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	§	

INTERVENORS DATA FOUNDRY/AUSTIN CHAMBER *CORRECTED* COST ALLOCATION, REVENUE DISTRIBUTION AND RATE DESIGN PRESENTATION

INTRODUCTION

It is critical that Commercial Class customers be assessed no more than a reasonable portion of AE's revenue requirement, once AE's overall requirements are established. The Austin Chamber of Commerce and Data Foundry ("Data Foundry/Chamber") intervened in this proceeding to ensure that Data Foundry and Chamber members bear no more than their fair share of Austin Energy's (AE's) approved revenue requirement and pay rates that are just and reasonable for their electricity requirements. These entities take service primarily in AE's Commercial Service classes and have decided to file a joint presentation regarding cost allocation, revenue distribution and rate design.

Data Foundry/Chamber will more than likely support many of the revenue requirement recommendations submitted by NXP/Samsung. Data Foundry is also separately recommending disallowance of AE's claimed variable and fixed production costs associated with their generation fleet since all of AE's generation is now entirely dedicated to serving the wholesale ERCOT market rather than AE's native retail load.

Data Foundry/Chamber's Cost Allocation, Revenue Distribution and Rate Design Presentation will address AE's recommendations on the same topics and supply alternative suggestions using the AE revenue requirement numbers for purposes of cost allocation, revenue distribution and rate design. We are also providing some specific proposals that will guide how any adjustments to the revenue requirement that are made in this case should be reflected in the cost allocation, revenue distribution and rate design changes that should flow from the revenue requirement reductions.

At least two of Austin Energy's proposals in this case serve to significantly, unreasonably and artificially increase the production costs attributed to and then recovered from Commercial

Class customers. First, AE has proposed a new and unprecedented cost allocation method that increases the estimated cost responsibility of Commercial Class customers. AE's proposed cost allocation method is significantly different than the previous approved method, which followed long-standing precedent at the Public Utility Commission of Texas (PUCT), and was also approved by the Austin City Council in AE's most recent rate case.

Second, AE's proposed revenue distribution unfairly maintains significant existing inter-class subsidies and fails to adequately move several large Commercial classes toward their actual cost of service. AE's own cost analysis shows that the Commercial classes currently pay more than $50 million more than cost of service, while the Residential class pays approximately $50 million less than cost. AE's proposed revenue distribution fails to make adequate movement toward cost of service, *e.g.*, a relative rate of return equal to the system rate of return ("unity"), for all customer classes in general and the Residential and Commercial classes in particular.

AE's Overall Proposal

AE proposed a significant change in its cost-of-service methodology for the largest component of its revenue requirement by recommending a change to its allocation method that differs from both the method most commonly approved by PUCT and the method most recently approved for AE by the Austin City Council. AE's new method allocates significantly more cost to Commercial customers and significantly less cost to Residential customers than the old method. This new method is unprecedented for the purpose that AE has proposed it and, contrary to AE's assertions, is not supported by generally accepted practices in the industry.

Furthermore, the revenue distribution proposed by AE is inappropriate. Under any cost allocation method considered by AE there are significant inter-class subsidies among AE's rate classes. AE's proposed revenue distribution nonetheless fails to take adequate steps toward elimination of these existing and long-standing subsidies even though there is a revenue surplus that can be used for this purpose. Finally, some of AE's specific rate design proposals, and in particular the change to the Regulatory Charge, should be rejected.

Summary of Findings and Recommendations

If AE is allowed to assign production costs to retail base rates notwithstanding the reality of how ERCOT operates and the actual purpose served by AE's owned generation fleet, it is imperative that those production costs be assigned in a rational manner that comports with the precedent and sound ratemaking principles. AE's cost-of-service study has a significant flaw, since it is based on an unprecedented and inappropriate method of allocating production costs, the largest component of the utility's claimed "retail" costs. AE's proposed method is inconsistent with cost allocation methods previously approved by the Austin City Council and the PUCT. AE's proposed method tries to hide the actual extent to which the Residential class is being subsidized by the Commercial classes by struggling to make it appear to be smaller than it actually is if measured by traditional and generally accepted methods.

Further, even if one wrongly accepts AE's production cost allocator, AE's proposed revenue distribution still fails to adequately reduce the subsidy of AE's Residential class by AE's Commercial classes revealed by AE's own (inappropriate) production allocation method. AE's proposed revenue distribution overly constrains the rate changes on individual class revenue targets, resulting in less reduction to the subsidy than could be achieved by using AE's own professed guidelines. As a result, AE's proposed changes in individual class revenue targets do not properly address and compensate for the classes' existing relationships to their cost of service.

Summary of Recommendations

The Austin Chamber of Commerce and Data Foundry recommend:

1. AE's proposed Electric Reliability Council of Texas 12 Coincident Peak (ERCOT 12CP) method for allocating demand-related production costs should be rejected and the A&E-4CP method traditionally used by the Public Utility Commission of Texas (PUCT) should be used instead;

2. AE's proposed revenue distribution should be rejected in favor of a revenue distribution that more adequately reduces existing subsidies and better compensates for existing deviations from cost of service; and

3. AE's proposed 358~~423~~% increase to the Regulatory Charge for the P2 class should be rejected because AE has not shown that this increase is either reasonable or cost-based.

These topics will be discussed in detail below.

COST OF SERVICE STUDY

Cost allocation is the process of allocating a utility's common costs among its customers. Many of the utility's costs are undertaken to serve numerous customers. After the utility's total revenue requirement has been determined, it is necessary to allocate joint costs among customer classes.

