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APPLICATION OF SOUTHWESTERN ELECTRIC POWER COMPANY FOR CERTIFICATE OF CONVENIENCE AND NECESSITY AUTHORIZATION AND RELATED RELIEF FOR THE WIND CATCHER ENERGY CONNECTION PROJECT IN OKLAHOMA	§ § § §	**PUBLIC UTILITY COMMISSION OF TEXAS**

COMMISSION STAFF'S EXCEPTIONS TO THE PROPOSAL FOR DECISION

Respectfully Submitted,

PUBLIC UTILITY COMMISSION OF TEXAS LEGAL DIVISION

Margaret Uhlig Pemberton
Division Director

Stephen Mack
Managing Attorney

Rachelle Nicolette Robles
State Bar No. 24060508
Rosemary Hambright
State Bar No. 24101856
1701 N. Congress Avenue
P.O. Box 13326
Austin, Texas 78711-3326
(512) 936-7268 (facsimile)
rachelle.robles@puc.texas.gov

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326

TABLE OF CONTENTS

SOAH DOCKET NO. 473-17-5481
PUC DOCKET NO. 47461

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COMES NOW the Staff (Staff) of the Public Utility Commission of Texas (Commission), representing the public interest, and files Staff's exceptions to the Proposal for Decision. Pursuant to the Office of Policy and Docket Management's Notice of May 24, 2018, Staff's exceptions to the Proposal for Decision are timely filed.

I. INTRODUCTION

Staff is grateful for the reasoned consideration of the Administrative Law Judges (ALJs). This proceeding has required the ALJs and parties to make complex estimates of the precise economic value of multiple future variables, and the ALJs have carefully considered each of the issues in this proceeding, as set forth in the Proposal for Decision (PFD).[1] The PFD ultimately concludes that the Wind Catcher Energy Connection Project in Oklahoma (Wind Catcher Project) should be approved, with conditions to limit a portion of the risk borne by customers,[2] because the ALJ's have determined estimated cost savings to Southwestern Electric Power Company (SWEPCO) in the amount of $354 million net present value, on a *Company-wide*

[1] Proposal for Decision (May 18, 2018) (PFD).
[2] PFD at 79.

basis.[3] The *Texas retail* customers' share of the net present value of savings estimated by the PFD is unstated.

Staff recommends denial of the Wind Catcher Project. SWEPCO estimates net present value benefits from the Wind Catcher Project at $1,495 million, on a Company-wide basis.[4] By simply adjusting three variables, the PFD reduces SWEPCO's estimated benefits by over $1.14 billion net present value. Intervenors estimated that the Wind Catcher Project will not generate savings, but will actually result in net costs to customers.[5] Although the ALJ's estimate of projected benefits may be just as probable as SWEPCO's or Intervenors, Staff recommends that the Wind Catcher Project be denied a CCN as the range of probable outcomes do not justify incurring the costs that Texas customers would ultimately have to pay whether or not the net benefits actually materialize.

The capital cost of the Wind Catcher wind farm and generation tie-line (Wind Catcher Facilities) would dramatically increase the rate base and return of SWEPCO. SWEPCO estimates that the original cost of the Wind Catcher Facilities, wind turbines and gen-tie, would be $4.6 billion,[6] with $3.2 billion assignable to SWEPCO,[7] and $1.1 billion allocated to the Texas jurisdiction.[8] Although the PFD appropriately recommends a cost cap for SWEPCO's initial investment,[9] there is no substantial guarantee that the benefits of the Wind Catcher Project will outweigh the revenue requirement that Texas customers would be obligated to pay.

The return on the initial capital costs, and the depreciation expense, would be combined with other annual expenses over the life of the asset to produce the revenue requirement. SWEPCO's direct testimony estimated the total revenue requirement to be paid by ratepayers over the life of the project to be $11.4 billion on a nominal basis, with $8 billion assignable to SWEPCO, and $2.7 billion on a Texas jurisdictional basis, as set out in the table below.

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[3] PFD at 2, 9, 46.
[4] Tr. at 32:17-20; SWEPCO Initial Brief at 3.
[5] *See e.g.*, TIEC Initial Brief at 8.
[6] Staff Ex. 5 ($4,605,490,437 = $2,981,520,825 (Generators and ARO Asset) + $1,623,969,612 (Tie Line)).
[7] *Id.* ($3,223,843,305 = 70% x $4,605,490,437).
[8] *Id.* ($1,105,317,705 = 24% x $4,605,490,437).
[9] PFD at 59.

