AUSTIN ENERGY'S TARIFF PACKAGE: § 2015 COST OF SERVICE STUDY § AND PROPOSAL TO CHANGE BASE § ELECTRIC RATES §

BEFORE THE CITY OF AUSTIN IMPARTIAL HEARING EXAMINER

DATA FOUNDRY, INC.'S BRIEF ON REVENUE REQUIREMENTS

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DATA FOUNDRY, INC.'S BRIEF ON REVENUE REQUIREMENTS

TO THE HONORABLE ALFRED R. HERRERA, IMPARTIAL HEARING EXAMINER:

Data Foundry, Inc. ("Data Foundry") respectfully presents this Brief on Revenue Requirements[1] and shows as follows.

This Brief does not follow the outline proposed by AE. Data Foundry's revenue requirements case relates to a discrete set of claimed costs that AE's outline entirely ignores in its "Revenue Requirements" section. AE refused to include Data Foundry's revenue requirement issues in the revenue requirements portion of the outline - where they belong. Instead, AE insisted on relegating Data Foundry's revenue requirements issues to "policy" at the end (in part VII.E) in an obvious effort to minimize their import. Data Foundry's issues, however, are not about mere "policy." They involve hundreds of millions of dollars that AE is trying to confiscate from captive ratepayers through rates. Data Foundry's argument is based on the straightforward application of longstanding and well-accepted legal and ratemaking principles. For this reason, Data Foundry chose to eschew AE's skewed outline. We trust the Independent Hearing Examiner ("IHE") will recognize AE's ploy for what it is, and consider Data Foundry's argument in the proper context and order.

To enhance understanding and impact the amounts and many (but not all) of the characterizations used herein come directly from Austin Energy ("AE") and its Rate Filing Package, discovery responses or testimony. This is so even though Data Foundry agrees with the recommended adjustments recommended by NXP/Samsung, except insofar as NXP/Samsung would allow recovery of production related costs.[2]

[1] Data Foundry is separately supplying a joint Brief on Cost Allocation and Revenue Distribution with the Austin Chamber of Commerce. That separate Brief accepts, for argument purposes, the Austin Energy ("AE") claimed revenue requirement in order to allow comparisons with AE's non-revenue requirement recommendations. Data Foundry obviously does not agree with AE's revenue requirements amounts, however, as should be evident from this Brief.

[2] Data Foundry did not conduct a full revenue requirements analysis. NXP/Samsung did, and Data Foundry concurs with their recommendations except to the extent NXP/Samsung would allow recovery of

I. Introduction

The evidence starkly reveals that AE's wholesale operations lost $210 million during the test period, and AE wants captive retail ratepayers to cover those losses, through "**Wholesale Competitive Losses Charged to Retail Ratepayers**."

Captive monopoly retail ratepayers cannot reasonably or lawfully be charged for the $308 million in wholesale-related production costs ("**Wholesale Fixed Costs With GFT**") AE wants to include in retail base rates.

If there was competitive choice in Austin retail ratepayers would pay $200 million dollars per year less than they do now. In other words AE's captive customers suffer a $200 million "**No Choice Penalty**."

The Glossary below explains the source and basis for the terms, concepts and numbers used to form these characterizations and conclusions. "RFP" stands for AE's Rate Filing Package (Bate 1-178). Data Foundry will also reference various Schedules and Workpapers in the more voluminous "2014 Electric System Rate Study" (Bate 760-1106). "HOM Tr." refers to the Transcript of the proceedings conducted on May 31, June 1 and June 2.

Term	What it Means	Dollars Involved	Source
No Choice Penalty	Amount AE ratepayers would not have to pay if there was Competitive Choice	$200,778,242	The amount is the value for Wholesale Non-Fuel Production O&M. ERCOT rates recover short run variable (marginal) costs, which are essentially fuel related costs only. RFP at 3-13, Bate 42; AE Exhibit 3 (Mancinelli Reb.), p. 25, lines 20 – 22. AE Exhibit 9, Dreyfus Reb.), p. 45, lines 1-3, pp. 58-59; HOM Tr. p. 96, lin 13 – p. 98, line 20, p. 752, line 24 – p. 767, line 24.

any AE wholesale production costs. NXP/Samsung did offer some production-related adjustments for other reasons, so there is some overlap. For example, NXP/Samsung recommended significant reductions to various production O&M amounts. NXP/Samsung Exh.NS-1 (Fox Dir.), p. 6 of 51, lines 5-6. Data Foundry would deny these same costs as well, but has additional reasons beyond those set out by Ms. Fox.

Term	What it Means	Dollars Involved	Source
			Prices charged to retail ratepayers in the Texas competitive market typically do not include the wholesale generators' fixed production costs. AE's retail ratepayers, on the other hand, must also pay for all of AE's fixed and variable production costs. They cannot fire AE and use an REP so they have no ability to avoid the "No Choice Penalty."
Wholesale Competitive Losses Charged to Retail Ratepayers	Amount AE is losing in the competitive generation market that it seeks to charge to retail ratepayers	$210,047,663	Wholesale Fixed Costs With GFT minus Net Wholesale Revenues and Benefits
Wholesale Fixed Costs With GFT	Fixed costs of AE-owned generation that sells power to wholesale market, including GFT – Wholesale Fixed	$308,047,663	Schedule G-8, line 19, Bate 993; HOM Tr. p. 91, line 5 – p. 93, line 16
Wholesale Fixed Costs Without GFT	Fixed costs of AE-owned generation that sells power to wholesale market, excluding GFT – Wholesale Fixed	$263,749,957	Amount in Schedule G-8, line 19, Bate 993 minus amount in Schedule A, Line 18, Column K, Bate 767
Wholesale Fuel Related Costs	"Recoverable Fuel Costs" AE assigns to PSA	$411,649,196	Schedule G-7, lines 11, 16 and 18, Bate 992; HOM Tr. p. 93, line 18 – p. 97, line 9
Total Wholesale Costs	Wholesale Fixed Costs With GFT plus Wholesale Fuel Related Costs	$719,696,859	Amount in Schedule G-8, line 19, Bate 993 plus amount in Schedule G-7, lines 11, 16 and 18, Bate 992
Net Wholesale Revenues and	Net dollar amount of the benefits to retail ratepayers AE claims flow from AE's	$98,000,000	RFP p. 3-23, Bate 52; p, 3-26, Bate 55; p. 3-28, Bate 57; p. 5-4, Bate 107; p. 5-14, Bate 117; p. 5-15, Bate 118;

Term	What it Means	Dollars Involved	Source
Benefits	wholesale activities		AE Exh. 3 (Mancinelli Reb.) p. 35, line 13 – 36, line 4, p. 39, lines 3-9, p. 41, lines 27-30; HOM Tr. pp. 161-182. This figure represents the net of wholesale revenues and hedging benefits after recovery of Wholesale Fuel Related Costs. It excludes Green Choice revenue, which is a retail activity.
Wholesale Production O&M	Operations and Maintenance costs related to AE-owned generation that sells power to wholesale market, including Fuel Related Costs	$612,427,438	Figure 4.7, Bate 103; HOM Tr. p. 97, line 15 – p. 98, line 20
Wholesale Non-Fuel Production O&M	Wholesale Production O&M minus Wholesale Fuel Related Costs	$200,778,242	Amount in Figure 4.7, Bate 103 minus amount in Schedule G-7, lines 11, 16 and 18, Bate 992. See HOM Tr. p. 98, lines 15-20
GFT - Total	Total General Fund Transfer sought by AE	$105,000,000	Schedule A, Line 18, Column A, Bate 767
GFT – Wholesale Fixed	Portion of General Fund Transfer allocated to Wholesale Fixed Costs	$44,297,706	Schedule A, Line 18, Column K, Bate 767

The costs AE incurs in order to reap its Wholesale Competitive Losses are, and must be, wholly distinct from its retail activities. AE's Wholesale Fixed Costs are not necessary to or useful for retail service. The retail rates flowing from this case must reflect only the reasonable and necessary expenses that AE must incur in order to provide retail electric utility service. If retail rates include any Wholesale Fixed Costs they will not constitute a reasonable measure of use by or benefit to retail ratepayers and will lead to an unreasonable rate structure.

Reasonable, cost-based base and pass-through annual rate recoveries would lead to between $210 million and $165 million[3] more than the $24 million in reductions AE itself admits are due. The IHE must recommend that AE's revenue requirement exclude AE's claimed Wholesale Fixed Costs With GFT ($308,047,663).[4] If Council prefers to retain the $44,297,706 in GFT – Wholesale Fixed then the IHE should at least recommend base rate exclusion of the $263,749,957 in Wholesale Fixed Costs Without GFT.

