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MEMORANDUM

TO: Austin Energy Utility Oversight Committee ("UOC")
FROM: Thomas L. Brocato
DATE: November 30, 2022
RE: Response to UOC Information Requests Made at November 29, 2022 Meeting

OVERVIEW

The purpose of this memorandum is to provide responses to requests for additional information made at the November 29, 2022 Austin Energy Utility Oversight Committee ("UOC") meeting. Specifically, Austin Energy ("AE") was asked to explain its position and provide support addressing several contested revenue requirement issues that arose during the Impartial Hearing Examiner ("IHE") Process. Information responsive to these requests is detailed below.

As a preliminary matter, it is important to note that the IHE Process, established by City Ordinance, relied upon widely accepted ratemaking principles in establishing Austin Energy's rates. These principles have been adopted throughout the United States for nearly a century. Imbedded within these principles is the use of a cost-of-service study that comprehensively examines the utility's expenses and revenues during a normalized historical test year, adjusted for known and measurable changes. This approach avoids piecemeal or "on-going" ratemaking that would result in an incomplete evaluation of the utility's financial condition and produce unintended outcomes that unfairly impact the utility or ratepayers.

ISSUES

1. General Fund Transfer ("GFT")

Consistent with standard practice among municipally owned utilities ("MOUs") and Texas Government Code § 1502.059, AE transfers a percentage of revenues to the City. AE makes transfers to the City's general fund in lieu of paying franchise fees, taxes, dividends, and also in lieu of earning a return on investment as is done with investor owned utilities ("IOUs"). The transfer payment from AE to the City is invested directly back into the local community, rather than flowing to outside investors, which is a benefit to residents in Austin and those in surrounding communities. The GFT is not based on earnings, margins, or profits. The GFT is calculated and determined during the City's budget process. AE has made a GFT to the City since at least 1946.

The proposed fiscal year ("FY") 2023 budgeted GFT of $115 million is based on 12% of a three-year average of actual base revenues for FY 2021 and FY 2020 and estimated revenues for FY 2022. The revenues for those years utilize existing base rates and not the proposed base rates, which would not be in effect until FY 2023. The GFT amount of $120 million is based on 12% of operating revenues, minus revenues from the PSA and non-electric business (rounded to the nearest $1 million). However, rather than take a three-year average (two actual and one estimate) of revenue, as is done when establishing the GFT annually, the amount of the GFT in the base rate review relied on the amount of revenue that is estimated from the test year only in order to align the amount of the GFT with the base rates proposed. Because the GFT will be recovered in base rates that may be in place for potentially five years or more, it is important that the amount of the GFT to be paid during the time the proposed rates are in effect is properly calculated. The budget process is separate from the rate-setting process. The budgeted GFT is calculated pursuant to the City's Financial Policies and should not be used as a basis for approving a GFT for purposes of ratemaking. The $120 million GFT is the amount AE would expect to pay over the time the proposed base rates are in effect. Failure to align the GFT with base rates will result in AE under-recovering this cost.

Based on the arguments made by several parties, the IHE recommended that the GFT be set based on the test-year GFT of $114 million or, at most, the $115 million estimate that AE used only for FY 2023. The City's Financial Policy Nos. 12, 13, and 17 prescribe how the GFT is determined. Per Financial Policy No. 13, the GFT is based on 12% of AE's three-year average base revenues using the current year estimate and the previous two years' actual revenues and excludes power supply and district cooling revenues. Despite this requirement from the City's Financial Policies, the IHE recommended that the GFT be calculated in accordance with the City's Financial Policies *using known data*. AE expressed concern that adopting this recommendation would fail to include all GFT payments made in accordance with the City's Financial Policies described above. However, after consultation with the City Manager, AE can accept assuming only a $115 million GFT in the revenue requirement so long as future City budgets calculate the GFT to achieve a result consistent with this assumption until the next base rate review.

2. Late Payment Fees

Late payment fees are revenues AE receives from customers who have been late in paying their electric bills. These revenues provide an offset to the revenue requirement. AE made no adjustment to the test year late payment fee amount of $3,347,969 in the rate filing package ("RFP"). The Independent Consumer Advocate ("ICA") proposed an upward adjustment of $2.2 million and 2WR proposed a similar adjustment. Specifically, the ICA excluded FY 2020 and FY 2021 due to the COVID pandemic and instead proposed an average of FY 2018 and FY 2019 to arrive at this late payment fee adjustment. It is improper to use FY 2018 and FY 2019 because those are two years prior to the current test year of FY 2021 and will be four years prior to the FY once base rates approved in this proceeding become effective (FY 2023). 2WR's recommendation is similar in that they propose an averaging of prior year late payment fees. These proposals do not accurately reflect the test year or more recent experience.