Table 1 Wind Catcher CCN Project Revenue Requirement[10] (nominal dollars)					
	1 **Total Project**	2	3 **SWEPCO** Col. (1)x(2)	4	5 **Texas Jurisdictional** Col (1)x(4)
After Tax Rate of Return	$3,695,945,614	70%	$2,587,161,930	24%	$887,525,798
Depreciation, Taxes, and O&M	$7,744,826,863	70%	$5,421,378,804	24%	$1,859,803,784
Revenue Requirement	**$11,440,772,477**		**$8,008,540,734**		**$2,747,329,582**

Subsequent to SWEPCO's original estimate of project costs, the federal income tax rate was reduced, which has the effect of increasing the revenue requirement of the Wind Catcher Project. In rebuttal, SWEPCO provided its projected impact of the change in income tax rate on the revenue requirement. However, SWEPCO's exhibits and workpapers do not explicitly state the Texas jurisdictional or the nominal impact on the revenue requirement. SWEPCO estimates that the change in tax rates would increase the revenue requirement of the project assignable to SWEPCO by $154 million, net present value.[11] The nominal value, of course, would be much greater. Thus, the projected revenue requirement of the project in rebuttal with the impact of the 21% tax rate is not readily ascertainable from the evidence.

Texas ratepayers would be subject to paying for the $2.7 billion revenue requirement ($1.3 billion on a net present value basis),[12] plus the additional project costs resulting from the change in tax rates, over the life of the project, whether or not the projected benefits actually materialize. In order for ratepayers to receive any benefit from the project, the savings generated must exceed the costs on a Texas jurisdictional basis. If the savings are not greater than 100% of

[10] Staff Ex. 5. Staff Exhibit 5 is based upon the original workpapers not reflecting the reduced tax rate changes. SWEPCO Ex. 25, Revised Rebuttal Exhibit KDP-1R demonstrates that the change in tax rate would increase the project costs (or decrease benefits) to SWEPCO by at least $486 million on a net present value basis to SWEPCO. The nominal increase in costs of the project would of course be much higher. As Mr. Pearce testified, the nominal value of the increase in costs (decrease in benefits) is not specifically stated. Tr. at 1108:5 to 1109:1.

[11] SWEPCO Exhibit 25, Revised Rebuttal Exhibit KDP-1R ($154 million = $241 million (Deferred Tax Asset Carrying Charges) - $87 million (21% Corporate Tax rate effect on Income Tax Expense and ADIT)).

[12] Staff Ex. 5.

the $2.7 billion and additional costs due to the tax change, the Wind Catcher Project would ultimately only increase bills to ratepayers.

The largest contingency risks involved in SWEPCO's proposed Wind Catcher Project are either changes in law, such as a reduction or elimination of the production tax credits (PTCs), or events outside of SWEPCO's control, such as a future market price of energy lower than the price projected by SWEPCO. Neither SWEPCO's proposed "guarantees" nor the PFD's proposed conditions protect customers from the risks of occurrence of these specific contingencies.

V. PRELIMINARY ORDER ISSUES

A. Certificate of Convenience and Necessity Standard of Review (PFD page 5)

Staff agrees with the PFD that a key statutory factor for purposes of the Commission's review in this case is "whether the Project will result in lower costs to consumers."[13] However, that factor is only one of several elements that must be considered in a CCN application, the most important of which are the adequacy of existing service and the need for additional service. PURA § 37.056 does not require the Commission to approve any transaction that is not necessary for the convenience or necessity of the public.[14] Because the requested CCN is not necessary to provide reliable electric service, Staff recommends that the Commission require proof of a heightened degree of probability that the proposed CCN will result in lower costs to customers.

As the Austin Court of Appeals has found, the Commission has considerable discretion in interpreting PURA § 37.056.[15] SWEPCO's Initial Brief acknowledges that the Wind Catcher

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[13] PFD at 7.

[14] PURA § 37.056(a), (b) ("The commission may . . . refuse to grant the certificate.").

