AUSTIN ENERGY'S TARIFF PACKAGE:	§	
2015 COST OF SERVICE STUDY	§	**BEFORE THE CITY OF AUSTIN**
AND PROPOSAL TO CHANGE BASE	§	**IMPARTIAL HEARING EXAMINER**
ELECTRIC RATES	§	

AUSTIN REGIONAL MANUFACTURERS ASSOC'S POSITION STATEMENT/ PRESENTATION

The following is the position statement for the Austin Regional Manufacturers Association (ARMA), intervenor in the Austin Energy (AE) 2016 Rate Case.

ARMA believes the secondary and primary classes are charged an unfair rate. By AE's own data, classes S2, S3, P1, P2, and P3 pay rates that exceed cost of service by a combined $71.7 million. AE has publicly acknowledged that these classes are subsidizing other classes. It is long overdue to substantially reduce rates for these payers.

ARMA believes AE should and can accomplish a rate reduction to make commercial and industrial classes in line with cost of service without raising rates on other classes. We recommend:

- Reducing the $105 million transfer to the City of Austin. At 12% of total revenue less fuel, it's too high. This is especially true in light of the bad decision the utility and prior City Councils have made, such as the purchase of the Biomass plant, which sits idle and cost $50 million annually, a burden that is unfairly passed on to rate payers.
- Reducing the revenue requirements. ARMA agrees with the cost savings outlined by Samsung and NXP in the April 06 Memorandum to City Council and attached to this statement, addendum I. Adopting these recommendations would allow for an appropriate and adequate rate reduction.

AE has surpassed the affordability goal established by the City Council. It is no longer in the bottom 50% of retail rates across the State. A manufacturer operating a company within Austin Energy service area pays 40% more for energy than in the deregulated market, such as in Dallas or Houston. See the attached comparison, addendum II, provided by a neutral third party, Priority Power Management, demonstrating the regional differences of an AE customer, Luminex Corp, versus other utilities. If the City wants to attract and retain companies like Luminex Corp that provide good jobs to all educational demographics, from GEDs to PHDs, then they must reduce energy rates to be more competitive.

Please note, ARMA anticipates supporting the arguments made by Samsung and NXP, as well as other intervenor at public hearing.

In closing, if the City of Austin, The City Council, and Austin Energy care about fairness, affordability, livability, and economic development for the region, then secondary and primary rates should immediately be brought in line with cost of service through reducing the general transfer and reducing the revenue requirement.

AUSTIN ENERGY 2016 MAY -4 PM 4:55

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Date Submitted: May 3, 2016

Addendum I

NXP/Samsung firmly believe the most effective approach to address utility affordability in Austin is to review and thoroughly understand Austin Energy's (AE) revenue requirement. The higher the revenue requirement the higher the rates charged to customers.

AE has identified their revenue requirement as $1.2 billion annually. This revenue requirement pays for clear and tangible expenses like ERCOT fuel expenses and employee salaries. This requirement also incorporates less tangible, more subjective expenses that are subject to staff discretion like collecting cash reserves and accruing for future expenses.

Based on the data provided by AE during the pending rate case NXP/Samsung have identified **$218 million** in potential reductions to the revenue requirement and other charges to ratepayers. The reductions are summarized in the following table and discussed in more detail below.

Potential Cost Reductions:

Description	Reduction	Comments (Problem/*Solution*)
Power Supply Adjustment	**$70 million**	AE includes this reduction as an estimated pass-through in its filing, but claims the Pass-Through Adjustments are not within the scope of this proceeding. *We have included the proposed reduction in the Power Supply Adjustment (-$70 million) to be implemented in April 2016.*
Regulatory Charge	**($10) million**	AE did not use the most recently approved cost factors for Transmission costs (as approved by the Public Utility Commission of Texas (PUCT)) paid to others in ERCOT. *We recommend using the most recent information, which results is an increase to the Regulatory Charge.*
Community Benefit Charge	**$15.3 million**	AE included in the Community Benefit Charge the cost for providing municipal lighting, which means they are charging the ratepayers instead of the General Fund. *We recommend eliminating this General Fund subsidy and re-instate the more transparent Municipal Lighting tariff to be paid for by the City of Austin.*
Reserves	**$44.7 million**	*As Operation & Maintenance (O&M) is reduced, the amount of reserves (return) is reduced. We recommend a reduction to the reserves.*
(Capital	**$23.7 million**	AE used a 4 year average to calculate anticipated

