

**CHAPTER 25. SUBSTANTIVE RULES APPLICABLE TO ELECTRIC SERVICE PROVIDERS**

**Subchapter J. COSTS, RATES AND TARIFFS.**

**DIVISION 1. RETAIL RATES.**

**§25.231. Cost of Service.**

- (a) **Components of cost of service.** Except as provided for in subsection (c)(2) of this section, relating to invested capital; rate base, and §23.23(b) of this title, (relating to Rate Design), rates are to be based upon an electric utility's cost of rendering service to the public during a historical test year, adjusted for known and measurable changes. The two components of cost of service are allowable expenses and return on invested capital.
- (b) **Allowable expenses.** Only those expenses which are reasonable and necessary to provide service to the public shall be included in allowable expenses. In computing an electric utility's allowable expenses, only the electric utility's historical test year expenses as adjusted for known and measurable changes will be considered, except as provided for in any section of these rules dealing with fuel expenses.
- (1) **Components of allowable expenses.** Allowable expenses, to the extent they are reasonable and necessary, and subject to this section, may include, but are not limited to the following general categories:
- (A) Operations and maintenance expense incurred in furnishing normal electric utility service and in maintaining electric utility plant used by and useful to the electric utility in providing such service to the public. Payments to affiliated interests for costs of service, or any property, right or thing, or for interest expense shall not be allowed as an expense for cost of service except as provided in the Public Utility Regulatory Act §36.058.
  - (B) Depreciation expense based on original cost and computed on a straight line basis as approved by the commission. Other methods of depreciation may be used when it is determined that such depreciation methodology is a more equitable means of recovering the cost of the plant.
  - (C) Assessments and taxes other than income taxes.
  - (D) Federal income taxes on a normalized basis. Federal income taxes shall be computed according to the provisions of the Public Utility Regulatory Act §36.060.
  - (E) Advertising, contributions and donations. The actual expenditures for ordinary advertising, contributions, and donations may be allowed as a cost of service provided that the total sum of all such items allowed in the cost of service shall not exceed three-tenths of 1.0% (0.3%) of the gross receipts of the electric utility for services rendered to the public. The following expenses shall be included in the calculation of the three-tenths of 1.0% (0.3%) maximum:
    - (i) funds expended advertising methods of conserving energy;
    - (ii) funds expended advertising methods by which the consumer can effect a savings in total electric utility bills;
    - (iii) funds expended advertising methods to shift usage off of system peak; and
    - (iv) funds expended promoting renewable energy.
  - (F) Nuclear decommissioning expense. The following restrictions shall apply to the inclusion of nuclear decommissioning costs that are placed in an electric utility's cost of service.
    - (i) An electric utility owning or leasing an interest in a nuclear-fueled generating unit shall include its cost of nuclear decommissioning in its cost of service. Funds collected from ratepayers for decommissioning shall be deposited monthly in irrevocable trusts external to the electric utility, in accordance with §25.301 of this title (relating to Nuclear Decommissioning Trusts). All funds held in short-term investments must bear interest. The level of the annual cost of decommissioning for ratemaking purposes will

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be determined in each rate case based on an allowance for contingencies of 10% of the cost of decommissioning, the most current information reasonably available regarding the cost of decommissioning, the balance of funds in the decommissioning trust, anticipated escalation rates, the anticipated return on the funds in the decommissioning trust, and other relevant factors. The annual amount for the cost of decommissioning determined pursuant to the preceding sentence shall be expressly included in the cost of service established by the commission's order.

- (ii) In the event that an electric utility implements an interim rate increase, including an increase filed under bond, an incremental change in decommissioning funding shall be included in the increase.
- (iii) An electric utility's decommissioning fund and trust balances will be reviewed in general rate cases. In the event that an electric utility does not have a rate case within a five-year period, the commission, on its own motion or on the motion of the commission's Office of Regulatory Affairs, the Office of Public Utility Counsel, or any affected person, may initiate a proceeding to review the electric utility's decommissioning cost study and plan, and the balance of the trust.
- (iv) An electric utility shall perform, or cause to be performed, a study of the decommissioning costs of each nuclear generating unit that it owns or in which it leases an interest. A study or a redetermination of the previous study shall be performed at least every five years. The study or redetermination should consider the most current information reasonably available on the cost of decommissioning. A copy of the study or redetermination shall be filed with the commission and copies provided to the commission's Office of Regulatory Affairs and the Office of Public Utility Counsel. An electric utility's most recent decommissioning study or redeterminations shall be filed with the commission within 30 days of the effective date of this subsection. The five year requirement for a new study or redetermination shall begin from the date of the last study or redetermination.

