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 CONTEST OF AE IMPLEMENTATION OF INDEPENDENT HEARING EXAMINER'S REPORT REVENUE DISTRIBUTION AND REPLY TO AE EXCEPTIONS TO INDEPENDENT HEARING EXAMINER'S REPORT

TABLE OF CONTENTS

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 §

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

Data Foundry, Inc. ("Data Foundry") respectfully presents this Contest of AE Implementation of Independent Hearing Examiner's Report Revenue Distribution and Reply to AE Exceptions to Independent Hearing Examiner's Report.

I. Introduction.

This Reply involves two topics (revenue distribution and treatment of AE's wholesale activities) raised by the AE-provided "Updated Revenue Requirements Model" that was posted on Wednesday July 20 and then AE's Exceptions. Data Foundry contends that AE did not correctly implement the revenue distribution prescribed in the Independent Hearing Examiner's ("IHE") Report. Data Foundry will then discuss AE's Exceptions regarding transmission revenues, because AE's position there cannot be squared with its advocacy on Wholesale Fixed Costs and revenues.

II. AE's "Updated Revenue Requirements Model" does not correctly implement the IHE's recommended revenue distribution.

A. The Report's direction on revenue distribution.

The Report described AE's revenue distribution approach on pages 200-201, by quoting almost verbatim from AE's Closing Brief on pp. 95-96:

> To achieve the goal of delivering the greatest relief to those furthest above COS, the S2 and S3 customer classes initially received a $10.1 million reduction in annual base revenues. Of this $10.1 million, S2 received approximately $8.3 million, given its greatest disparity to class COS and the large number of customers assigned to the class. The remaining $7 million reduction primarily benefited the P1, P2, and P3 classes. However, rather than distribute a pro rata share of the reduction to each customer class based on the COS results, AE also acknowledged the impacts of estimated pass- through charges. Austin Energy has proposed a relatively significant change to the Regulatory Charge rate design in an effort to bring the P2 rate class closer to COS. Without any other mitigating efforts, AE contends that this change in the Regulatory Charge would likely result in a significant bill increase for P2 customers, an illogical result given the

overall context of a revenue decrease. Therefore, AE proposed that P2 receive a larger share of the remaining $7 million as an offset to what would have been an overall bill increase.

The Report then approved that approach and directed that AE implement the surplus "through the same *proportional relationships* as were used in AE's original case[1] (emphasis added). In particular the Report specifically ratified using some of the additional base surplus as a way to offset the 358% increase in the regulatory charge for the P2 Class,[2] finding that "a larger share of the decrease in the overall revenue requirement should be allocated to the P2 class"[3] The Report did not state, or even imply, that AE should or could fail to apply the same proportional relationships and instead set class base rates on "the price points mathematically determined by the CCOS study." Indeed, the Report specifically rejected doing any such thing.[4]

B. AE CCOS "rerun" and AE's subsequent explanation to Data Foundry.

AE provided an updated revenue requirements model late Wednesday, July 20 (including a CCOS "rerun") that purported to implement the IHE recommendations, including revenue distribution. Data Foundry's analysis indicated a concern that AE had not faithfully implemented the IHE's direction that the 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 make up for the significant increase in the regulatory charge. Data Foundry noted its concerns in Exceptions filed on Friday July 22, and in the interim sought an explanation and further information from the utility.

AE responded to Data Foundry's inquiries in a series of communications during the week of July 25. AE asserts that the Report is contradictory in places, and claimed it used judgment but also relied on a statement that appeared in the revenue

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[1] *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.")

[2] Report pp. 295-296.

[3] Report p. 295.

[4] Report p. 208.

requirements portion of AE's brief as a guide for implementation of the Report's allegedly contradictory revenue distribution rulings.

AE's more detailed explanation referred Data Foundry to the same workpaper Data Foundry analyzed (WP G-10.2) prior to seeking more information. This was helpful since it ensured the parties were working off of the same document. The utility explained that it added the $7,084,569 in CBC funding to system revenues, and then attributed that entire amount to residential by way of a credit to residential revenues in B3[5] to show where the Residential Class would be if there was no CAP discount within that customer class. AE noted that this method mathematically reduces the extent to which the Residential class is under its recalculated CCOS (see B19).[6] AE also stated that the adjustment is not a cost reduction, has no cost impacts on other customer classes, and did not change the CCOS Residential revenue requirement (B6)[7] or impact the new proposed rates (B27).[8] AE said that if you take the difference between Line No. 10[9] and Line No. 22,[10] you will see that the sum of the difference equals the full system $63,689,983 over-recovery. AE further claimed that the $63,689,983 over-recovery is distributed in full to customer classes that are above cost under the CCOS rerun (as reflected on Line No. 27[11]). Finally, AE says it took P2 to its re-calculated full cost of service, and then went no further.

