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Addendum StartPage: 0

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APPLICATION OF AEP TEXAS CENTRAL COMPANY FOR AUTHORITY TO CHANGE RATES	§ § §	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

INITIAL BRIEF OF THE CITY OF GARLAND

CHARLES M. HINTON, JR.
State Bar No. 09710500
City Attorney
CITY OF GARLAND
200 North 5th Street, Suite 125
Garland, Texas 75040
Telephone: (972) 205-2380
Fax: (972) 205-2389

ATTORNEY FOR THE
CITY OF GARLAND

LLOYD, GOSSELINK, BLEVINS,
ROCHELLE, BALDWIN &
TOWNSEND, P.C.
111 Congress Avenue, Suite 1800
Austin, Texas 78701
Telephone: (512) 322-5830
Fax: (512) 472-0532

LAMBETH TOWNSEND
State Bar No. 20167500

MELISSA E. RAMIREZ
State Bar No. 24027645

ATTORNEYS FOR THE
CITY OF GARLAND

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588

TABLE OF CONTENTS

SOAH DOCKET NO. 473-04-1033
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TO THE HONORABLE ADMINISTRATIVE LAW JUDGE:

City of Garland ("Garland") files this Initial Brief and would argue as follows:

VI. Cost of Service

18. Third Party Contract Margin Sharing Proposal

TCC[1] has the burden to show good cause exists to preclude it from crediting transmission customers with the revenues received during the test year pursuant to third party contracts with Magic Valley Electric Cooperative ("MVEC"), Sharyland Utilities, L.P. ("Sharyland"), and LCRA Transmission Service Corporation ("LCRA"). The record indicates that TCC has failed to meet this burden. The third party contracts were for the provision of construction services for certain transmission projects. Specifically, the evidence shows that TCC's transmission customers have already paid $9 million for these phantom transmission assets. Additionally, the record shows that under the contracts, TCC has added a considerable amount of margins to every service provided to the third parties, and that transmission customers will eventually bear these costs. As a result, transmission customers will pay significantly more for the transmission projects than originally estimated by TCC.

Despite the substantial costs that transmission customers have already paid for the projects and the costs they will pay in the future because of the agreements, TCC is requesting that it be allowed to keep an additional $1.3 million of the test year profits. The Commission's rule requires TCC to credit all revenues received from offering these services, and TCC has not demonstrated good cause to except it from this provision.[2] On the contrary, because of the payment for phantom transmission assets and the excessive final cost to ratepayers, TCC should not be permitted to keep ***any*** of the profits that have accrued under the third party contracts, including those that are known and measurable and that accrued outside of the test year.

Therefore, Garland recommends that all profit under the third party contracts collected for years 2001, 2002, and 2003 under the LCRA agreements in the amount of $5,284,287.01 plus the amount of revenue collected from MVEC and Sharyland during the test year in the amounts of $291,284.00 and $536,605.79, respectively, be credited to TCC's wholesale transmission customers. A total revenue credit of **$6,112,176.80** should be applied to the transmission cost of service for the profits earned from third party contracts for these revenues.

Background

TCC has what it calls Associated Business Development ("ABD") services. These services consist of transmission- and distribution-related work for third parties.[3] During the test year, TCC provided transmission–related construction services pursuant to contracts with, and on behalf of, MVEC, Sharyland, and LCRA.[4] In each case, TCC provided planning and

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[1] AEP Texas Central Company ("TCC" or "the Company") formerly known as Central Power & Light ("CP&L").

[2] P.U.C. SUBST. R. 25.342(f)(1)(D)(ii)(III).

[3] TCC Exh. 12 at 23 (Crowder Direct Testimony).

