

**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 §**

**DATA FOUNDRY, INC.'S EXCEPTIONS TO INDEPENDENT HEARING EXAMINER'S
REPORT**

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**DATA FOUNDRY, INC.'S EXCEPTIONS TO INDEPENDENT HEARING EXAMINER'S
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TO THE HONORABLE ALFRED R. HERRERA, IMPARTIAL HEARING EXAMINER:

Data Foundry, Inc. ("Data Foundry") respectfully presents these Exceptions to the Impartial Hearing Examiner's Report ("Report"). The filing is addressed to the Independent Hearing Examiner ("IHE") to provide him an opportunity to rectify the errors as part of the promised Supplemental Report.

I. Introduction and Glossary

For purposes of these Exceptions, Data Foundry will employ the same terminology and amounts it used in briefing. The Glossary used in brief and repeated below explains the source and basis for the substantive terms, concepts and numbers used in the revenue requirements portion of these Exceptions.

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. 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

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Term	What it Means	Dollars Involved	Source
			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	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 Benefits	Net dollar amount of the benefits to retail ratepayers AE claims flow from AE's wholesale activities	\$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; 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

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Term	What it Means	Dollars Involved	Source
			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

Data Foundry will not exhaustively repeat all of the arguments it made in its Revenue Requirements brief or the Cost Allocation/Revenue Distribution brief Data Foundry jointly submitted the Austin Chamber. Data Foundry will instead directly address the challenged portion of the Report and respond to the claims and findings made therein insofar as they pertain to the issues raised by Data Foundry in these Exceptions. In the interest of having a lower page count, Data Foundry will often cite to those briefs rather than repeat the entirety of their contents, although some passages may be cut and pasted.

The points presented in these Exceptions do not involve *any* contested or disputed fact issues. The numbers come directly from AE's rate filing package and testimony, and the Report either expressly or implicitly accepts them. Nor is there any dispute between AE and Data Foundry (or the IHE) about the nature of the generation/production costs that Data Foundry has focused on in this case. AE has forthrightly agreed that its production plant, and therefore all Wholesale Fixed Costs, are

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entirely dedicated and incurred in order to generate power that AE then sells in the unregulated wholesale market. AE has admitted without qualification that none of its generation directly serves retail customers. The Report agrees with all of these facts, but nonetheless says retail ratepayers should still be charged for AE's Wholesale Fixed Costs and required to make AE whole for its Wholesale Competitive Losses. The disagreements are about legal issues and/or the proper application (*vel non*) of well-accepted, consistently-used ratemaking concepts.

Specifically, these Exceptions note that the Report does not correctly characterize Data Foundry's position on revenue requirements. They then question (1) the Report's recommendation that captive retail ratepayers be required to pay for AE's Wholesale Fixed Costs that AE incurs to generate the power it sells on the unregulated wholesale generation market (revenue requirements) and thereby cover AE's Wholesale Competitive Losses; and (2) how much each class will be required to pay toward these wholesale costs (cost allocation).

Data Foundry strongly contests the Report's determination that AE should be allowed to recover Wholesale Fixed Costs from captive retail ratepayers. Data Foundry notes that the Report entirely fails to address important legal issues related to recovery of AE's Wholesale Fixed Costs, and requests that the Supplemental Report include a narrative addressing those legal issues. Data Foundry fully intends to press this matter before Council, and reserves the right to subsequently take the matter to other venues. Council deserves to know the IHE's thoughts on whether and to what extent the longstanding "used and useful" and "reasonable and necessary" legal prerequisites to retail revenue requirement inclusion still apply, or should apply, to AE's Wholesale Fixed Costs.

Data Foundry also contends that the Report erred in its selection of 12CP as the means to allocate production costs rather than A&E 4CP, which is the prevailing method used in Texas by the PUC. Finally, Data Foundry excepts to one characterization error revenue distribution and rate design, but does not – at present – except to the recommended result.