Cost allocation has two purposes: 1) to determine the cost of serving different groups of customers through a cost-of-service study, and then 2) to reasonably and equitably allocate the utility's revenue requirement between these groups of customers based on their respective costs of service.

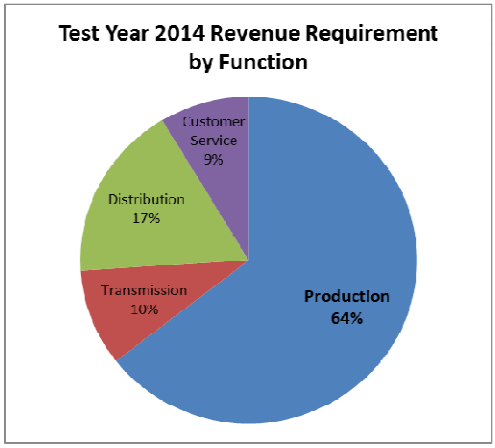
While some costs are obviously associated with certain classes or customers and can be directly assigned, many of the utility's costs are "common costs," that is, costs that are incurred to serve more than one customer or class. In such cases it is necessary to allocate these common costs on the basis of some measurement that provides an estimate of the proportional cost responsibility among the different classes. A cost-of-service study provides a means for analyzing various classes' cost responsibility.

The primary consideration in cost allocation is cost causation. Cost should be allocated among customers based on the best possible estimate of the factors that cause the cost to be incurred. For example, utility distribution systems are sized to meet expected peak demand. As a result, there is a causal relationship between peak demand on the distribution system and the

magnitude of the utility's investment in facilities that are required to provide the capacity to meet peak demand. Therefore, utility investments that are made to provide capacity on the transmission and distribution system should generally be allocated among customer classes on the basis of some measure of individual class contributions to the maximum demand on the system. This report will address AE's proposed allocation of its claimed production costs,[1] after assuming (without necessarily accepting) that those claimed costs are properly recoverable from base rates given that all of AE's production is actually dedicated to the wholesale market.

AE's Cost of Service Proposal

Production costs comprise the largest component (almost two-thirds) of AE's claimed base revenue requirement. Therefore, if AE's production costs are put in the base revenue requirement and recovered through base rates[2] the proper allocation of these costs has a major impact on the rates that customers pay.



[1] Production costs include fuel and purchased power expenses; certain Operating and Maintenance expenses; and expenses related to the financing, repair, and replacement of AE's power generation resources. Source: Austin Energy's Tariff Package: 2015 Cost of Service Study and Proposal to Change Base Electric Rates, January 25, 2016, page 5-5.

[2] As noted above, AE's generation fleet is dedicated to ERCOT rather than AE's native load. Production costs have typically been included in retail base rates **only** when the generation is dedicated to the retail customers that will pay those base rates. When retail customers are served by a utility that purchases power to serve native load – as is now unquestionably the case for AE – then the generation costs incurred by the wholesale generator should be recovered through charges to the wholesale purchaser. The purchaser then passes the wholesale purchased power costs on to retail ratepayers through pass-through charges that are dealt with separately from the base revenue requirement and base rates. That is the essential basis for Data Foundry's recommendation that AE's variable and fixed production costs should be excluded from the base revenue requirement.

Source: Austin Energy's Tariff Package: 2015 Cost of Service Study and Proposal to Change Base Electric Rates, January 25, 2016, Figure 5.2, page 5-4.

AE has recommended using an "ERCOT Twelve Coincident Peak (ERCOT 12CP)" methodology for allocating demand-related production costs[3] between customer classes. AE's justification for this significant change in cost allocation is the utility's assertion that "[t]his is an appropriate methodology for a regulated entity like Austin Energy that operates in a centralized dispatched environment like the ERCOT Nodal Market" and it "better aligns the relationship between the costs and benefits that accrue from owning and operating its fleet."[4]

Discussion of AE's Cost of Service Proposal

AE has proposed using all of the same cost allocation methods that were approved by the City Council in 2012, ***except* for** production cost allocation. AE recommends that the Council change the production cost allocator from the Average and Excess 4 Coincident Peak ("A&E 4CP") method that has historically been applied. AE wants to instead use what it calls the ERCOT 12 Coincident Peak ("12CP") allocator.[5] Data Foundry and the Chamber oppose this change. AE has not proven that any change is warranted, and the alternative method does not correctly measure production costs given AE's system and specific retail class load characteristics.

Methods for allocating demand-related production costs typically rely on some measure of customers' demand on the utility system. The proposed change to ERCOT 12CP is a significant departure from the method that was previously approved by the Austin City Council

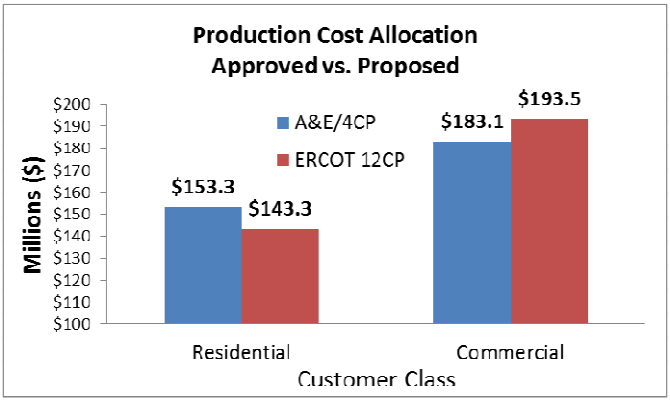
[3] AE claims to have $341,575,538 in demand-related production costs. According to the NARUC Cost Allocation Manual, p. 35, "[p]roduction plant costs are either fixed or variable. Fixed production costs those revenue requirements associated with generating plant owned by the utility, including cost of capital, depreciation, taxes and fixed O&M. Variable costs are fuel costs, purchased power costs and some O&M expenses. Fixed production costs vary with capacity additions, not with energy produced from given plant capacity, and are classified as demand-related. Variable production costs change with the amount of energy produced, delivered or purchased and are classified as energy- related."