In addition, the test year included only eight months of late payment fees due to AE waiving them in response to COVID and Winter Storm Uri. As a result, AE included a known and measurable adjustment to late payment fees of $1,154,575 (i.e., $3,347,969 + $1,154,575 = $4,502,544). This was derived using a 12-month total of late payment fees billed beginning May 2021 through April 2022, which is after the expiration of COVID and Winter Storm Uri policies that temporarily eliminated late payment fees. The ICA did not take this adjustment into account in making his recommendation.

The IHE agreed with AE on this issue. Specifically, the IHE noted that "AE's rate package uses a FY 2021 test year, not 2018, 2019, or an average of prior years." The IHE went on to point out that "[m]ost importantly, however, the COVID pandemic and its impacts, whatever they may be, are ongoing. Reaching back to a time before the pandemic does not reflect the current and ongoing reality of the pandemic's effects, which can be viewed as the new normal." Finally, the IHE recommended adoption of AE's adjustment as it is focused on more recent data than that proposed by ICA and 2WR. AE's proposal should be adopted.

3. Winter Storm Uri Expenses

It is undisputed that Winter Storm Uri was an exceptional event. This fact does not mean, however, that storm costs associated with it were exceptional or abnormal. AE experiences storm outages every year and substantially all of the resources used in the Winter Storm Uri response are utilized in the normal course of the year, including regular storm response. The power outage associated with Winter Storm Uri lasted over an extended period of time, but that was due primarily to Electric Reliability of Council of Texas ("ERCOT")-directed load shed as opposed to storm related damage requiring crews to repair. While AE also experienced storm-related outages, the expenses associated with those outages were not exceptional as compared to other years. Accordingly, AE did not adjust its revenue requirement for storm costs associated with Winter Storm Uri.

In contrast, the ICA recommended amortizing $6.8 million dollars in Winter Storm Uri expense over five years and to include only one-fifth of that amount, or $1.36 million, in the test year revenue requirement. Significantly, the ICA did not contest the reasonableness of the overall test year costs. AE has storm outages on its system every year and substantially all of the resources used in the Winter Storm Uri response are utilized in the normal course of the year, including regular storm response. While AE experienced significant storm-related outages, the *expenses* associated with those outages were not exceptional as compared to other years due to the fact that outages caused by Winter Storm Uri were not attributable to storm related damages.

The $6.8 million in expenses the ICA proposes to disallow are comprised of $4.3 million related to labor and benefits, $1.2 million related to overtime, and $1.3 million related to contract labor. In his rebuttal testimony, AE witness Maenius responded by explaining that AE regularly incurs labor, overtime, and contractual labor costs during the course of the year, including during periods of storm restoration. With respect to the $4.3 million in labor and benefits, Mr. Maenius testified that these "were regular wages and benefits paid to Austin Energy employees who would have been paid during the period that Winter Storm Uri occurred regardless of whether the storm had happened or not." As such, these costs are part of normal operations and should not be removed from the revenue requirement.

As to overtime (i.e., $1.2 million) and contractual labor costs (i.e., $1.3 million), AE proposes to include the full amount (i.e., $2.5 million) in its revenue requirement. In contrast, the ICA proposed amortizing the amount over five years. Adoption of the ICA's recommendation would reduce AE's revenue requirement by $2.0 million (i.e., $2.5 million / 5 years = $500,000 per year rather than $2.5 million per year). However, in response to the ICA's recommendation, AE witness Maenius explained that the $1.2 million in overtime costs are identical to those AE regularly incurs during normal operations and annual storm outages. As demonstrated by Mr. Maenius, overtime costs incurred by AE during the test year are consistent with historical overtime over the last five years, especially in light of yearly wage increases and rising job vacancies. Finally, Mr. Maenius explained that the $1.3 million in contractual labor costs incurred during Winter Storm Uri restoration were attributable to vegetation management companies for their services. Notably, AE paid less to these contractors in total during the test year than in the previous year and not abnormally more than the two prior years.

Finally, the ICA provided no proof that restoration costs incurred during the test year were atypical. Instead, the ICA based his recommendation on his assertion that Winter Storm Uri was not a normal storm. Although Winter Storm Uri was exceptional in many ways, its impact on AE's labor, overtime, and contract costs was similar to the impacts experienced on a yearly basis due to less extreme events. The IHE agreed with AE on this issue. AE's proposal should be adopted.

4. Bad Debt

AE applies a consistent methodology in calculating bad debt expense for all City of Austin utility balances managed through the customer care and billing system, including Austin Water and Austin Resource Recovery. The methodology has been subject to an external financial audit for FY 2021 and is consistent with FY 2022. The annual cost to the utility is determined by calculating the current year change of account balances determined to be uncollectable. The below criteria determine that designation:

1. Inactive customer balances greater than 30 days old.
2. Active customers not on payment arrangements use the below percentages:
   5% of balances 61 to 90 days old;
   10% of balances 91 to 130 days old;
   25% of balances 131 to 180 days old;
   1/2 of balances 181 to 365 days old; and
   100% of balances greater than 365 days.

