

**FIRST SUPPLEMENTAL COMMENTS
OF
LANETTA COOPER
ON BEHALF OF
TEXAS LEGAL SERVICES CENTER**

To the Electric Utility Commission for the City of Austin:

Texas Legal Service Center (“TLSC”) supplements its comments to read as follows:

INTRODUCTION

TLSC wants to preface its comments with an acknowledgement that Austin Energy provides good service to its customers. The 311 system initiated by the City of Austin has been experienced by the undersigned to be an exemplar of how consumers should be treated by their public service providers.

This preface having being said, the contested issues before you are not about the quality of service or customer communication but the issues are about the fairness of the rate request presented by Austin Energy (“AE”). TLSC has several concerns starting with its request for what appears to be a large increase in revenues. For residential customers, the unfairness of the rate request continues

with a proposed cost of service study that does not mirror how costs are incurred by Austin Energy in the nodal market but allocates and therefore charges costs to residential customers that they did not cause. In addition, AE upends a residential rate design that was innovative at the time established and now mirrors recommended rate design principles for energy conservation. Lastly, AE is proposing to create separate charges for certain elements of its business operations updated annually without providing refund protections established in the Texas electric retail market.

TLSC will start with a short discussion concerning AE's continuing statement that AE hasn't had a rate case in seventeen years. Next they will turn to the revenue requirement. Cost of service will be next followed by rate design. TLSC has not had the benefit of discovery in this case. TLSC has had outstanding discovery requests since July 18, 2011. Answers to those questions would have allowed TLSC the opportunity to ascertain whether the inferences they have made in their examination of AE's ratefiling are accurate.

The recommended adjustments will not be cumulative. The revenue requirement reductions will not flow through to proposed adjustments commentators will make in the cost of service ("COS"). If the EUC recommends

revenue requirement reductions, then the rate effects of commentators' proposed COS adjustments will be greater.

WHY HAS THERE BEEN SEVENTEEN YEARS SINCE THE LAST RATE CASE.

AE commences its discussion of this rate case with a statement that AE hasn't had a rate case in seventeen years. This statement implies that the inevitable increase in expenses is causing this rate case. But AE has made major changes in its financial policies that play a substantial part in the requested increase in revenues. In the recent past, AE had a policy of maintaining a debt/service coverage ratio of 1.5¹. As AE noted in its rate case, the current rates—that is no rate increase-- would allow AE to maintain a little over 1.5x debt/service coverage ratio. AE's proposed 2x debt/service coverage ratio has a substantial impact on AE's request for more revenues. Another issue involves the increase in the percentage of cash used in AE's capital improvement program. AE is requesting that its rates be priced high enough to put in \$100 million cash contribution to a \$200 million capital improvement program². Reducing the cash contribution to 30% from the 50% proposed -cash contribution would result in a substantial

¹ See 2003 AE Strategic Plan. (Relevant excerpt was provided the EUC as an addendum to its Rate Design Primer.

² See AE Ratefiling package, p. 48, Appendix C, p. 4 of 5, line 237.

reduction to AE's proposed rate increase. Lastly, the rise of significant AE funding of economic development is also a major contributor to the revenue increase, comprising 7.6% of the \$131 million AE alleges it needs in increased revenues. Just these three changes alone would negate a rate increase.

The question that commentators have is why AE did not reduce residential customer rates in the past seventeen years. In this seventeen year time period, AE paid cash for a 500 MW gas plant³ instead of reducing residential rates. Over this same time period, AE was reducing rates to its large customers below cost, and shifting that cost responsibility onto the residential and other customer classes. In the 2009 test year AE has over recovered approximately \$22.7 million⁴ in fuel expenses.

AE has also failed to put its last rate case into context. In 1994, AE had far fewer customers who had fewer kWh sales to spread over the cost of South Texas nuclear power plant. The nuclear power plant is the most expensive capital investment AE has ever made⁵. That huge capital cost spread over substantially fewer kWh produced a rate that should have over recovered going forward as

³ See RW Beck White Paper No. 1, "Introduction to Austin Energy's Rate Review Process", p.7.