In response to Data Foundry's specific inquiry about the base rate offset to make up for the significant increase to the P2 regulatory charge, AE claimed that moving P2 to its recalculated cost of service served as sufficient mitigation of the regulatory charge increase. AE justified its decision to stop applying reductions once it reached P2's re-

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[5] In order to be consistent with the way AE does things the "cell" references used herein are those inserted by AE within each Excel worksheet rather than the native Excel column and row indicators. AE's replacement identifiers (called Line Numbers, or "Line No.") for each row appear in Excel native column A. The replacement identifiers for each column appear in Excel native row 6. Thus, for example, AE's assigned "B3" is actually Excel assigned E10. This can occasionally lead to confusion, since AE of course had to use the Excel native identifiers when expressing formulae or functions for a particular cell.

[6] Excel cell E25.

[7] Execl cell E12.

[8] Excel cell E33.

[9] Excel row 16.

[10] Excel row 28.

[11] Excel row 33.

calculated CCOS by citing to an obscure portion of its brief (dealing with revenue requirements, not revenue distribution) that – contrary to the plain literal meaning of its actual arguments in the revenue distribution portion of the case – asserted AE would not intentionally take a class below cost of service.[12]

C. Data Foundry contests AE's implementation.

Data Foundry disagrees with AE's implementation method and rationale. The Report expressly rejected pricing based exclusively or primarily on the mathematical results of a CCOS study, and doing so would not address the impact of the significant increase in the P2 regulatory charge. AE's re-calculated base cost of service by class appears to be problematic in any event, even if one accepts without question the use of 12CP for the production allocator.[13] AE did not correctly implement the Report's findings and direction on revenue distribution. The IHE should require AE to do it again, but correctly.

1. AE did not flow through the $11,699,038 IHE Adjustment for TCOS to each class, and therefore failed to properly calculate the extent to which each class approximated its cost of service, even if one accepts 12CP is the correct production allocator.

Data Foundry challenges the way AE implemented the "IHE Adjustment for TCOS Revenue" in its CCOS re-run. The $11,699,038 calculated by AE is treated as an offset to "Total Company" revenue requirements in A7, but AE did not distribute that

[12] *See* AE Closing Brief, p. 12 (emphasis added by AE in its communication to Data Foundry):

> II. REVENUE REQUIREMENT A. Residential Base Revenue Customer Assistance Program Adjustment Austin Energy's initial filing did not account for revenues generated from a separate funding source under the Community Benefit Charge ("CBC") to reimburse the Customer Assistance Program ("CAP") discount expenses. This issue was raised by Austin Energy Low Income Customers ("AELIC") and the ICA during discovery. This error was acknowledged and discussed in Mr. Dombroski's rebuttal testimony. This correction adds approximately $7,085,000 to AE's projected base rate over-recovery. Therefore, Austin Energy is proposing to decrease base rates by $24,559,000. This compares to the $17,474,000 decrease proposed in Austin Energy's initial filing. ***<u>AE proposes this additional revenue be allocated using the same approach that was applied to its initial filing. However, if a class reaches its class cost of service, the remaining amount will be applied to the other classes.</u>***

[13] Data Foundry still believes that to the extent AE is allowed to recover its Wholesale Fixed Costs from captive retail ratepayers the CCOS should use A&E 4CP as the production allocator, but AE has now caused a new problem associated with transmission rather than production.

across the various classes, as is evident from Line No. 7,[14] and the absence of an entry similar to how AE treated the "Billing Adjustment" by class in Line No. 18[15] and the $7,084,569 in CBC funding in Line No. 19.[16] AE should have had a row for TCOS Revenue after Line No. 19 that includes the $11,699,038 in column A[17] and then distributes it across each class in some manner in columns B through N,[18] before it calculated Total Base Revenue for system (A) and then in each class (B through N) in what is now Line No. 20.[19] This would extend the benefit of the $11,699,038 to each class, and properly calculate the extent to which a particular class' revenues match up with that class' calculated cost. AE's approach leads to the incongruous result where the reported sum of the COS for all classes shown in B8 through N8[20] equal $586,972,087, even though the total retail revenue requirement shown in O8[21] is actually $11,699,038 less, or $557,273,049. The Excel spreadsheet formula AE used to obtain the value in O8[22] reveals how AE gimmicked this incoherent outcome. AE summed O6[23] and O7[24] to get the result reflected in O8.[25] If it had actually summed B8 through N8[26] the result in O8[27] would have been $586,972,087, not $557,273,049.