AE's captive retail ratepayers presently suffer a significant No Choice Penalty. They are paying at least $200,778,242 per year more than they would if Austin had competitive choice and ratepayers could contract with competitive Retail Electric Providers ("REPs"). Since this proceeding is designed to create retail rates using traditional ratemaking principles by developing a retail revenue requirement and then distributing that revenue requirement amongst the various captive retail classes, however, the IHE cannot directly solve that problem. But the IHE can and should exclude AE's Wholesale Fixed Costs by faithfully applying the "used and useful" concept to retail rate base and the "reasonable and necessary" requirements for expenses. AE's Wholesale Fixed Costs are not "necessary" to the provision of retail base rate service, and recovery is not reasonable. The generation assets are not used by, or useful to, base ratepayers. The expenses AE incurs to operate them must be excluded from the retail revenue requirement.

Interestingly enough, the required result under traditional utility ratemaking ($210 million or $165 million annual reduction from exclusion of Wholesale Fixed Costs with the difference turning on whether the GFT – Wholesale Fixed is allowed) will be relatively close to the $200 million in ratepayer savings that would obtain if Austin had

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[3] The difference between the $210 million and $165 million is "GFT-Wholesale Fixed" – the $44,297,706 in General Fund Transfer that AE has allocated to fixed production costs, but are not truly incurred to produce the power it sells in the wholesale market. Data Foundry will further address this below.

[4] In order to be consistent about separating wholesale activities from retail activities, however, the IHE should recommend that the Council consider changing the PSA revenue requirement calculation so that it is no longer be reduced by AE's Net Thermal and Renewable Generation and Bilateral Power revenue and any other claimed benefits, including hedging. This is discussed below. If the Council believes that participating in the wholesale market can be profitable notwithstanding the evidence adduced in this case then it can allow the utility to play in that risky market. Since retail ratepayers would be immunized from losses they would not have any reasonable claim to any gains. This means that the contemplated profits could go directly to the general fund and need not be applied to the "benefit" of retail utility ratepayers.

retail competitive choice and no longer had to suffer a No Choice Penalty. Although the calculations are somewhat different, this relative confluence is not an aberration. After all, a primary desired outcome where monopolies exist is that regulation will serve as a "substitute for competition."[5]

Data Foundry emphasizes that the exclusions discussed here relate to AE's ongoing but fixed costs of operation: the operational costs it incurs in order to be in position to sell wholesale power to the ERCOT market on a day-to-day basis. Retail ratepayers can reasonably be expected to contribute toward payment of a large part of the remaining debt associated with the "legacy" portions of the generation fleet as it existed immediately prior to the time AE's generation fleet was dedicated to wholesale service instead of serving its retail load.[6] A considerable portion of the legacy debt is conceptually the same thing as the stranded cost and/or regulatory assets that investor-owned utilities were allowed to recover as part of the transition to a competitive market.[7] But recovery of debt related stranded and regulatory asset "costs" – preferably accomplished through a non-bypassable charge[8] – must be resolved elsewhere, since those amounts have nothing to do with the current, ongoing expenses associated with providing retail electric service. That means, for example, the $58,314,647 in "debt service" attributed to Production in AE's rate filing package[9] cannot be allowed into base rates since the "debt" itself is related to plant that is no longer used by or useful to retail

[5] Tex. Util. Code §11.002(b) ("Public utilities traditionally are by definition monopolies in the areas they serve. As a result, the normal forces of competition that regulate prices in a free enterprise society do not operate. Public agencies regulate utility rates, operations, and services as a substitute for competition.")

[6] Although "competition" began in Texas on January 1, 2001, AE's generation fleet was still dispatched to serve its retail load until 2010, when ERCOT transitioned to a "nodal" market. Therefore the proper date for identifying ***AE's*** stranded costs would be 2012 rather than January 1, 2001. We have now had several more years than were used with investor owned utilities for things to stabilize and it is possible to identify the relevant values. *See, e.g., CenterPoint Energy, Inc. v. PUC*, 143 S.W.3d 81, 93 (Tex. 2004).

[7] AE does not have invested capital *per se*. The legacy debt, however, can be analogized to a securitized amount, although we do not yet know the exact value equivalent to AE's "net book value of generation assets over the market value" and "regulatory assets." *See City of Corpus Christi v. PUC of Tex.*, 51 S.W.3d 231 (Tex. 2001); *TXU Electric Co. v. Pub. Util. Comm'n*, 51 S.W.3d 275 (Tex. 2001).

[8] AE's nuclear decommissioning costs can also be included in any nonbypassable transition charges, in the same way they would be under Tex.Gov't Code §39.205. *C.f.*, NXP/Samsung Exh. NS-1 (Fox Dir.) p. 52 of 51, lines 5-6 (recommends Nuclear Decommissioning be handled through reserve).

[9] Schedule A, line 16, Column E, Bate 767; Schedule C-3, line 6, Column E, Bate 822, Workpaper C-3.1, line 6, Column F, Bate 823.

ratepayers.[10] But a separate assessment akin to the Legislature's nonbypassable transitional charges designed to recover "stranded" debt associated with legacy plant that is no longer used by or useful to retail ratepayers would likely pass judicial muster, and would be reasonable, if and to the extent it measured the difference between book amounts and the market value of the assets and then recovered any shortfall.

The IHE's specific charge is to make recommendations on base rates that allow AE to recover the retail-related costs it will incur to provide retail service during the rate-effective period. Nonetheless, he can offer some suggestions on other matters, including that the Council initiate a process for identification of the stranded costs amounts and develop a means to recover them – outside of base rates.[11]

II. Argument

A. Retail ratepayers in Austin pay a $200 million annual **No Choice Penalty**.

AE's captive retail ratepayers are presently paying at least $200 million dollars per year more than they would if Austin had competitive choice and ratepayers could use competitive REPs instead of AE. Ratepayers in Austin suffer a significant No Choice Penalty. This figure is easily derivable from the evidence.

Prices charged to retail ratepayers in the Texas competitive market typically do not include the wholesale generators' fixed production costs, which mostly consist of Operations and Maintenance expenses. ERCOT rates recover short run variable (marginal) costs, which for purposes of this case are AE's Wholesale Fuel Related Costs that are subset of AE's total Wholesale Production O&M. Generators' O&M costs

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[10] AE witness Dombrowski recognized the legal problem with trying to recover debt-related costs pertaining to plants that are not presently used and useful to current from retail ratepayers at HOM Tr. p. 607, lines 15-22:

> Q Okay. So wouldn't you also agree that there might be legal or regulatory challenges to Austin Energy if the utility were to try to recover the debt on a plant that has already been retired?
>
> A Yes. I believe there's a regulatory rule called "used and useful" that collecting -- paying debt off an asset that's no longer in service could cause a problem.

[11] Public Citizen/Sierra Club's "FPP Debt Defeasement" concerns (AE Briefing Outline II.E) can be addressed as part of this process, since FPP is one of AE's legacy generation facilities. But FPP debt service or defeasement amounts cannot be put in base rates since FPP is now dedicated to wholesale and is not used by or useful to retail, which means that debt repayments are not "reasonable and necessary" expenses of providing retail service.

other than fuel are not included in the ERCOT wholesale price.[12] Retail users in areas where there is retail customer choice purchase their power from an REP. The REP buys wholesale power at the ERCOT short-run marginal cost, and then adds a small mark-up. The distribution utility's regulated "wires" charges are added in, and that represents the user's total bill.

AE's retail ratepayers, on the other hand, pay customer and distribution charges, but the price they must pay includes all of AE's production costs, both fixed and variable, whereas in customer choice areas the user bears only short run variable costs. In particular AE ratepayers are required to pay all of AE's short and long run costs, including all fixed costs. The amounts are captured in AE's claimed O&M expenses. Rate Filing Package Figure 4.7, Bate 103 indicates that AE's test year production O&M expenses were $612,427,438. This amount includes AE's claimed $411,649,196 in "Recoverable Fuel Costs."[13] If you subtract the Wholesale Fuel Costs from AE's Wholesale Production O&M, the difference would be AE's Wholesale Non-Fuel Production O&M[14] and it equals $200,778,242. This amount represents AE's production costs that are not short run marginal costs. They are not sent to the PSA, and AE wants them in base rates. Customers in competitive choice areas, however, do not pay for these production-related costs in their base rates or in their purchased power costs. If retail users in Austin could fire AE and instead take service from a competitive REP they would avoid them. The $200,778,242 is a "No Choice Penalty" that AE's captive ratepayers are required to bear merely because they are captive and must suffer monopoly rather than competitive prices.