[15] *PUC v. Texland Elec. Co.*, 701 S.W.2d 261, 265-67 (Tex. App.—Austin 1985, writ ref'd n.r.e.). The Austin Court of Appeals held:

> [The] factors [listed in PURA §37.056(c)] are, of course, stated in the broadest possible terms. They are expressions of the Legislature's policy concerning the granting and amending of certificates of convenience and necessity, in light of the tenor of PURA as a whole. They give the Commission stated objectives toward which to work in that part of its responsibilities pertaining to such certificates. Stated another way, they are legislative *standards* guiding the Commission in its administration of the certificate process.
>
> To implement in particular circumstances such broadly stated legislative objectives and standards, the Commission must necessarily decide what they mean in those circumstances; and because some of them obviously compete *inter se*, the agency may in some cases be required to adjust or accommodate the competing policies and interests involved. For example, a "need" for

Project is not needed for capacity or reliability purposes.[16] From a ratepayer savings perspective, SWEPCO is requesting the authority to own and operate a facility that SWEPCO expects will cost customers in excess of $2.7 billion dollars on a Texas jurisdictional basis over just the 25 years that the wind turbines are anticipated to be in service.[17]

Staff recommends that the Commission should only grant the requested CCN if: (1) there is a *significant probability* of lowering costs, which there is not here; or (2) there is a probability of *significantly lowering costs*, which there is not here. In other words, without a need for additional capacity and all other factors being equal, Staff would not recommend that the Commission approve a hypothetical CCN that would require ratepayers to pay multiple billions of dollars for a 51% probability that some customer classes would receive a net benefit while other customer classes would be paying higher costs, even if on balance Texas ratepayers would be receiving a minimal net benefit.

As is clear by the totality of the evidence in this case, the probability of generating net benefits for ratepayers cannot be estimated with certainty.[18] The net benefits estimated by the PFD are unknown on a Texas jurisdictional basis,[19] but are certainly a small fraction of the costs that SWEPCO would obligate customers to pay, which SWEPCO estimated as $2.7 billion prior to the change in tax law that had the effect of further increasing the revenue requirement to customers.[20] Moreover, as the PFD determined, there is a very low probability that the Wind

> additional service implies a relative requirement, ranging from an imperative need to one that is minimal; and, if a "need" be sufficiently grave, it may have to prevail notwithstanding an adverse affect upon another interest, such as the environment. Conversely, "environmental integrity" may in some circumstances have to prevail over a need for the additional service. None of the statutory factors is intended to be absolute in the sense that any one shall prevail in all possible circumstances. In making these sometimes-delicate accommodations, the agency is required to exercise its "expertise" to further the *overall* public interest. (emphasis in original).

[16] SWEPCO Initial Brief at 7, 53.

[17] Staff Ex. 5. The revenue requirement impact must also be increased to reflect the change in the federal income tax rates. SWEPCO's exhibits and workpapers do not explicitly state the nominal impact on the project costs of the change in Federal income tax rate. However, SWEPCO estimates that the change in tax rates would increase the costs of the project assignable to SWEPCO by $154 million, net present value. SWEPCO Ex. 25, Revised Rebuttal Exhibit KDP-1R ($154 million = $241 million (Deferred Tax Asset Carrying Charges) - $87 million (21% Corporate Tax rate effect on Income Tax Expense and ADIT)).

[18] *See e.g.*, Tr. at 112:1-4 (Chodak Cross) (Feb. 13, 2018); SWEPCO Initial Brief at 6 ("Neither SWEPCO nor the intervenors have a crystal ball in which the future can been seen with complete accuracy.").

[19] *See* Tr. 449:1450:24 (Aaron Cross) (Feb. 14, 2018) (indicating that the net benefits on a Texas jurisdictional basis are not provided). The PFD's estimate of $345 million in benefits is a SWEPCO-wide benefit on a provided on a net present value basis.

[20] Staff Ex. 5 ($2,747,329,582). The revenue requirement impact must also be increased to reflect the change in the federal income tax rates. SWEPCO's exhibits and workpapers do not explicitly state the nominal impact on the project costs of the change in Federal income tax rate. However, SWEPCO estimates that the change in tax rates

Catcher CCN will generate the savings estimated by SWEPCO, as SWEPCO's modeling assumes inflated energy savings as a result of SWEPCO's projected cost of gas and modeling of non-existent carbon costs.[21]

Staff's position stands in contrast to SWEPCO's,[22] which is that "[t]he controlling legal standard applicable in this proceeding is whether the proposed facility is needed and will result in the *probable* lowering of costs to customers, not a *guarantee* of lower costs under all circumstances[.]"[23] If the Commission is to approve SWEPCO's Wind Catcher Project with conditions, Staff recommends that those conditions sufficiently address the risks imposed upon customers due to the potential change in tax law associated with PTCs and the risks associated with potential future energy costs that are lower than estimated by the PFD.