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II. Individual Exception Points

1. Exception to IHE Report Point 1: The Report mischaracterizes Data Foundry's revenue requirements recommendations.

The Report mischaracterized Data Foundry's specific dollar recommendations regarding base revenue requirements amounts. Report p. 20 erroneously states that Data Foundry recommended a base rate cut between \$165 and \$210 million.¹ The Report erroneously references the calculated impact of *complete elimination of all wholesale activity – all fixed and variable wholesale costs, and all claimed benefits – from both **base rates** and the PSA*. Data Foundry's base rate revenue requirements recommendation was to deny base rate recovery of all Wholesale Fixed Costs With GFT (\$308,047,663) or, in the alternative, to deny all Wholesale Fixed Costs Without GFT (\$263,749,957).²

Data Foundry then went on to observe that in order to be consistent about completely separating AE's wholesale activities from retail activities the Council could choose to no longer pass the alleged \$98 million in Net Wholesale Revenues and Benefits through to the PSA, and instead use those dollars for other, non-retail

¹ See, Report p. 20:

Data Foundry appears to recommend a reduction of between \$165 million and \$210 million in addition to the \$24 million in reductions Austin Energy proposed. However, Data Foundry also concurs in the NXP/Samsung revenue requirements case, except insofar as NXP/Samsung's proposal would allow production costs in base rates. Thus, Data Foundry's proposed reduction is not entirely clear given that Data Foundry also concurs in NXP/Samsung's recommendations.

² See Data Foundry Revenue Requirements Brief p. 5 and note 3 (emphasis added):

Reasonable, cost-based base and pass-through annual rate recoveries would lead to between \$210 million and \$165 million^[note 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). 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.

^[note 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.

See also p. 29 (same text in body, without note) and, *inter alia* pp. 21-22 ("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 in claimed production demand costs (Wholesale Fixed Costs With GFT) must be disallowed.") (emphasis added)

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purposes.³ Doing so would *increase* the PSA revenue requirement by \$98 million.⁴ The “between \$165 million and \$210 million” referenced on Report page 20 is the net effect of the base revenue requirement reduction flowing from exclusion of the Wholesale Fixed Costs (with or without GFT) and the \$98 million increase to the PSA calculation as a result of no longer passing on AE’s claimed Net Wholesale Revenues and Benefits if Council chooses to completely separate all of the costs, revenues and claimed benefits associated with AE’s wholesale and retail activities, while still immunizing retail ratepayers from AE’s Wholesale Competitive Losses. Data Foundry requests that the Supplemental Report correct the characterization error regarding Data Foundry’s position and request concerning the base revenue requirement exclusion and the optional action on PSA calculation and then the net effect of taking both actions.

Report p. 20 also claims that Data Foundry’s complete revenue requirement position was unclear with regard to NXP/Samsung’s recommendations. While we disagree that is so, Data Foundry submits the following explanation, and requests that the Supplemental Report reflect Data Foundry’s position, as clarified.

Data Foundry concurred in NXP/Samsung’s revenue requirements case on all matters other than AE’s claimed production costs. Data Foundry did note that Data Foundry and NXP/Samsung both recommended some adjustments to some production-

³ Data Foundry Revenue Requirements Brief pp. 19-20 (notes omitted, emphasis added):

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. ... 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. This would accomplish complete removal of both costs and revenues, and eliminate the Wholesale Competitive Losses Charged to Retail Ratepayers. If 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.

⁴ See, e.g., *inter alia* Data Foundry Revenue Requirements Brief p. 15 (notes omitted, bracketed text added):

All told, with all assumptions in AE’s favor granted, this document [Data Foundry Exh. 3] appears to indicate that its wholesale activities provided Net Wholesale Revenues and Benefits equaling \$98 million dollars 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.

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related costs so there was some overlap.⁵ But Data Foundry's complete revenue requirement position was that all of AE's Wholesale Fixed Costs should be excluded from base rates and then all of NXP/Samsung's other recommendations on matters not touching on production costs should also be adopted. Data Foundry agreed with the rest of NXP/Samsung's other adjustments for all revenue requirement matters other than wholesale production costs but otherwise did not extensively write about the NXP/Samsung revenue requirements case. The remaining NXP/Samsung recommendations pertained to costs other than production costs, and Data Foundry chose to focus its active advocacy on revenue requirements on production cost issues.

As further explained in Exception Point 2, Data Foundry contends that as a matter of law and under longstanding basic ratemaking principles that still apply regardless of AE's notional "unique" status as a publicly-owned integrated utility operating in competitive and monopoly markets the Council must eliminate all of AE's Wholesale Fixed costs from the base revenue requirement. There is no discretion and no "policy" excuse that can justify forcing captive monopoly retail ratepayers to subsidize AE's loss-infested competitive wholesale generation activities.