Since this proceeding is designed to create retail rates using traditional ratemaking principles by developing a retail revenue requirement and then distributing that revenue requirement amongst the various captive retail classes, however, the IHE cannot directly solve the No Choice Penalty problem. But the IHE can and should act as a "substitute for competition"[15] and get to the same approximate place by faithfully

[12] RFP at 3-13, Bate 42; AE Exhibit 3 (Mancinelli Reb.), p. 25, lines 20 – 22. AE Exhibit 9, (Dreyfus Reb.), p. 45, lines 1-3, pp. 58-59; HOM Tr. p. 757, line 11 – p. 764, line 22.
[13] Schedule G-7, lines 11, 16 and 18, Bate 992; HOM Tr. p. 97, lines 19–23.
[14] HOM Tr. p. 98, lines 15-20.
[15] Tex. Util. Code §11.002(b).

applying the long-accepted "used and useful" concept to retail rate base and the "reasonable and necessary" requirements for expenses. The necessary result of these fundamental principles is exclusion of AE's production costs from base rates.

It is ultimately quite simple. The Wholesale Fixed Costs are not related to plant that is used by or useful to retail ratepayers. The Wholesale Fixed Costs are not a reasonable and necessary part of providing retail electric utility service.[16] Inclusion as part of the retail base revenue requirement (and then approved retail rates) is not just or reasonable; allowing them would be unjust and unreasonable, arbitrary, capricious, an abuse of discretion or unwarranted exercise of discretion. Inclusion of these costs will not yield a reasonable measure of use by or benefit to retail ratepayers and will lead to an unreasonable rate structure. Allowance will lead to unlawful and confiscatory rates.

B. AE's Wholesale Activities Incur Wholesale Fuel Related Costs and Wholesale Fixed Costs.

A bit more precision may be helpful. 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.[17] Production resources and costs can be classified as fixed (demand related) or variable (energy related).[18] AE claims to have $341,575,538 in fixed (demand related) production costs[19] and $442,455,280 in variable (energy related) production costs.

[16] The Texas PUC has held that voluntary wholesale load can be included in forecasted load when a utility seeks a certificate for new plants, but wholesale related costs can not be included in the retail revenue requirement. Only production costs used for retail purposes can be allowed in base rates. *Application of Southwestern Electric Power Company for a Certificate of Convenience and Necessity Authorization for Coal Fired Power Plant in Arkansas*, Docket 33891, Order, p. 9 (Aug. 12, 2008), *aff'd Southwestern Elec. Power Co. v. PUC of Tex.*, 419 S.W.3d 414, 427 (Tex. App. Amarillo 2011), *motion for rehearing on petition for review denied*, 2013 Tex. LEXIS 655 (Tex., Aug. 23, 2013) ("*SWEPCO*"). ("Further, the granting of the CCN does not waive the Commission's rights in subsequent rate cases, fuel reconciliations, rulemakings, or other proceedings to make determinations as to the appropriate allocation of costs related to contracts that SWEPCO enters into with wholesale customers. Additionally, in approving this CCN the Commission does not approve or otherwise validate any ratemaking treatment applicable to SWEPCO power sales to wholesale customers for resale, directly or indirectly, to other wholesale customers. The Commission's approval of the CCN for the Turk Plant does not constitute authority for rate recovery for any of the costs of the Turk Plant. The Commission specifically disallows any allocation of the Turk Plant base rate costs that are not used for retail purposes to Texas retail ratepayers.") *See also* Ordering Paragraphs 5-8 and especially Paragraph 8 ("The Commission disallows any allocation of the Turk Plant base-rate costs that are not used for retail purposes to Texas retail ratepayers.") (Emphasis added).

[17] RFP p. 5-5, Bate 108.

[18] According to the NARUC Cost Allocation Manual, p. 35 (Data Foundry Ex. ON-A), "[p]roduction plant

These amounts must be further broken down to indicate what they truly represent, because some of them are not actually related to operation of AE's generation plant.

1. Wholesale Fixed Costs. AE seeks to recover $341,575,538 of its claimed $784,030,818 in production costs[20] from retail base rates. Some of the $341,575,538, however, is not related to operation of AE's generation plants. The actual amount of ERCOT-dedicated Wholesale Fixed Costs is $308,047,663.[21] These are the expenses AE incurs in order to then be in position to run its wholesale generation and be ready to sell wholesale power to the ERCOT market.[22] If these costs were not incurred AE would have no power to sell in the wholesale market; they are a necessary prerequisite to actual operation and then dispatch. They are clearly wholesale in nature, and exclusively so.

2. Wholesale Fuel Related Costs. With regard to the claimed $442,455,280 in over variable (energy related) production costs, $411,649,196 represents AE's claimed "Recoverable Fuel Costs." Those are ultimately sent to the PSA.[23] The remaining $30,806,084 is composed of $6,818,839 for "Regulatory Adjustment"[24] that has its own pass-through, $22,772,679 that is actually <u>retail</u> revenues from Green Choice applied as a reduction to PSA costs[25] and $1,214,566 related to

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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."

[19] As noted, only $308,047,663 is truly related to operation of AE-owned generation.

[20] Rate Filing Package Figure 5.8 p. 5-12, Bate 115.

[21] The $341,575,538 in Figure 5.8, Bate 115 and Figure 5.13 Bate 122 includes $33,527,875 related to Community Benefit. See Schedule G-8, line 13 on G-8. The Community Benefits Charge represents amounts for Energy Efficiency Services, Service Area Street Lighting, and the Customer Assistance Program (CAP). Rate Filing Package p. 2-7, Bate 19. Those are not truly Wholesale Fixed Costs. HOM Tr. p. 91, line 5 – p. 93, line 16. The remaining $308,047,663 on Schedule G-8, line 19, Bate 993 are Wholesale Fixed Costs. That is the amount Data Foundry contests.

[22] HOM Tr. p. 841, line 14 – p. 842, line 23.

[23] Schedule G-7, lines 11, 16 and 18, Bate 992; HOM Tr. p. 93, line 18 – p. 97, line 9.

[24] Schedule G-8, line 48, Column A; HOM Tr. p. 94, lines 15-17.

[25] RFP p. 5-9, Figure 5.4, Bate 109; Schedule G-8, line 50, Column A; Data Foundry Ex. 3; HOM Tr. p. 94, lines 18-25, p. 165, line 21 – p. 166, line 12, p. 170, lines 9-11, p. 272, lines 4-13, p. 577, lines 1-15. The Green Choice "benefit" to the PSA must be ignored even under AE's wholesale benefits theory.

costs initially allocated to Street Area Lighting.[26] Therefore, Wholesale Fuel Related Costs equal AE's claimed Recoverable Fuel Costs.

3. Total Wholesale Costs. The relevant Total Wholesale Costs that Data Foundry addresses here are the alleged $308,047,663 of Wholesale Fixed Costs for which AE seeks base rate treatment and the alleged $411,649,196 in Wholesale Fuel Related Costs AE incurs to actually generate the wholesale power it sells on the ERCOT market. The Wholesale Fuel Related Costs are sent to the PSA, but the Wholesale Fixed Costs are in the claimed base, and AE wants to charge captive retail ratepayers for them even though they are entirely wholesale in nature, and are not used by or useful to retail ratepayers or a reasonable and necessary expense associated with providing retail service.

C. AE's **Wholesale Competitive Losses Charged to Retail Ratepayers** Must be Disallowed. This Can be Accomplished by Excluding AE's **Wholesale Fixed Costs** From Base Rates.

1. Background.

A large portion of AE's generation fleet was originally put in service before 1997 when SB 7 became law, or 2002 when the ERCOT wholesale market "opened."[27] More was likely in place before the change to a nodal approach in 2010.[28] Data Foundry does not contest the prudence of the decisions surrounding placement of the pre-1997 plant. Some arguments could be made that continued operation and any expansion after 1997, 2002 or 2010 was questionable because of the risks and extraordinary changes afoot. Data Foundry does not, however, base its position on an "imprudence" theory.

Nonetheless, the moves to a wholesale market and then to the nodal approach lead to an undeniable fact: much of AE's generation was originally dedicated to serving its native retail load, but things have materially changed. **All** of AE's generation is now exclusively and inescapably dedicated to servicing the ERCOT <u>wholesale</u> market.[29] **None** of the Wholesale Fixed Costs relate to the operation of assets that are dedicated

[26] Schedule G-8, line 55 and 56, Columns A and L. HOM Tr. p. 95, lines 1-15.
[27] RFP p. 3-11, Bate 40 and p. 3-12, Bate 41.
[28] RFP p. 3-8, Bate 37.
[29] HOM Tr. p. 167, line 11 – p. 168, line 4.

to or do directly serve AE's retail load.[30] **None** of AE's self-owned generation services retail customers; AE services retail customers entirely through purchased power obtained through the ERCOT market.[31] AE's Total Wholesale Costs are exclusively wholesale in nature, and have nothing to do with retail.