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Improvements Plan) Transfer		capital improvements. *We recommend reducing the CIP transfer to the amount approved in the 2016 Spending Plan.*
Outside Services	**$23.7 million**	AE included $33 million in cost for outside services: the largest dollar amount being for Employment ($8,925,683), IT ($9,556,812), and Other ($5,225,316). Both Employment and IT are for contracts to support technology. In addition, AE transfers $6,451,092 to the City's technology department. *We recommend additional review to Outside Services to determine if the expenses are necessary and reasonable to provide electricity service.*
Decommissioning Costs	**$19.4 million**	AE included estimated costs to decommission Decker Creek, Fayette Power Plant, and Sandhill Energy Center at the maximum level recommended by the NewGen study. AE requested that the cost be treated as an operations cost instead of a reserve as previously approved by Council. *We recommend using the amount allowed per kW in previous PUCT cases to calculate the $3,136,350 to be placed in a reserve funded from the discontinued Emergency Reserve, resulting in a $19.4 million reduction in Revenue Requirement.*
Transmission Revenue	**$14.5 million**	AE did not increase Other Revenue to reflect the PUCT approved transmission revenue factors for 2016. *Increased revenue from transmission reduces revenue requirement from ratepayers.*
EGRSO Fund Transfer	**$9.4 million**	*The programs that are funded by the transfer are not necessary and reasonable to provide electric service, and therefore do not meet the requirement for inclusion and should be removed from the revenue requirement.*
Loss on Disposal of Assets	**$7.1 million**	These costs are Included in the Test Year and should be non-recurring. *We recommend this reduction as AE should not be incurring a loss on their assets every year.*
Rate Case Expense	**$200,000**	AE Rate case expenses were amortized over 3 years. Council resolution requires a cost of service study (rate review) every 5 Years. *We are recommending a 5 year amortization period to be consistent with the resolution.*
Total	**$218 million**	

The reduction recommendations are based on the information provided as part of the rate case process to date and are subject to change as additional information becomes available. Below we provide additional detail on each of the above recommendations.

We also strongly support the Debt Service Coverage method to determine return for AE instead of the Cash Flow method as requested by AE. The Debt Service Coverage method encourages the utility to be fiscally responsible to insure utility rates remain affordable in Austin. Additionally, use of the Debt Service Coverage method is similar to the Rate of Return method used by Investor-Owned Utilities in that rates are set to allow the utility the "opportunity" to earn its rate of return, not a "guarantee." The burden is on the managers of the utility to control costs and insure that coverage is sufficient.

Pass-Through Adjustments

The Pass-Through Adjustments were developed and approved in Austin Energy's last City Council rate review. They include the Power Supply Adjustment (PSA, which replaced the previous Fuel Adjustment Factor), the Community Benefit Charge, the Regulatory Charge, and Customer Assistance Programs. These adjustments comprise approximately **one-half of AE's total cost of service** ($600 million out of $1.2 billion).

AE on its own initiative included information concerning the pass-through charges in their rate filing package. (See Bates number 176 of AE rate filing package). In addition, in the current base rate proceeding, AE is requesting to change the PSA to reflect the summer season and a new Regulatory Charge calculation. However, AE has objected to questions concerning how the PSA estimates were determined although the reference to the PSA is made in Bates Numbers 176 and 1002 of AE's filing. AE recommends that any future over-recovery of the PSA be transferred to a "Rate Stabilization" reserve instead of returning the over-recovery in next year's PSA, which is approved by the City Council yearly. (Bates Number 999).

We have identified net changes to various pass-through charges that would result in a decrease of $75,330,750. However, Austin Energy maintains that these charges are not under consideration in the pending review before the Impartial Hearing Examiner (IHE) because the PSA is outside the terms of the current tariffs, as they are included in the City's Budget Process. The City Council certainly has the authority to modify that requirement and consider the pass-through charges within the pending review, especially in light of the fact the City Council will be conducting its budget review at the same time it will be considering the IHE's recommendation.

<u>Power Supply Adjustment (PSA)</u>

In March, after the pending rate review process had already begun, AE announced that it will decrease the PSA by $70 million beginning in April. We applaud the utility for passing on fuel savings to customers, but are baffled that the utility believes the PSA does not impact the pending base rate case. The PSA greatly impacts customer's rates and has been discussed by Austin Energy in their rate package.

Failure to reflect the full decrease in the PSA will result in Austin Energy over recovering an amount that is in excess of an amount required by the bond rating agencies. Because the PSA makes up a large percentage of AE's overall rates, at a minimum, it should be considered during any rate review process. Failure to do so will result in an overstatement of base rates that cannot be corrected until the next rate review. Given the size and impact to customer's bills we strongly recommend the PSA components be reviewed.