⁴ See Austin Energy Performance Report (Draft July 2011), p. 8. See also AE Response to CmDay2.

⁵ The nuclear investment may still not be the most expensive investment if inflation is not considered. If inflation is considered the nuclear power plant is still the most expensive.

additional customers and therefore sales were used to recover ensuing costs that on an incremental basis should have been lower.

The fact that there has been no rate increase over seventeen years really begs the question about how fair residential customer rates have been over this time period. The current rate request is asking residential customers to continue to subsidize AE's large commercial customers and to almost completely fund AE's contribution to COA's economic development. It would seem that residential customers should continue to question the fairness of the residential rate increases AE is seeking in this case.

DOES AE NEED ADDITIONAL REVENUES?

AE's revenue requirement should be reduced by no less than \$40 million.

1. AE's rates should be set on using a debt/equity ratio for capital improvement funded programs of 70:30 instead of 50:50. This adjustment would reduce the cash portion by approximately \$40 million. Given, that this amount of funding will still have a "debt" cost to be included in the cost

of service, TLSC estimated the revenue requirement reduction amount to be \$30 million.⁶

TLSC would also note that AE has increased its equity portion of its proposed capital improvement budget approved by the council from the \$88.3 million included in its 2011-2012 budget to the council to \$111million, an increase of \$22.7 million.⁷

Debt is a cheaper form of capital funding. The result of increasing the debt funding of capital investment is a lower cost of service. It also spreads the cost of the investment over the life of the project ensuring that customers who use the investment pay for the investment. In other words, debt funding provides for intergenerational ratepayer equity. For private utilities, ratepayers are not asked to commence reimbursement until the investment starts operating. That cost reimbursement is then made through depreciation over the life of the investment as well as reimbursing the shareholders with a profit for its investment risks. Using a higher level of

⁶ In replies to some RFIs in this case, AE argued that the PUC blessed its debt/equity ratio. That is not entirely true. First, the PUC was only addressing transmission costs, not the majority of AE's costs. Second, TLSC is unaware of any interventions in that case contesting this issue. The PUC is bound by the evidence in the case. Since the issue probably was not contested, the PUC was bound to adopt AE's proposed debt/equity ratio. This point would be a hotly contested issue on appeal to the PUC.

⁷ The level of capital investment is virtually identical: \$222 in the ratefiling package; and \$220.4 in the budget. See COA proposed budget, volume 2, p. 33.

debt more closely mirrors the private investor owned model involving intergenerational ratepayer equity.

2. The economic development costs (“EGRSO”) currently included in the COS should be excluded.⁸ Under the PUC Substantive rules, utilities are limited to three tenths of one percent of gross revenues for advertising, including advertising for energy efficiency, donations, and contributions.⁹ TLSC has estimated that AE has approximately \$14.788 million of these costs included in the COS. Three tenths of one percent of AE’s requested revenue requirement of \$1,136,020,803 is \$3,408,062.40. Consequently, even with the most liberal calculation of gross revenues, AE has included excessive amounts for these types of costs. Therefore, TLSC’s recommendation to exclude the economic development costs is conservative. This reduces the revenue requirement by \$10,140,552.¹⁰

3. The \$1 million dollar adjustment to uncollectible expenses should be excluded from the COS. AE has increased bad debt expenses by \$1 million

⁸ It is interesting to note that AE views the discount rates as economic development. See ratefiling package at p. 33.

⁹ See P.U.C. SUBST. Rule 25.231(b)(1)(E).

¹⁰ See Appendix C: Known and Measureable Changes, page 3, Line147, FERC account No. 911.

based on increased rates. AE has provided no workpapers to justify this adjustment. Further, it is higher than the adjustment AE made in its 2011-2012 budget to council. In that budget, AE claimed the increase was due to increased hot weather. AE sales are normalized for weather for rate setting purposes.¹¹ Since sales are normalized to exclude sales related to extreme weather, then the corresponding bad debt expense should also be excluded. This reduces the revenue requirement by \$1 million.

