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Addendum StartPage: 0

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APPLICATION OF AEP TEXAS CENTRAL COMPANY FOR AUTHORITY TO CHANGE RATES	§ § §	BEFORE THE PUBLIC UTILITY COMMISSION OF TEXAS

CROSS REBUTTAL TESTIMONY

OF

CLARENCE JOHNSON

ON BEHALF OF THE
OFFICE OF PUBLIC UTILITY COUNSEL

February 26, 2004

476

TABLE OF CONTENTS

DIRECT TESTIMONY OF CLARENCE JOHNSON

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Clarence Johnson. My business address is 1701 North Congress Avenue, Suite 9-180, Austin, Texas 78701.

Q. PLEASE STATE YOUR CURRENT EMPLOYMENT.

A. I am employed as Director of Regulatory Analysis for the Office of Public Utility Counsel ("OPC" or "Office").

Q. ARE YOU THE SAME CLARENCE JOHNSON WHO PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony responds to recommendations made by witnesses Mr. Pollock and Ms. Peveto.

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS.

A. My conclusions are as follows:

(1) Mr. Pollock's recommended change to the allocation and recovery of franchise fee expense should be rejected.

(2) Ms. Peveto's proposed changes to the customer allocator applied to Account 903 should be rejected.

(3) Ms. Peveto's proposal rate moderations proposal does not appear to be consistent with the Commission's treatment of cost of service study exceptions in the UCOS cases. To the extent that the PUC decides to deviate

from cost-based rates in this case, the determination should include a policy statement for consistency in future TDU rate cases.

(4) If the PUC adopts Ms. Peveto's rate moderation proposal, the Commission should also re-visit the "headroom" exception raised by OPC in the last UCOS case.

II. ALLOCATION OF LOCAL FRANCHISE FEES TO CUSTOMER CLASSES

Q. HAS AN INTERVENOR OBJECTED TO TCC'S ALLOCATION OF MUNICIPAL FRANCHISE FEES AMONG CUSTOMER CLASSES?

A. Yes. TIEC's Mr. Pollock opposes TCC's allocation, which is based upon the classes' percentages of retail energy sales. Mr. Pollock characterizes TCC's approach as a "spread" method and states that he instead supports a "direct" assignment. In other words, he proposes that the local fees should be assigned to, and only collected from, customers who are located inside municipal city limits.

Q. DO YOU AGREE WITH MR. POLLOCK'S CRITICISM?

A. No. TCC's proposed allocation of local franchise fees is appropriate.

Q. MR. POLLOCK ASSERTS THAT TCC'S PROPOSED ALLOCATION IS A CHANGE TO THE COMPANY'S EXISTING ALLOCATION OF LOCAL FRANCHISE FEE. DOES MR. POLLOCK'S RECOMMENDAITON MAKE A CHANGE TO THE ALLOCATION METHOD EMBEDDED IN TCC'S CURRENT RATES?

A. Yes. The current allocation reflects a settlement of this issue in AEP's most recent UCOS cases. The settlement reflects a compromise of the franchise fee allocation

methods, and the results cannot be characterized as either a pure "spread" or "direct" method.[1] Therefore, adoption of Mr. Pollock's proposal would increase the current assignment of franchise fees to certain classes. TCC's proposed allocation in this case is the same as its original proposal on this issue in the prior UCOS case.

Q. PLEASE EXPLAIN WHY TCC'S PROPOSED ALLOCATION METHOD FOR FRANCHISE FEES IS APPROPRIATE.

A. The use of an energy allocator is consistent with the kilowatt hour billing basis for the fee. Mr. Pollock's recommendation[2] does not appear to dispute this conclusion. Calculation of that allocator on the basis of systemwide consumption, rather than consumption inside city limits, is consistent with systemwide average cost rate making. Mr. Pollock's position might be appropriate if the class cost of service study reflected a geographic de-averaging of costs and rates. However, that is not the basis for ratemaking. Even though analysts understand that many types of utility costs vary on a locational basis, there is no attempt to recognize geographic differentials for those costs. As an example, rural customers are not charged the higher infrastructure costs associated with serving those areas. Mr. Pollock's approach, in essence, is to "cherry-pick" one cost item for geographic allocation because that benefits his clients.