[4] *ibid*., page 2-11.

[5] Austin Energy's Tariff Package, January 25, 2016, page 2-11.

and that has traditionally been accepted by the PUCT. The 2012 rate ordinance, for example, adopted a modified version of the A&E 4CP method to allocate production demand costs.[6]

This proposed change in cost allocation has a significant impact on the allocation of production costs among the customer classes. Compared to the more traditional and generally accepted A&E-4CP production cost allocation method, the use of the ERCOT 12CP results in the transfer of approximately $10 million in cost responsibility from the Residential class to the Commercial classes.



AE's proposed production-related demand cost allocation method is unprecedented and rests on a questionable theoretical foundation. AE's assertion that the ERCOT 12CP is appropriate because of the ERCOT Nodal market and better aligns the costs and benefits from use its own fleet[7] is contrary to AE's own stated considerations for the selection of an allocation method. AE's introductory comments concerning production demand cost allocation state that "production demand cost allocation methods vary depending upon historical precedent and the utility's view of the underlying nature and cause of generation capacity."[8] *(emphasis added)*

[6] City of Austin Ordinance No. 20120607-055, Part 6, (June 7, 2012).

[7] AE's claim that its 12CP reflects the transition to a nodal market is curious since AE's effort to recover its production costs through base rates entirely ignores that fact that under the nodal market AE's generation fleet is now entirely dedicated to servicing the wholesale market rather than AE's native retail load. AE's rationalization falls flat, since it – once again – completely obliterates the distinction between AE's foray into trying to service the ERCOT-driven monopsony wholesale market and what should be its entirely different set of costs associated with essentially now being a distribution utility providing service to its captive monopoly retail customers that meets most of its requirements by purchasing power from the wholesale market. Again, this is essentially how the ERCOT nodal approach works when it comes to retail electric utilities.

[8] *ibid.*, page 5-14.

The American Public Power Association (APPA) "Cost of Service Procedures for Public Power Systems," however, has this to say about the 12CP method:

> *12CP allocates demand costs over an annual period of time and, in this respect, can dilute, or reduce, the allocation of demand cost of those customer classes heavily contributing to sharp maximum system peak demands. If the power system has a high winter or summer peak demand relative to demands of other times, use of this method is questionable if a cost-price signal were desired to reduce peak demand.*[9]

On the other hand, the Average and Excess (A&E or AED) method recognizes that production costs are not driven solely by peak demands or energy usage but are the result of both. The APPA cost allocation manual has this to say about the A&E method for allocating production costs:

> *AED considers demand requirements as well as energy consumption of customer classes of service in allocating demand cost to classes. AED is probably the most commonly used method for public power systems in annual average cost of service studies today as it attempts to consider class of service demands as well as the extent to which the classes used the facilities installed for service*.[10]

AE also suggests that an important consideration in selecting a production demand cost allocation method is the underlying nature and cause of generation capacity. This is an important consideration but AE's rationale for utilizing the ERCOT 12 CP does not reflect this consideration.

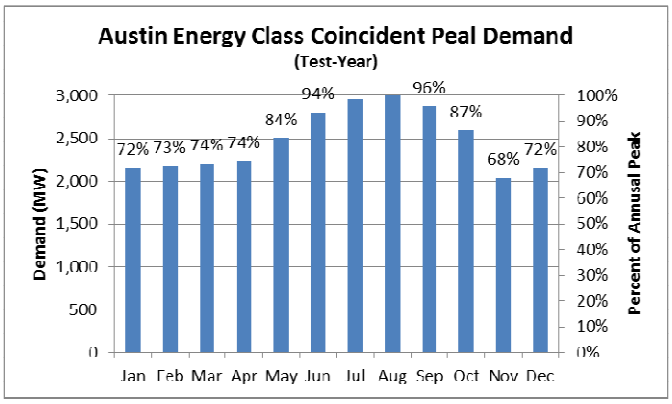
Peak electrical demands in Texas tend to occur in the summer. Generation planning therefore typically focuses on ensuring that adequate generation capacity is available during the summer months. Production demand allocation methods in Texas also tend to focus on customer demands during the summer months in order to recognize that peak capacity demand, and planning for that demand, are mostly about meeting the summer peak.

AE's response to Data Foundry's RFI 1-11 notes that the National Association of Regulatory Utility Commissioners Cost Allocation Manual states that the 12 CP method "uses an allocator based on the class contribution to the 12 monthly maximum system peaks. This

[9] "Cost of Service Procedures for Public Power Systems," American Public power Association, page X-4.

[10] *ibid*., page X-3.

method is usually used when the monthly peaks lie within a narrow range." This does not describe the annual load characteristics of AE or other utilities in Texas, which tend to be summer peaking.