2. Exception to IHE Report Point 2: Disallowance of AE's Wholesale Fixed Costs is compelled as a matter of law notwithstanding AE's status as a publicly-owned integrated utility operating in the competitive generation market and the non-competitive transmission and distribution markets. The Report effectively contemplates that there are no controlling legal or policy principles, and thus leaves room for entirely arbitrary and unfair results.

The facts here are uncontested and the quantified amounts are not subject to dispute. AE wants captive retail ratepayers to pay \$308 million in Wholesale Fixed Costs even though AE's wholesale generation activities no longer serve AE's retail

⁵ See Data Foundry Revenue Requirements Brief pp. 1-2 and note 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 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.

Data Foundry's case used AE's filed numbers relating to production costs rather than NXP/Samsung's filed numbers in order to reduce the number of factual disputes and so as to crisply present the precise issue on production cost base rate inclusion for legal determination.

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customers. AE recovers \$98 million over and above its variable costs, and that money flows to the PSA, not the base. \$308 million minus \$98 million is \$210 million. It is obvious AE is losing \$210 million a year through its wholesale activities, and wants to force captive retail base ratepayers to make up that difference.

Like the plant itself, the fixed operational costs associated with AE's owned generation are not used by or useful to the provision of retail electric utility service, nor are they reasonable or necessary to the provision of retail electric utility service. The resolution is dictated by law and longstanding basic ratemaking principles that still apply regardless of AE's notional "unique" status as a publicly-owned integrated publicly-owned utility operating in competitive and monopoly markets. AE's alleged unique status does not constitute a distinction that makes a difference, and the rationale used to justify requiring retail ratepayers to subsidize AE's wholesale costs and losses do not survive objective scrutiny.

There is no choice, no discretion, and no legal or logical rationale for rate base inclusion of AE's Wholesale Fixed Costs. All of AE's Wholesale Fixed costs must be removed from the base revenue requirement. The IHE should change his recommendation on this point. But even if he does not do so the Supplemental Report should at least address the legal points raised by Data Foundry.

. . .

The meat of the IHE's analysis and recommendation dedicates a mere 150 words to Data Foundry's issue regarding inclusion of AE's Wholesale Fixed Costs in the retail base revenue requirement:

... While interesting, fundamentally DF/ACC's arguments ignore the unique circumstances of a vertically integrated utility operating in the ERCOT nodal market.

... AE's customer-owners interact with the utility in a fundamentally different way than do shareholders of a merchant generator in the ERCOT nodal market, or customers of a competitive retailer: AE's customers serve both roles simultaneously. Thus, the IHE agrees: the MOU-ERCOT, nodal-market paradigm has changed the relationship between the utility and its customers, but that change does not mean, as suggested by DF/ACC, that costs of production should not be recovered through AE's rates.

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In the end, DF/ACC present a facile argument for a complex relationship in which AE's customers are at once the owners of AE's production plant and its ratepayers that operate in a market where some entities' production plant is not subject to rate regulation and yet AE's in effect is.

The Report can also be charged with using "interesting" but "facile" arguments, which are compounded by the summary and conclusory analysis rather than a detailed discussion of the facts and law. Council deserves better, as do all of the captive monopoly retail ratepayers who will be charged with hundreds of millions of dollars in non-retail costs, and forced to subsidize hundreds of millions in competitive losses if the recommendation stands. Data Foundry fully intends to continue pressing this issue – including in other venues if necessary – and respectfully suggests that the IHE should consider strengthening the analysis so that Council is better informed regarding this important issue because it is not going to so easily go away.

A. The Report entirely fails to address, much less dispose, important legal issues.

The Report conspicuously fails to address in any manner Data Foundry's *legal* argument that notwithstanding AE's integrated operations and public ownership age-old black-letter ratemaking principles still apply and completely determine the outcome. For example, the Report entirely fails to acknowledge and deal with the fact that AE never alleged – and certainly did not prove – that its Wholesale Fixed Costs are used by or useful to the provision of retail service, or that inclusion of AE's Wholesale Fixed Costs are "reasonable and necessary" costs related to the provision of retail service.⁶ The Report does not find that the costs are used, useful, reasonable or necessary to the provision of retail base electric utility service. The reason it does not do so is that these findings are legally and factually impossible. AE admitted them away.

