SUMMARY OF B. DAY's PROPOSED ADJUSTMENTS TO REVENUE REQUIREMENT

TEST YEAR CONCEPT

A utility selects a "test year" and shows the actual revenue and expenses, adjusting only for known and measurable changes. For instance, if a generating plant has been taken off line permanently, then the O&M expenses associated with that plant in the test year will be removed. Other than such known and measurable changes, the test year represents the revenue and expenses used in setting rates going forward. An additional principle that is applied is that revenues and expenses must be matched so that if expenses for a generating plant are included [O&M and capital costs], the revenues associated with sales must be included, be they native sales or off-system sales.

AE's REVENUE

AE has made two adjustments to test year revenue which violate either the known and measurable principle or the matching principle.

<u>Off system sales revenues</u>

AE has completely removed $35 million in off system sales revenues from the test year. AE admits it will continue to make off-system sales. It has given two answers to questions about not explicitly recognizing off-system sales revenues. First, AE said it does not know how much such revenues are due to a change to the nodal market. The correct amount of off-system sales revenues is not $-0-. The test year level of revenues and expenses should be reflected and "matched" with the O&M and capital costs associated with such sales. To leave expenses in but remove revenues overstates the need for a rate increase. The second response AE gave for not recognizing the test year level of off system sales revenues is that in the nodal market a settlement process is used and such revenues are included. AE needs to demonstrate what it used as a settlement figure in the rate case and where it is. So far, AE has been either unwilling or unable to demonstrate where such "settlement" revenues are reflected in this case. In the absence of such demonstration the EUC should reject AE's proposal and include the test year amount of off system sales revenues: $35 million.

<u>Normalizing for weather</u>

AE has removed $9.7 million from test year revenue on the theory that sales in the future will not be as great as in the test year because the test year had abnormally hot weather. Having just completed the hottest summer on record, it is clear that 2009 was not abnormally hot. The adjustment of sales is not known and measurable and should be rejected.

Summary of revenue adjustments

$44.7 million of revenue adjustments to the test year should be reversed and the revenue recognized when setting rates. These two adjustments should be made in order to meet the matching principle, the test year principle, and the known and measurable principle.

AE's EXPENSES

Reserve Fund Contributions

Strategic Fund reserve AE seeks recovery of a new expense reserve category named strategic reserve. The purpose of this fund is to provide money to be used to evade compliance with the Council's 2% affordability cap on electric rates. In other words, this expense would over charge customers to build up a fund that could be used to circumvent the affordability cap in the future. This is a hypothetical "expense" and it violates the Council's entire purpose for adopting a cap.

Repair and Replacement Reserve This fund is a double collection of monies for repair and replacement. AE has included a depreciation expense in its rates and that is exactly what such money is for. Plus AE receives a generous amount for construction. The repair and replacement reserve expense should be rejected as redundant.

Working Capital AE has not presented a cash working capital [lead lag] study to justify this as a legitimate expense item. In cases at the PUCT and across the county, cash working capital is a negative amount for most utilities because the utility receives its revenue before it has to pay its bills so it actually earns money on the differential.

Required disallowance to expense for these three items. AE has quantified these three reserve funds at $15,960,533. None is warranted, supported, or consistent with regulatory principles.

Non-nuclear decommissioning reserve. AE has requested $6,716,995 for non-nuclear decommissioning reserve. AE has presented no study to substantiate this request. STP is already covered by an expense for decommissioning. No study or even discussion of what plants AE might need to decommission, projected cost, offset of salvage value, etc. has been presented. This $6.7 million request is unsupported, not known and measurable.

Rerserve Fund Adjustment. AE's expense request should be reduced by $22,677,528 as unsupported, contrary to Council policy, and hypothetical.

Capital Expenditures

Recommend adoption of Data Foundry's [DF] CIP adjustment. DF recommends adjusting AE's requested level of capital expenditures by $32,674,311. DF's adjustment is based on two factors. First, AE should not assume 50/50 debt equity funding of construction. CPS uses a 60/40 debt equity ratio. This is more the norm in the electric business. Austin Water Wastewater uses 80% debt, 20% equity. Given the cost of debt in today's market, a greater debt funding represents a wise financial decision. DF has assumed 37% equity funding, which is a reasonable level and within City Council's policies. Further, DF recommends removal of monies already spent on Holly decommissioning. DF's proposal is to allow CIP in the amount of $78,416,700, instead of the $111,091,011 AE proposes. Therefore, the expense adjustment would be $32,674,311.

SUMMARY OF ADJUSTMENTS

Revenue adjustments reversed	$44.7 million
CIP expense adjustment	$32.7 million
Reserve account adjustments	$22.7 million

ENERGY ADJUSTMENT CLAUSE

AE has requested an energy adjustment to pass-through additional or unrecovered fixed costs without a rate review. AE says it will pass through "*unrecovered fixed costs from the customer, electric delivery, and/or demand charges*". In other words, such a pass-through mechanism would permit AE to simply charge any amounts without review. Moreover, AE proposes to apply this adjustment on a per kwh basis. In an extreme example this would permit AE to charge the $20 million associated with the below-cost contract rates to certain industrial customers to all other customers. It would violate the very principle AE claims it wants to follow of keeping losses within the class where generated. AE has a fuel adjustment on the theory that fuel costs are variable costs. This proposed energy adjustment is not for variable costs but fixed costs. This is simply a mechanism to charge customers higher costs without a rate review. It is especially dangerous due to AE's propensity to hide behind an argument of the complexity of the nodal market. The request for an energy adjustment clause should be denied.