Source: AE Work Paper F-6.1

AE examines three tests to guide the determination of the appropriate CP allocator for a utility: the Season to Peak test, the Lowest Peak to Annual System Peak test and the Average Annual Peak to System Peak test. AE concludes that two out of the three tests indicate that AE's load is not seasonal. However, the results of each of the tests are at best borderline. On the Season to Peak test, a score of less than 19% supports a 12 CP. AE's score on this test is 21.7%, according to AE, supporting the use of the seasonal CP rather than 12 CP. On the Lowest Peak to Annual System Peak test, scores greater than 66% support 12 CP. The annual variation for AE is 68%, so AE concludes that its load is not overly seasonal. On the Average Annual Peak to System Peak test, a score greater than 81% supports use of the 12 CP. AE's annual variation is 83%, which AE again concludes indicates the 12 CP is appropriate. The results of these tests are, in fact, mixed and inconclusive.

Finally, a 12CP is not appropriate for allocating AE's demand-related production costs because ERCOT demands, like AE's, are seasonal and the production cost allocation should, therefore, recognize that the peak season is the primary cause of these costs. In its discussion of its proposed rate changes, AE states that "[u]nlike non-power supply fixed costs, the price of

power in the ERCOT market is highly volatile and reflects changes in seasonal demands."[11] For these reasons, a production cost allocation that reflects the importance of seasonality, such as 4CP, is more appropriate than a 12CP allocator that relies on an assumption that these costs are the result of demands throughout the year.

AE states that "[f]or the production function, AE is concerned with making generation available during ERCOT system peak throughout the year."[12] This is a completely different rationale than AE's stated objective and also different from traditional and generally accepted rationales for selecting a production cost allocation method, which focus on cost causation.[13]

AE's other stated consideration for selecting a production demand cost allocation method is "the underlying nature and cause of generation capacity." AE's proposed production cost allocation method does not reflect the cause of its generation capacity as AE suggests a proper production cost allocation method should.

In explaining the purpose of its cost allocation, AE's rate filing package states:

> *For the production function, AE is concerned with making generation available during the ERCOT system peak throughout the year; therefore, to allocate demand costs to each customer class, Austin Energy calculates each customer class' contribution to the twelve monthly peak days that occur from January through December.*

The entirety of AE's generation is now entirely dedicated to sales within the ERCOT wholesale market, even though the majority of AE's generation fleet was neither planned nor originally built to serve the ERCOT wholesale market. It was placed to serve AE's native load customers but that is no longer how it works. That means, among other things, that there is little, if any, direct connection between the ERCOT 12CP and AE's fixed production costs.[14] For

[11] Austin Energy's Tariff Package, January 25, 2016, page 6-6.
[12] *ibid*., page 5-11.
[13] Notice also that AE admits that its focus is the ERCOT system peak, rather than AE's native system peak or the individual class peaks for the various AE retail classes.
[14] AE's Rate Filing Package at 5-5, Bate 108 and 5-11, Bate 114 acknowledge that ERCOT wholesale prices are driven in part by peak requirements, but they are purposefully designed to recover variable production, *e.g*., energy-related costs. This is yet another reason why the ERCOT 12CP method is an inappropriate mechanism for allocating demand related costs as between AE's retail classes.

example, AE is obligated to serve its native load customers but it has no duty or obligation to build generation to meet ERCOT load,[15] and as a result of the ERCOT market AE is functionally prevented from directly serving its retail customers by any part of its generation fleet. All of AE's power consumed by its retail users is now, for all intents and purposes, purchased power.

That is why AE's production costs at least arguably should not be reflected in base rates. But if they are, the historical relationship between AE's native load and its generation investments that has governed the allocation of the cost of its generation assets should be retained. Otherwise AE's retail ratepayers (individually and collectively) will be forced to bear non-cost-based rates that do not reflect the demand caused by their native load **and** they will additionally be forced to serve as captive guarantors of AE's competitive wholesale activities in a market that is risky and presently laden with non-compensatory returns (especially for fixed costs) for all but a very few nimble competitors. As a general rule monopolists do not fare well in competitive endeavors and the captive customers inevitably suffer the consequences. The required cultures are entirely discordant.

Second, there is no historical precedent for using AE's proposed ERCOT 12CP production demand allocation method either at AE or any other retail utility in the state of Texas. The 12CP method is used primarily in geographical locations without dramatic summer or winter peaks, unlike Texas, which tends to have a strongly summer peaking load. That is why most Texas utilities have relied on production cost allocation methods utilizing a 4CP-based allocation factor, more heavily weighting customer demands in the months of June through September.

There is long-standing precedent in Texas for using a 4CP-based method to allocate demand-related production costs. AE itself admits that "[a]t the state level, the Public Utility Commission of Texas (PUCT) has established a precedent of using the Average and Excess Demand (AED)/4 CP which is mathematically similar to the 4 CP demand allocation method.[16]

[15] *See* AE's response to Data Foundry RFI 1-9, "Austin Energy is not legally obligated to make resources available for dispatch to the ERCOT wholesale market during the system peak throughout the year."

[16] Austin Energy's response to Data Foundry RFI 1-11.

Finally, in addition to selecting the cost allocation method that most reasonably reflects "cost causation" (the reason these costs are incurred) it is also important to maintain some consistency in cost allocation methods. This is known in ratemaking as the "consistency principle." Cost of service study methods and results that fluctuate wildly between cases send conflicting price signals to customers.

Cost of Service Study Recommendation

Data Foundry and the Austin Chamber contend that – if and to the extent production costs are included in the retail base revenue requirement even though the production is in fact 100% dedicated to the wholesale market – the PUCT-sanctioned and Council approved A&E-4CP method for allocating demand-related production costs should be retained. This is a commonly used method for allocating production cost among customer classes and has been used by AE in the past. Furthermore, the PUCT has most often approved the A&E 4CP method in the most recent rate cases in which allocating production cost among customer classes was an issue.