Instead, the Report summarily contends that since AE is a "vertically integrated utility operating in the ERCOT nodal market"⁷ and "AE's customers are at once the

⁶ Data Foundry Revenue Requirements Brief p. 12 ("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."). *See also* pp. 18, 27, 28 (asserting that AE failed to carry its burden of proving the costs are used, useful reasonable or necessary).

⁷ IHE Report p. 275.

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owners of AE's production plant and its ratepayers that operate in a market where some entities' production plant is not subject to rate regulation and yet AE's in effect is"⁸ then AE should be allowed to recover "its expenditures related to production plant"⁹ from captive retail ratepayers.

The Report multiply errs, through both omission and commission. The IHE applied the "reasonable and necessary to retail electric utility service" concept elsewhere in the Report, so it is evident that the IHE believes it still applies notwithstanding AE's allegedly "unique" status.¹⁰ But there is no mention here, even though Data Foundry extensively briefed the issue, and directly challenged inclusion on that basis (along with "used and useful").¹¹

There is no plausible excuse for the Report's failure to expressly rule on the legal issues Data Foundry raised concerning "used and useful" and "reasonable and necessary" with regard to AE's Wholesale Fixed Costs. The omission must be rectified in the Supplemental Report. Data Foundry respectfully requests that the IHE, at minimum, provide a legal rationale supporting the proposition that these age-old, universally-applied legal concepts no longer apply with regard to this issue even though it was expressly used as the basis to exclude other costs, if that is the IHE's position and conclusion.

Data Foundry submits, once again, that there is no discretion and no "policy" excuse that can justify the confiscation of captive monopoly retail ratepayers' property in order to subsidize AE's loss-infested competitive wholesale generation activities. As a matter of law AE's Wholesale Fixed Costs are not used by or useful to retail customers. AE's Wholesale Fixed Costs are not "reasonable and necessary" costs related to the provision of retail electric utility service. They must be disallowed, because inclusion of

⁸ *Id.*

⁹ IHE Report p. 276.

¹⁰ See IHE Report pp. 8, 95 ("Thus, while the Austin Energy, and the City, may view these expenditures to be of value, the source of funding for the cost associated with these activities should not be treated as a cost of service for providing electric utility service. And to that extent, the IHE also agrees with NXP/Samsung that the economic development and community programs are not a reasonable and necessary expense to provide electric utility service." (emphasis added)

¹¹ Data Foundry's Revenue Requirements Brief mentioned the "reasonable and necessary" test at least 38 times, in a host of places throughout. The point was specifically raised and directly briefed in a discrete part of the brief, in part II.D, and then in the Conclusion, on pages 20-29.

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AE's Wholesale Fixed Costs in the retail base revenue requirement would be arbitrary, capricious, unjust, unreasonable, discriminatory, confiscatory and therefore flatly unlawful.¹² Inclusion of AE's Wholesale Fixed Costs would not constitute a reasonable measure of use by or benefit to retail ratepayers and would lead to an unreasonable rate structure. The resulting retail charges would not be reasonably related to the benefits received by retail ratepayers. Captive retail ratepayers cannot be compelled to cross-subsidize AE's wholesale activities and losses as a matter of law. There is no discretion to be exercised,¹³ and no "facile" policy or theoretical excuse that can be used to justify any other result.

B. The distinctions made in the Report make no difference, and are misplaced in any event.

The Report claims that AE is a "vertically integrated utility operating in the ERCOT nodal market"¹⁴ and "AE's customers are at once the owners of AE's production plant and its ratepayers that operate in a market where some entities' production plant is not subject to rate regulation and yet AE's in effect is."¹⁵ There are actually three