B. Analysis of Economics of Wind Catcher (PFD page 7)

Staff does not dispute that the PFD's estimate of net benefits of $354 million, net present value, is a reasonable estimate of the projected net benefits of the Wind Catcher Project. However, Staff notes that the PFD's estimate is merely an estimate. There are any number of factors within the PFDs estimate that could decrease, or even eliminate net benefits. For example, the PFD bases its estimate on SWEPCO's alleged 51.1% capacity factor,[24] yet the PFD does not require that SWEPCO guarantee that capacity factor to generate energy savings.[25] Failure to meet the projected capacity factor alone could result in the elimination of the PFD's estimated net benefits.

The PFD's estimate is not adjusted to reflect the fact that the ALJ's "were not convinced by SWEPCO's analysis of the operating-reserve expense issue."[26] The PFD identifies this issue as one for the Commission to consider.[27]

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would increase the costs of the project assignable to SWEPCO by $154 million, net present value. SWEPCO Ex. 25, Revised Rebuttal Exhibit KDP-1R ($154 million = $241 million (Deferred Tax Asset Carrying Charges) - $87 million (21% Corporate Tax rate effect on Income Tax Expense and ADIT)).

[21] PFD at 8-9.

[22] Commission Staff's Reply Brief at 7 (Mar. 21, 2018)

[23] SWEPCO Initial Brief at 4.

[24] PFD at 9.

[25] PFD at 61 (recommending a guaranteed capacity factor of 44.7%).

[26] PFD at 19.

[27] *Id.*

Staff raised concerns about the potential need for additional transmission upgrades to be determined by a study from the Southwest Power Pool.[28] The PFD's cost benefit analysis did not account for any potential transmission upgrades resulting from the Southwest Power Pool's facility study, which has not been completed.[29]

The PFD's estimate also assumes that the production related revenue requirement is decreased annually to reflect the accumulation of depreciation when,[30] in reality, the production related revenue requirement that customers pay through base rates will not be reduced to reflect the accumulation of depreciation unless SWEPCO files a base rate case to adjust them.

Moreover, the energy cost assumptions used in the PFD's estimate of benefits are inherently volatile. The PFD does not propose any guarantees against a decreased cost of energy, as is discussed in more detail below.

Staff also notes that the PFD's estimated benefits are stated on a total SWEPCO basis—not a Texas jurisdictional basis because SWEPCO's analysis in rebuttal did not present benefits on a Texas jurisdictional basis.[31] If the PFDs estimated net benefits were stated on a Texas jurisdictional basis, they would be relatively insignificant compared to the revenue requirement costs of $2.7 billion (nominal), $1.3 billion (net present value),[32] that Texas customers would be guaranteed of paying. The PFD's estimated net benefits would also be relatively small in comparison to SWEPCO's Texas jurisdictional overall return on investment of $888 million (nominal),[33] or $497 million (net present value),[34] that Texas customers would be paying through rates.

In conclusion, the prospect of customers receiving the net benefits estimated by the PFD do not provide sufficient justification for requiring Texas customers to bear the costs of the Wind Catcher Project.

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28 PFD at 12-13.

29 *See* PFD at 18-19 (lacking any reference to transmission upgrades).

30 *See* CARD Ex. 1, Direct Testimony of Scott Norwood at 21-22; *see also* Staff Ex. 5.

31 *See* Tr. 449:1450:24 (Aaron Cross) (Feb. 14, 2018) (indicating that the net benefits on a Texas jurisdictional basis are not provided).

32 Staff Ex. 5.

33 Staff Ex. 5 ($887,525,798 = $3,695,945,614 (Total Project) * 24.01% (Texas Jurisdictional Share)).

34 Staff Ex. 5 ($496,992,613 = $2,069,638,624 (Total Project) * 24.01% (Texas Jurisdictional Share)).

1. Project Description and Cost (PFD page 9)

Given the PFD's recommendation to cap the initial costs as proposed by Staff, Staff does not dispute the project description or costs, but notes that the Texas jurisdictional share of costs are not stated. On a Texas jurisdictional basis, the project costs are as follows:

Table 2 **Wind Catcher Project Capital Costs**[35]			
	Total (billions)	**Texas Jurisdictional Allocator**[36]	**Texas Jurisdiction (billions)**
Wind Facility	$2.902	24%	$0.697
Gen-Tie	$1.624	24%	$0.390
Project (Both)	$4.526	24%	$1.087