2. Required ratemaking treatment of AE's ongoing Wholesale Fixed Costs.

The foregoing uncontested facts have extraordinary legal significance, and determine the required ratemaking treatment. AE's generation now has absolutely no direct relationship, and does not in any way relate, to the power actually consumed by AE's retail customers. The assets are not used by or useful to retail ratepayers and the ongoing operational costs are not reasonable or necessary retail costs. The *only* connection is that AE's wholesale "settlements" revenue is deposited in the Power Supply Adjustment ("PSA") account and – along with some other "benefits" from things like "hedging" – serves to reduce to some extent the amount retail ratepayers contribute toward AE's purchased power costs ("Load Zone Cost").[32]

AE's rate filing package does not assert that its production assets or the costs incurred to be able to operate them are either "used by" or "useful to" AE's retail customers. AE's rebuttal case does not make a used and useful or reasonable and necessary showing. The AE witnesses merely claim that retail ratepayers receive some "benefits."[33] AE admits that the wholesale production assets are not used to provide retail service, and it has functionally admitted that the ongoing Wholesale Fixed Costs AE incurs in order to be in position to sell power in the wholesale market are not "reasonable or necessary" expenses associated with provision of retail service.

[30] RFP p. 3-20, Bate 49 ("Initially, these power production operations served Austin Energy's customers directly by meeting their daily demand for electricity. Since the restructuring of the ERCOT wholesale market, however, Austin Energy owned or contracted power plants no longer serve Austin Energy customers directly. Instead, the energy produced is sold into the wholesale market.")

[31] RFP p. 5-4, Bate 107 ("Austin Energy no longer serves its customer load with its own generation. Rather, all power is purchased in the ERCOT market and then delivered to the Austin Energy load zone.")

[32] Data Foundry Exh. 3; see also *inter alia* HOM p. 178, line 20 – p. 180, line 8.

[33] RFP p. 3-23, Bate 52; p, 3-26, Bate 55; p. 3-28, Bate 57; p. 5-4, Bate 107; p. 5-14, Bate 117; p. 5-15, Bate 118; AE Exh. 3 (Mancinelli Reb.) p. 35, line 13 – 36, line 4, p. 39, lines 3-9, p. 41, lines 27-30; HOM Tr. pp. 161-182.

> 3. AE's claim that retail ratepayers "benefit" from AE's wholesale activities is belied by the evidence. AE's wholesale activities are actually Wholesale Competitive Losses once all relevant costs are taken into consideration.

AE admits that its variable (energy-related) Wholesale Fuel Related Costs are not incurred to serve its native retail customers. It functionally admits that they are not necessary to the provision of retail base utility service. To the contrary: they are entirely attributable to AE's wholesale activities. AE forthrightly explains that its wholesale settlements payments are not booked as a credit to the base revenue requirement. Instead they credit against the PSA balance and count against AE's Wholesale Fuel Related Costs, which are debited in the PSA. AE insists, however, that the PSA composition and calculation is not part of this case. Nonetheless, AE does want to require retail ratepayers to fund AE's Wholesale Fixed Costs in base rates:

> As discussed in Chapter 3, **Austin Energy no longer serves its customer load with its own generation. Rather, all power is purchased in the ERCOT market and then delivered to the Austin Energy load zone**. In the Nodal market, the energy generated by Austin Energy serves as a physical and financial hedge against ERCOT market power price fluctuations, providing a direct benefit to AE's customers. Specifically, Austin Energy's diverse fuel types and technologies provide AE's customers with a vital risk management strategy that guards against exposure to the volatility of the wholesale market.[34]
>
> …
>
> **The utility's variable operating costs are recovered through the sale of energy into the ERCOT wholesale market. Austin Energy then passes this revenue on to customers through the Power Supply Adjustment**.[note 91] **However, revenues from sales into the ERCOT wholesale market are not treated as a recovery mechanism for the fixed costs associated with AE's generation**. ***Instead, Austin Energy recovers these fixed costs through base retail rates assigned to its customers*** and the production function is used to appropriately assign the fixed operating costs to the appropriate customer classes.
>
> [note 91] The Power Supply Adjustment is calculated each year based on the expected net ERCOT wholesale market settlements, anticipated fuel expenditures, and net costs associated with Austin Energy's Power Purchase Agreements. These items are totaled together, adjusted for any over- or under-recovery from the prior year's PSA revenues, and then allocated to customer classes. **This rate review does not address the**

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[34] RFP p. 5-4, Bate 107 (emphasis added).

calculation of the PSA because the issue is addressed by the Austin City Council each year during the budget process.[35]

As noted, AE claims that retail ratepayers "benefit" from its wholesale activities because they operate as a hedge against wholesale price spikes. In theory retail ratepayers could be said to benefit overall if AE makes an actual profit (*e.g.*, full recovery of AE's Wholesale Fuel Related Costs *and* Wholesale Fixed Costs and then an additional amount for return or profit) from its wholesale activities that then served to materially reduce ratepayers' total bill. In theory there might be other benefits as well, although AE identifies none other its price spike "hedge" benefit that yielded $4 million in gains during the test period, but is likely to be less valuable in the rate-effective period if gas prices stay low.[36]

AE is not earning a profit in the wholesale market, however. To the contrary. AE's claim to net benefits is entirely based on willful exclusion of the Wholesale Fixed Costs when calculating the claimed "benefits." The evidence clearly demonstrates that the "benefits" are far outweighed by the relevant costs, once you actually consider all relevant costs. In any event, the "benefits" (if such they can be called) all accrue to the PSA, not the base even though almost half of the costs are in the base. Even after being challenged to do so AE never identified *any* benefit to base rates or base ratepayers from the over $300 million in Wholesale Fixed Costs AE seeks to include in base rates.

Base rate inclusion of the Wholesale Fixed Costs cannot be allowed merely on account of speculative and non-quantified subjective notions about benefits accruing to PSA prices that are squarely not in issue in this case. There is no base rate benefit, and that resolves the matter. Base ratepayers cannot be forced to make base rate payments that far exceed any benefits that can be said to accrue to the PSA. Base ratepayers cannot be forcibly made to fund AE's forays into risky competitive endeavors merely because AE says they will enjoy lower prices in rates that are outside of any real scrutiny in this proceeding. Ratepayers would be better off if AE entirely exited the

[35] RFP p. 5-5, Bate 108 (emphasis added).
[36] HOM Tr. p. 181, line 17 – p. 182, line 21.

wholesale generation market, since Total Wholesale Costs exceed Net Wholesale Revenues and Benefits by $210,047,663.

The chart supplied with AE's Third Supplemental Response to NXP/Samsung's 1st RFI 1-51[37] advises that AE apparently received approximately $174 million in net settlements[38] from its thermal generation. The same document seems to indicate that AE's self-owned renewable generation suffered net revenue losses of $80 million dollars.[39] The response also says there was a net gain of $4 million from "hedging."[40] All told, with all assumptions in AE's favor granted, this document appears to indicate that its wholesale activities provided Net Wholesale Revenues and Benefits equaling $98 million dollars[41] and this amount served to reduce AE's purchased power expenses ("Load Zone Cost") by $98 million. None goes toward the production costs claimed in base revenue requirement.[42]

The Wholesale Fixed Costs AE incurs to be in position to run its generation plant are said to be $308,047,663. AE wants base rate recovery of these amounts. Wholesale Fuel Related Costs attributed to the PSA are $411,649,196. The most beneficial reading of the document cited above shows that AE received wholesale payments that were $98,000,000 over and above its $411,649,196 in Wholesale Fuel Related Costs. That means AE experienced Wholesale Competitive Losses equaling $210,047,663 during the test period if you consider AE's Wholesale Fixed Costs. This includes the alleged "hedging" benefit of $4,000,000.[43] A concern that spends almost $720 million per year so that it can receive about $510 million per year in revenues and other benefits (or pays $308 million for $98 million in "benefits") will not be a going concern for very long. Unless, of course, it is a monopoly utility that can continually demand confiscatory retail

[37] Data Foundry Exh. 3.

[38] Net Settlements equal settlement revenues minus fuel related costs. HOM Tr. o. 155, line 11 – p. 156, line 4, p. 156, line 24 – p. 157, line 12, p. 162, line 13 – p. 164, line 24.

[39] HOM Tr. p. 164, line25 – p. 165, line 20.

[40] HOM Tr. p. 166, line 13 – p. 167, line 10.

