. 8642. Examiner's Report adopted August 30, 1989. Applicant's request for a change in depreciation and amortization rates granted.

Southwestern Bell Telephone Company, Docket No. 8700. Examiner's Report adopted August 3, 1989. Application for $10 rate reduction to the monthly charge for Toll Restriction Service approved.

Coleman County Telephone Cooperative, Docket No. 8708. Examiner's Report adopted August 16, 1989. Applicant's request for special amortization of central office equipment granted.

Industry Telephone Company, Docket No. 8810. Examiner's Report adopted August 30, 1989. Applicant's request to offer new optional customer services granted.

ELECTRIC

Victoria County Electric Cooperative, Docket No. 7022. Examiner's Report adopted October 1, 1987. Company's back billing upheld over customer's complaint of meter error but limited to six months under P.U.C. SUBST. R. 23.45(g).

Southwestern Public Service Company, Project No. 7130. The Commission signed a Resolution of Endorsement of the utility's planned Nichols 3 circulating fluidized bed boiler project, encouraging the United States Department of Energy to provide funding for the project under the Clean Coal Technology Demonstration Program.

Central Power and Light Company, Docket No. 7500. Application dismissed pursuant to CP&L's withdrawal on July 20, 1988.

Lower Colorado River Authority, Docket No. 7535. Examiner's Report adopted October 22, 1987. Utility's sale of part of its distribution and general plant and transfer of part of its certificated retail service area to the City of Kerrville was approved.

Guadalupe-Blanco River Authority, Docket No. 7630. Supplemental Examiner's Report adopted July 13, 1989. Complaint by Canyon Lake Area Citizens Association against the authority dismissed with prejudice for lack of jurisdiction.

Central Power and Light Company, Docket No. 7928. Examiner's Report adopted January 17, 1989. Commission recommended approval of a stipulation stating that CP&L will not have any avoided capacity until 2000.

Houston Lighting and Power Company, Docket No. 7931. Examiner's Report adopted January 17, 1989. Commission recommended approval of a stipulation stating that HL&P will not have any avoided capacity until 1997.

El Paso Electric Company, Docket No. 8078. Examiner's Report adopted August 2, 1989. Commission adopted the examiner's recommendation that the sale/leaseback of 39.5 percent of the company's 15.8 percent share of Palo Verde NGS Unit 3 is consistent with the public interest.

Johnson County Electric Cooperative, Inc., Docket No. 8288. Amended Examiner's Report adopted August 17, 1989. Industrial customer filed a petition under PURA Section 42. The Commission approved the parties' stipulation which proposed a new large power rate.

Sam Rayburn G & T, Inc., Docket No. 8595. Examiner's Report adopted August 11, 1989. Application to change rates was approved pursuant to stipulation.

Gulf States Utilities Company, Docket No. 8612. Examiner's Report adopted August 16, 1989. Applicant's request for approval of several revisions to Schedule EEDS granted.