<u>Transmission Cost</u>

AE recovers its Transmission Cost through the Regulatory Charge. However, this Transmission Cost is not set by AE or Austin City Council, but instead it is set by the PUCT. Austin Energy's 2016 Transmission Cost was set by the PUCT in Docket 45382, *Commission Staff's Application to Set 2016 Wholesale Transmission Service Charges for the Electric Reliability Council of Texas*. By using this PUCT approved Transmission Cost, AE customers would see a reduction of $14,479,686 in AE's base rate revenue requirement. However, because AE did not use the most recent PUCT approved Transmission Cost, but used an outdated 2014 cost, AE customers do not see this savings; instead of passing savings to customers, AE is inflating their required base rate requirement.

Community Benefit Charge

AE currently charges all ratepayers within the City Limits for municipal lighting costs through the Community Benefit Charge. Before the last rate case before the City Council, municipal lighting costs were paid by the General Fund. We believe this should be done again. By not paying for municipal lighting costs out of the General Fund, the City of Austin is ostensibly increasing their general fund transfer; these are expenses that should be paid for by the City, but instead the City is charging ratepayers. AE ratepayers would see a reduction to the Community Benefit Charge of $15.3 million without this hidden subsidy to the City's General Fund. AE should re-instate the Municipal Lighting Class and charge the City as it does the municipalities outside the city limits of Austin, as required by the Final Order in PUCT Docket 40627, which was an evaluation by the PUCT of AE's rates to customers outside of the city limits. The change in the Community Benefit Charge does not lower the overall revenue requirement but charges the City of Austin, and not the ratepayers, for the cost of municipal lighting. This policy is consistent with other integrated utilities within the state of Texas as well as AE's customers outside of the city limits.

Reserves

Austin Energy's Financial Policies establish various reserves to provide cash for operations. The policies are approved each year by City Council as part of the Budget Process. The current financial polices were instituted over a period of years beginning in 1989. AE has recently engaged the consulting group NewGen Strategies & Solutions (NewGen) to review the existing policies and to recommend changes. Based on the report produced by NewGen, AE recommends changes of $3,398,128 to the level of reserve funding and a change to its reserve structure. Surprisingly however, AE has maintained an additional $11,590,703 in reserves based on current outdated policies, and has included this unnecessary $11,590,703 as part of return.

Based on NewGen's report, part of AE's recommendation is an increase of $125 million to the Rate Stabilization Fund, which will be funded from the elimination of the current Emergency Fund. AE also recommends an increase in the number of days for working capital from 45 days to 60 days. Pursuant to PUCT Subst. R. 25.231, the agency requires 45 days working capital. [1] AE is also asking to add $27.6 million cash on hand to meet the 150 days of cash on hand criteria used by the rating agencies. In addition, AE included a Mark-to-Market adjustment to reduce the unaudited balance of $985,000 to adhere to a Governmental Accounting Standard. Using 60

[1] PUCT Substantive Rule § 25.231(c)(2)(B) specifies that cash working capital allowance be no greater than one-eighth of O&M, which is 45 days, and requires Investor-Owned Utilities to file Lead-Lag Studies to support cash working capital. Lead time is the number of days between the company's receipt and payment of invoices it receives. Lag time is the average number of days between the companies' billing of its customers and its receipt of payment.

days of working capital instead of the standard 45 days, in combination with having 150 days of cash on hand as well as a reduction in unaudited balance is inappropriate in a cash-based filing.

In addition to the above changes, we recommend that the non-nuclear decommissioning amounts for Decker be placed into a reserve to be built up over a 4-year period, in the amount of $3,136,350. AE has assumed Decker will be retired in 2018, which we believe is very optimistic. After considering the adjustments for the Fiscal Year 2016 PSA, for non-nuclear decommissioning and outside services there is no need to increase the reserves. As of September 2015, there is a $33,180,869 reduction to the current balances of the reserves, which results in $370,219,341 to meet a 150-day target.

We therefore recommend the total adjustment to AE's requested level of reserves (return) should be a decrease of $44,771,572.

Capital Improvements Plan (CIP) Transfer

AE determined the amount requested for CIP transfer by using the average of cash funding portion of CIP for the years 2011 through 2015. The 2011 through 2015 average, that was funded through internally generated cash instead of debt, was 52%. If, instead, AE used the approved budget for Fiscal Year 2015-2016, which was $64,624,113, customers would see a $23,717,342 reduction in the CIP transfer. We find this to be a more appropriate method.