- (G) Accruals credited to reserve accounts for self-insurance under a plan requested by an electric utility and approved by the commission. The commission shall consider approval of a self insurance plan in a rate case in which expenses or rate base treatment are requested for a such a plan. For the purposes of this section, a self insurance plan is a plan providing for accruals to be credited to reserve accounts. The reserve accounts are to be charged with property and liability losses which occur, and which could not have been reasonably anticipated and included in operating and maintenance expenses, and are not paid or reimbursed by commercial insurance. The commission will approve a self insurance plan to the extent it finds it to be in the public interest. In order to establish that the plan is in the public interest, the electric utility must present a cost benefit analysis performed by a qualified independent insurance consultant who demonstrates that, with consideration of all costs, self-insurance is a lower-cost alternative than commercial insurance and the ratepayers will receive the benefits of the self insurance plan. The cost benefit analysis shall present a detailed analysis of the appropriate limits of self insurance, an analysis of the appropriate annual accruals to build a reserve account

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for self insurance, and the level at which further accruals should be decreased or terminated.

- (H) Postretirement benefits other than pensions (known in the electric utility industry as "OPEB"). For ratemaking purposes, expense associated postretirement benefits other than pensions (OPEB) shall be treated as follows:
- (i) OPEB expense shall be included in an electric utility's cost of service for ratemaking purposes based on actual payments made.
  - (ii) An electric utility may request a one-time conversion to inclusion of current OPEB expense in cost of service for ratemaking purposes on an accrual basis in accordance with generally accepted accounting principles (GAAP). Rate recognition of OPEB expense on an accrual basis shall be made only in the context of a full rate case.
  - (iii) An electric utility shall not be allowed to recover current OPEB expense on an accrual basis until GAAP requires that electric utility to report OPEB expense on an accrual basis.
  - (iv) For ratemaking purposes, the transition obligation shall be amortized over 20 years.
  - (v) OPEB amounts included in rates shall be placed in an irrevocable external trust fund dedicated to the payment of OPEB expenses. The trust shall be established no later than six months after the order establishing the OPEB expense amount included in rates. The electric utility shall make deposits to the fund at least once per year. Deposits on the fund shall include, in addition to the amount included in rates, an amount equal to fund earnings that would have accrued if deposits had been made monthly. The funding requirement can be met with deposits made in advance of the recognition of the expense for ratemaking purposes. The electric utility shall, to the extent permitted by the Internal Revenue Code, establish a postretirement benefit plan that allows for current federal income tax deductions for contributions and allows earnings on the trust funds to accumulate tax free.
  - (vi) When an electric utility terminates an OPEB trust fund established pursuant to clause (v) of this subparagraph, it shall notify the commission in writing. If excess assets remain after the OPEB trust fund is terminated and all trust related liabilities are satisfied, the electric utility shall file, for commission approval, a proposed plan for the distribution of the excess assets. The electric utility shall not distribute any excess assets until the commission approves the disbursement plan.
- (2) **Expenses not allowed.** The following expenses shall never be allowed as a component of cost of service:
- (A) legislative advocacy expenses, whether made directly or indirectly, including, but not limited to, legislative advocacy expenses included in professional or trade association dues;
  - (B) funds expended in support of political candidates;
  - (C) funds expended in support of any political movement;
  - (D) funds expended promoting political or religious causes;
  - (E) funds expended in support of or membership in social, recreational, fraternal, or religious clubs or organizations;
  - (F) funds promoting increased consumption of electricity;
  - (G) additional funds expended to mail any parcel or letter containing any of the items mentioned in subparagraphs (A)-(F) of this paragraph;