4. The rate case expenses should be excluded from the COS. AE has estimated that it will incur approximately \$4 million. This is a nonrecurring item; that is, it is not a normal business expense, but is an extraordinary one that is being included for recovery assuming a three year payback. AE has already stated its intent to not have another rate case for a number of years. This means that in year four into the new rates, this annual amount will still be recovered in the rates but will not have any costs attached to it. This is a cost that should be recovered in a surcharge, if at all. However, the extreme weather this summer created excess sales that could be used to pay for this expense. This reduces the revenue requirement by \$1.29 million.

¹¹ See City of Austin budget, volume 2, p. 38.

5. The debt/service coverage ratio should be reduced to 1.7. TLSC's proposed adjustment to the debt/equity funding ratio of AE's capital investment may affect the debt/service coverage ratio. AE has provided no economic analysis to support its ratio of 2x debt/service coverage. The City of San Antonio uses a 1.4x debt/service coverage ratio.¹² The COA's water/wastewater utility uses a 1.5x debt/service coverage ratio.¹³ A 1.7x debt service coverage ratio is conservative. Without considering any adjustment that may have already been made by TLSC's recommended debt/equity ratio for financing its capital improvements program, this adjustment reduces the revenue requirement by \$50 million dollars.¹⁴

Has AE fairly allocated its costs of operating the utility among the customer classes?

1. Production plant costs should be allocated on the BIP¹⁵ method. AE concedes that among the three proposed COS production cost methodologies, this cost allocation methodology most accurately tracks

¹² See City of San Antonio's Fiscal Year 2012 Budget Report, included in the workpapers of these comments filed separately.

¹³ See back-up material of COA W/WW gave to W/WW subcommittee on budget, July 7, 2011.

¹⁴ TLSC multiplied the amount identified on p. 20 of 296 of Appendix D: Cost of Service, Line 176 by 30%.

¹⁵ Baseload, Intermediate, and Peaking

how costs are incurred by AE in providing electric service to its various customer class customers throughout the operating day. The Average Excess method utilized by AE is not the methodology that has been used by Texas utilities. This is because AE used customer classes off-system peak maximum usages (non- coincident peaks—“NCP”) in its methodology instead of system peaks (“coincident peak” or “CP”). The resulting allocation factors turn out to place higher costs onto residential customer classes than the 4CP method that just allocates on system peak responsibility, thereby showing the illogical nature of AE’s application. Further, AE advocates rate designs to shift usage off of system peaks. AE’s use of a NCP in the Average and Excess method is inconsistent with this advocacy because it penalizes customer classes who are able to shift their peak usage off of the system peak. The best example involving this rate penalty is the lighting class whose costs skyrocketed under AE’s average and excess peak method. (The AEP shows the lighting class needs a rate increase of 98%; the 4CP shows an increase of 57.4%; and the BIP a rate increase of 72.5%).¹⁶ This AEP-justified huge increase is because AE is using the lighting class NCP which occurs

¹⁶ Note that BIP allocates more cost to the lighting class than 4CP. This is because the BIP method assumes that all use on the utility system regardless of time has a cost. The 4CP assumes that cost responsibility should only reflect the cost incurred on the system for the four highest system usage days of the year thereby ignoring all other days.

usually at night when there is no fear that it will contribute in any significant way to AE's system peak. The system peak drives a utility's future costs and current costs can skyrocket if the peak is higher than what the utility had financially planned for.¹⁷ AE's proposed Average and Excess methodology is flawed and does not accurately track cost causation as well as the BIP method.¹⁸ Further, it punishes customer classes who shift their usage off of system peak. Using the BIP method to allocate production costs should reveal, without any other cost adjustments, a proposed residential rate that is above costs.¹⁹

2. AE has inappropriately allocated certain costs on customers, in whole or in part.

a. Assuming the costs related to the economic development are included in AE's COS, these costs should not be allocated among the customer classes based on customer. AE's allocation of economic development costs based on customers means that the

¹⁷ AE states at p. 5 of its Rate Analysis Recommendations, "Coincident peak demand is an important consideration in planning for power generation and transmission facilities. . ."