¹² *San Antonio Indep. Sch. Dist. v. San Antonio*, 550 S.W.2d 262, 264 (Tex. 1976) ("A city which owns and operates its own public utility does so in its proprietary capacity"); *Hatten v. Houston*, 373 S.W.2d 525, 537 (Tex. Civ. App. 1963) (and cases cited therein) ("The general rule is well established that when a municipality undertakes to furnish a public service, such as the supplying of water to consumers, it acts in its proprietary, and not its governmental, capacity and it is obliged to serve its customers at reasonable and non-discriminatory rates.") Forcing retail ratepayers to subsidize AE's wholesale costs and losses constitutes a form of unjust and unreasonable discrimination, and would be unreasonable. Data Foundry reminds all concerned that while inside-the-city ratepayers cannot "appeal" municipal utility rates to the PUC they retain the constitutional and statutory right to file an original action in state district court seeking to overturn the ratemaking ordinance. While the burden is high, a legal demonstration that the municipal utility (water, sewer, electric) rates are unjust, unreasonable, discriminatory, confiscatory, do not reflect a reasonable measure of use by or benefit to ratepayers, or the ratemaking body abused its discretion will result in a holding that the rate ordinance is illegal and it will be enjoined. See, e.g. *San Antonio Indep. Sch. Dist. v. San Antonio*, *supra* at 264-67; *Tara Partners, Ltd. v. City of S. Hous.*, 282 S.W.3d 564, 571-575 (Tex. App. 2009, *pet. den.*); *Black v. City of Killeen*, 78 S.W.3d 686 (Tex. App. 2002, *pet. den.*); *Schenker v. San Antonio*, 369 S.W.2d 626 (Tex. Civ. App. 1963, *writ ref'd n.r.e.*); *Bexar Cty. v. San Antonio*, 352 S.W.2d 905 (Tex. Civ. App. 1961, *error dismissed w.o.j.*).

¹³ Once the Wholesale Fixed Costs are removed from base rates Council would have the discretionary power to continue passing on to retail ratepayers the alleged \$98 million in Net Wholesale Revenues and Benefits as an offset to the PSA revenue requirement. But Council could fairly decide to no longer do so and instead use the wholesale revenues for any other purpose, including non-utility purposes. Data Foundry contends that retail ratepayers cannot be forced to contribute to AE's wholesale costs, but it also acknowledges that if retail ratepayers do not pay any of the costs then they do not have any legitimate claim to the claimed benefits. Data Foundry's Revenue Requirements brief pp. 13-19 showed that the alleged benefits are illusory and far outweighed by the costs in any event.

¹⁴ IHE Report p. 275.

¹⁵ *Id.*

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separate arguments buried in these assertions. Data Foundry will address them individually.

- i. AE's lack of structural separation and retention of vertical integration makes accounting safeguards even more necessary.

First, the Report observes that AE is vertically integrated, *e.g.*, there is no structural separation, and the same entity has both retail and wholesale operations. Apparently the IHE believes that this fact – perhaps in combination with the other two facts addressed below – allows the result where captive monopoly retail customers can be involuntarily forced to subsidize AE's Wholesale Competitive Losses by paying for AE's Wholesale Fixed Costs. That is simply wrong. The caselaw is ripe with regulatory holdings that captive retail customers cannot be required to pay costs incurred by the same entity in a separate wholesale market, and that such subsidization is flatly prohibited.¹⁶ This is so because it unduly burdens captive monopoly ratepayers with costs that are not associated with the cost of providing service to them, but also because the subsidization will undercut and tend to discourage full and fair competition in the unregulated market over the long term. In other words, the subsidization blessed by the Report is not merely unjust and unreasonable to captive retail ratepayers who must bear the burden; it is *also* anticompetitive *vis-à-vis* other unregulated generation companies in the wholesale market that do not have a base of captive retail customers that can be forced to prop up the wholesale activity and cover wholesale losses.

- ii. AE's voluntary participation in the unregulated ERCOT wholesale market does not justify forcing captive retail customers to cross-subsidize AE's Wholesale Fixed Costs or Wholesale Competitive Losses.

The Report seems to imply that since the ERCOT nodal market tends to drive wholesale prices toward short-run variable costs it is reasonable for captive retail ratepayers to subsidize AE's wholesale-related long-term fixed costs, and make up for AE's Wholesale Competitive Losses. Wrong.

¹⁶ The prohibition on cross-subsidization between retail and wholesale and the obligation to separate costs as between the two activities are fundamental rules that have been reaffirmed in so many utility contexts that a string cite should not be necessary. Data Foundry provided a relatively recent PUC decision related to an integrated utility (albeit one that is privately owned and not in the ERCOT market) in its Revenue Requirements brief, on p. 24, note 69.

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It is true that the city cannot control the price that it can recover in the wholesale market. But the city did decide to remain in the market and thereby incur the losses associated with the failure to recover longer-term costs through the wholesale revenues it receives. Austin could exit that market – and Data Foundry suggests it should seriously consider doing so, because current wholesale prices are non-compensatory.