REVENUE DISTRIBUTION

Revenue distribution is the second and final part of the cost allocation process. The costs that are calculated in the cost-of-service study do not typically lead directly to rates for the classes. Rather, the cost-of-service study provides a revenue requirement for each class at exactly their cost under a unity (1.0) relative rate of return. The cost-of-service study is a starting point for determining class revenue targets from which rates are designed. The process of moving from the class revenue amounts indicated by the cost-of-service study to the actual class "revenue targets" used for rate design purposes is referred to as revenue distribution.

Revenue distribution determines target revenues for each class based on an examination of the relationship between current rates and the cost to serve each rate class or customer class. Revenue distribution is the intermediary step between calculating the cost of service for each class and designing rates for service to these classes. Revenue distribution

determines the class revenue targets that the individual rate components will be calculated to recover.

Revenue distribution is necessary because there are often considerations that come into play that cause class revenue targets to differ from the cost of serving each class of customers, as determined by the cost-of-service study. For example, there may be policy reasons for deviating from cost in setting class revenue targets. The most common reason for deviating from cost is to prevent "excessive" changes in rates. The existence of significant subsidies in current rates could necessitate large changes in rates in order to bring rates into line with costs. This concept of "gradualism" is often employed to mitigate extremely large rate increases that could lead to "rate shock."

AE's Proposed Revenue Distribution

AE has relied on gradualism to constrain class rate changes by not recommending that all classes pay their cost-of-service. AE acknowledges that "certain customer classes are experiencing significant deviations from cost of service" and "the size of that deviation is large for some customer classes." AE suggests that "moving all customer classes immediately to cost of service would result in a financial burden for certain customers in classes with an indicated large rate increase. The associated rate shock of such a dramatic change would place undue hardship on the customers in these classes and would be undesirable." AE has proposed a maximum rate increase of 2.6% for the Transmission Voltage ≥ 20 MW class.

The Residential class is the only major rate class that is significantly below cost-of-service under every production cost allocation method evaluated by AE. Even under AE's proposed cost allocation method, Residential customers are currently paying more than $50 million less than their actual cost. Interestingly, the Residential class is paying $53.4 million less than its cost-of-service, while the Commercial classes[17] are paying a combined $53.7 million MORE than their cost-of-service. This conspicuous direct subsidy of the Residential class by Commercial customers is unfair and longstanding.

[17] Commercial classes: S1, S2, S3, P1, P2 and P3.

AE's 2012 rate case at the PUCT was resolved based on a "black box" settlement, therefore class costs of service were not determined at the PUCT.[18] However, AE's proposed cost-of-service study in that case indicated that Residential customers were paying approximately $78 million less than their cost and it appears the settlement rate design included at least some progress toward unity. The disparity must now be finally acknowledged and concrete, explicit action must be taken to advance even closer to a unity relative rate of return for all classes.

It is not uncommon to limit the maximum rate increase to individual customer classes for policy reasons. In this instance, the Austin City Council has approved affordability guidelines for Austin energy's rates. AE summarized the City Council's policy framework, including important considerations concerning "Affordability":[19]

- Limiting rate adjustments to no more than 2 percent annually; and
- Remaining in the lower 50 percent of retail rates across the State

The Residential class is receiving a $50+ million subsidy under even AE's cost study approach. The City Council's "Affordability" goal of only limiting rate adjustments to "no more than 2 percent annually" would easily allow an adjustment to Residential rates that makes more progress to cost. AE, however, has proposed to maintain current Residential class revenues and recommended NO increase in rates for the Residential class even though an increase of up to 2% would be allowed under the Council's Affordability goal.

Discussion of AE'S Proposed Revenue Distribution

The fundamental consideration in evaluating a revenue distribution is whether the proposal adequately reduces inter-class subsidies subject to certain parameters. This typically includes ensuring that the classes that are farthest away from their cost of service make the greatest movement toward cost of service. The Council's Affordability goal of limiting rate adjustments to more than 2% annually represents such a parameter. Although this constraint is

[18] As noted earlier, however, the Council rate ordinance that was appealed to the PUC employed a modified version of A&E 4CP.

[19] Affordability goals adopted for Austin energy by the Austin City Council on February 17, 2011.

subject to interpretation it is worth considering as a limit on the increase to any individual rate class. In comparison to the affordability limit, AE has only proposed a rate increase for one class, a 2.6% increase for the Transmission Voltage greater than 20 MW class. All other classes receive either no change or rate decreases ranging up to 7.2%.

AE's proposed revenue distribution has several fatal flaws. First, AE's upper limit on class rate changes is too small. AE has overly constrained increases indicated by the cost of service study, including some large revenue classes that are significantly below cost-of-service. This causes the revenue for some other classes to be higher than it should be.

Based on AE's proposed revenue requirement and cost of service, the Residential class is currently $53.4 million below~~above~~ cost and it would require a rate increase of 11.3% to bring the Residential class to its cost of service. AE says that the 2% limit in the Affordability goal applies to total revenue, including base rates and all pass-through charges.[20] However, rather than give the Residential class the 2% increase suggested by the Affordability goal, AE has proposed no rate increase for the Residential class.