¹⁸ TLSC notes that under the BIP, the lighting class is allocated more costs than under a 4CP. This is because the BIP method rightfully acknowledges that production costs are being incurred in serving the lighting class even if that service is provided at night.

¹⁹ See Page 12 of AE handout presented to the EUC on July 18, 2011.

residential customer class is picking up \$8,994,095.63 of these costs, representing 88.7% of the total cost of this program²⁰.

Economic development is about attracting new business and therefore sales to AE business operations. As such, these costs should be allocated either on average demand or on revenues.

Taking the most conservative estimate²¹, this means that instead of the approximate \$8.9 million dollars being allocated to the residential class, the amount allocated would be \$4.23 million, a difference of \$4.76 million. Further, AE has inappropriately placed this cost in the customer charge. It is clearly a cost connected with revenues, not number of customers. As such, it should be recovered in the energy charge.

- b. AE has done some kind of functional unbundling of the general fund transfer that has the effect of allocating and therefore including portions of this cost into AE's fixed residential customer costs. The general fund transfer is calculated by taking a percentage of sales that are based on a three year rolling average of

²⁰ Source: AE answers to TLSC question No. LC 3.37 released Sept. 16, 2011.

²¹ TLSC used AE's COS rate class revenue requirements as a surrogate to sales revenues.

AE's gross revenues. The costs of the general fund transfer are therefore directly driven by AE's sales revenues. Many regulators view the general fund transfer as a substitute for the lost franchise tax revenues the city would have received if the utility was an investor-owned one. Franchise fees are allocated based on revenues and recovered as a surcharge on sales, much like a sales tax. Sales taxes and franchise fees, by nature, are considered regressive taxations that more negatively impact low income consumers. AE's apparent proposal to recover portions of the general fund transfer through fixed customer charges makes AE's proposed cost of service even more regressive than a sales tax or franchise fee. Placing any of this cost in the customer or wires charge is anathema to cost causation and exacerbates the recessive nature of AE's requested rate recovery of this cost. It inequitably is asking those customers who use the least to pay more than their fair share of a cost that was incurred by sales volume, not number of customers. TLSC has outstanding RFIs involving this issue²².

²² This supplemental issue comment has been modified in response to AE's answers, but TLSC is asking additional RFIs on this issue.

c. Bad debt expense should not be allocated on customer. Bad debt expense is driven by sales volume. Further, paying customers did not cause the bad debt. This fact is the reason bad debt is generally considered an overhead expense that should be borne by all customer classes. Bad debt should be allocated on revenues.²³ If bad debt had been allocated on revenues, residential customers would have been allocated \$1.96 million in bad debt expense instead of \$4.01, a difference of \$2.05 million. In addition, this cost is being sought by AE to be recovered in the customer charge. Bad debt expense is a function of revenues and should be priced out in the rate design accordingly. As such this cost should be recovered in the energy charge.

3. The number of kWh sold should be adjusted upward to reflect the number of residential customers AE had in 2010. Looking at the known and measureable adjustments AE made in this rate case, it appears that AE essentially increased all of its costs to incorporate 2010 costs. Yet, it failed to increase its revenues due to the change in the number of

²³ Allocating costs among the customer classes shifts more costs onto the residential customer class than if the allocation was on kWh because the residential class, in general have higher rates per kWh. Therefore, the higher kWh prices lead to a higher allocation factor to the residential customer class.

customers. If AE had accounted for its increased residential customer count as it had for its 2010 increased expenses, AE would have shown an increase in revenues attributable to the residential customer class of \$3.985 million.²⁴

TLSC's proposed COS adjustments reflect that AE has been over allocated costs that should fairly have been allocated to other customer classes. In addition, the failure to include 2010 customer additions in the COS causes the revenue requirement deficiency for the residential class to be over stated. Further, the application of a more accurate and fair COS model results in moving \$20 million in unfair costs that residential customers did not cause, resulting in residential customers moving from AE's alleged 95% COS to substantially over their COS under AE's proposed residential rates. The proposed twenty per cent increase to the residential class is excessive and should be significantly reduced.