But AE's captive retail ratepayers had absolutely no choice in the matter. They cannot control the wholesale price; they cannot control AE's participation in the wholesale market; and they have no power to pay any rate other than the retail rate established by the city. Retail, after all, is still a monopoly.¹⁷ AE's production plant is not used by or useful to retail ratepayers. The wholesale costs have nothing to do with the cost of providing retail base electric utility service. It is neither reasonable nor fair to force captive retail customers to pay AE's Wholesale Fixed Costs or support AE's Wholesale Competitive Losses. AE's retail rates must be based on the cost AE incurs to provide retail service, and no more. The increment above retail costs will mean that retail ratepayers will not be paying rates that constitute a reasonable measure of use by or benefit to retail ratepayers. The resulting retail charges will not be reasonably related to the benefits received by retail ratepayers.¹⁸

iii. AE ratepayers do not, in fact or law, "own" the utility.

The Report employs facile linguistics that do not comport with reality. AE is indeed a publicly-owned utility, but that does not mean that the ratepayers "own" it. They are ratepayers, not owners. Even when the ratepayer is also a citizen there is no ownership in the property sense. Ratepayer/citizens obtain no equity interest, and do not contribute capital, receive capital gains or suffer capital losses. They have no property right, whatsoever. They cannot convey their asserted interest – for value or otherwise. When the ratepayer/citizen moves to another town he or she gains nothing other than the right to buy retail service from a different utility, and loses nothing other than the burden associated with paying rates promulgated by Council. The city is acting in a proprietary rather than governmental capacity when it operates a public utility. Governance, regulation processes and venues are different, but that is it. In all other

¹⁷ This means retail ratepayers cannot avoid the subsidization of AE's wholesale activities by purchasing from another retail provider. They are stuck with the No Choice Penalty.

¹⁸ *Bexar Cty. v. San Antonio*, *supra* at 907-908.

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ways AE ratepayers are in exactly the same position as they would be if they resided in a monopoly area where service is provided by a privately-owned utility. They are ratepayers, no more, no less.

But let's extend the "ownership" theory to its logical conclusion, since the Report justifies retail rate base inclusion of Wholesale Fixed Costs costs and recovery of AE's Wholesale Competitive Losses on that invalid notion. The Report effectively contends that since ratepayers "own" the utility they can be forced by the government to be part of a "bail-in" by having to contribute additional funds that will be used for purposes unrelated to the provision of retail base service that are instead use to subsidize competitive losses in a separate endeavor. There is a legal term for that. It is called "confiscation": a compelled taking of private property without reasonable compensation. The state and federal constitutions flatly prohibit such action, and the courts have made clear that municipal ratemaking ordinances leading to confiscation are unlawful.¹⁹

The Report uses distinctions that make no difference when it comes to the compelled legal result. In fact, they only make the illegality more evident.

C. The Report effectively contemplates that there are no controlling legal or policy principles, and thus leaves room for entirely arbitrary and unfair results.

One of the more bothersome aspects of this portion of the Report is that it articulates no limiting principle, and provides no boundaries regarding what outcomes are permitted. The Report effectively says there are no rules, and the City can do anything it wants. Rates can be set at astronomical levels, without constraint or rationale. The "owner" ratepayer/citizens can be made to suffer virtually any price, merely because AE is a "vertically integrated utility operating in the ERCOT nodal market"²⁰ and "AE's customers are at once the owners of AE's production plant and its ratepayers that operate in a market where some entities' production plant is not subject to rate regulation and yet AE's in effect is."²¹ Such unconstrained discretion provides fertile ground for arbitrary and capricious action.

¹⁹ *Hatten v. Houston*, *supra* at 539.

²⁰ IHE Report p. 275.

²¹ *Id.*

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Data Foundry respectfully requests that the IHE at least provide some indication of where he thinks the boundaries of permitted action lie when it comes to inclusion of non-retail costs in the retail base revenue requirement, in the allegedly unique situation at hand. Data Foundry, of course, contends that the age-old “used and useful” and “reasonable and necessary” tests still apply. But if they do not then the IHE needs to come up with a new rule that will provide a reliable and useable alternative test for reasonableness and, ultimately, lawfulness.

3. Exception to IHE Report Point 3: The IHE erred by recommending recourse to 12CP as a production allocator, and should have used A&E 4CP. The rationales used in the Report to reject A&E 4CP and to apply 12CP do not in fact support selection of 12CP as “more accurate.”