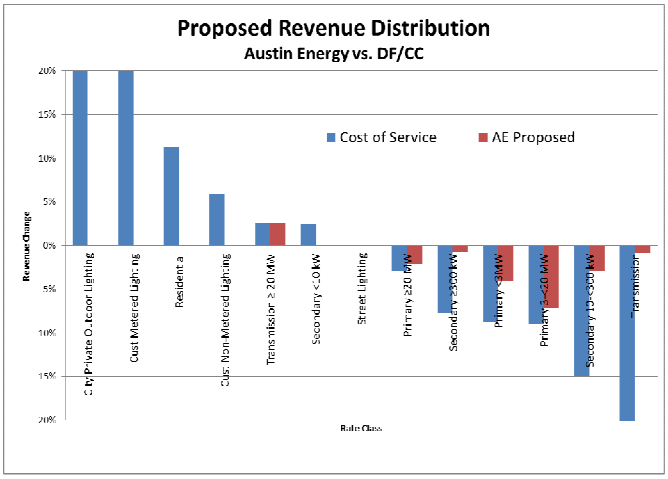
On the other hand, the S2 class (Secondary Voltage customers between 10 and 300 kW) is currently paying $42.3 million more than its cost. Under AE's proposed reduce revenue requirement, the S2 class would require a $34 million (12.4%) rate decrease to reduce its rates to cost. Notwithstanding this large disparity, AE has proposed only an $8.3 million (2.9%) rate decrease for the S2 class.

AE's own results show a revenue surplus. This provides a unique opportunity to make movement toward unity without severe rate increases for any class. AE's allocation of its proposed system-wide revenue reduction does not adequately reduce existing subsidies even though this could be done to at least some extent with a moderate increase. When a revenue surplus exists, the classes that are farthest above cost-of-service are typically assigned the largest reduction, and regulators typically use the opportunity to make greater steps toward unity for the classes that are below cost, by promulgating a moderate increase. In this case, however, AE did not assign the largest rate decreases to the classes that are currently the

[20] AE Response to Data Foundry RFI 2-19.

farthest above cost of service, nor did AE use the opportunity to bring the classes that are currently the farthest below cost more in line with a unity relative rate of return. This is so on an absolute dollar basis and on a percentage basis.

Data Foundry and the Austin Chamber propose an alternative revenue distribution below that remedies these shortcomings.



Finally, AE's proposed revenue distribution is based on the utility's proposed base rates and test-year Pass-Through rates. The revenue distribution should be based on Projected Pass-Throughs rather than Test-Year Pass-Throughs. Evaluating a revenue distribution based on Rate-Year Pass-Through costs, instead of Test-Year costs, is important because it reveals the rates customers will actually pay and, therefore, the actual impact of the proposed rates.

The class revenue targets that will exist after the new rates take effect most accurately represent the actual cost each class will pay under the new rates. A revenue distribution based on Test-Year Pass-Throughs ignores the impact of expected changes. This is especially important in this instance because AE's Projected Pass-Throughs are approximately $51 million less than Test-Year Pass-Throughs.

Comparison of Pass-Through Rates	
Test-Year vs. Projected	
Proposed Base Rates and Test-Year Pass-Through Rates (1)	$1,217,290,318
Proposed Base Rates and Projected Pass-Through Rates (2)	$1,166,309,563
Difference	$50,980,755
Source:	
(1) Austin Energy's Tariff Package, January 25, 2016: Figure 5.21	
(2) Austin Energy's Tariff Package, January 25, 2016: Figure 6.28	

The decrease in Projected Pass-Throughs results in class specific revenue changes that are significantly less than shown in AE's proposed revenue distribution. As can be seen below (based on AE's Proposed Base Rates and Projected Pass-Throughs) all rate classes would receive rate decreases, ranging from 0.1% to 12.3%.

Customer Class	Total Cost of Service ($)	Existing Base Rates and Test Year Pass-Through Rates ($)	Excess/ (Deficient) Revenue ($)	Increase/ (Decrease) Needed to Meet Cost of Service (%)	Change from Existing to Proposed Base Rates ($)	**AE Proposed Base Rates and Projected Pass-Through Rates** ($)	Excess/ (Deficient) Revenue ($)	Increase/ (Decrease) Needed to Meet Cost of Service (%)	Proposed Change Existing to Proposed (%)
Residential	527,473,323	474,062,283	(53,411,040)	11.3%	(22,210,085)	451,852,198	(75,621,125)	16.7%	-4.7%
Secondary Voltage <10 kW	32,241,755	31,458,282	(783,473)	2.5%	(305,222)	31,153,060	(1,088,695)	3.5%	-1.0%
Secondary Voltage 10-<300 kW	241,019,337	283,339,669	42,320,332	-14.9%	(15,131,321)	268,208,348	27,189,011	-10.1%	-5.3%
Secondary Voltage ?300 kW	220,057,525	238,491,828	18,434,303	-7.7%	(13,054,680)	225,437,148	5,379,623	-2.4%	-5.5%
Primary Voltage <3MW	42,224,997	46,257,714	4,032,717	-8.7%	(4,033,594)	42,224,120	(877)	0.0%	-8.7%
Primary Voltage 3-<20 MW	47,471,430	52,185,478	4,714,048	-9.0%	(6,255,910)	45,929,568	(1,541,862)	3.4%	-12.0%
Primary Voltage ?20 MW	87,271,333	89,945,727	2,674,394	-3.0%	(6,201,286)	83,744,441	(3,526,892)	4.2%	-6.9%
Transmission Voltage	1,317,596	2,146,390	828,794	-38.6%	(1,636)	2,144,754	827,158	-38.6%	-0.1%
Transmission Voltage ? 20 MW @ 85% LF	13,863,814	13,517,421	(346,393)	2.6%	(970,414)	12,547,007	(1,316,807)	10.5%	-7.2%
Service Area Street Lighting	N/A	N/A				N/A			
City-Owned Private Outdoor Lighting	3,776,457	2,884,834	(891,623)	30.9%	(180,403)	2,704,431	(1,072,026)	39.6%	-6.3%
Customer Owned Non-Metered Lighting	114,954	108,555	(6,399)	5.9%	(10,023)	98,532	(16,422)	16.7%	-9.2%
Customer Owned Metered Lighting	394,788	303,428	(91,360)	30.1%	(37,469)	265,959	(128,829)	48.4%	-12.3%
							0		
Total	1,217,227,309	1,234,701,609	17,474,300	-1.4%	-68,392,043	1,166,309,566	-50,917,743	4.4%	-5.5%