Q. IS GEOGRAPHIC RATEMAKING JUSTIFIED BY THE MOVE TO COMPETITION?

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[1] Like many settlements, the stipulation compromises "principles" and instead adopted agreed upon numerical allocation factors. The stipulation of this issue for the CPL UCOS Case was part of a comprehensive settlement of the franchise fee allocations applied to SWEPCO and WTU also.

[2] Ex. JP-2 utilizes kilowatt hours as the starting point for Mr. Pollock's allocation.

A. No. The move to competitive electric markets has been accompanied by a trend toward uniformity and system averaging of wires rates. Texas' restructuring law requires recovery of transmission costs on a statewide postage stamp basis, ignoring regional cost differences in order to remove impediments to competitive power transactions. For the same reason, the transmission access rule rolls transmission lines dedicated to specific industrial customers into the system average costs. The generic UCOS rate design decision in Docket No. 22344 reduced the number and complexity of both rate classes and rates based upon the belief that simple, uniform rates will reduce transaction costs for competitive REPs. The order in that case regarding substation costs reiterated that costs should not be allocated based upon customers' location.[3] Thus rates within a TDU's service area which vary based upon the location of the customer are counter to this trend.

Keeping track of geographic-based rates and the changing nature of municipal boundaries can increase the administrative burden of the REP and make the REP's costs less predictable. At a time when billing issues are a significant impediment to retail competition, the need to track each customer's municipal jurisdiction, complicated by changing municipal boundaries, becomes yet another potential source of error. Mr. Pollock claims that his proposal is "easier" for REPs which market their power exclusively either inside or outside city boundaries.[4] However Mr. Pollock fails to identify how many REPs will engage in such restrictive marketing plans. Instead most REPs will engage in mass marketing, often relying upon uniform price offers set out in FACTS labels or on the "Power To Choose" web site. In order to effectively aggregate

[3] Docket No. 22344, Generic Rate Design for TDUs, Order No. 40 at 10.
[4] Pollock Direct at 22.

retail loads, REPs are likely to make a broad appeal to customers which is not limited to arbitrary city boundaries.

Q. WHAT ABOUT MR. POLLOCK'S VIEW THAT SPREADING THIS COST CONSTITUTES "TAXATION WITHOUT REPRESENTATION"?

A. That statement ignores the fact that the franchise fee is levied upon utilities -- not the customers. The item is simply a cost incurred by the utility. Just prior to restructuring, the Commission rejected that argument when TIEC sought to directly assign the Entergy Gulf States franchise fee cost responsibility based upon city boundaries. The PFD in Docket No. 16705 states:

> As Cities assert, TIEC is advocating allocation based on geography. Current cost of services studies are not based on geographical differences. Classes are not divided based on geography, and industrial sites are not self-sufficient islands. The use of city streets and property enables EGS to have an integrated utility system from which all ratepayers benefit.[5]

If TIEC's argument were valid, then TCC's property taxes would be allocated by local jurisdiction. Instead these taxes are "spread" systemwide. Similarly, Texas ratepayers frequently pay an allocated portion of multi-state utilities' tax levies in other states if the assessed property benefited the Texas system.

Q. SEC. 33.008(a), PURA, PREVENTS A MUNICIPALITY FROM CHARGING THE UTILITY FOR ELECTRICITY SERVICE PROVIDED OUTSIDE THE MUNICIPALITY. MR. POLLOCK CITES THIS PROVISION AS SUPPORT FOR FULL DIRECT ASSIGNMENT. DO YOU AGREE?

[5] *Application of Entergy Gulf States For Change in Rates,* Docket No. 16705, PFD at 357.

A. I do not view this legal provision as adding anything new to the traditional debate regarding direct vs. spread methods of recovery. The jurisdictional limit which exists on the municipality's tax base is for purposes of calculating the actual tax assessment collected by the city, but does not dictate any particular treatment of the costs in utility rates. As an analogy, city and county property taxes are levied upon the value of utility property located within the city or county boundaries. As pointed out previously, this method of determining the jurisdiction's tax base does not prevent the Commission from spreading those costs on a system basis for rate making purposes. Indeed, the Commission always has included property taxes in utility rates on the basis of an average effective tax rate for the utility system.

Q. MR. POLLOCK CITES THE RELIANT AND TXU UCOS DECISIONS TO SUPPORT HIS POSITION. ARE THOSE CASES COMPLETELY CONSISTENT WITH HIS RECOMMENDATION?