2. Economic Evaluation Methodology and Assumptions (PFD page 20)

Staff does not take exception to the reasonableness of the PFD's reliance on the Energy Information Administration's forecast of gas prices. However, to properly evaluate any assumptions relying on future gas prices, there should be a stress test employing forecasted gas prices that are higher and lower than the selected gas price forecast in order to test the vulnerability of the projected benefits to swings in gas prices. Given that the Wind Catcher Project is being relied upon solely as an economic opportunity, it is reasonable to make conservative assumptions about the projected low level of natural gas prices as the lower the gas price, the less economic the project is. As such, even if the Commission were to adopt the PFD's use of the Energy Information Administration's forecast of gas prices as the most reasonable or likely outcome, the Commission should nonetheless consider the effects that lower gas prices would have on the Wind Catcher Energy Project. Staff notes that both ETI and SPS, in evaluating the benefits of their proposed CCNs, projected a low levelized natural gas price that is at least $2.68/MMBtu less than the levelized Energy Information Administration forecast.[37] In

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35 PFD at 10.
36 Staff Ex. 5.
37 PFD at 29.

the event that ETI's or SPS's forecast of low gas prices were to prevail, then the Wind Catcher Project would likely increase costs to customers rather than decrease costs to customers.

3. Projected Benefits of Wind Catcher (PFD page 41)

Staff addressed the projected benefits of the Wind Catcher Project above.

C. Proposed Conditions to CCN (PFD page 46)

Staff recommends that the proposed CCN for the Wind Catcher Project be denied. If the Commission chooses to approve the CCN with conditions necessary to insulate customers from the financial risks associated with the Wind Catcher Project, Staff recommends that the Commission require SWEPCO to guarantee production tax credits, even if there is a change in law, in the amounts represented by SWEPCO[38] and require SWEPCO to guarantee some level of net benefits to customers over and above the annual revenues customers are obligated to pay for the base rate costs of the Wind Catcher Project.[39]

D. Other CCN Issues (PFD at 64)

7. Effect on Implementation of Customer Choice

Staff does not dispute that SWEPCO is not currently in the process of implementing customer choice. However, Staff disagrees with the PFD's conclusion that the proposed Wind Catcher Project could not create stranded costs. In the event that SWEPCO transitions to competition in the future, SWEPCO could potentially have stranded costs resulting from approval of the Wind Catcher Project.

9. Whether the Commission Should Grant CCNs for Generation Proposed for Economic Purposes or Require Utilities to Acquire Additional Generation Through Competitive Affiliates (PFD page 66)

Staff agrees with the PFD's conclusion that the Commission may grant a CCN solely for economic reasons and Staff does not dispute the PFD's restatement of Staff's argument. However, Staff clarifies that the argument made by Staff raises factors for the Commission to consider in its determination whether the Commission should approve a CCN for economic

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[38] Staff Ex. 2A at 20.

[39] Staff Ex. 3A at 13; Staff Ex. 2A at 20.

reasons, Staff's was not addressing whether the Commission may approve a CCN for economic reasons.

E. Proposed Ratemaking Treatments (PFD at 68)

3. Proposal to Flow PTCs through Fuel

Staff does not take exception to the ALJ's finding that the PTC's should flow through fuel. However, Staff recommends that the allocation of PTC's to customer classes should be made on the same basis as the allocation of the production costs associated with the Wind Catcher Facilities. As such, a determination that the PTCs flow through fuel should not predetermine the allocation of the PTCs or the base rate production costs.

4. Deferred Tax Asset for PTC's (PFD at 72)

Staff takes exception to the PFD's statement that "[b]y requiring only its cost of debt on 40% of the asset, SWEPCO has shifted some of the risk to shareholders and away from ratepayers." It is unknown what capital structure the Commission will approve in SWEPCO's next base rate case. In the event that the capital structure approved by the Commission has less than a 60% share of equity, it would be customers that would be paying more to shareholders if the return on the deferred tax asset were based on a 40% debt to 60% equity capital structure.

VI. CONCLUSION (PFD PAGE 79)

Staff is grateful for the reasoned consideration of the ALJs. However, Staff respectfully excepts to the ultimate conclusion of the PFD and recommends that the Wind Catcher Project be denied a CCN. The evidence presented does not support a sufficient probability of improvement of service or lowering of costs to ratepayers.

In the alternative, Staff recommends that the Commission require, as a condition of approval of the CCN, that SWEPCO guarantee production tax credits, even if there is a change in law, in the amounts represented by SWEPCO[40] and that SWEPCO guarantee some level of net benefits to customers over and above the annual revenues customers are obligated to pay for the base rate costs of the Wind Catcher Project.[41]

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[40] Staff Ex. 2A at 20.

[41] Staff Ex. 3A at 13; Staff Ex. 2A at 20.

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CERTIFICATE OF SERVICE

I certify that a copy of this document will be served on all parties of record on June 12, 2018 in accordance with 16 TAC § 22.74.

Rachelle Nicolette Robles