

AUSTIN ENERGY 2016 RATE REVIEW

**AUSTIN ENERGY'S TARIFF
PACKAGE UPDATE OF THE 2009
COST OF SERVICE STUDY AND
PROPOSAL TO CHANGE BASE
ELECTRIC RATES**

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**BEFORE THE
CITY OF AUSTIN
IMPARTIAL HEARING EXAMINER**

**IMPARTIAL HEARING EXAMINER'S
SUPPLEMENTAL REPORT**

AUSTIN ENERGY
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I. Introduction

A. "Exceptions" or Requests for Reconsideration of the IHE's Report

The Impartial Hearing Examiner ("IHE") established deadlines for parties to file "exceptions" to the IHE's Report. "Exceptions" provide the parties an opportunity to point where a party believes the IHE erred in the IHE's Report. In the rate-review process before the City of Austin with regard to Austin Energy's rates, the more appropriate characterization of the "exceptions" is a request for reconsideration of a particular recommendation in the IHE's Report.

The IHE established July 22, 2016 as the due date for a party's "Exceptions" and August 1, 2016 as the due date for "Reply to Exceptions."

B. Parties that Submitted Exceptions/Requests for Reconsideration

Several parties availed themselves of the "exceptions" process. Parties that filed exceptions and reply to exceptions are: Austin Energy; Austin Energy Low Income Customers ("AELIC"); Data Foundry; the Independent Consumer Advocate ("ICA"); and NXP Semiconductors and Samsung Austin Semiconductors, LLC (collectively "NXP/Samsung").

C. Issues Upon Which the IHE Clarifies or Modifies the IHE's Report

The IHE has reviewed the parties' exceptions and replies to exceptions, and below lists the issues in which the IHE is either clarifying the IHE's Report or modifying it.

- 1. Transmission Costs and Revenues (clarification)**
- 2. Customer Care (modification)**
- 3. Functionalization of 311 Call Center (modification)**
- 4. Allocation of Transformers and Capacitors (modification)**
- 5. Allocation of Customer Service Accounts – Service Connection Fees (modification)**
- 6. Revenue Distribution (clarification)**
- 7. “Used and Useful” ‘Wholesale’ Production Plant (clarification)**

Below, the IHE addresses the parties’ requests for reconsideration in each area of these issues.

II. Issues Upon Which the IHE Clarifies or Modifies the IHE Report’s Recommendations

A. Transmission Costs and Revenues (clarification)

Austin Energy took exception to the IHE Report’s recommendation that its proposed revenue be offset by \$74.3 million instead of the offset of \$62,129,919 it proposed.¹ Offsetting Austin Energy’s revenue by the \$74.3 million recommended by the IHE produces an additional reduction of \$12,170,081 in Austin Energy’s retail base rates.

Austin Energy asserted that the IHE’s Report proposed this recommendation “without any discussion of the legal barriers, no examination of the appropriateness of the adjustment, and no examination of AE’s TCOS,” and that “the only analysis in the Report focuses on the correct number to use to offset retail rates and an incorrect rejection of the fact that there is a distinction between Austin Energy’s retail and wholesale operations. Instead, the Report simply reduces

¹ AE’s Exceptions at 9 and 13.

AE's retail rates by the amount of wholesale transmission revenue contained in Austin Energy's 4th Quarter FY 2014-2015 Report of Expected Revenue."

To be clear, what the IHE found most troubling about Austin Energy's position is the marked discrepancy between the approximate \$62.1 million Austin Energy presented in its rate filing package in this proceeding and in its exceptions,² and the amount of the corresponding amount it presented to the PUCT in its TCOS filings. As noted in the IHE's Report, the amounts Austin Energy presented for the same component of its operations vary markedly between its presentation in this proceeding and the amounts it presented to the PUCT:

Austin Energy FY 2014 <i>Recorded</i> Revenue	\$68,974,261
Austin Energy <i>Adjusted</i> FY 2014 (for use in this proceeding)	\$62,129,919
PUCT Approved Amount June 3, 2014 (Dkt. 42385)	\$75,697,440
Austin Energy 4 th Quarter FY 2014-2015 Report of Expected Revenue	\$74.3 million*
PUCT Approved Amount March 25, 2016	\$76,609,559