AE's cost-of-service study indicates that significant subsidies currently exist among some customer classes, even using AE's proposed ERCOT 12CP. As a result of the decreased actual impact of the proposed rates, there is more flexibility in increasing the proposed base rates of classes that are below cost-of-service, such as the Residential class. Due to the decrease in

Projected Pass-Throughs the underlying base rates for classes below cost-of-service can be increased even further without violating the Affordability limit.

It is important to identify and eliminate inter-class subsidies to the greatest extent possible within the stated, reasonable constraints. However, AE believes that "[t]here is not a direct causal relationship between revenue requirement and class deviation from cost of service. Whether the rates for a particular class should be increased or decreased depends upon the outcome of the cost of service and the ratemaking policy objectives of the utility and its governing body, not solely the magnitude of the revenue requirement."[21]

Data Foundry and the Austin Chamber disagree with AE's position. The ratemaking policy objectives of the utility and its governing body should not support subsidies between rate classes. Regulated utility rates are intended to be set based on cost of service, not value of service or other considerations that may come into play in a competitive market. Captive customers should not be forced to pay above-cost rates in order to subsidize other classes of customers.

Minimization of cost shifting between classes is a fundamental principle of utility regulation. In addition to equity, cost-based rates are also important for economic efficiency, an important consideration in setting rates. Economic efficiency involves the allocation of resources between competing uses. If prices are set too low, consumers purchase too much of a product or service. If rates are set too high the user does not purchase enough of the product or service that is optimum, and may even cease taking service all together.

Revenue Distribution Recommendation

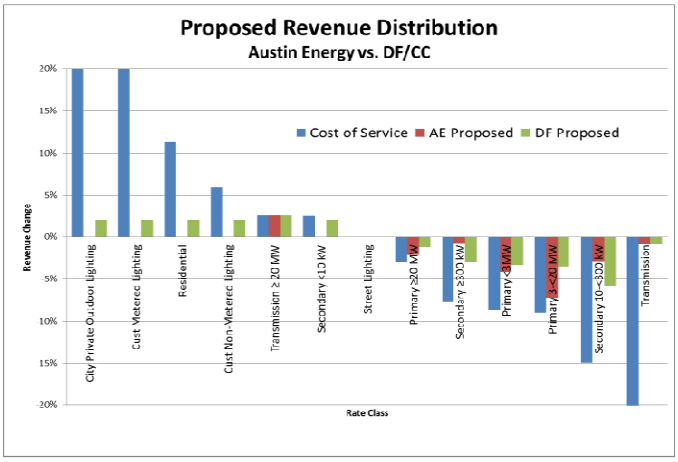
The Chamber of Commerce/Date Foundry proposed Revenue Distribution is shown below. It addresses the shortcomings of AE's revenue distribution by: 1) giving all of the classes that are below cost-of-service a 2% increase, and 2) in addition, spreads the remaining revenue decrease to the classes that are currently above cost in proportion to the degree to which they

[21] AE Response to Data Foundry RFI 2-25.

are above their cost of service. These numbers use AE's claimed revenue deficiency and cost allocation in order to allow an apples-to-apples comparison:

Proposed Base Rate Changes Needed to Meet Total Cost of Service by Customer Class									
Customer Class	Total Cost of Service ($)	Existing Base Rates and Test Year Pass-Through Rates ($)	Excess/ (Deficient) Revenue ($)	Increase/ (Decrease) Needed to Meet Cost of Service (%)	Change from Existing to Proposed Base Rates ($)	Proposed Base Rates and Test Year Pass-Through Rates ($)	Change	Excess/ (Deficient) Revenue ($)	Increase/ (Decrease) Needed to Meet Cost of Service (%)
Residential	527,473,323	474,062,283	(53,411,040)	11.3%	(9,481,246)	483,543,529	2.000%	(43,929,794)	9.1%
Secondary Voltage <10 kW	32,241,755	31,458,282	(783,473)	2.5%	(629,166)	32,087,448	2.000%	(154,307)	0.5%
Secondary Voltage 10-<300 kW	241,019,337	283,339,669	42,320,332	-14.9%	16,377,968	266,961,701	-5.780%	25,942,364	-9.7%
Secondary Voltage ?300 kW	220,057,525	238,491,828	18,434,303	-7.7%	7,134,075	231,357,753	-2.991%	11,300,228	-4.9%
Primary Voltage <3MW	42,224,997	46,257,714	4,032,717	-8.7%	1,560,661	44,697,053	-3.374%	2,472,056	-5.5%
Primary Voltage 3-<20 MW	47,471,430	52,185,478	4,714,048	-9.0%	1,824,337	50,361,141	-3.496%	2,889,711	-5.7%
Primary Voltage ?20 MW	87,271,333	89,945,727	2,674,394	-3.0%	1,034,990	88,910,737	-1.151%	1,639,404	-1.8%
Transmission Voltage	1,317,596	2,146,390	828,794	-38.6%	17,297	2,129,093	-0.806%	811,497	-38.1%
Transmission Voltage ? 20 MW @ 85% LF	13,863,814	13,517,421	(346,393)	2.6%	(346,341)	13,863,762	2.562%	(52)	0.0%
Service Area Street Lighting	N/A	N/A							
City-Owned Private Outdoor Lighting	3,776,457	2,884,834	(891,623)	30.9%	(57,697)	2,942,531	2.000%	(833,926)	28.3%
Customer Owned Non-Metered Lighting	114,954	108,555	(6,399)	5.9%	(2,171)	110,726	2.000%	(4,228)	3.8%
Customer Owned Metered Lighting	394,788	303,428	(91,360)	30.1%	(6,069)	309,497	2.000%	(85,291)	27.6%
Total	1,217,227,309	1,234,701,609	17,474,300	-1.4%	17,426,641	1,217,274,968	-1.411%	47,659	0.0%

