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Witness: Douglas P. Horton, Brendan J. O' Brien and Garrett J. Murray
Request from: Office of Education, Outreach, and Enforcement

Question:

(F-FACTOR; COST OF REMOVAL/RETIREMENTS) Respond to the following:

a. Compare and contrast the Company's incorporation of cost of removal and retirements to the approach used in RAM filings for the Electric System Improvements (ESI) mechanism.
b. Discuss whether cost of removal is included within the Company's Targeted System Performance (TSP) plan, including the corresponding projections. If included, discuss how the projections were derived and cite relevant references to this topic.
c. If response to subsection (b) is negative, explain how the Company derived the projected cost of removal amounts within its Financial Forecast and provide supporting workpapers for the proposed amounts referenced in the F-Factor Excel spreadsheet within the PBR-4 F-Factor tab.

Response:

a. The Company's treatment of cost of removal and retirements under the F-Factor is fundamentally different from, and not comparable to, the treatment reflected in Electric System Improvements ("ESI") Revenue Adjustment Mechanism ("RAM") filings.

   The ESI mechanism is a narrowly tailored recovery mechanism that is limited to the revenue requirement impacts associated with incremental ESI plant additions. ESI considers only qualifying plant additions and the corresponding depreciation expense and accumulated deferred income taxes ("ADIT") associated with *those* additions. ESI does not incorporate plant retirements, cost of removal, depreciation expense, or ADIT related to *all* existing system investment.

   The F-Factor, by contrast, is not limited to a discrete subset of capital additions. Rather, it reflects plant-related activity affecting the entire distribution system. As a result, the F-Factor considers the effects of the full range of plant-related rate base activity, including plant additions, plant retirements, cost of removal, depreciation expense, and ADIT related to all investment, thereby resulting in a level of rate base truly representative of the capital deployed in the provision of utility service during a given Rate Year.

   Accordingly, the two mechanisms serve different regulatory purposes, rely on different inputs, and measure different categories of utility activity.

b. Cost of removal is inherently reflected in the Company's capital planning process, including investments within the Targeted System Performance ("TSP") plan. The Company's long-range capital planning process is intended to identify and forecast the overall level of system investment necessary to maintain, modernize, and improve the electric system. As a result, cost of removal is not a distinct TSP cost driver, rather a consequence of forecasted asset replacement activity.

   Cost of removal projections are informed by recent experience, circumstance, and trends relative to overall levels of investment and applied to the Company's expectations of future system needs. For example, the Company's capital expenditure forecast includes $86.1 million for emergent line failures in 2028, per the Company's response to OCC-858 (see OCC-858, Attachment 1). Of that $86.1 million, cost of removal can be expected, based on recent experience, to account for roughly 20%, or $17.2 million.

   In this way, cost of removal is assumed to be reflected within the overall system investment activity that underlies the Company's capital planning process and associated rate base projections. Accordingly, although the TSP plan does not identify or quantify cost of removal separately from installation costs, cost of removal is inherently contemplated as part of the overall system investment assumptions reflected in the Company's capital planning process.

c. Please refer to the Company's response to subpart (b) above.