The IHE understands the distinction Austin Energy draws between its "retail transmission costs" and its "wholesale revenue." The IHE also recognizes that Austin Energy is both a transmission service provider and a load serving entity. Nonetheless the fact remains that Austin Energy is a vertically integrated utility and not comprised of two or three corporate entities participating in the ERCOT market.³ But what Austin Energy failed to explain is the wide discrepancy between the revenue amounts it presents in this proceeding and the corresponding amounts it presented to the PUCT. Taking Austin Energy's claims to heart that its ratepayers are Austin Energy's owners and/or shareholders, from the owners/shareholders' perspective, Austin Energy will be the beneficiary of about an additional \$12.2 million. Thus, while generally speaking "[t]ransmission assets are built for the benefit of all those entities within the ERCOT

² *Id* at 13.

³ NXP/Samsung Reply Exceptions at 5.

market that use the transmission system, not simply for Austin Energy’s ratepayers,”⁴ like any other transmission and distribution utility, a company’s assets are in the end deployed to benefit the owners of those assets.

Further, the IHE’s recommendation does no more than to substitute the more current amount of \$74.3 million (the amount reported by Austin Energy in its “4th Quarter FY 2014-2015 Report of Expected Revenue”), for the entry Austin Energy refers to as its “Adjustment to remove wholesale transmission COS” in its Schedule A. Austin Energy explains that it made this adjustment to remove “the net wholesale transmission cost of service (“COS”) components embedded in the retail revenue requirement.”⁵ The IHE’s recommendation does the same thing, but with more current data.

Austin Energy did not contest that the more current amount for its wholesale transmission cost of service is what it presented to the PUCT in Docket No. 42385 (i.e., \$75,697,440), or the amount the PUCT approved in March 25, 2016 (i.e., \$76,609,559); nor did it contest the accuracy of those amounts. But lacking in Austin Energy’s arguments is a credible explanation of why \$62,129,919 is the more accurate amount to include for its wholesale transmission revenue which it used “as the mechanism to remove wholesale transmission COS components embedded in the retail revenue requirement,” instead of the more current amounts it presented to the PUCT.

Also, the IHE agrees with NXP/Samsung that 16 Tex. Admin Code § 25.275(o)(1)(C) (TAC) does not appear to support Austin Energy’s argument. Section 25.275(o)(1)(C) prohibits the subsidization of the competitive activities of retail electric or generation companies by their regulated affiliates, but Austin Energy does not have any competitive activities that need to be

⁴ Austin Energy Exceptions at 10.

⁵ *Id.*

shielded from its regulated activities because Austin Energy continues to be a fully-integrated municipally owned utility. Also, 16 TAC § 25.275(b)(1)(A) makes clear that § 25.275 applies to a municipally owned utility that has chosen to participate in customer choice pursuant to PURA §40.051(b) or PURA § 41.051(b).⁶

Finally, The IHE agrees that authority to set Austin Energy's TCOS rates is the PUCT's exclusive domain. But by recognizing the more current amount of wholesale transmission COS components embedded in the retail revenue requirement the IHE's Report is not usurping the PUCT's jurisdiction to set Austin Energy's TCOS rates; the IHE's Report does nothing more than accept the same "mechanism to remove wholesale transmission COS components embedded in the retail revenue requirement" as did Austin Energy, but uses more current data.

For these reasons the IHE continues to recommend to the City Council that the amount to use to remove wholesale transmission COS components embedded in the retail revenue requirement is \$74.3 million, instead of \$62,129,919 as proposed by Austin Energy.

B. Customer Care (modification)

The IHE modifies his recommendation regarding allocation of 100% of the Utility Customer Center ("UCC") to Austin Energy ratepayers. As the IHE noted in the IHE's Report, the IHE found troublesome that 100% of customer-complaint costs are allocated to electric ratepayers, even though the record is clear that a number of complaints arise from services provided by other city departments.