[41] One of the components in the chart is $33 million in positive net revenue associated with "Green Choice." Figure 5.4 on p. 5-9, Bate 109 of the rate filing package states that $22.8 million of the Green Choice revenue comes from retail customers, so it is not a "wholesale benefit." HOM Tr. p. 94, lines 18-25, p. 165, line 21 – p. 166, line 12, p. 170, lines 9-11, p. 272, lines 4-13, p. 577, lines 1-15. That amount must be ignored even under AE's wholesale benefits theory.

[42] HOM Tr. pp. 161-182.

[43] Data Foundry Exh. 3.

rates from captive ratepayers in order to make up the Wholesale Competitive Losses. Retail base ratepayers cannot and should not be required to bear AE's Wholesale Competitive Losses.

The $98 million in alleged benefits is illusory and no "benefit" at all. AE is losing huge sums in the wholesale market, and captive retail ratepayers are being forced to make up the difference. The test year results show that there were $210 million in Wholesale Competitive Losses Charged to Retail Ratepayers, and the best information in the record indicates it very well may get even worse. AE witness Ball testified that if gas prices stay low during the rate effective period then the annual claimed "benefit" would be even smaller than the $98 million calculated using Data Foundry Exh. 3.[44]

AE's witnesses repeatedly touted the benefits of "hedging."[45] The rate filing package information, however, shows that the "hedging" benefit, while theoretically plausible, has not in fact provided significant monetary support against retail base or even PSA passthrough rates and in will not be in position to do so for so long as gas prices remain relatively low. The theory is that when wholesale prices spike AE can employ its generation fleet to supply energy and gain very high profits that reduce the PSA.[46] That could be possible if there were a lot of such spikes and the profits were extraordinary. AE admits, though, that there were not many spikes during the test period that allowed AE to race in and achieve huge margins over its variable costs, and there is no indication that the wholesale market will be any more "spiky" during the rate effective period.[47] The claimed "hedge" benefit is very small – approximately $4 million[48] – and it applies to the PSA, not the base, in any event.

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[44] HOM Tr. p. 181, line 17 – p. 182, line 20.

[45] Mr. Dombrowski said AE suffered a net loss on hedging. Ms. Ball (and Data Foundry Exh. 3) reflect a $4 million net gain. *Compare*, HOM Tr. p. 156, lines 1-19 (net loss) with pp. 166, line 9 – 167, line 6 (net $4 million gain). Data Foundry will accept Ms. Ball's representation purposes of argument since it is consistent with Data Foundry Exh. 3.

[46] *See, e.g.*, HOM Tr. p. 836 – p. 845, line 6.

[47] RFP p. 3-14, Bate 43:

> Over the past four years, wholesale market prices have been relatively stable. Figure 3.4 shows that wholesale market prices have ranged between $0 and $50 per MWh in about 32,000 of the total 35,064 operating hours in the years 2011 through 2014. Figure 3.4 also demonstrates that pricing events above the average market price occur very infrequently. Approximately 3 percent of all hours (about 1,000 hours over those four years) had wholesale prices above $100 per MWh.

[48] Data Foundry Exh. 3, asserting $4 million in "Hedging Net Revenue" during the test period. AE Witness

AE is losing a ton of money in the wholesale market. AE can only recover fixed costs to the extent it consistently enjoys huge margins over and above variable costs and that is not happening for any competitive generator, much less AE. AE nonetheless wants its retail ratepayers to cover the Wholesale Competitive Losses through base rates even though none of the Wholesale Fixed Costs are related to, or properly demanded from, AE's retail utility operations. That is not just, reasonable or supported by any known ratemaking principle. AE must make up its Wholesale Competitive Losses from some source other than confiscatory base rates charged to captive retail ratepayers.

4. The Wholesale Fixed Costs far outweigh any benefits to the PSA. AE is suffering significant Wholesale Competitive Losses, so there are no benefits to the base.

AE's justification for base rate inclusion is premised on the argument that its participation in the wholesale market provides a "benefit" to retail ratepayers because the wholesale activities produce revenue that serves to reduce the PSA prices paid by retail ratepayers.[49] AE also claims that its generation activities can be a kind of "hedge" against radical wholesale price spikes because during price spikes AE can earn extraordinary margins that then offset some of high wholesale purchase power costs AE incurs during the same price spike.[50] These alleged benefits pertain to the PSA, however, and do not involve the base rates in issue here. There is no benefit to **base** rates and AE admits as much since it never tries to demonstrate any benefit to the base.

Ball repeatedly pointed to Data Foundry Exh. 3 as representing the only dollar quantification of "benefits" that have been presented in evidence in the case. She mentioned another document that was not in evidence, but AE chose to not offer it despite Data Foundry's open invitation that it do so. HOM Tr. pp. 161-182. *See especially* p. 173, line 6 – p. 174, line 8.

[49] *Id.*

[50] *See, e.g.*, RFP p. 5-4, Bate 107:

> As discussed in Chapter 3, Austin Energy no longer serves its customer load with its own generation. Rather, all power is purchased in the ERCOT market and then delivered to the Austin Energy load zone. In the Nodal market, the energy generated by Austin Energy serves as a physical and financial hedge against ERCOT market power price fluctuations, providing a direct benefit to AE's customers. Specifically, Austin Energy's diverse fuel types and technologies provide AE's customers with a vital risk management strategy that guards against exposure to the volatility of the wholesale market.

If you consider both base rates and the PSA in tandem AE is spending $719,696,859[51] ($44,297,706 of which is actually GFT[52]) in Total Wholesale Costs per year to participate in the ERCOT sales market. AE receives $509,649,196 in revenues and other "benefits." After you deduct the $411,649,196 in Wholesale Fuel Related Costs, AE's "net" benefit is $98 million.[53] In other words AE is spending almost $720 million per year so that it can receive about $510 million per year in revenues and hedging savings. Stated another way, AE wants retail ratepayers to pay $308 million more in base rates in order to "enjoy" $98 million lower PSA passthroughs.

AE's alleged $98 million PSA "benefit" is no such thing. That figure is merely the extent to which AE received revenues over and above its Wholesale Fuel Related Cost, and then the relatively small $4 million in "hedging" savings. It entirely ignores AE's Wholesale Fixed Costs. Bring those amounts into the calculation and it turns out that AE's wholesale activities in fact lead to a significant detriment because AE is experiencing a whopping $210,047,663 in Wholesale Competitive Losses Charged to Retail Ratepayers.

AE has not carried its burden of proof that the Total Wholesale Costs incurred used exclusively to be able to and then make sales in the <u>wholesale</u> market are used by or useful to ***retail*** base ratepayers. AE has not proved that recovery of Wholesale Fixed Costs (expenses) through inclusion in the retail base revenue requirement and then retail base rates is just and reasonable.[54] The expenses associated with AE's Wholesale Fixed Costs are not reasonable or necessary for purposes of this case

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[51] Amount in Schedule G-8, line 19, Bate 993 plus amount in Schedule G-7, lines 11, 16 and 18, Bate 992.

[52] Schedule A, Line 18, Columns A and K, Bate 767.

[53] Data Foundry Ex. 3.

[54] This is why the Texas PUC ruled as it did in *SWEPCO* ("The Commission specifically disallows any allocation of the Turk Plant base rate costs that are not used for retail purposes to Texas retail ratepayers.") Similarly, the U.S. Supreme Court has expressly recognized that the "used and useful" test requires consideration of the extent to which an asset is actually used by and useful to the group of customers in issue. *See Wabash Valley Electric Co. v. Young*, 53 S. Ct. 234, 237 (1933) (emphasis added):

> Appellant further contends that, assuming this method to be free from constitutional objection, the valuation put upon the property is so low as to result in confiscation. To meet <u>**this objection it is only necessary that there shall be brought into the rate base the value of all property of appellant which is in fact used and useful for supplying the electric current to the city**</u>. Manifestly, the local plants in other towns and cities bear no such relation to the Martinsville plant.

because they have nothing to do with the provision of retail electric utility base service, and are unreasonable in any event since AE is losing $210 million per year in ratepayer-contributed funds as a result of the activities that give rise to the costs in issue. The Wholesale Fixed Costs must therefore be excluded from the base revenue requirement. Longstanding, well-accepted fundamental ratemaking principles compel this result. Costs associated with AE's generation fleet must be recovered – to the extent they can or should be recovered at all – through some mechanism other than retail base rates.