[4] *Id.*

construction services for new transmission facilities that the other party would own.[5] TCC used independent contractors as well as its own work force to carry out its responsibilities under the contracts.[6] The Company's role was to provide the overall management for the independent contractors to ensure that the transmission facilities were built as planned.[7]

The costs of the lines constructed under the contracts were not included in TCC's rate base or revenue requirement in this case because they were billed to and recovered from MVEC, LCRA, and Sharyland.[8] For each of these contracts, TCC has been and continues to be compensated on a cost-plus basis.[9] As a result, TCC received a significant amount of profit from these third parties; profit that the wholesale transmission ratepayers will have to pay. TCC received a net revenue or profit of $2,708,122.16 on the construction services it provided to MVEC, LCRA, and Sharyland during the test year (July 2002 to June 2003),[10] and has received a total of $5,284,287.01 in profit under the LCRA contract for years 2001, 2002, and 2003.[11] Instead of adjusting its test year revenues for these known and measurable changes and crediting ***all*** revenues received back to customers in accordance with P.U.C. SUBST. R. 25.342(f)(1)(D)(ii)(III), TCC is proposing to share the net revenues from the unadjusted test year on a 50/50 basis with customers.[12] It is, therefore, seeking a good cause exception to the rule. Garland opposes the margin sharing and the inadequate revenue credit proposed by TCC in this proceeding.

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[5] TCC Exh. 9 at 15 (Bailey Direct Testimony).

[6] *Id.*

[7] *Id.* at 18.

[8] *Id.* at 20:1-5.

[9] *Id.* at 18:10-11.

[10] TCC Exh. 12, JCC-3.

[11] STEC Exh. 4 at 3.

[12] TCC Exh. 12 at 34.

TCC's request should be denied and ***all*** revenues associated with the LCRA contract for years 2001, 2002, and 2003, as well as the revenues collected during the test year from MVEC and Sharyland should be credited to transmission customers. The record supports this determination because:

1) Wholesale transmission customers have paid TCC over $9 million for the transmission lines that TCC constructed for LCRA at a profit of over $5 million.

2) TCC's agreements allow TCC to include a margin on almost every aspect of the provision of services for construction that are provided to the third parties. TCC has recovered these amounts from the third parties; thus, a substantial amount of profit has accumulated to TCC. That TCC proposes to credit only a small portion of the actual revenue received is incredulous and cannot be approved.

3) Ratepayers will pay at least $13 million more for the LCRA transmission projects than was estimated by TCC because of the arrangement between TCC and LCRA, which allows both utilities to build in profits on the construction and purchase of the lines. These profits will ultimately be recovered from LCRA's wholesale transmission customers.

4) TCC has failed to demonstrate that the ABD program benefits the ratepayers and that it is entitled to a good cause exception preventing it from being required to credit 100% of the revenues to customers.

Because of the over collection of costs from ratepayers for the transmission projects, there is no justification for TCC to keep any of the revenues it has collected through these ABD third party contracts.

Argument

1) TCC has recovered over $9 million from wholesale transmission customers for phantom transmission assets since January 1, 2002.

Costs of construction for five transmission projects eventually constructed for and transferred to LCRA are currently being collected from TCC's wholesale transmission customers. In Docket No. 22352, CP&L's UCOS proceeding,[13] the final order reflected the parties' stipulation to use of a forecasted test year for rates to be charged beginning January 1, 2002.[14] Included in that forecasted test year rate base were construction costs for five transmission lines—the Coleto Creek-Pawnee Project and the Highway 9, Nueces Bay, North Oak and Lon Hill Projects (known collectively as the Corpus Christi Cogeneration Project).[15]

Since the time the rates established in CP&L's UCOS case became effective, transmission ratepayers have paid approximately $9 million for these five non-existent lines. The record establishes that $29 million was included in rate base in Docket No. 22352 for these lines.[16] Based on the Stipulation and on representations made at the hearing in this case, TCC has been collecting a 9.37% rate of return on the $29 million of rate base, totaling approximately $2.8 million annually, and an estimated annual depreciation expense of approximately $978,000.[17] Thus, it appears that by the time an order is entered in this case, TCC will have collected about $9,321,865 from customers for these five transmission projects.[18]

Although customers have paid $9.3 million for these lines, TCC never made the investment to plant as planned.[19] Instead, TCC entered into the third party contract with LCRA

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[13] *Application of Central Power and Light Company for Approval of Unbundled Cost of Service Rate Pursuant to PURA § 39.201 and Public Utility Commission Substantive Rule § 25.344*, Docket No. 22352 (Oct. 5, 2001).

[14] Tr. at 2730:23-26 (Mar. 17, 2004); Cities Exh. 13, Exh. A.