A. Not really. The Commission's decision on franchise fees in those two cases could be characterized as a middle ground between the direct and spread methods. The allocation to classes was calculated on the basis of inside-city sales, but the costs were spread on a proportionate basis to all customers within each class (i.e., both inside and outside city customers paid the allocated cost). Thus, the decision did not reflect a purely direct assignment.

Keep in mind that the majority of UCOS decisions in 2001 did not reflect a purely direct or spread approach -- or even the mixed approach of the Reliant and TXU cases. The Entergy, CPL, WTU, SWEPCO, and TNMP UCOS decisions each allocated and collected franchise fees based upon settlements of the issue which reflected stipulated

numerical factors. Given that the UCOS decisions reflect a variety of approaches to this issue, I do not find the UCOS precedents very compelling.

Q. STAFF WITNESS TROXEL RECOMMENDS THE "MIXED" DIRECT AND SPREAD METHODS ADOPTED IN THE TXU AND RELIANT CASES. DO YOU DISAGREE WITH HIS PROPOSAL?

A. I disagree. From a pragmatic stand-point, his approach is an improvement over Mr. Pollock's recommendation. However, his allocation of franchise fees contravenes the tenets of system-wide allocation applied to all other costs in the cost of service study. TCC's cost of service study lists 70 allocation factors, and none of those factors is determined in a manner which reflects locational or geographic differences in costs. Isolating franchise fees for special treatment based upon customer locations is inconsistent and inappropriate. Because Mr. Troxel's method does not establish different rates for customers based upon their locations inside or outside city boundaries, his approach implicitly concedes that geographic rate making is inappropriate. If geographically differentiated rates are improper at the customer level, then surely that same form of differential pricing at the class level is also inappropriate.

III. ALLOCATION OF CUSTOMER BILLING

Q. DOES AN INTERVENOR WITNESS OPPOSE TCC'S ALLOCATION OF BILLING EXPENSE?

A. Yes. State witness Kit Peveto, proposes to change the allocation basis for customer records and collection expense (Acct. 903) from weighted customers to unweighted customer count.

Q. DO YOU AGREE WITH HER RECOMMENDATION?

A. No. The customer allocation factor must be weighted to reflect the higher cost per customer incurred in serving larger industrial, large commercial, and IDR customers. Relying upon a pure customer count, without a recognition that cost differentials exist, ensures that residential and small commercial customers will cross subsidize larger users. If anything, Ms. Peveto's recommendation goes in the wrong direction. In my view, TCC's weighting factors probably are insufficient—particularly in comparison to customer weighting factors which the utilities in Texas apply.

Q. PLEASE EXPLAIN WHY CUSTOMER ALLOCATION FACTORS ARE WEIGHTED.

A. Customer allocations have been a somewhat controversial aspect of electric class cost allocation over the years. This is because percentages based upon pure customer count generally have a weak causal relationship with costs. As Dr. Bombright's oft-cited text points out, the cost analysts is tempted to make customer costs a "dumping ground" for unallocable costs.[6]

A pure customer allocation implies that the amount of the cost in question varies in direct proportion to changes in the number of customers. Far most costs there is no such direct relationship. In most cases other variables (such as building type or the complexity of the customer's tariff) intervene and preclude a on-to-one relationship between customer count and costs.

[6] James Bombright, Principles of Public Utility Rates (1961), pp. 247-248.

The use of weighting factors in developing a customer allocator is one means of accounting for the fact that the relationship between costs and customers is indirect. As an example, meter reading costs are greatly influenced by the dispersion of different types of customers. Utility personnel reading meters in compact residential subdivisions can read more meters per day than meter readers who have to drive longer distances to read meters at more dispersed business locations.

Similarly a demand meter takes longer to read than a kilowatt-hour meter. Thus, the cost per customer for meter reading varies by rate class. By estimating or approximating the cost differentials, ratios can be developed which are applied as weighting factors to the customer count calculation. This same type of reasoning is also applied to the weighting of allocators for other customer accounts.

Q. DO MOST ELECTRIC UTILITIES IN TEXAS RELY UPON WEIGHTED CUSTOMER ALLOCATORS?

A. Yes. The Texas electric utilities I have reviewed utilize weighted customer allocation factors for most, if not all, customer-related accounts. In some instances the utilities have performed special studies to determine the weighting factors. In other instances, known cost relationships from one type of customer account are applied as a proxy for other accounts. For instance, frequently a cost study will use meter investment cost as a proxy for the weighting of customer-related accounts other than meters.