SHOULD AE DESIGN ITS RESIDENTIAL RATES TO PROMOTE ENERGY EFFICENCY ?

TLSC has previously addressed this issue and will be filing a separate rate design paper. In addition, Ms. Biedrzycki has filed comments on this issue. TLSC agrees with those comments.

²⁴ Source: Austin Energy Performance Report (Draft July 2011), p. 9; Table 2.9, p. 39 Austin Rate Analysis Package.

HAS AE PRESENTED ADEQUATE RATE CASE MATERIALS TO
ENACT ITS RIDERS?

AE has proposed several riders. Riders are separate charges made for specific operating cost elements. The classic rider is the fuel charge that AE has historically used. Surprisingly and at a time AE is arguing a need for rate transparency, AE chooses to stop the use of a separate fuel charge. Instead, it seeks to mingle these costs in with other operating costs. Instead of a fuel charge, AE is recommending riders for recovering transmission costs, its CAP program and its energy efficiency program. Unfortunately, AE did not separate these costs out of its total cost of service. Instead these costs are co-mingled with other costs leaving the EUC and other parties with no ability to verify whether the proposed rider rate is fair and equitable and is correctly recovering the costs sought to be unbundled. Further, riders, which are interim rates, should have a tariff or procedural rule requiring reconciliation. Specifically, overearnings from a rider should lead to refunds applied as credits to utility bills. TLSC is also very concerned that money recovered for a specific purpose will not be used for that purpose. The system benefit fund is a classic example of this dilemma. In the deregulated market, consumers are surcharged a system benefit fund fee whose purpose was to help with low income bills. These collected revenues were

transferred to the legislature who addresses the PUC's budget and activities. Instead of passing these monies on to the PUC for the purpose of the system benefit fund, these funds have been trapped at the legislature for purposes of balancing the state budget. For several years, low income residential customers received diminished help with these monies in paying their bills. Today, the amount of assistance is greatly reduced.

TLSC questions the rider relating to the CAP program and the rider relating to the Energy Efficiency Program. Ms. Biedrzycki has discussed this issue extensively in her comments filed in this case. TLSC's concerns are mirrored in Texas ROSE's comments, and, for brevity purposes, refers the EUC to these comments. TLSC is urging the EUC to require AE to unbundle the costs relating to these riders from the cost of service, provide the workpapers to ensure that the costs are properly removed and not double counted, and to establish a proposed tariff for each of these riders that:

- Establishes the rate formula;
- Does not provide for an increase in the rider if the utility's operations or its program operations related to the rider is overearning;

- Provides for billing credits if AE has a revenue balance involving the rider;
- Ensures that the program elements underlying the rider are properly laid out and the correlating costs are identified;
- That the public has an opportunity to address the program elements and verify that the costs are reasonable and necessary;
- That sales or customer growth is taken into consideration in the setting of any new rate; and
- Such other criteria to ensure riders are not used as substitutes for needed rate cases.

CONCLUSION

TLSC believes AE is requesting excessive revenues by the use of questionable financial policies and the inclusion of inappropriate costs. AE exacerbates this problem unreasonably by over allocating costs to the residential customer class. AE's COS and rate design proposals result in an excessive and extremely regressive rate design for residential customer classes.

TLSC urges the EUC to ask tough questions of the AE staff , to adopt its recommendations, to request AE to make the adjustments accordingly to its ratefiling package. TLSC additionally requests the EUC to direct the adjusted rate filing package be proffered to the council with a recommendation that the council adopt it.

Respectfully Submitted

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