[15] STEC Exh. 3; Tr. at. 2730-2731 (Mar. 17, 2004).

[16] STEC Exh. 3 at 3 of 6.

[17] Tr. at 2734-2735 (Mar. 17, 2004); Garland Exh. 8.

[18] Garland Exh. 8; assuming rates to be in effect through July of this year.

[19] Tr. at 2741 (Mar. 17, 2004).

for the construction and transfer of these same projects and associated lines.[20] Under the contract, TCC received total net revenue or profit in the amount of $5.3 million from LCRA for the lines.[21] This amount is in addition to the funds already being collected from transmission customers in accordance with rates set in Docket No. 22352.

Further, TCC collected $393,518 in AFUDC[22] from LCRA. AFUDC is interest on funds used during construction.[23] However, because TCC included the costs of these lines in its forecasted test year, ratepayers were paying the costs up front. When asked about the reasoning behind collecting AFUDC on funds already being drawn from ratepayers, Mr. Crowder had no response.[24] It appears, then, that TCC collected not only immediate funds from ratepayers for the lines, but also additional interest on funds used during construction from LCRA. No doubt, LCRA will be charging the additional $393,518 it paid to TCC to its own transmission customers.

Notwithstanding the windfall of about $14.6 million[25] that TCC has accumulated, TCC is proposing merely to "share" the profits received from the third party contracts for an ***unadjusted*** test year, thereby crediting transmission customers only $1.3 million. Given that ratepayers will have paid approximately $9.3 million for the investment by the time a final order setting new rates is established in this docket, that the Company never made the investment to plant with the

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[20] *See Joint Application of Central Power & Light Company and LCRA Transmission Services Corporation to Transfer Certificate Rights and for Approval of Transfer Facilities*, Docket No. 25774 (Corpus Christi Cogeneration Project); and *Joint Application of AEP Texas Central Company and LCRA Transmission Services Corporation to Transfer Certificate Rights and for Approval of Transfer Facilities in Goliad and Karnes County*, Docket No. 27282 (Coleto Creek-Pawnee project).

[21] STEC Exh. 4.

[22] Allowance for Funds Used During Construction ("AFUDC").

[23] STEC Exh. 3 at 5 of 6; Tr. at 2741:9-25 – 2742:1-13 (Mar. 17, 2004).

[24] Tr. at 846 (Mar. 5, 2004).

[25] This includes the $9.3 million collected so far under rates established in TCC's UCOS and $5.3 million in revenues collected from LCRA; *see also* Garland Exh. 9.

funds received from ratepayers, and that TCC received over $5 million in profits from LCRA for construction of these same lines, it is totally inappropriate for TCC to keep any amount of the profit received from any third party contract.

2) Revenues collected from third parties under the contracts include substantial profits that have accrued and will continue to accrue to TCC, and these revenues should be credited to customers.

The third party contracts permit TCC to recover substantial margins; however, TCC proposes to credit customers only a small portion of the profits received from the institution of these margins. TCC's proposal must be rejected. The effect of these contracts requires transmission customers to pay more in construction costs than had TCC built the projects itself, in addition to the costs already being paid by transmission customers under TCC's current rates. Further, transmission customers will ultimately be responsible for paying TCC's profits through rates charged by the third party utilities. TCC's request that it not be required to credit the net revenues collected under these unreasonable contracts is unacceptable and inequitable. The Commission must grant relief to transmission ratepayers and prevent the perpetuation of contracts that effect such a result by requiring TCC to credit to customers not only all the net revenues collected during the test year but all known and measurable net revenues collected under the contracts for years 2001, 2002, and 2003.

Under the third party contracts, TCC places margins on every aspect of the construction services provided and then recovers the profits from the third parties.[26] For example, TCC testified that it charges LCRA for the use of the service company **PLUS** a margin, use of independent contractors **PLUS** a margin, costs of materials **PLUS** a margin, O & M expense **PLUS** a margin, and costs of TCC's own project management **PLUS** a margin.[27] These

[26] TCC Exh. 9 at 18.