Data Foundry accepts that it will likely not be able to convince the IHE to change his mind on the production allocator. But we will try, at least briefly.

The IHE chose 12CP because it allegedly “more accurately reflects the affect of nodal markets in ERCOT on production costs,” “the ERCOT nodal market is based on the supply of and demand for energy in five-minute intervals, the price for power is a product of supply and demand, where prices change throughout the year and not only in 4 months out of the year during peak demand” and “generation resources are dispatched based on the marginal price offered by the resource owner and not on system peak demands.”²²

Data Foundry must first observe that the IHE’s discussion plainly accepts the basic and uncontested fact that AE’s production costs are entirely wholesale in nature, because the energy is sold in the wholesale market and dispatch occurs when the generation owner can make a wholesale transaction. But we face the problem on how to allocate these purely wholesale costs among the various retail classes, which are no longer directly served by the energy generated or dispatched by AE.

All of the methods in the NARUC manual – including each suggested by the parties here – necessarily and explicitly assume that the “cost” in issue is being incurred to provide retail service. The exercise is dedicated to making a direct or proportional attribution of the cost to serve the class that “causes” the cost to be incurred.²³

²² IHE Report p. 167.

²³ NARUC CAM pp. 12-13 (emphasis added):

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The problem no party other than Data Foundry has recognized is that no retail class causes these fixed or variable costs in any manner, and no retail class receives any direct base electric service benefit from the activity. There is a complete disconnect between costs incurred and benefits received. The "causal" link has been entirely severed. That necessarily means that any and every cost of service method will be entirely subjective and wholly arbitrary, because no retail class "causes" AE's Wholesale Fixed Costs. Indeed, one must wonder why production costs should have even been the subject of a "cost of service study" to allocate between retail classes using any of the methods suggested by any of the parties since AE "production cost" has nothing at all to do with AE's actual "cost" of providing service to any retail class. Let's just stop pretending we are studying "costs." What we are actually doing is trying to find some way to rationalize the entirely arbitrary task of determining how much each retail class will be required to supply toward the illegal cross-subsidies of AE's wholesale activities and losses.

Demand allocators are useless since no retail customer is demanding anything from AE's wholesale generation. Energy allocators are useless because no retail class receives the energy, or causes it to be created. Dispatch-based allocators are useless since no retail class consumption leads to AE's decision to dispatch. Base, intermediate

Cost of service studies are among the basic tools of ratemaking. While opinions vary on the appropriate methodologies to be used to perform cost studies, few analysts seriously question the standard that service should be provided at cost. Non-cost concepts and principles often modify the cost of service standard, but it remains the primary criterion for the reasonableness of rates.

The cost principle applies not only to the overall level of rates, but to the rates set for individual services, classes of customers, and segments of the utility's business. Cost studies are therefore used by regulators for the following purposes:

- o To attribute costs to different categories of customers based on how those customers cause costs to be incurred.
- o To determine how costs will be recovered from customers within each customer class.
- o To calculate costs of individual types of service based on the costs each service requires the utility to expend.

...

- o The cost allocation procedure - The total revenue requirement of the utility is attributed to the various classes of customers in a fashion that reflects the cost of providing utility services to each class. The cost allocation process consists of three major parts: functionalization of costs, classification of costs, and allocation of costs among customer classes.

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and peak methods are equally irrational since AE no longer designs or dispatches units using the “base,” “intermediate” or “peak” concept.

The rationales stated in the Report do not support the conclusion. Data Foundry originally tried to convince the IHE that A&E 4CP was “better” but it is now apparent that no “cost causation study method” that tries to allocate costs to customers that do not in fact cause the costs can ever be better than any other in terms of theory. The 12CP method is not “better” than the others, contrary to what the Report says. 12CP is still a peak demand method. But there is no evidence that AE makes dispatch decisions or incurs its production costs in a manner that corresponds in any way with the ERCOT demand peak in any month, or every month. As the Report notes, the process works on 5-minute supply and demand intervals, and prices do not correlate with peak demand. 12 CP calculates fixed costs, but ERCOT nodal prices allow for recovery of only short-term variable costs. The whole exercise is irrational and arbitrary because it is entirely disconnected from reality.

No retail production cost allocator can under these circumstances be rationally said to be “better” when the production cost is exclusively wholesale and has no relation to retail. There is no retail production “cost causer.” 12CP is not “more accurate” or a more “rational approach to assign cost to the various customer classes that AE service”²⁴ than would be any other method. Every method involves an attempt to quantify something (retail cost causation) that does not ever actually occur in the ways they did when the NARUC CAM methods were developed.