The IHE is persuaded that the complexity of Austin Energy's electric billing system is significantly greater than the billing system, e.g., for solid waste disposal. Thus it would be unfair to conclude that Austin Resource Recovery and Austin Energy are equally responsible for

⁶ See NXP/Samsung Reply Exceptions at 5.

the operation and maintenance of the Customer Care and Billing (“CC&B”) system. But the complexity of Austin Energy’s billing system compared to Austin Resource Recovery’s billing system does not negate the fact that Austin Energy’s ratepayers are bearing the cost of a City department’s costs that are unrelated to the provision of electric utility services. Ultimately, the IHE agrees with NXP/Samsung, the Independent Consumer Advocate (“ICA”), and the Austin Low Income Customers (“AELIC”): Austin Energy bears the burden of proof in this proceeding and with regard to these expenses and Austin Energy failed to meet its burden of proof.

As the ICA noted, the “evidence confirmed that customers contact the center seeking assistance on questions and complaints regarding services provided by other city departments.” This point is echoed by AELIC: “The record evidence shows that the study allows costs clearly attributable to other utilities to be included in costs AE is seeking to be recovered from its customers.” AELIC correctly notes that costs unrelated to the provision of electric utility service are not recoverable from electric ratepayers. With regard to the Austin Energy’s proposed allocation of Utility Customer Center (“UCC”) costs, the record establishes that 100% of those costs are not caused and are not related to the provision of electric utility service. Thus, the costs attributable to other City utilities or departments are not reasonable and necessary to provide *electric* utility service.

Thus, the issue is one of allocation of costs among the various City departments the UCC serves. And on this point the best evidence in the record for determining the reasonable amount of expense to include for UCC functions is that presented by NXP/Samsung’s witness Ms. Fox. Based on Ms. Fox’ testimony, the IHE modifies his prior recommendation and recommends to the Council that these costs be allocated to all users either on the basis of revenue or the number of bills, depending on which allocation is more

appropriate as proposed by NXP/Samsung and that the Council adjust Austin Energy's expense for UCC costs by \$10,371,602.⁷

C. Functionalization of 311 Call Center (modification)

The IHE modifies his recommendation regarding functionalization of the 311 Call Center. In revisiting the record and the parties' exceptions on this issues, the IHE finds Austin Energy's explanation of the functions performed by personnel at the 311 Call Center to better support a conclusion that the costs for the 311 Call Center are better correlated to the number of customers, and hence functionalized as a customer related, instead of related to O&M expenses for the distribution function.

In reevaluating the ICA and Austin Energy's testimony on this issue, the IHE better understands the functions of the 311 Call Center and its function is not focused on disaster recovery but instead receives calls from customers for all matter of service issues from service interruptions to billing inquiries. The record does not show that the costs of the 311 Call Center are correlated to the expenditures associated with Austin Energy's distribution system. Instead, the 311 Call Center is more correlated to the number of customers Austin Energy has.

Therefore, the IHE modifies his recommendation and recommends that the costs of the 311 Call Center be assigned to the customer function.

D. Allocation of Transformers and Capacitors (modification)

The IHE modifies his recommendation regarding allocation of Transformers from an allocation based on Austin Energy's 4NCP to Austin Energy's proposed "Sum of Maximum Demands" ("SMD").

⁷ See NXP/Samsung Exh. 1 at 32-34.

Both Austin Energy and NXP/Samsung agree that transformers should be allocated based on demand (as opposed to energy or a mix of energy and demand). The difference between Austin Energy and NXP/Samsung's respective positions is that Austin Energy believes a SMD approach, which reflects the maximum monthly demand a customer places on the system during each month of the year, better captures load diversity among its customers. As NXP/Samsung notes, quoting from Austin Energy's rate-filing package, "[t]he distribution function is concerned with meeting localized demands; therefore, class maximum demands are often used to allocate distribution costs. Finally, for individual customers, AE is concerned with the maximum demand that the specific customer places on the system. These demands are significant cost drivers for AE's capital expenses, including debt."⁸ Further, the record shows that for estimating customer maximum demands for purposes of determining transformer needs for customers takes into account the fact that "maximum demand for the service for one residence will be different from the maximum demand for the secondary serving two residences, and these will differ still from the maximum demand for the transformer serving eight residences because of load diversification."⁹

Also, as Austin Energy points out in its exceptions, transformer costs are configured to meet customers' maximum demands on Austin Energy's system, and in the long run, these costs are fixed and do not vary with energy usage.