The chart below compares the class cost of service with the revenue distributions proposed by AE and Chamber of Commerce/Date Foundry:



The Chamber of Commerce/Date Foundry's proposed revenue distribution is based on AE's proposed revenue requirement and cost of service study. The revenue targets and classes increase are likely to change as the result of changes to the total revenue requirement in this case, so the Chamber of Commerce/Date Foundry recommend that a set of guidelines be applied as follows, after the revenue requirement is established:

- the Revenue Distribution should be based on proposed rates including Rate-Year Pass Through Rates rather than Test-Year Pass-Through Rates;
- rates increases should be constrained to a maximum of 2% and all classes below cost-of-service should be given a 2% total increase, unless that would take them above cost-of-service; and
- all classes that are above cost-of-service should be moved toward cost-of-service in proportion to the degree to which they are above their cost of service.

The Chamber of Commerce/Date Foundry's revenue distribution recommendation is more just and more reasonable than AE's proposal because it better reflects proper revenue distribution principles typically applied by the PUCT and other ratemaking authorities, and also produces more appropriate changes in class rates.

RATE DESIGN

AE has proposed an excessive change to the Regulatory Charge to be applied to the Primary Voltage 3-20 MW (P2) class. The existing Regulatory Charge for the P2 Class is $0.69 per kW. AE has proposed to increase this charge to $3.61 per kW, a 358~~423~~% increase, with little to no justification or support.

AE's rate filing package states that "[t]he P2 rate class is set to receive a large change to the Regulatory Charge in order to restore a logical rate design for the class as it compares with the Regulatory Charge assessed on the P1 and P3 classes." In response to an interrogatory from Data Foundry requesting a complete explanation of this change to the P2 Class Regulatory Charge, AE stated that due to an over-recovery of the P2 class Regulatory Charge in 2012 when it was $2.92 per kW, the P2 class' Regulatory Charge was reduced to $0.38 per kW for 2013. AE concluded that "[t]he continuing legacy of this over-recovery has resulted in the P2 rate being significantly below its cost to serve."[22]

AE asserts that the Regulatory Charge for the P2 class is "significantly below its cost to serve" but it has provided no evidence to support that claim. AE's response to Data Foundry RFI

[22] AE Response to Data Foundry RFI DF 2-27.

2-27 directs to WP (Workpaper) H-5.6, line 123, which AE states "shows current, cost based and proposed regulatory charge for P2 Class." However, this workpaper provides no actual support for the calculation or derivation of this number. It merely recites values for the Test Year, "Cost of Service" and Rate Year charges.

Furthermore, in response to the same interrogatory that asks whether the rate increase to the P2 Regulatory charge is fully cost-based, AE would only state that "[o]n a system basis, the Regulatory Charge is fully cost-based." This response says nothing about the cost basis of the charge for the P2 class, which strongly suggests that the Regulatory Charge specific to the P2 class itself is not cost-based. If there was cost support AE would have undoubtedly provided some.

Due to the large magnitude of the increase in this charge, the lack of evidence that it is cost-based and lack of support for the specific value, Data Foundry and the Chamber contend that the change to the Regulatory Charge for the P2 class should be rejected. The Regulatory Charge for P2 should be kept at its current value.

Conclusion

The Austin Chamber of Commerce and Data Foundry recommend:

1. AE's proposed Electric Reliability Council of Texas 12 Coincident Peak (ERCOT 12CP) method for allocating demand-related production costs should be rejected and the A&E-4CP method traditionally used by the Public Utility Commission of Texas (PUCT) should be used instead.

2. AE's proposed revenue distribution should be rejected in favor of a revenue distribution that more adequately reduces existing subsidies and better compensates for existing deviations from cost of service. The alternative revenue distribution proposed in this Presentation should be adopted.

3. AE's proposed 358~~423~~% increase to the Regulatory Charge for the P2 class should be rejected because AE has not shown that this increase is either reasonable or cost-based.

Data Foundry and the Austin Chamber respectfully request that the Independent Hearing Examiner adopt the forgoing recommendations and requests.

Respectfully submitted,

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May 27~~3~~, 2016

STATEMENT OF COUNSEL

I, W. Scott McCollough, represent and certify that I have been authorized to submit this Presentation on behalf of the Austin Chamber and further represent and certify that the Austin Chamber has ratified and does join in the Presentation.

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W. Scott McCollough

CERTIFICATE OF SERVICE

I, W. Scott McCollough, certify that I have served a copy of this Presentation on all parties listed on the Service List for this proceeding as it exists on the date this document is filed, using the email address provided for the party representative.

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W. Scott McCollough