Outside Services

Austin Energy's cost of service includes $27 million for Outside Services Employed in the Test Year and AE recommends an additional increase of $7.2 million resulting in a total cost for Outside Services Employed of $33 million. This amounts to almost 20% of AE's total labor cost. We have removed $23,707,811 specified as Employment, IT, and Other, because AE has not provided adequate information for us to determine if these costs are recurring and necessary and reasonable to provide electric service.

Decommissioning Costs

Austin Energy has included $19,442,308 in O&M for decommissioning costs for Decker Creek, Fayette Power Plant, and Sandhill Energy Center. Previously, funds for non-nuclear decommissioning were treated as a reserve. However, AE has relied upon NewGen's report and is now recommending the maximum amount identified by NewGen be the basis for AE's request, resulting in higher than necessary decommissioning costs. The costs established by AE based on the NewGen report are: $28 million for Decker Creek; $30 million for Fayette Power Plant; and, $22 million for Sand Hill Energy Center. However, these numbers are inflated. The NewGen report surveyed the various decommissioning costs allowed by the PUCT per kW and determined their mean to be $17.40 per kW, yet AE is requesting $38.83 per kW for the three plants. This $21.43 per kW difference is unreasonable and AE's request of $38.83 per kW is unnecessarily high and unsupported.

Using the mean allowed by the PUCT (and included in NewGen's report), we are recommending a total for all three plants of $12.5 million. Of this amount we recommend that only decommissioning costs for Decker Creek be allowed into rates at this time because, though not authorized for decommissioning at this time, the City Council has stated they wish to retire the plant by 2018. Currently, the City Council has not authorized any of the plants to be decommissioned.

NewGen's report was correct in its assessment that decommissioning costs should be collected from ratepayers over the life of the asset. This is usually done through depreciation rates for investor owned utilities. However, the fact that AE did not include decommissioning or cost of removal in its prior depreciation rates does not mean that it should now be included in O&M. The increase in the amount of O&M impacts the working cash reserve and contingency reserve as well as the measurement of the number of days of cash on hand targeted by the bond rating agencies. We are recommending that $3,136,350 be placed in a reserve and funded from the remaining amounts from the Emergency Reserve that AE requested go to the Rate Stabilization Reserve. (See discussion of reserves)

Economic Growth and Redevelopment Services Office (EGRSO) Fund Transfer

AE included $9,090,429 as O&M for the transfer to the City's EGRSO fund. This transfer goes to the Economic Development Department (EDD) whose "FY 2015-16 Budget is $47.9 million. Of this amount, $14.8 million is for day-to-day operations and includes incremental increases for employee wages and benefits, administrative support, rental adjustments, and removes onetime funding for the Austin Tech Partnership." The remaining $33.1 million of funding in EDD's FY 2015-16 Budget is for cultural arts contracts, Economic Incentive payments, small business loans, and for business retention and music venue assistance. The expenditures for these programs, while worthy, are not necessary and reasonable to provide electric service and should therefore not be paid for by AE ratepayers. These costs are not associated with the provision of electric services and should therefore not be included in AE's budget. If the City Council continues to fund these programs it should do so out of the General Fund.

Loss on Disposal of Assets

AE has included in its Test Year $7,170,039 for Loss on Disposal of Assets. In NXP and Samsungs' Third Request for information, question 3-4, we asked why this loss is recurring as only recurring costs should be included in the cost of service. AE responded that "loss on disposal of assets occurs as a result of the retirement of assets. Generally, this happens yearly." We are of the opinion that "generally" should not constitute "recurrent" and therefore does not meet the criteria of "known, measurable, and recurring," the standard applied to Investor Owned Utilities within the state.

Rate Case Expenses

AE seeks amortization of rate case expense from their last rate case over a three-year period, however, AE is required to conduct a cost of service review every five years. Therefore, amortizing the expense over five years is a more consistent approach and would result in a reduction of $215,000.