In revisiting the record and reviewing the parties' exceptions regarding allocation of transformer costs, the record favors an allocation methodology that better captures the diversity of load placed on the system by Austin Energy's customers, and Austin Energy's SMD approach

⁸ AE Ex. 3 at 43.

⁹ *Austin Energy's Tariff Package: 2015 Cost of Service Study and Proposal to Change Base Electric Rates*, Austin Energy's Response to the First Request for Information from NXP Semiconductors and Samsung Austin Semiconductor, LLC at 1-76 (Feb. 28, 2016).

better captures not only the maximum demands placed on its transformers, but also the diversity of load presented by its customer base. Further, using a 4NCP approach as proposed by NXP/Samsung could result in off-peak or seasonal customers being excluded in calculating the 4NCP. Austin Energy's SMD approach captures more accurately the demand placed on its transformers by its customer classes.

Therefore, the IHE modifies his recommendation with regard to allocation of transformers from use of 4NCP to Austin Energy's proposed SMD methodology.¹⁰

E. Allocation of Customer Service Accounts – Service Connection Fees (modification)

The IHE modifies his recommendation regarding allocation of Service Connection Fees. The IHE's review of the record and the ICA's exceptions on this point persuade the IHE that Service Connection fees are more a function of the number of customers than the sizing of Austin Energy's distribution system. As the ICA notes, these fees do not recover the incremental facility costs of new services and new meters, but instead are more closely related to initiation of service. In turn, service initiation pertains to access by the customer to service; the frequency of service initiation is a function of the number of customers as opposed to the distribution demands; and customer access is part of the customer function.

Thus, the IHE modifies his recommendation regarding the allocation of Service Connection Fees from Austin Energy's proposed methodology that allocated Service Connection fees using its customer billed-demand allocator, and instead the IHE recommends that Service Connection Fees be assigned as function of the number of customers.

¹⁰ The IHE notes that allocating Transformers based on Austin Energy's SMD methodology is more consistent with the IHE's recommendation to allocate Distribution Costs based on Austin Energy's proposed 12NCP approach, instead of NXP/Samsung's 4NCP method.

F. Revenue Distribution (clarification)

With regard to the Revenue Distribution, the IHE agrees with the reply “exceptions” submitted by Data Foundry.¹¹ Data Foundry contends that Austin Energy did not correctly implement the revenue distribution prescribed in the IHE’s Report and that instead, Austin Energy distribute the additional reductions, that if adopted by Council, proportionally to each class of customers as the IHE recommended.

While Data Foundry provides in detail why it believes Austin Energy strayed from the IHE’s recommendations regarding distribution of revenue to the customer classes, suffice it to say that the IHE agrees in part with Data Foundry’s assessment regarding the distribution of revenue.

The IHE did not intend that there be a “stop” of some sort for distribution of the revenue should the City Council adopt the IHE’s recommendations to implement further reductions to Austin Energy’s revenue requirement. The IHE instead recommended in the IHE’s Report that the additional revenue reductions the IHE proposed for Council’s consideration, be implemented based on the same proportional relationships as presented in Austin Energy’s initial distribution of revenue.

G. “Used and Useful” ‘Wholesale’ Production Plant (clarification)

Lastly, the IHE accepts Data Foundry’s invitation to respond with regard to Data Foundry’s proposal to exclude all of Austin Energy’s production-plant costs from base rates on the theory – as best as the IHE deciphers Data Foundry’s pleadings – that because Austin Energy participates

¹¹ The IHE notes that Data Foundry’s filing with regard to Revenue Distribution is more on the nature of a brief on a new issue – the re-running of Austin Energy’s revenue requirement to present the effect of the IHE’s recommendations – than exceptions to the IHE’s Report.

in the ERCOT wholesale power markets, those costs should be excluded from Austin Energy's retail, base revenue requirement.