AE's incoherent and illogical approach means that "unity" for each class is not in fact in "unity" with the system. Every class' reported cost of service is artificially higher than it should be.[28] This in turn means that if AE's revenue distribution sets prices for a

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[14] Excel row 13.

[15] Excel row 24.

[16] Excel row 25.

[17] Excel Column D.

[18] Excel Columns E through Q.

[19] Excel row 26.

[20] Excel cells E14 through Q14.

[21] Excel cell R14.

[22] Excel cell R14.

[23] Excel cell R12.

[24] Excel cell R13.

[25] Excel cell R14.

[26] Excel cells E14 through Q14.

[27] Excel cell R14.

[28] Total retail costs and the recalculated cost for every class are already artificially high because they include AE's Wholesale Fixed Costs, even though no retail class actually causes AE to incur those costs. *See* "Updated Revenue Requirements Model" Schedule G-8, Line No. 19 (Excel row 24) (showing total

class at "unity" then it is still not a "cost-based" rate, because AE's "sum of all class' costs" do not equal its "system sum of revenues," unlike every other CCOS from the beginning of time.

The CCOS re-run Line No. 30[29] tries to explain the problem and shortcoming away by asserting that while the TCOS revenue can be recognized at the system level, there is "currently no way to allocate to a class cost level." This argument is eerily similar to the argument Data Foundry made in its exceptions regarding the fact that it is not possible to rationally "allocate" a wholesale cost to retail ratepayers that do not cause AE to incur that cost. But AE is likely just opportunistically asserting the obvious truism that the amount in issue is about *revenue* rather than *cost*. Of course there is no "cost" to "allocate" under any known costing theory, because we are dealing with *revenues*. Class cost of service studies attribute revenues, and then they allocate costs. The mathematical difference between attributed revenues and allocated costs indicates whether the costs and revenues match (costs and revenues are at unity) and the amount of any mismatch. The size of the mismatch is the extent to which a given class is above or below cost. AE is gaming the CCIS by not attributing the TCOS revenue to each class.

AE is clearly aware of the right way to do things because it had no difficulty "attributing" the $7,084,569 in CBC *revenues* to the residential class for *cost/revenue* mismatch purposes. AE went on to correctly observe that taking this proper attribution step reduced the extent to which the residential class is below cost under the re-run. This is so because there is more reported residential revenue to meet the reported residential cost. AE also correctly noted in its explanation to Data Foundry that its revenue attribution of CBC revenues to residential did not change the *cost of service* for residential or the CCOS results for any other class. It is obvious that AE knew exactly

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updated claimed Wholesale Fixed Costs in base revenue requirement and the amount that is improperly charged to each class). The amounts have been reduced from the original by $5,813,125 in total because of one or more individual rulings in the Report, but the principal issue in contest is still quite live. For example, the P2 class is still burdened with $10,988,112 in Wholesale Fixed Costs. Schedule G-8, AE cell H19 (Excel cell O24).

[29] Excel cell B36.

what it was doing, and therefore should have known it was creating a problem with the way it handled the transmission revenue ruling.

Although the task is admittedly more difficult, AE should have found a way to "attribute" a portion of the $11,699,038 in revenue to each class on the revenue side of the equation if and to the extent it was going to stick with the effort of dividing its total costs by class, and then rely on the disparity between costs and revenues as the determining factor for establishing prices for each class. It should have at least sought further instructions from the IHE by way of a clarification request or a point in its Exceptions on how the $11,699,038 in revenues should be attributed to each class.

AE's re-run revenue distribution approach means P2 does not receive additional reductions in base rates to offset the severe increase in the regulatory charge beyond the amount that was implicit under AE's original case, even though AE was the party that proposed using the same proportions for any surplus beyond the original $17,474,000. The P2 class is not, in fact, at "unity" because it did not receive the benefit of a portion of the $11,699,038 in transmission revenues. AE's Brief – not the Report – was the item that injected inconsistency on this issue by inserting a hidden qualifier that it should not have applied, but then went on to implement in improper fashion.

2. The Report adopted clear directions and expressly rejected setting class base rate prices on the mathematical results from AE's CCOS.