5. Wholesale revenues and "benefits" could properly be excluded from the PSA if Council deems that action appropriate.

In order to be consistent about entirely separating wholesale activities from retail activities, however, the IHE should recommend that the Council consider changing the PSA revenue requirement calculation so that it is no longer reduced by the revenues associated with AE's Net Thermal and Renewable Generation and Bilateral Power revenue and any other claimed benefits, including hedging. In other words, it may be appropriate to no longer include "ERCOT Settlements – charges and credits from ERCOT, other than the Administrative and Nodal Fees" and the $411,649,196 in "Fuel Costs – costs for fuel and fuel transportation, and hedging gains and losses" for purposes of calculating "PSA Costs."[55] This would mean that the PSA would be based only on the remaining retail-related components, which principally constitute AE's purchased power expenses ("Load Zone Cost") minus the retail revenues AE obtains from Green Choice. During the test year Load Zone Cost was $580 million and Green Choice Revenue was $33 million, which means the Net Power Supply Adjustment cost would be $547 million rather than the $449 million reflected on Data Foundry Exhibit 3. If wholesale costs and revenues are both removed from the base revenue requirement and the PSA revenue requirement the "entire bill" reduction for ratepayers would be $210,047,663.[56] This would accomplish complete removal of both costs and revenues, and eliminate the Wholesale Competitive Losses Charged to Retail Ratepayers. If

[55] According to AE those components lead to about $98 million in gains (or reductions) to the PSA. See Data Foundry Exh. 3, revealing that the sum of "Thermal Generation Net Revenue" (+$174 million), Renewable Generation Net Costs" (-$80 million), "Bilateral Power Net Revenue" ($0) and "Hedging Revenue" (+$4 million) equals $98 million. *See also* HOM Tr. pp. 161-182.

[56] Wholesale Fixed Costs equal $308,047,663. AE's claimed $98 million in Net Wholesale Revenues and Benefits is a net figure after recovery of AE's Wholesale Fuel Related Costs. The $210,047,663 is merely Wholesale Fixed Costs minus Net Wholesale Revenues and Benefits.

Council insists on still recovering the entire $105 million in GFT - Total from retail operations and desires to move the $44,297,706 of GFT – Wholesale Fixed to other aspects of retail operations, the entire bill reduction for retail ratepayers would be $165,749,957.

If the Council believes that participating in the wholesale market can be profitable notwithstanding the evidence adduced in this case then it can allow the utility to continue playing in that risky market. Since retail ratepayers would be exempt from any obligation toward fixed or variable production costs and immunized from any risk of loss they would not have any reasonable claim to the gains, if there are any. This means that any amounts received after wholesale revenues fully recover fixed and variable wholesale costs could go directly to the general fund and need not be used to "benefit" retail utility ratepayers.[57]

D. The IHE Must Apply the "Used and Useful" and "Reasonable and Necessary" Preconditions to Allowance in Base Rates.

1. AE has failed to prove that its wholesale production costs are related to plant that is used by and useful to retail ratepayers, or that the ongoing operational expenses are reasonable and necessary. These costs must therefore be disallowed and excluded from the retail base revenue requirement.

The "used and useful" requirement for inclusion in revenue requirements is well established throughout the domestic United States in both state and federal regulatory jurisdictions. It has been in place for over a hundred years,[58] and it specifically applies in Texas.[59] There can be no question that this is a fundamental requirement. If an asset is

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[57] Data Foundry recognizes that this might increase exposure to future severe price spikes in the PSA. As explained below, however, the evidence indicates there have not been very many since the market has recently been relatively stable and the "hedging against spikes" benefit to date has been very small, almost to the point of insignificance. There are also other smoothing tools that could be used to ameliorate ratepayer impact. The base rate cost to ratepayers far outweighs the PSA benefit.

[58] *Smyth v. Ames*, 169 U.S. 466 (1898).

[59] As noted, the Texas PUC excluded wholesale costs from the retail base revenue requirement under used and useful concept in *SWEPCO*. But this was not a novel thing, by any means. *Smith v. Ames* has been cited at least 22 times by Texas courts. Those that were utility cases addressed how to value invested capital, but each of them also by necessity accepted the prerequisite that assets be used and useful before they can be included in invested capital. A representative sample includes *Gulf, C. & S. F. R. Co. v. Railroad Com. of Texas*, 113 S.W. 741 (Tex. 1908); *Baytown v. General Tel. Co.*, 256 S.W.2d 187, 191 (Tex. Civ. App. – Galveston, 1953, *writ ref'd n.r.e*); *Texas & N. O. R. Co. v. Railroad Com.*, 286 S.W.2d 112, 126 (Tex. 1955); *Railroad Com. of Texas v. Houston Natural Gas Corp.*, 289 S.W.2d 559 (Tex. 1956) (extended discussion of "rule of *Smyth v. Ames*"); *Southwestern Bell Tel. Co. v. Public Utility*

not both used by and useful to captive utility customers then the capital costs must be excluded from rate base. It is true that AE does not have "invested capital" *per se* so there is no need to much debate the amount of allowable invested capital for return purposes. But AE's debt is a proxy for invested capital, and AE is seeking to recover $58,314,647 in "production-related" debt service[60] even though the "debt" is related to plant that is no longer used by or useful to retail ratepayers.[61] AE is also claiming there should be an allowed "return" or profit through the $105,000,000 General Fund Transfer ("GFT").[62] Data Foundry's point here is that if an asset is not used and useful, then no "return" or recovery of debt service can be allowed into base rates, which means that neither the $44,297,706 in GFT – Wholesale Fixed associated with the $308,047,663 in Wholesale Fixed Costs, nor the $58,314,647 in "production-related" debt service can be allowed, since all of these amounts are related to assets and costs incurred to run assets that are not used by or useful to retail ratepayers and therefore the costs are not reasonable and necessary.

In addition, and more important, any ongoing costs AE incurs to operate the non-used and useful assets are by definition not reasonable or necessary and must be disallowed from the regulated base revenue requirement. Therefore the $308,047,663

Com., 560 S.W.2d 157, 161-162 (Tex. Civ. App. - Austin 1977), *rev'd other grnds*, 571 S.W.2d 503 (Tex. 1978) (but noting need for determination of "present usefulness," 571 S.W.2d at 516).

The *Smith v. Ames* "used and useful" requirement is also codified in Tex. Util. Code §36.051:

> In establishing an electric utility's rates, the regulatory authority shall establish the utility's overall revenues at an amount that will permit the utility a reasonable opportunity to earn a reasonable return on the utility's invested capital <u>used and useful</u> in providing service to the public in excess of the utility's <u>reasonable and necessary operating expenses</u>.

[60] Schedule A, line 16, Column E, Bate 767; Schedule C-3, line 6, Column E, Bate 822, Workpaper C-3.1, line 6, Column F, Bate 823.

[61] AE witness Dombrowski recognized the legal problem with trying to recover debt-related costs pertaining to plants that are not presently used and useful to current from retail ratepayers at HOM Tr. p. 607, lines 15-22:

> 15 Q Okay. So wouldn't you also agree that there
> 16 might be legal or regulatory challenges to Austin
> 17 Energy if the utility were to try to recover the debt
> 18 on a plant that has already been retired?
> 19 A Yes. I believe there's a regulatory rule
> 20 called "used and useful" that collecting -- paying debt
> 21 off an asset that's no longer in service could cause a
> 22 problem.

[62] Schedule A, line 18, Column K, Bate 767.

in claimed production demand costs (Wholesale Fixed Costs With GFT) must be disallowed.[63]

The "used and useful" requirement and the "reasonable and necessary" criterion can admittedly be harsh to the utility, but they are black letter law and are absolutely necessary to protect captive monopoly ratepayers, who have no choice but to purchase from the regulated utility whatever the price may be. There are equally harsh rules that routinely cut against ratepayers.

AE's generation assets are being "used." They may or may not be "useful" to someone. Some or all of the Total Wholesale Costs may (or may not) be reasonable and necessary for some purpose other than provision of retail electric utility base service. AE forthrightly admits that all production operations are wholly dedicated to the competitive wholesale market, so in a "wholesale" case AE might have a powerful claim for recovery of its Wholesale Fixed Costs from its wholesale customers based on the used and useful and reasonable and necessary tests. But AE has not shown that the assets are both used by and useful to its ***retail base ratepayers***. AE has not proven that the Wholesale Fixed Costs are "necessary" to the provision of retail electric utility base service and can therefore be reasonably recovered through retail base rates.[64] The Wholesale Fixed Costs must be entirely "assigned" to, and recovered from, AE's wholesale endeavors or otherwise recovered, if at all, through some mechanism other than retail base rates.[65]

2. AE is trying to require its retail ratepayers to pay more than the reasonable and necessary costs of providing retail service by including Wholesale Fixed Costs in base rates in order to make up for (subsidize) AE's Wholesale Competitive Losses.

Although AE tried very hard to obscure and hide the true dollar impacts, the utility was quite candid about its ultimate goals. AE clearly sought base rate recovery of the

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[63] If the GFT – Wholesale Fixed portion, which equals $44,297,706, is sent to some other item so it can still be recovered, then the Wholesale Fixed Costs Without GFT, which equals $263,749,957, must still be disallowed.