AE made a known and measurable *downward* adjustment to bad debt expense of $7,837,013 to reflect the moratorium on disconnections during a portion of the test year ($13,831,190 - $7,837,013 = $5,994,177). In response, the ICA proposed to reduce bad debt expense by an additional $1,419,161 based upon a three-year average. However, there is no indication that a three-year average is more appropriate than the actual test year data. In addition, the impact of the pandemic is ongoing and neither AE nor any other participant can predict the end of the pandemic or the possibility of any future events.

The IHE agreed with AE on this matter. The test year is based on FY 2021, from October 1, 2020 through September 30, 2021. The ICA's proposed three-year average would not include any test year data. While the pandemic's impact began in the first half of 2020, the IHE agreed with AE that the pandemic's impact is continuing and its end is unknown. Regarding the impact of Winter Storm Uri, the IHE acknowledged its severity and magnitude but found that the evidence does not link the storm to uncollectible expense. The fact that disconnections were suspended for a period after Winter Storm Uri, as pointed out by the ICA, does not establish that the storm contributed abnormally to uncollectible expense in FY 2021; rather, suspension of disconnections would suggest that any uncollectible expenses were delayed or avoided. Accordingly, the IHE recommended that AE's bad debt expense be set at $5,994,177. While AE does not condone looking beyond the test year, a review of preliminary FY 2022 figures reveals that AE experienced $7,830,569 in bad debt. This is significantly higher than the adjusted test year amount and affirms that the requested amount is reasonable.

5. Contributions in Aid of Construction ("CIAC")

Contributions in Aid of Construction are contributions from customers that offset the cost of building infrastructure. CIAC revenues reduce the revenue requirement of a utility. AE reflected CIAC it has received in the RFP. 2WR and Paul Robbins raised issues related to CIAC during the IHE Process. Both 2WR and Mr. Robbins misunderstand or mischaracterize the facts.

In 2014, City Council adopted a resolution (City Council Resolution No. 20140612-057) directing the City Manager to "plan for full cost recovery of line extensions, with an exception for certain affordable housing," which AE has done. Additionally, at its June 13, 2022 meeting, the EUC discussed the CIAC policy and the allocation of system growth costs. The EUC voted that City Council should review the CIAC policy and AE should provide a presentation to the EUC regarding the CIAC policy. Therefore, 2WR's recommendations are unnecessary as the EUC will be reviewing the CIAC policy over the next few months and making recommendations to City Council on possible revisions.

With respect to Mr. Robbins' argument, the line extension policy referenced above is memorialized in Austin Energy's Design Criteria Manual, subsection 1.3.12 AE Line Extension Policy. The Manual states:

> In accordance with Austin City Council Resolution No. 20140612-057, Austin Energy collects 100% of the costs for line extensions and new infrastructure associated with requests for new electric service, with an exemption for certain affordable housing. A Customer applying for new service will be charged all estimated costs for labor and material required to modify existing infrastructure and to extend service from Austin Energy's existing infrastructure to the Customer's point of service to serve the requested load, sometimes referred to as 'Contributions in Aid of Construction,' or 'CIAC.' This includes the service drop and meter.

Austin Energy is fully compliant with City of Austin Resolution 20140612-057.

Austin Energy's statement in the RFP in section 7.2.1, Customer Growth, states that the costs related to customer growth are about "investments in power production, transmission lines, substations, distribution poles, and conductor, customer support systems, and support services." These costs are incurred to ensure that capacity is available for all customers and that the system is reliable. The costs identified in the RFP are not included in the Line Extension policy, cannot be directly attributed to a single customer, and are not necessarily known when customers are added to the electrical system. Therefore, no adjustments to AE's revenue requirement are warranted regarding this issue.

6. Impact Fees

Texas Local Government Code Chapter 395 allows Austin Water ("AW") to charge Impact Fees to new users connecting to the water and wastewater systems. However, these state statutory provisions do not allow electric utilities such as AE to charge Impact Fees, and, in fact, Chapter 395 expressly prohibits the City from charging impact fees for purposes other than water, drainage, and roadway infrastructure. The use of impact fees in this rate proceeding is therefore not an option.

Impact fees should not be confused with CIAC and line extension fees, which AE currently charges in full compliance with current Council policy. Impact Fees (also known as Capital Recovery Fees) allow AW to pass on the costs of expanding the overall capacity of its systems directly to the new growth users. Determination of the fee is prescribed by state law and includes a requirement that the fee be updated at least every five years. AW prepares an impact fee study at least every five years to meet the state requirement. Updated land use assumptions and the capital improvement program plan underpin the calculation of the maximum allowable impact fee, whereas the actual collected fees are determined by City Council.