Q. WHAT IS MS. PEVETO'S OBJECTION TO THE CUSTOMER WEIGHTING FACTOR FOR BILLING (ACCOUNT 903)?

A. She objects to a weighting factor of 10 applied to IDR rate classes. She questions whether such a cost differential could exist.

Q. DOES AEP'S WEIGHTING FACTOR SEEM UNUSUALLY HIGH TO YOU?

A. No. In Southwestern Public Service Company's (SPS) UCOS case, the utility applied a weighting factor of 40 to the meter reading costs for IDR customers. For the same account 903 (customer records and collection), CenterPoint/HL&P utilized a 53.47 weighting factor for the high voltage classes.

Q. IS IT REASONABLE TO MAKE COMPARISONS OF THE WEIGHTING FACTORS FOR HIGH VOLTAGE CUSTOMER CLASSES?

A. Yes. High voltage industrial customers historically have been more likely to use IDR meters and currently are required to use IDR meters. However, TCC assigns zero meter reading expense to transmission voltage customers, whereas other utilities assign a portion of meter reading expense to high voltage customers. This perhaps indicates that some expenses assigned by other utilities to Account 902 (meter reading) have been assigned by TCC to Account 903 (customer records and collection). Given this background, the range of weighting factors applied by other utilities to the meter reading account for high voltage customers is a useful test of reasonableness. The weighting factors applied to high voltage classes by CenterPoint/HL&P, TXU and Entergy are 52.91, 151.44, and 20.75, respectively. TCC's weighting factor of 10 applied to the transmission voltage class seems low by comparison.

Q. WOULD YOU EXPECT IDR CUSTOMERS TO HAVE A HIGHER COST PER CUSTOMER FOR ACCOUNT 903?

A. Yes. IDR customers are billed for transmission service on an ERCOT 4CP basis. This means that the customers' 4CP measurement cannot be determined until after the aggregate ERCOT 4CP has been identified and calculated. AEP previously has stated

that this requirement increases the labor hours necessary to determine each customer's 4CP billing.[7] [8] Furthermore, the utility's large industrial customers have IDR meters, and each of those customers' bills represent individually large sources of revenue. Given the size of the billings and the adverse consequences of an error, utilities' customer service personnel should focus special attention on the quality of those customers' billings. An error in the IDR data transmitted to ERCOT and REPs, and/or a failure of the IDR equipment, can result in adverse consequences for the overall market, the market settlement process, and the amount of unaccounted for energy (UFE) which must be absorbed by all market participants.

ERCOT data indicates that 2% – 4% of IDR customers are billed on the basis of default profiles; generally this means that an error or failure occurred in the IDR billing process, which presumably requires investigation and corrective action by the utility's staff.

Q. DOES TCC INCUR AFFILIATE CHARGES FOR SERVING IDR CUSTOMERS?

A. Yes. CPL witness Laine states that the AEP service company allocates $99,921 of support cost to TCC based upon the number of industrial customers on its system.[9] The services support IDR customer transactions and involve "assessment of impact of business processes related to IDR customers," "repair of [IDR] transactions," development and maintenance of systems used for transmittal of IDR data," and

[7] Brief of AEP Distribution Companies on Generic Rate Design at 7, Docket No. 22344.
[8] AEP estimated that this would produce an IDR Customer Cost of $4,000 per month—which is substantially more than the proposed transmission voltage customer charge which is proposed to be less than $1,800/month. (id.)
[9] Laine direct testimony, Ex. JLL-1 at 2.

"preparation of data for transmittal to ERCOT and CRs."[10] These costs appear to pertain to customer records and collection and clearly should be assigned to industrial IDR customers. However, Mr. Peveto's cost of service study allocates only $708 of records and collection cost to the transmission class and only $1,222 in *total* customer O&M expense to the transmission class. Obviously this is insufficient to pay for the affiliate charges attributable to industrial customers' billings.

Q. WHAT IS YOUR CONCLUSION?

A. Ms. Peveto's recommendation magnifies the subsidization of IDR customers by residential and non-IDR commercial customers.

IV. MODERATING RATE IMPACTS

Q. DOES AN INTERVENOR WITNESS ADVOCATE A DEPARTURE FROM THE CLASS COST OF SERVICE STUDY RESULTS?

A. Yes. Ms. Peveto proposes to moderate the impact of class rate changes associated with the distribution and meter functions. In particular, she recommends capping the rate increases indicated by the cost of service study for some classes and eliminating some class rate reductions which would otherwise result from the cost of service study. The most significant impact of her recommendation is to eliminate a substantial rate reduction for the small secondary non-IDR class and moderate the size of rate increase required from the transmission class.