[64] *See, SWEPCO*, *supra* ("The Commission specifically disallows any allocation of the Turk Plant base rate costs that are not used for retail purposes to Texas retail ratepayers.")

[65] Again, and in the alternative, if the GFT – Wholesale Fixed portion, which equals $44,297,706, is sent to some other item so it can still be recovered, then the Wholesale Fixed Costs Without GFT, which equals $263,749,957, must be disallowed.

claimed $308,047,663 in the Wholesale Fixed Costs that are exclusively related to AE's wholesale activities in the competitive wholesale generation market.[66] AE witness Mancinelli's written rebuttal openly and directly asserted that AE's captive monopoly **retail** ratepayers should be required to make up for and subsidize all of AE's Wholesale Competitive Losses.[67] He repeated the assertion that AE's Wholesale Fixed Costs should be recovered from retail base rates during the hearing in response to the IHE's clarifying questions, in between his twice-stated admission that AE cannot sell wholesale power (after incurring Wholesale Fuel Related Costs) unless it first incurs the Wholesale Fixed Costs.[68] This is a clear and unequivocal admission that AE wants to

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[66] *See, e.g.,* Rate Filing Package at 5-5, Bate 108 ("revenues from sales into the ERCOT wholesale market are not treated as a recovery mechanism for the fixed costs associated with AE's generation. Instead, Austin Energy recovers these fixed costs through base retail rates assigned to its customers…")

[67] AE Exh. 3, Mancinelli Rebuttal, p. 26, line 23 – p. 27, line 4. ("AE's classification of production variable costs aligns with the economics of 24 generation dispatch in ERCOT and reflects costs AE will recover from the market. Depending upon market prices, other costs above and beyond these short-run variable costs may be recovered, but this is not guaranteed. As a result, AE customers are ultimately responsible for some or all of the generation costs above short-run variable costs." (Emphasis added)

[68] HOM Tr. p. 841, line 14 – p. 842, line 23 (emphasis added):

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14 Q Can you imagine --
15 A This is the, this is the --
16 Q -- that scenario?
17 A -- fixed and variable thing. If the plants
18 aren't running, there are no variable costs.
19 Q Thank you.
20 A And so you don't have to worry about that,
21 but there are fixed costs because they have to maintain
22 them, they have to keep them ready to run because they
23 don't know when they need, need them next, and so they
24 maintain them, they operate them, and they keep them in
25 a, in a kind of a state of readiness to serve**, and**

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1 **those ultimately are fixed costs and then they end up**
2 **in basically the base rates. The base rates are**
3 **covering those costs.**
4 Q Could there be a situation where the market
5 prices are so much more attractive than the dispatch of
6 the Austin Energy's own plants that -- the plants that
7 they're ready to serve but aren't doing anything, so
8 your variable costs are low, they're not --
9 A Yeah. I mean, that happens all the time.
10 Yeah.
11 Q But you still have the what I'll call the
12 fixed costs associated --
13 A Yeah.
14 Q -- with the units being available?
15 A Yeah. You've got, you've got staff at the

force its captive monopoly retail customers to subsidize AE's competitive wholesale generation activities by covering its Wholesale Competitive Losses. AE's monopolist attitude and effort can be expected, but its goals are not reasonable or lawful. The result is directly contrary to Texas policy, which forbids any requirement that monopoly retail customers subsidize an integrated utility's Wholesale Competitive Losses.[69]

AE tries to avoid having to separate its costs and revenues associated with its wholesale generation business from its retail activities for ratemaking purposes. AE

> units, you've got, you've got the debt service associated with them, you know, the depreciation, the staffing, the labor, the materials and supplies to keep it there ready to go even though you're not using it. So those, those are costs that are fixed, and they're required in order for your fleet to be effective by that effective hedge, and they're fixed. So they're in the, in the -- they end up in the base rates.

[69] Proposal for Decision, *Application of Southwestern Public Service Company for Authority to Change Rates; Reconciliation of its Fuel Costs for 2004 and 2005; Authority to Revise the Semi Annual Formulae Originally Approved in Docket No. 27751 Used to Adjust its Fuel Factors; and Related Relief*, SOAH Docket No. 473-06-2536; PUC Docket No. 32766 (Jun. 7, 2007), reported at 2007 TX SOAH LEXIS 355, *6, *22-24, 36, 40-41, adopted by PUC in Docket 32766 by Order dated July 27, 2007 (footnotes omitted):

> But to the ALJ's knowledge, no Commission decision has ever approved of a regulated utility's voluntary decision to enter into a money-losing contract, and certainly not one where the loss is recovered by the utility at the expense of captive retail customers
>
> …
>
> SPS is attempting to increase its competitive market share by offering below-market sales to customers who have a choice in purchasing electricity, while increasing costs to those customers who have no choice but to obtain service from SPS.
>
> …
>
> The ALJ recommends the Commission find that PURA § 36.003, and the resulting just and reasonable rate doctrine, will not allow this cross-subsidization.
>
> …
>
> Traditional ratemaking is appropriate for customers in SPS' certificated area where other interests, primarily of providing electricity to everyone, are dominant. In such an instance, assignment of system average costs is reasonable and necessary. However, when a utility is entering into contracts of its choosing and has the option of selling excess power on the open market, it does not make sense to allow it to provide service to another utility at an amount below cost on the backs of its regulated customers. To do so effectively grants the utility a premium on its monopoly. To do so is also neither traditional ratemaking nor traditional market-based economics.
>
> …
>
> SPS has been granted a monopoly in its certificated area. Unless the state protects the interests of SPS' captive retail customers, they have no choice but to pay whatever amount SPS chooses to charge. For SPS' arguments to ring true, its captive customers would need the ability to participate in the free market, allowing them to choose other providers (cheaper providers) when SPS enters into money losing contracts and raises the rates of captive customers to make up the short fall. Only then would the ALJ agree with SPS' analysis. In reality, SPS' captive customers do not have a choice; therefore, regulations and policy must be made to protect their interest from the SPS monopoly.

hides behind the label of an "integrated utility" in order to have retail subsidize wholesale by bearing the Wholesale Fixed Costs even though they are not reasonably attributable to retail, and involve expenses that are not necessary to provide retail service. But it is surely aware of these fundamental ratemaking principles. Indeed, AE affirmatively wields the "separate activities" and "don't subsidize separate activities" and even the "used and useful" arguments when it suits AE's interests.

This became quite evident during AE's rebuttal case. Mr. Maneius strongly advanced the same theories advocated by Data Foundry when it came to transmission costs.[70] AE's counsel repeatedly urged that wholesale transmission matters were entirely outside the scope of the case, and consistently objected to NXP/Samsung's efforts to delve into the proper revenue amounts that should be used for AE's systemwide numbers before they are allocated to the retail base.[71] A decent synopsis of AE's legal argument and its witnesses' opinion and fact testimony occurs at HOM Tr. pp. 979-1016. At one point Mr. Maneius asserted that acceptance of AE's position was necessary "so that in this retail base rate case no wholesale transmission costs would be included."[72] He claimed that the "whole purpose of adjusting the revenue" was to ensure that "no wholesale transmission cost was included in the rate-filing package in this case."[73] Mr. Maneius also asserted that any other result would be asking AE's "wholesale transmission customers to subsidize this retail base rate case."[74]

Mr. Maneius was clear and unequivocal about the horrors of cross-subsidization between wholesale and retail during his redirect, on HOM Tr. p. 1008:

14 Q Is it your understanding that NXP is
15 proposing that wholesale transmission customers

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[70] AE Exh. 8 (Maneius Reb.), p. 8, line 3 to p. 10, line 17.

[71] NXP/Samsung is not trying to cross-subsidize, notwithstanding what AE says. NXP/Samsung is making an accounting adjustment that has little to do with cost assignment. NXP/Samsung is merely trying to match up the relevant and time-appropriate transmission costs and revenues at the systemwide level. This is necessary because if NXP/Samsung's adjustment is not made then the transmission costs that are not matched with the transmission revenues will end up falling into the retail revenue requirement, or the non-recognized revenues will go to the reserve. Data Foundry's observation here is not about the merits of the NXP/Samsung adjustment, however. Rather, Data Foundry is observing that AE embraces Data Foundry's argument in the wholesale transmission context.

[72] HOM Tr. p. 993, lines 7-20; *See also* HOM Tr. p. 994, lines 10-16.

[73] HOM Tr. p. 993, lines 10-11, p. 998, lines 12-14, p. 1015, lines 15-18. Similarly, Mr. Mancinelli emphasized that "[t]he transmission function is not in this case." HOM Tr. p. 822, lines 8-11.

[74] HOM Tr. p. 994, lines 15-16.