[27] Tr. at 517-520 (Mar. 3, 2004); *see also* STEC Exh. 1.

agreements between TCC and the third parties, LCRA in particular, permit TCC the opportunity to make a substantial profit on the provision of these services at the expense of wholesale transmission customers.

While TCC witness Crowder indicates that "if you want to retain a customer, you certainly don't want to do it at excess cost,"[28] end-use customers, the transmission customers, and not LCRA, will ultimately pay the profits and bear the excess costs. Although transmission customers are not paying these costs through TCC's rates, the third parties who paid the expenses will undoubtedly charge those costs to transmission customers with an additional surcharge for their own services. Indeed, LCRA has in fact added its own profit into the construction costs and is now seeking to collect all of these charges (TCC's profit plus LCRA's profit) from customers.[29]

Because transmission customers will ultimately be responsible for the payment of the profits accrued to TCC under the third party contracts, the Commission must grant relief here. The total margin collected by TCC under the contracts for the test year is approximately $2.7 million.[30] The record shows that for years 2001, 2002, and 2003, TCC has actually collected more than $5.2 million under just the LCRA contract.[31] Yet TCC did not adjust its test year to include its known and measurable charges and does not plan to credit this revenue to customers. Further, it plans to provide transmission-related services to third parties with the margins intact for several years to come.[32] Considering this amount of revenue, plus the costs TCC is currently

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[28] Tr. at 519 (Mar. 3, 2004).

[29] STEC Exh. 6.

[30] TCC Exh. 12, JCC-3.

[31] STEC Exh. 4, page 3; Tr. at 853:12-18 (Mar. 5, 2004); STEC Exh. 5.

[32] Tr. at 848:16-23 (Mar. 5, 2004).

receiving through its rates, it is no surprise that TCC is seeking a decrease in transmission costs in this matter.[33]

Clearly, it is entirely inappropriate for TCC to keep ***any*** of the profits associated with the third party contracts. That it limits its proposal to "share" half of the profits earned during the test year only is even more egregious.

To rebut recommendations that the profits be fully credited to customers, TCC witness Crowder argued that, for the LCRA projects, TCC would have built these same facilities for itself using the same employees, equipment, and contractors if it did not have the agreement with LCRA.[34] However, Mr. Crowder testified on cross-examination that there would not have been margins associated with the work had they done it themselves.[35] Thus, had TCC not been charging the work to LCRA, customers would not be paying the exorbitant margins that have accumulated as a result of the "costs-plus" arrangement. In addition, although Mr. Crowder argues that TCC was having cash flow problems and that undertaking the financing of the projects would have placed a significant burden on TCC,[36] the fact is that TCC was already collecting funds for these projects from its ratepayers as discussed above. TCC is not entitled to keep the revenues from transmission customers.

3) As a result of the repetitive inclusion of the profits in accordance with the third party contracts, transmission ratepayers will end up paying $13 million more in construction costs than originally estimated.

Transmission customers will be paying for transmission lines at much higher costs than originally estimated because of the contracts' effects. While TCC is not seeking recovery of the

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[33] Although TCC witness Crowder testified at hearing that TCC did not overearn in its overall transmission rates during the years 2002 and 2003, Tr. at 2765:22-25 through 2766:1 (Mar. 17, 2004), TCC has asked that transmission rates be ***decreased*** by $2.3 million in this rate proceeding. Tr. at 2772:12-17 (Mar. 17, 2004).

[34] TCC Exh. 73, at 22.

[35] Tr. at 2728-2729 (Mar. 17, 2004).

costs associated with the third party contracts from its transmission customers, the costs will be recovered through the third party utility's rates. However, customers will be paying for the estimated costs inflated substantially for profits built into the contracts. Customers will be significantly harmed if no revenue credit is passed to them because they will ultimately be responsible for the excess costs, almost all of which is profit that the utilities will keep.[37]

Garland demonstrated at the hearing that ratepayers will end up paying substantially more than was estimated for the construction of the lines because of the profits that have been placed on the projects by TCC and LCRA. According to TCC's PUC applications for certificates of convenience and necessity for the new transmission lines, estimated costs of construction for the LCRA lines were:

Coleto Creek Project	$29,693,049
Corpus Christi Cogen Project	$26,092,360
TOTAL	$55,785,409[38]

These estimates reasonably reflect close to what ratepayers would have paid had TCC built the lines for itself. However, TCC entered into the agreement with LCRA and charged the following for these same projects:

Coleto Creek Project	$36,254,943
Corpus Christi Cogen Project	$40,834,151
TOTAL	$77,089,094[39]

Thus, as a result of the third party contract with LCRA, these transmission lines will cost ratepayers $21 million more than originally estimated. But, in addition to even this, for the

[36] TCC Exh. 73 at 23.