Again, the IHE should be candid about what is really going on. We are not trying to find any or the best or even the “least-worse” measure of cost causation. We are allocating “costs” that none of the retail classes actually cause. What we are doing is assigning the amount of wholesale cross-subsidy burden each retail class will be required to bear. We are allocating subsidies, and losses, not “retail costs” caused by retail customers.

But what we do know is that the PUC currently exclusively uses A&E 4CP as the production allocator for retail utilities that operate generation. If this matter ends up

²⁴ IHE Report p. 207.

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there, that is what will be required. No purpose is served by inviting an appeal. For that single practical reason the IHE should recommend A&E 4CP.²⁵

4. Exception to IHE Report Point 4: Request for correction of error concerning Data Foundry position on Regulatory Charge

Report p. 293 states that "DF/ACC"²⁶ oppose AE's request to increase the P2 class regulatory charge. That is not correct. Data Foundry and the Chamber did initially make some noise about the charge, and counsel adduced some evidence on the issue. But we ultimately chose to drop our opposition and accepted the rough trade off AE made in its revenue distribution.²⁷ Data Foundry and the Chamber did not address the issue in their joint brief.²⁸ We had assumed that the failure to brief the point would be taken as an abandonment, like it was intended to be. Data Foundry requests that the error be corrected in the Supplemental Report by noting that Data Foundry and the Chamber no longer contest the increase to the P2 regulatory charge.

Data Foundry still does not contest based on the understanding and expectation that "a larger share of the decrease in the overall revenue requirement should be allocated to the P2 class"²⁹ consistent with the direction in the Report that IHE's further disallowances will be implemented through the same proportional relationships as were used in AE's original case.³⁰

AE provided an updated revenue requirements model late Wednesday, July 20. Data Foundry's initial review indicates that AE may not have faithfully implemented the IHE's direction that the IHE's additional revenue requirement decreases be flowed through using the same proportional relationships as were used in AE's initial revenue distribution, and that more benefit be given to the P2 class in base rates in order to

²⁵ See IHE Report p. 208 (recommending against BIP because it would "invite disputes that would likely lead to the PUC").

²⁶ Data Foundry and Austin Chamber of Commerce.

²⁷ See IHE Report p. 294 (describing AE proposal, and citing to AE Exh. 1 at 5-27).

²⁸ Data Foundry/Chamber Joint Brief, p. 17, Issue ("B. Regulatory Charge (Not addressed)").

²⁹ IHE Report p. 295.

³⁰ See Report pp. 209-210 ("Therefore, the IHE recommends to Council that it adopt the proposed revenue distribution AE proposed for the initial \$17.5 million revenue reduction and that the Council allocate the additional \$7 million decrease associated with the CAP program in the same manner. Further, the IHE recommends to Council that if the Council reduces AE's revenue requirement beyond the approximate \$24.5 million conceded by AE, that it use the same proportional relationships attendant to the \$24.5 million to distribute the additional reductions.")

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make up for the significant increase in the regulatory charge. Data Foundry has sought an explanation and further information from the utility, and if necessary will address this point further in the reply round once we have a better understand about AE's rationale and calculations.

Data Foundry, however, wants to be clear that its disinclination to contest the revenue distribution approach recommended in the Report does not serve to waive or abandon Data Foundry's opposition to inclusion of AE's Wholesale Fixed Costs in retail base rates, or the ultimate recovery of them through rates developed in the cost allocation, revenue distribution and rate design phases. We firmly and inalterably contend those costs cannot be included in base rate and then recovered using *any* revenue distribution or rate design.

III. Conclusion

Data Foundry respectfully requests that these Exceptions be granted and the IHE Report be modified as indicated herein.


Respectfully submitted,

W. SCOTT MCCOLLOUGH
Texas Bar No. 13434100
wsmc@dotlaw.biz
MATTHEW A. HENRY
henry@dotlaw.biz
McCOLLOUGH|HENRY PC
1290 S. Capital of Texas Hwy Bldg 2-235
West Lake Hills TX 78746
512.888.1112 (V)
512.692.2522 (FAX)
Counsel for Data Foundry, Inc.

July 22, 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.



W. Scott McCollough