The Report adopted a set of clear and unambiguous directions that were taken almost verbatim from AE's Closing Brief pp. 95-96, and summarized in AE Closing Brief p. 98.[30] The Report did not adopt AE's hidden qualifier, or even hint of adoption. AE clearly did not follow the literal meaning of the words used in the directions on Report pp. 208-210 and 295-296 that it use the same proportional relationships employed with the original $17,474,000, to distribute the AE-admitted additional $7,085,000 and the IHE's further amounts that AE says sum to $39,110,293.[31] The Report did not mention

30 AE recommends the IHE adopt the proposed revenue spread policy outlined for the initial $17.5 million revenue reduction. Assuming the IHE accepts this proposal, AE will allocate the additional $7 million using these same principles. If the IHE includes other changes to the revenue requirement in his recommendation to City Council, then AE requests the IHE propose an appropriate methodology for allocating the total revenue requirement reduction, including the $24.5 million of revenues already offered by AE.

31 The AE calculation has been challenged by other parties and the IHE will resolve the dispute. Data

the out-of-place discussion of revenue distribution in the revenue requirements portion of AE's Closing Brief argument on p. 12, in either the revenue distribution portion of the Report or even on Report pp. 20-21, which corresponds to the topic AE was addressing in the portion of the brief on p. 12 AE says justifies AE's action (that is incorrectly applied in any event). The Report considered only (and liberally quoted from) AE Closing Brief pp. 95-95, without in any manner indicating AE should stop applying reductions to a class when the mathematical results of the problematic CCOS re-run indicated unity.

AE's decision to stop at the problematic re-calculated class cost of service for P2 means that the P2 class is not at "unity" and does not truly receive an additional increment in base rate reductions that adequately offsets the 358% increase to the P2 regulatory charge, beyond whatever amount it had assigned as part of its initial revenue distribution of the original $17.4 million. Stopping at AE's misidentified unity is therefore directly contrary to the direction in the Report that AE use "*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 make up for the significant increase in the regulatory charge. The Report literally and without qualification directed AE to take these steps, and never gave AE permission to unilaterally stop at an incorrectly quantified "unity" amount.[32]

AE's interpretation is based on an inconsistency in AE's own brief that the Report did not expressly or implicitly incorporate, and therefore cured. The IHE's logic, rationale and direction on revenue distribution do not say "stop at unity." In fact, the IHE rejected pure cost of service as a guide to revenue distribution and rate design: "[t]hus, the IHE disagrees with NXP/Samsung and other parties that suggest that rates must be set at the price points mathematically determined by the CCOS study."[33] Nonetheless, AE

Foundry will defer to the other parties and the IHE with regard to the actual amount of the IHE's additional surplus.

[32] As noted, AE's CCOS re-run artificially inflates the reported cost of service, since the sum of all the classes CCOS "costs" is $11,699,038 higher than AE's actual total revenue requirement. In other words, AE's re-run artificially inflates the disparity between revenues and cost of service for every class, including P2. That means AE's recalculated "unity" rate for P2 is not actually at cost since it does not receive any portion of the $11,699,038. This provides yet another reason for not stopping "at unity" with the P2 class.

[33] Report p. 208.

unilaterally set the base rate for P2 "at the price point[] mathematically determined by [AE's re-run] CCOS study" and used the re-run CCOS results as a limit on reductions to the P2 class. AE stopped applying any of the additional surplus to the P2 class after it reached unity under the CCOS re-run, even though the Report did not mention, much less authorize, this limit. AE imposed the limit even though the Report expressly rejected setting price points solely on CCOS mathematical results.

3. AE did not use the same proportional relationships and did not give an additional increment to P2 to offset the extraordinary increase to the P2 regulatory charge.

The bottom line is that the utility did not use "use the same proportional relationships" for the revenue distribution of the additional surplus, and it did not give P2 an additional increment in base rate reductions to offset the 358% regulatory charge. AE did not correctly implement the Report's findings and direction on revenue distribution. The IHE should require AE to do it again, but correctly.

4. The P2 class suffers the most from AE's noncompliance.

This is no small thing. AE's supposed "IHE Report compliant" revenue distribution gave the following amounts to the various classes:

Res	S1	S2	S3	P1	P2	P3
$(20,210)	$(848,300)	$(34,055,352)	$(15,991,200)	$(4,327,232)	$(5,874,967)	$(2,708,885)
T1	**T2**	**SAL**	**City Priv Out Lgtng**	**Cust Lgtng (unmetered)**	**Cust Lgtng (metered)**	**Total**
$(75,384)	$232,227	$0	$0	$0	$10	$(63,669,293)

But that is not what the result would be if AE actually used the same proportional relationships as were applied in the original proposal. AE's original revenue distribution split the original $17.5 million surplus using these percentage allocations:

Res	S1	S2	S3	P1	P2	P3
0.03%	0.10%	47.64%	10.37%	11.00%	21.64%	11.11%
T1	**T2**	**SAL**	**City Priv Out Lgtng**	**Cust Lgtng (unmetered)**	**Cust Lgtng (metered)**	**Total**
0.10%	1.99%	0.00%	0.00%	0.00%	0.00%	100%

If AE used the same percentages to distribute the additional surplus amounts found by the IHE the reductions to each class would have been:

Res	S1	S2	S3	P1	P2	P3
$(16,196)	$(63,077)	$(30,334,440)	$(6,602,278)	$(7,005,818)	$(13,775,885)	$(7,074,060)
T1	**T2**	**SAL**	**City Priv Out Lgtng**	**Cust Lgtng (unmetered)**	**Cust Lgtng (metered)**	**Total**
$(63,250)	$1,226,494	$0	$0	$0	$(63)	$(63,669,293)

The difference between AE's claimed "compliance" distribution and the distribution that would flow from using the same proportional relationships is shown below. A positive number means the class received more by way of benefit than it should have and a negative number (in parenthesis) means the class was shorted by the stated amount:

Res	S1	S2	S3	P1	P2	P3
$4,014	$785,223	$3,720,912	$9,388,922	$(2,768,586)	$(7,909,918)	$(4,365,175)
T1	**T2**	**SAL**	**City Priv Out Lgtng**	**Cust Lgtng (unmetered)**	**Cust Lgtng (metered)**	
$12,134	$994,267	$0	$0	$0	$(63)	

Data Foundry is in the class that was hurt the most by AE's decision to not use the same proportional relationships for the revenue distribution of all additional surplus amounts beyond the original $17,474,000. P2 would have received $7,909,918 in more reductions from the surplus if AE had followed the literal, unqualified and unambiguous revenue distribution direction in the Report. Data Foundry respectfully requests that the IHE reject AE's implementation of the revenue distribution prescribed by the Report and require AE to do it again, but correctly.

III. AE's argument on wholesale transmission revenues fatally conflicts with its position on Wholesale Fixed Costs.

Data Foundry urges the IHE to again read AE's assertions and arguments in AE Exceptions pp. 4-5 and 9-17. Whenever the word "transmission" appears, replace it with "production" and contemplate the straightforward result of applying AE's arguments on the "transmission" issue to the points raised by Data Foundry regarding inclusion of AE's Wholesale Fixed Costs in the retail revenue requirement and retail base rates. The dissonance between AE's arguments and urgent pleas to keep transmission revenues *out* of the retail base revenue requirement, and its simultaneous urgings that Wholesale Fixed (production) Costs should be *in* the retail base revenue requirement calculation simply cannot be logically reconciled.[34] AE cannot have it both ways. If they are right on transmission then they are necessarily wrong on production.

Data Foundry tends to agree with NXP/Samsung on the precise proper outcome on the transmission revenues issue, because the issues are actually different. AE should lose on both issues. Nonetheless, and for the record, Data Foundry's ultimate position is that <u>all of the costs</u> and <u>all of the revenues</u> from AE's **entire line of wholesale activities** – both *production and transmission* – must be entirely segregated from retail for ratemaking purposes. There should be no subsidization of any kind. Retail should not subsidize wholesale, and wholesale should not subsidize retail. If that means AE wins on the transmission issue, then so be it, so long as the right result is ultimately obtained on the production costs issue. But the IHE should most certainly not reverse course on the transmission revenues issue and then also still allow AE to recover its Wholesale Fixed Costs through captive customers' retail base rates.

IV. Conclusion

Data Foundry respectfully requests that the IHE reject AE's implementation of the revenue distribution prescribed by the Report. Data Foundry also requests that the IHE note the incurable conflict between AE's advocacy on the wholesale transmission revenue issue and its position on wholesale production costs, and take that into account when resolving Data Foundry's opposition to inclusion of AE's Wholesale Fixed Costs and Wholesale Competitive Losses in the retail base revenue requirement. Data

[34] On a loosely related point, Data Foundry has contended that AE's Wholesale Fixed Costs are not "reasonable and necessary" expenses related to the provision of base retail electric utility service. AE has at least implicitly agreed that the "reasonable and necessary" test applies, since it dedicated pages 19-21 of its Exceptions to an effort to show that its $9,090,429 in Economic Development expenses are "reasonable and necessary." We shall see whether AE reverses position and now claims that the reasonable and necessary test does not apply to other expenses, and in particular its wholesale costs.

Foundry, once again, respectfully requests that its Exceptions be granted and the IHE Report be modified as indicated therein.

Respectfully submitted,

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August 1, 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