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- (H) payments, except those made under an insurance or risk-sharing arrangement executed before the date of the loss, made to cover costs of an accident, equipment failure, or negligence at an electric utility facility owned by a person or governmental body not selling power within the State of Texas;
  - (I) costs, including, but not limited to, interest expense, of processing a refund or credit of sums collected in excess of the rate finally ordered by the commission in a case where the electric utility has put bonded rates into effect, or when the electric utility has otherwise been ordered to make refunds;
  - (J) any expenditure found by the commission to be unreasonable, unnecessary, or not in the public interest, including but not limited to executive salaries, advertising expenses, legal expenses, penalties and interest on overdue taxes, criminal penalties or fines, and civil penalties or fines.
- (c) **Return on invested capital.** The return on invested capital is the rate of return times invested capital.
- (1) **Rate of return.** The commission shall allow each electric utility a reasonable opportunity to earn a reasonable rate of return, which is expressed as a percentage of invested capital, and shall fix the rate of return in accordance with the following principles.
    - (A) The return should be reasonably sufficient to assure confidence in the financial soundness of the electric utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low because of changes affecting opportunities for investment, the money market, and business conditions generally.
    - (B) The commission shall consider efforts by the electric utility to comply with the statewide integrated resource plan, the efforts and achievements of the electric utility in the conservation of resources, the quality of the electric utility's services, the efficiency of the electric utility's operations, and the quality of the electric utility's management, along with other applicable conditions and practices.
    - (C) The commission may, in addition, consider inflation, deflation, the growth rate of the service area, and the need for the electric utility to attract new capital. The rate of return must be high enough to attract necessary capital but need not go beyond that. In each case, the commission shall consider the electric utility's cost of capital, which is the weighted average of the costs of the various classes of capital used by the electric utility.
      - (i) Debt capital. The cost of debt capital is the actual cost of debt at the time of issuance, plus adjustments for premiums, discounts, and refunding and issuance costs.
      - (ii) Equity capital. For companies with ownership expressed in terms of shares of stock, equity capital commonly consists of the following classes of stock.
        - (I) Common stock capital. The cost of common stock capital shall be based upon a fair return on its market value.
        - (II) Preferred stock capital. The cost of preferred stock capital is the actual cost of preferred stock at the time of issuance, plus an adjustment for premiums, discounts, and refunding and issuance costs.

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- (2) **Invested capital; rate base.** The rate of return is applied to the rate base. The rate base, sometimes referred to as invested capital, includes as a major component the original cost of plant, property, and equipment, less accumulated depreciation, used and useful in rendering service to the public. Components to be included in determining the overall rate base are as set out in subparagraphs (A)-(F) of this paragraph.
- (A) Original cost, less accumulated depreciation, of electric utility plant used by and useful to the electric utility in providing service.
- (i) Original cost shall be the actual money cost, or the actual money value of any consideration paid other than money, of the property at the time it shall have been dedicated to public use, whether by the electric utility which is the present owner or by a predecessor.
- (ii) Reserve for depreciation is the accumulation of recognized allocations of original cost, representing recovery of initial investment, over the estimated useful life of the asset. Depreciation shall be computed on a straight line basis or by such other method approved under subsection (b)(1)(B) of this section over the expected useful life of the item or facility.
- (iii) Payments to affiliated interests shall not be allowed as a capital cost except as provided in the Public Utility Regulatory Act §36.058.
- (B) Working capital allowance to be composed of, but not limited to the following:
- (i) Reasonable inventories of materials, supplies, and fuel held specifically for purposes of permitting efficient operation of the electric utility in providing normal electric utility service. This amount excludes appliance inventories and inventories found by the commission to be unreasonable, excessive, or not in the public interest.
- (ii) Reasonable prepayments for operating expenses. Prepayments to affiliated interests shall be subject to the standards set forth in the Public Utility Regulatory §36.058.
- (iii) A reasonable allowance for cash working capital. The following shall apply in determining the amount to be included in invested capital for cash working capital:
- (I) Cash working capital for electric utilities shall in no event be greater than one-eighth of total annual operations and maintenance expense, excluding amounts charged to operations and maintenance expense for materials, supplies, fuel, and prepayments.
- (II) For electric cooperatives, river authorities, and investor-owned electric utilities that purchase 100% of their power requirements, one-eighth of operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, fuel, and prepayments will be considered a reasonable allowance for cash working capital.
- (III) Operations and maintenance expense does not include depreciation, other taxes, or federal income taxes, for purposes of subclauses (I), (II), and (V) of this clause.
- (IV) For all investor-owned electric utilities a reasonable allowance for cash working capital, including a request of zero, will be determined by the use of a lead-lag study. A lead-lag study will be performed in accordance with the following criteria:

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- (-a-) The lead-lag study will use the cash method; all non-cash items, including but not limited to depreciation, amortization, deferred taxes, prepaid items, and return (including interest on long-term debt and dividends on preferred stock), will not be considered.
  - (-b-) Any reasonable sampling method that is shown to be unbiased may be used in performing the lead-lag study.
  - (-c-) The check clear date, or the invoice due date, whichever is later, will be used in calculating the lead-lag days used in the study. In those cases where multiple due dates and payment terms are offered by vendors, the invoice due date is the date corresponding to the terms accepted by the electric utility.
  - (-d-) All funds received by the electric utility except electronic transfers shall be considered available for use no later than the business day following the receipt of the funds in any repository of the electric utility (e.g. lockbox, post office box, branch office). All funds received by electronic transfer will be considered available the day of receipt.
  - (-e-) For electric utilities the balance of cash and working funds included in the working cash allowance calculation shall consist of the average daily bank balance of all non-interest bearing demand deposits and working cash funds.
  - (-f-) The lead on federal income tax expense shall be calculated by measurement of the interval between the mid-point of the annual service period and the actual payment date of the electric utility.
  - (-g-) If the cash working capital calculation results in a negative amount, the negative amount shall be included in rate base.
- (V) If cash working capital is required to be determined by the use of a lead-lag study under the previous subclause and either the electric utility does not file a lead lag study or the electric utility's lead-lag study is determined to be so flawed as to be unreliable, in the absence of persuasive evidence that suggests a different amount of cash working capital, an amount of cash working capital equal to negative one-eighth of operations and maintenance expense including fuel and purchased power will be presumed to be the reasonable level of cash working capital.
- (C) Deduction of certain items which include, but are not limited to, the following:
- (i) accumulated reserve for deferred federal income taxes;
  - (ii) unamortized investment tax credit to the extent allowed by the Internal Revenue Code;
  - (iii) contingency and/or property insurance reserves;
  - (iv) contributions in aid of construction;
  - (v) customer deposits and other sources of cost-free capital;

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- (D) Construction work in progress (CWIP). The inclusion of construction work in progress is an exceptional form of rate relief. Under ordinary circumstances the rate base shall consist only of those items which are used and useful in providing service to the public. Under exceptional circumstances, the commission will include construction work in progress in rate base to the extent that:
- (i) the electric utility has proven that:
    - (I) the inclusion is necessary to the financial integrity of the electric utility; and
    - (II) major projects under construction have been efficiently and prudently planned and managed. However, construction work in progress shall not be allowed for any portion of a major project which the electric utility has failed to prove was efficiently and prudently planned and managed; or
  - (ii) for a project ordered by the commission under §25.199 of this title (relating to Transmission Planning, Licensing and Cost-recovery for Utilities within the Electric Reliability Council of Texas), if the commission determines that conditions warrant the inclusion of CWIP in rate base, the project is being efficiently and prudently planned and managed, and there will be a significant delay between initial investment and the initial cost recovery for a transmission project.
- (E) Self-insurance reserve accounts. If a self insurance plan is approved by the commission, any shortages to the reserve account will be an increase to the rate base and any surpluses will be a decrease to the rate base. The electric utility shall maintain appropriate books and records to permit the commission to properly review all charges to the reserve account and determine whether the charges being booked to the reserve account are reasonable and correct.
- (F) Requirements for post test year adjustments.
- (i) Post test year adjustments for known and measurable rate base additions (increases) to historical test year data will be considered only as set out in subclauses (I)-(IV) of this clause.
    - (I) Where the addition represents plant which would appropriately be recorded:
      - (-a-) for investor-owned electric utilities in FERC account 101 or 102;
      - (-b-) for electric cooperatives, the equivalent of FERC accounts 101 or 102.
    - (II) Where each addition comprises at least 10% of the electric utility's requested rate base, exclusive of post test year adjustments and CWIP.
    - (III) Where the plant addition is deemed by this commission to be in-service before the rate year begins.
    - (IV) Where the attendant impacts on all aspects of a utility's operations (including but not limited to, revenue, expenses and invested capital) can with reasonable certainty be identified, quantified and matched. Attendant impacts are those that reasonably follow as a consequence of the post test year adjustment being proposed.

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- (ii) Each post test year plant adjustment will be included in rate base at:
  - (I) the reasonable test year-end CWIP balance, if the addition is constructed by the electric utility; or,
  - (II) the reasonable price, if the addition represents a purchase, subject to original cost requirements, as specified in Public Utility Regulatory Act §36.053.
- (iii) Post test year adjustments for known and measurable rate base decreases to historical test year data will be allowed only when clause (i)(IV) of this subparagraph and the criteria described in subclauses (I) and (II) of this clause are satisfied.
  - (I) The decrease represents:
    - (-a-) plant which was appropriately recorded in the accounts set forth in clause (i)(I) of this subparagraph;
    - (-b-) plant held for future use;
    - (-c-) CWIP (mirror CWIP is not considered CWIP); or
    - (-d-) an attendant impact of another post test year adjustment.
  - (II) Plant that has been removed from service, mothballed, sold, or removed from the electric utility's books prior to the rate year.