Cash Flow Method vs. Debt Service Coverage

There are four different options identified by the PUCT for determining "return" for municipally-owned utilities: Cash Flow; Debt Service Coverage; Times Interest Earned Ratio (TIER); and, Rate of Return. AE has used the Cash Flow method to determine return. However, we believe the proper method for determining return should be the Debt Service Coverage method. In Austin Energy's last rate proceeding before the PUCT, which was settled, Commission Staff member, and head of the Rate Regulations Division, Darryl Tietjen, expressed concern over the Cash Flow methodology stating:

> . . . the Cash Flow method allows a utility to assert the total amount of return necessary to pay for all its cash needs, and that resulting amount is –*ipso facto*—the amount that the utility claims as the return that it "requires" in its revenue requirement. The bottom- line result is that a utility's demonstration and justification of its desired return amount is a foregone conclusion because it is a mathematical inevitability.[2]

We share this concern. Under the Cash Flow method utilized by AE, the General Fund and other transfers to reserves are taken as a given; this methodology does not incentivize prudence and savings because rates will be set based on these transfers.

Instead, we recommend AE use the Debt Service Coverage methodology as this methodology is similar to the Rate of Return method used by Investor-Owned Utilities in that rates are set to allow the utility the "opportunity" to earn its rate of return, not a "guarantee." The Debt Service Coverage methodology allows a utility to cover its principal and interest payments due in a given year, while also providing an additional amount of dollars as a cushion so the utility can pay other requirements, such as the General Fund Transfer and transfers to be used for construction. If reviewed periodically, in a consistent manner, the Debt Service Coverage methodology can serve as a check on the utility's spending by placing a transparent metric on amounts that are included in the return calculation. Under this methodology, the burden is on the managers of the utility to control costs and insure that coverage is sufficient, resulting in benefits to ratepayers through prudent expenditures.

Additionally, AE's bond requirements require coverage of only 1.5 times debt service. However, the AE Financial Policies, approved by Council, requires a higher minimum coverage ratio of 2 times debt service, which allows for the General Fund Transfer of $105 million. In stark contrast, the coverage that results from AE's use of the Cash Flow method is 2.77 times debt service. At a maximum, AE should be using PUCT Staff's recommended coverage of 2.15, which would result in a reduction to AE's requested revenue requirement of $50,932,157.[3]

Conclusion

We firmly believe the most effective approach to address utility affordability in Austin is to review and understand all aspects of Austin Energy's revenue requirement. The higher the

[2] Docket 40627, Direct Testimony of Darryl Tietjen, page 8 of 35, lines 8-13.

[3] This analysis assumes no adjustments to the remainder of AE's requested revenue requirement but is calculated to isolate the dollar difference in the methods. As other adjustments are made in the rate process this number will change.

revenue requirement the higher the rates charged to all customers. Throughout this memo we have explained how we have identified and determined that AE should make an additional **$218 million** in reductions to their revenue requirement and pass-through charges. This will have the added result of helping address the current affordability challenges facing all of AE's customers.

We also strongly support the Debt Service Coverage method. This method encourages the utility to be fiscally responsible to insure utility rates remain affordable in Austin.

Addendum II

Electricity Rate Comparison

Austin Energy vs. Deregulated Markets

Customer Name	Luminex Corp
AE Rate Class/Code	COA - Electric Commercial Secondary Voltage >50kW

			DEREGULATED MARKETS			
	City	**Austin**	**Dallas**	**McAllen**	**Pecos**	**Houston**
	Utility	Austin Energy	Oncor	AEP Central	TNMP	CenterPoint
Annual Energy	Demand (kW)	1,147	1,147	1,147	1,147	1,147
	Energy (kWh)	4,867,190	4,867,190	4,867,190	4,867,190	4,867,190
Rate ($/kWh)	Supply		$0.0339	$0.0350	$0.0339	$0.0347
	Delivery		$0.0205	$0.0238	$0.0230	$0.0212
	Subtotal		$0.0544	$0.0588	$0.0569	$0.0559
	GRT/PUCA		$0.0012	$0.0013	$0.0012	$0.0012
	Total	**$0.1032**	**$0.0555**	**$0.0601**	**$0.0582**	**$0.0571**
Cost ($/Year)	Supply		$164,998	$170,352	$164,998	$168,891
	Delivery		$99,637	$115,838	$112,087	$103,348
	Subtotal		$264,635	$286,190	$277,084	$272,239
	GRT/PUCA		$5,735	$6,202	$6,004	$5,899
	Total	**$502,516**	**$270,370**	**$292,392**	**$283,089**	**$278,139**
Annual Variance	($/Year)	Base	($232,146)	($210,124)	($219,427)	($224,377)
	(%)		-46.2%	-41.8%	-43.7%	-44.7%

Notes:

Deregulated Supply rates are based on market conditions as of 12/21/2015 for 1-yr fixed priced products.

Delivery rates are averages based on current published tariffs for transmission distribution service providers.

GRT/PUCA stands for State Gross Receipts Tax and Public Utility Commission Assessment Tax.