The fees paid by the developers can only be used to pay the direct costs or the principal and interest on bonds issued for constructing capital improvements or facility expansions identified in the growth-related capital improvement plan.

7. Customer Assistance Program ("CAP") Expansion

The CAP is supported by an AE team of 15 staff members. This small team administers and provides case management services for the discount program (currently 35,000 customers) and Plus 1 emergency financial assistance, Medically Vulnerable Registry, CAP weatherization, and arrearage management programs, and manages AE's non-profit network of 59 partners. To support the increased discount program enrollment goals in the upcoming IFC, AE anticipates that this team will need to expand by at least 50% by FY 2025. Additionally, AE anticipates an increase in contract costs for the third-party vendor that verifies enrollment eligibility.

While the value of the discount, weatherization and arrearage management programs are collected through the Community Benefit Charge ("CBC"), operational costs for the CAP are not. These costs are borne by AE's O&M budget. AE estimates these changes will require an additional $4 million to $6 million beginning in FY 2024. These numbers are preliminary estimates based on anticipated staff increases, overhead costs, and contract expansion and amendment. They do not reflect increased demand for other programs funded by the CBC. Any costs associated with the CAP expansion are not currently included in the revenue requirement.

8. Winter Storm Uri Impact on Sales

At the UOC meeting, AE was asked whether test year revenues from large industrial customers were lessened due to Winter Storm Uri. They were not. Base rate charges for large industrials are limited to customer and demand (kW) charges and exclude energy (kWh) charges. While Primary 2 base rates do include energy charges, they are very low. The impact on base rate energy charge revenue during February 2021 and March 2021 was approximately $4,000 less for the entire class as compared to the same period in 2020. Moreover, in its cost-of-service study, AE adjusted the test year billing determinants to reflect normalized weather. This process renders the impact of extraordinary weather events and resulting revenues moot.

Additionally, AE presented evidence in its Exceptions to the IHE’s Report demonstrating that the outages resulting from Winter Storm Uri did not depress test-year kWh sales and base revenues, so AE did not adjust test-year sales for the relatively short event. Although Winter Storm Uri had huge impacts, from a financial viewpoint, it did not impact system-wide test-year sales, revenues, and billing determinants. Therefore, no adjustments should be made regarding this issue.

9. Additional Real Estate Issues

a. Town Lake Center (“TLC”)

Following the UOC meeting, during the remainder of the work session, Council requested additional information regarding the transfer of the TLC. AE has agreed to transfer TLC to the City’s Financial Services Department. The $30.5 million transfer price was established using the appraised fair market value, as determined by an independent real estate appraiser contracted by the Office of Real Estate Services of the City of Austin. As of this date, no transfer of funds has occurred. Moreover, it would be inappropriate to reduce the revenue requirement to reflect the sale of TLC for the following reasons.

First, the acquisition of the Mueller Headquarters occurred during the test year, and the costs were documented. However, under typical ratemaking standards, single non-recurring costs such as the Mueller purchase are removed from the revenue requirement, as would the sale of TLC had transaction costs been known. The current revenue requirement excludes the acquisition of new headquarters and the sale of TLC. If Council moves to include the TLC sales proceeds in the cost of service and reduces Austin Energy’s revenue requirement, then the matching rule requires the new headquarters be included as well, increasing the revenue requirement by an estimated $25 million per year. Second, Austin Energy’s Capital Improvement Plan (“CIP”) adopted in the FY 2021 budget contained $55 million in funding sourced from the anticipated sale or transfer of TLC. Because that sale did not occur in FY 2021, Austin Energy was required to utilize its cash on hand to meet the CIP requirements. The TLC sales proceeds would then be used to reimburse Austin Energy’s cash on hand. Reducing the revenue requirement by the TLC sales proceeds denies Austin Energy the opportunity to replenish its cash reserves and diverts one-time sales proceeds to finance ongoing O&M costs, which customers are rightfully responsible for.

The IHE agreed with AE. He concluded that “it is premature to amortize the TLC as an offset.” He also noted that “AE has removed all operating expenses of the TLC from its revenue requirement." In summary, the IHE recommended "no adjustment to the revenue requirement associated with a potential, future sale of the TLC."

b. Grove Property / Ryan Drive

Additionally, Council inquired about the transfer of the Grove Property and the Ryan Drive Property to other City Departments. To determine the transfer price, AE used the book value of the property and created an amortization schedule using AE's weighted average cost of debt for the year AE acquired the property. This methodology ensures that AE customers are reimbursed for the principal and interest associated with the property (carrying costs).