Q. FOR PURPOSES OF DESIGNING CLASSES' RATES, IS IT APPROPRIATE TO DEVIATE FROM THE RESULTS OF COST OF SERVICE STUDIES?

[10] Id.

A. That question can be answered at two levels—as a general proposition and whether that is appropriate in this case. As a general principle, I have no problem with well thought out departures from the cost of service study which are undertaken in order to reflect policy objectives. Moderating the impact of rate changes is one of the policy considerations which can justify deviations from cost-based rates. However, I have a concern about the appropriateness of such deviations in this case because they may be inconsistent with the Commission's recent practices and policy.

Q. PLEASE EXPLAIN WHY YOU QUESTION WHETHER MS. PEVETO'S RECOMMENDATION IS CONSISTENT WITH THE COMMISSION'S RECENT PRACTICE.

A. During the UCOS cases in 2001, the Commission emphasized the need to set cost-based TDU rates. The Commission considered deviations from this policy only for headroom exceptions. Generally, this meant that the Commission entertained exceptions only for Price-to-Beat classes. However, even for those classes, the Commission seemed to impose a high threshold ("extraordinary impact") for deviating from cost based rates.

In the absence of a stipulated headroom exception, the Commission rejected most of the proposed deviations. With respect to the CPL UCOS case, the Commission rejected separate headroom exceptions proposed by OPC and the Cities. In light of the Commission's practice of strictly adhering to the UCOS class cost of service studies, Ms. Peveto's effort at rate moderation would represent an inconsistency with those cases.

Q. WHAT FACTORS SHOULD THE COMMISSION CONSIDER WITH RESPECT TO MS. PEVETO'S SPECIFIC RATE MODERATION PROPOSAL?

A. First, the Commission has to balance the benefits her recommendation provides to the transmission class against the adverse impact upon small commercial users. Her proposal has a negative effect upon the headroom which would otherwise be available for these customers. Second, in deciding whether to eliminate indicated rate reductions, the analysis should be based upon the total rate impact for all four functions (transmission, distribution, customer service, metering) in the aggregate. By focusing upon the rate impact for each function individually, Ms. Peveto's evaluation gives a misleading picture of the overall rate impact of achieving the cost of service. Under her cost of service study, only one class (Primary without IDR) would receive an aggregate rate decrease. Although she zeroes out the distribution rate decrease indicated for small secondary (without IDR), the increases indicated for the other functions would more than offset the application of that decrease. If rate impacts are examined on the basis of overall base revenues, then the nature and extent of deviations from cost of service could change.

Q. WHAT IS YOUR RECOMMENDATION?

A. If the Commission adopts a rate moderation proposal in this case, it should apply the same policy consistently in future TDU rate cases. A justifiable departure from cost of service becomes unjust if it is applied inconsistently or selectively from case to case. If the Commission decides to relax its policy with respect to cost-based rates, that change should be set out as a statement of policy.

Q. WOULD ADOPTION OF MS. PEVETO'S RECOMMENDATION RAISE ANY OTHER ISSUES WHICH SHOULD BE CONSIDERED?

A. Yes. In the event that the Commission is willing to consider departures from cost of service, the headroom exception proposed by OPC in the UCOS case should be re-

visited. TCC's proposed residential customer charge (metering and customer service) is $5.95. The Price-to-Beat (PTB) customer charge is $2.82—less than one-half the TDU's fixed charge. This creates obvious headroom problems for REPs trying to serve low-use customers. Therefore, the Commission should cap the TDU's residential customer charge at a level no higher than the PTB customer charge.

Q. WHY DOES THE DIFFERENCE BETWEEN THE PTB CUSTOMER CHARGE AND THE TDU FIXED CHARGE HARM LOW USE CUSTOMER HEADROOM?

A. Each REP must recover the TDU metering and billing costs as well as its own billing expense. Obviously, the PTB customer charge is inadequate to do that. Therefore, those costs must be recovered largely through the C-REP's energy rate. Because low use customers by definition, have fewer kilowatthour billing units, the C-REP's margin for serving those customers tends to be lower. Because the customer charge is a larger proportion of the low use customers' bill, shifting TDU costs from the fixed charge to the energy rate will free up more headroom for these customers, thereby improving their competitive options.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.