First, just as the IHE views Austin Energy as a vertically integrated utility for purposes of transmission costs and revenue, so does he view Austin Energy's production-plant costs and revenue. There is no separate entity providing wholesale production services. Austin Energy's utility service – to use the colloquial – is one big ball of wax – retail and “wholesale.”

Second, Data Foundry's reliance on *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) and *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”) is misplaced. Neither the Commission's order or the court's rulings in those cases dealt directly with the rate treatment to be afforded SWEPCO's production plant. Instead the *SWEPCO* cases addressed the granting of certificate of convenience and necessity (“CCN”) by the PUCT to SWEPCO for construction of production plant and whether it was in the “public interest” for SWEPCO to construct that plant. Issues of whether SWEPCO's investment in that production plant was prudently incurred was a matter left to a later rate proceeding.

Lastly, the reasons the IHE characterized Data Foundry's argument as facile are two-fold: One, Data Foundry's applied the “used-and-useful” standard in an *ex post facto* manner. It is saying, that today, the entirety of Austin Energy's production plant is not used and useful to service its retail load because Austin Energy no longer serves its customer load with its own generation. In doing so, Data Foundry ignores the decisions the City made decades ago to construct its production plants in the first instance. The more apt standard, as articulated by

Texas courts, is to determine whether the decisions the City made at the time it was making those decisions were prudent.¹² Were Austin Energy's plants prudently incurred investments based on the information available to management at the time the decisions were made to construct these plants? Had Austin Energy/the City initially built its production plants with the goal of solely serving the wholesale markets in the first instance, perhaps the City's investment in its production plants would be viewed differently.

And two, Data Foundry ignores the reality that Austin Energy is in a unique situation in competing in the ERCOT wholesale market as a fully integrated utility, while at the same time subjecting its production plant to regulation, in the first instance by its governing board the City Council, and then by the PUCT in an appeal by outside-the-city ratepayers. The cases to which Data Foundry cites are not instructive with regard to Austin Energy's unique circumstances. The case law to which Data Foundry cites involves investor-owned utilities operating as fully integrated utilities in a market where there is no competition for production of power in the market as a whole, and where the IOU's production plant is fully subject to government regulation be it the PUCT or cities exercising their original rate jurisdiction. In ERCOT, that model no longer exists. Thus, Austin Energy finds itself operating in a hybrid market where, for purposes of setting rates, the more traditional "used-and-useful" standard of identifying plant to include in rates advocated by Data Foundry is not directly applicable to Austin Energy.

Thus, the IHE suggests that the more appropriate inquiry is whether Austin Energy's production costs are reasonable and necessary. And on that front, Data Foundry presented no credible evidence to the contrary. Therefore, the IHE recommends to the City Council that it

¹² See, e.g., *Gulf States Utilities Co. v. Coalition of Cities for Affordable Utility Rates*, 883 S.W.2d 739, 752 (Tex. App. – Austin 1994, petition granted) and *Gulf States Utilities Co. v. Public Utility Commission of Texas*, 947 S.W.2d 887 (Tex. 1997).

reject Data Foundry's arguments and proposal to exclude from Austin Energy's rates all costs of production.

III. CONCLUSION

The IHE recommends to the Council that it adopt the IHE's recommendations as clarified or modified, as the case may be, by the IHE's Supplemental Report set forth above.

As noted in the IHE's Report, there are likely a myriad of "correct" answers to the many issues the parties raised in this proceeding, but based on the IHE's review of the record, the parties' live testimony and evidence admitted at the hearing, and the parties' exceptions and replies to exceptions, the IHE in his Report as modified by this Supplement Report, presents what he believes are the better recommendations based on his assessment of the record in this proceeding.

Again the IHE thanks the parties for the continued diligence with which they addressed the issues in this proceeding.

/s/Alfred R. Herrera
Alfred R. Herrera
Impartial Hearing Examiner

DATE: August 5, 2016