> subsidize AE's retail base rates by about 14 million dollars?
> A Yes. That is correct.
> Q Do you know if that's legal?
> A Well, it certainly doesn't meet a cost causation. I certainly wouldn't expect Austin Energy's retail customers to pay for wholesale transmission costs, no more than I would expect the wholesale transmission customers, the distribution service providers to pay retail costs.

AE abhors forcing its wholesale customers to "subsidize" retail costs. Apparently, however, its revulsion goes only one way, since the utility is adamant that its captive retail customers must pay the Wholesale Fixed Costs that it does not recover from its wholesale customers in the ERCOT wholesale generation market. Data Foundry objects to subsidization of all kinds, going in any direction. AE's retail customers cannot lawfully or reasonably be required to pay for wholesale costs, or subsidize AE's Wholesale Competitive Losses any more than wholesale customers can or should be required to pay retail costs. AE witness Maneius directly employs Data Foundry's position – for transmission – on HOM Tr. p. 1009:

> Cost causation dictates that retail customers pay for the costs that they incur and that wholesale customers pay for the costs they incur.

Data Foundry agrees, and the principle espoused by Mr. Maneius requires that all of AE's Wholesale Fixed Costs be eliminated from the retail base revenue requirement.

AE also manages to suddenly remember, and hastens to invoke, the "used and useful" and "reasonable and necessary" tests when it is convenient to AE's cause. Once again, Mr. Maneius' Rebuttal testimony illustrates. Indeed, he draws a logical link between cost causation, cross-subsidization and "reasonable and necessary."[75]

> Q. HOW DID AE ENSURE THAT RETAIL CUSTOMERS ONLY INCURRED THE RETAIL TRANSMISSION EXPENSE THAT WAS NECESSARY TO PROVIDE SERVICE AND DID NOT INCLUDE ANY WHOLESALE TRANSMISSION COSTS THAT SHOULD BE RECOVERED FROM ERCOT LOAD SERVING ENTITIES?
> A. AE adjusted its wholesale transmission revenues shown on WP E-5.1.1 to equal

[75] AE Exh. 8 (Maneius Reb.), p. 9.

> the wholesale TCOS. This was done so the only remaining transmission expense included in the cost of service is the FERC Account 565 retail transmission expense. This adjustment was necessary to avoid cross subsidization.

In similar vein AE itself invokes "used and useful" with regard to defeasement costs. AE witness Dombrowski urged that the "used and useful" requirement may pose a legal problem if future ratepayers are required to pay debt-related costs of a plant that has been retired from service, and is therefore not either used or useful.[76]

AE's ongoing Wholesale Fixed Costs are caused by, and incurred to produce, the electricity AE sells in the wholesale market. The cost causer is wholesale. But AE wrongly dumps a huge portion of these costs in the *retail* base requirement. AE assigns its Wholesale Fixed Costs to the retail base revenue requirement, but then further clouds the problem by placing the wholesale sales revenue in the PSA account, which is separate from the retail base.

Retail ratepayers did not create this situation, and cannot lawfully be required to bear the consequences. AE will have to craft some solution that does not involve base rate recovery, in a separate proceeding. AE has assiduously refused to provide detailed information regarding its wholesale activities, including its revenues, based on the argument that the information is competitively-sensitive (and thus exempt from disclosure). This lack of transparency meant that the parties were initially unable to determine whether AE is profiting or taking losses in its wholesale generation activities, but ultimately enough information came out to show that AE's wholesale activities are in the red by a huge amount and AE is suffering horrendous Wholesale Competitive Losses. There is no benefit, only large detriment. AE's ongoing Wholesale Fixed Costs cannot reasonably be recovered from retail ratepayers through base rates. AE's retail ratepayers cannot be forced to subsidize AE's Wholesale Competitive Losses.

In sum, AE has not carried its burden of proof that its Wholesale Fixed Costs are used by or useful to retail base ratepayers, are reasonable and necessary costs associated with the provision of retail electric utility service, or that recovery of these costs through base rates is just and reasonable.[77] They must be excluded from the base

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[76] HOM Tr. p. 607, lines 15-22.

[77] *See State v. PUC*, 450 S.W.3d 615, 662 (Tex. App. Austin 2014, pet. rev. granted *sub nom Oncor Elec. Delivery Co. LLC v. PUC of Tex.*, 2016 Tex. LEXIS 158, Feb. 19, 2016) ("… Oncor had the burden to

revenue requirement. These costs must be recovered – if at all – through something other than base rates and it must occur in some other proceeding.

III. Conclusion

The evidence starkly reveals that AE's wholesale operations lost $210 million during the test period, and AE wants captive retail ratepayers to cover those losses, through "**Wholesale Competitive Losses Charged to Retail Ratepayers**."

Captive monopoly retail ratepayers cannot reasonably or lawfully be charged for the $308 million in wholesale-related production costs ("**Wholesale Fixed Costs With GFT**") AE wants to include in retail base rates.

If there was competitive choice in Austin retail ratepayers would pay $200 million dollars per year less than they do now. In other words AE's captive customers suffer a $200 million "**No Choice Penalty**."

AE has not carried its burden of proving that AE's Wholesale Fixed Costs are used by and useful to AE's captive retail ratepayers, and AE has not proven that these are reasonable and necessary costs associated with the provision of retail electric utility service. They obviously are not any of these things since the uncontested evidence is that AE's generation fleet is entirely dedicated to the wholesale market and no longer serves retail to any extent. The Wholesale Fixed Costs therefore cannot be justly or reasonably included in the retail base revenue requirement. Retail ratepayers cannot be required to pay retail base rates that include compensation for AE's Wholesale Fixed Costs with the result that captive, monopoly ratepayers are forced to subsidize and act as conscripted guarantors of AE's significant Wholesale Competitive Losses. AE's Wholesale Fixed Costs must be excluded from the base revenue requirement.

Data Foundry is not saying that none of the debt costs associated with AE's legacy generation fleet can ever be recovered in some fashion; it is just that any recovery amount and mechanism cannot be determined in this case, or part of the base rate revenue requirement and then base rates that this case is all about. AE has made it perfectly clear that this proceeding is firmly confined to only a determination of AE's reasonable and necessary retail base rate revenue requirement and then retail base

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prove that the payments were …reasonable and necessary operating expenses 'incurred in furnishing normal electric utility service.'")

rates.[78] It cannot now press for recovery under other theories or obtain a means of recovery other than base rates in this proceeding. The Council is free to devise some other process to investigate potential rationales, amounts and methods in a separate case.

The IHE is well familiar with fundamental ratemaking concepts. Data Foundry merely asks that he faithfully apply them. The necessary and required outcome is complete exclusion of AE's Wholesale Fixed Costs from retail base rates. Reasonable, cost-based base and pass-through annual rate recoveries would lead to between $210 million and $165 million more than the $24 million in reductions AE itself admits are due.[79] The Independent Hearing Examiner ("IHE") must recommend that AE's revenue requirement exclude AE's claimed Wholesale Fixed Costs With GFT ($308,047,663). If Council prefers to retain the $44,297,706 in GFT – Wholesale Fixed then the IHE should at least recommend base rate exclusion of the $263,749,957 in Wholesale Fixed Costs Without GFT.

[78] The style of this proceeding is *Austin Energy's Tariff Package: 2015 Cost of Service Study and Proposal To Change Base Electric Rates* (emphasis added). AE has consistently insisted that only base rates can be determined in this proceeding and it has used that argument to oppose producing information it claimed did not pertain to base rate determinations. For example, page 2 of AE's Objections to NXP/Samsung's First Request for Information (Feb. 18, 2016) forcefully claimed that "Austin Energy is only proposing changes to its base electric rates. Thus, this rate review is limited to Austin Energy's base electric rates. Discovery in this proceeding should, therefore, be limited to issues concerning Austin Energy's base electric rates and is irrelevant to the extent it seeks information not related to Austin Energy's base electric rates." *See also* AE's Objection to NXP/Samsung's Second Request for Information (Feb. 29, 2016) pp. 1-2 (same). AE expanded on this theme in its Response to NXP/Samsung's Motion to Compel (Mar. 1, 2016): "Austin Energy indicated in its Tariff Package that this rate review is limited to Austin Energy's base electric rates. Indeed, the very style of this proceeding states clearly that this case is a 'proposal to change base electric rates.' Additionally, while the plain text of Ordinance No. 20120607-055 may not specify that only Austin Energy's base rates should be reviewed, the Ordinance's context and history evidence Austin City Council's intent for the review to be limited to AE's base rates."

[79] Data Foundry also concurs in the NXP/Samsung revenue requirements case, except insofar as they would allow any production costs into base rates.

Respectfully submitted,

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June 10, 2016

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