[37] STEC Exh. 4.

[38] Garland Exh. 10; Garland Exhs. 1-5.

[39] STEC Exh. 4.

Coleto Creek Project, LCRA is charging customers $43,534,000.[40] This amount includes $2.3 million of known profit that LCRA paid to TCC as well as LCRA's own additional costs of $7.3 million.

Further, the cost of the Coleto Creek lines is unreasonable when compared to the cost of other similar lines. The evidence indicates that LCRA is seeking to recover $807,680 per mile of transmission line for 53.9 miles of the Coleto Creek line built by TCC for LCRA.[41] Other evidence in the record shows that another portion of the same transmission line, which was built by STEC, was constructed for $566,481 per mile.[42] Customers would not have to pay this additional $200,000 per mile had TCC and LCRA not entered into a contract to allow each to build in the profits we see here.

Again, although TCC is not seeking to recover costs from ratepayers in this proceeding, the high prices that transmission customers will inevitably pay will be because of TCC's third party contract with LCRA. All of the third party contracts allow for the accumulation of substantial profits to the Company. TCC should not reap the benefit of these contracts while customers subsidize the profits of all the utilities involved. The net revenues that accrued as a result of the contract, which will require customers to pay $21 million more than the estimated costs (in addition to costs paid under TCC's existing rates for the same lines) should be entirely credited to TCC's transmission customers.

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[40] STEC Exh. 6. This amount does not include depreciation expense, which would likely be added. *See* Tr. at 2754-2755 (Mar. 17, 2004).

[41] Garland Exh. 7; *see also* Garland Exh. 6 and STEC Exh 6.

[42] Garland Exh. 11; *see also* Garland Exh. 7.

4) TCC has failed to prove a good cause for sharing profits for third party contracts between customers and shareholders.

While claiming the ABD third party contracts benefit ratepayers, TCC failed to provide any substantial justification for a good cause exception to the rule requiring it to apply all net revenue as a credit to its transmission customers as required by P.U.C. SUBST. R. 25.342. Additionally, known and measurable changes reflecting the entire amount of the net revenues collected by TCC under the third party contracts should be made, and a revenue credit of $6,112,176.80 should be applied. Any justifications provided by TCC to the contrary are inadequate.

TCC witness Crowder provided purported justification for a good cause exception; however, his reasons were insufficient. Specifically, Mr. Crowder claimed that TCC is entitled to an exception because of "the nature of the service provided" and because assessment of the benefits and burdens associated with the services "support the argument that TCC should retain some share of the net revenues from its third party services."[43] However, Mr. Crowder failed to detail what aspect of the "nature of services" provided particularly gives TCC the right to retain profits, and further failed to demonstrate any benefits to the wholesale transmission customers. Regarding the "nature" of services provided, Mr. Crowder claimed that to the extent TCC personnel were used for performing construction-related work for other utilities, the costs associated with employing them is not reflected in TCC's rates.[44] However, customers are in fact paying for the costs associated with the transmission projects because they were included in TCC's forecast test year and are being charged.

[43] TCC Exh. 12 at 35.

[44] *Id.*

In addition, no benefit outweighs the costs to customers. Mr. Crowder claimed benefits accrue from allowing it to keep more than half of the revenues received because that provides TCC more incentive to enter into similar projects.[45] Further, he claimed that customers benefit because they get profits that may not have materialized as a result of these incentives.[46] How can TCC suggest that customers benefit from receiving a credit of $1.3 million when TCC has received more than $5 million in profit and about $9 million from customers through its rates? Further, there is no benefit considering that customers will be responsible for subsidizing these profits through costs charged the customers by the third party utilities. Finally, TCC claims that being in the construction business is a burden because it carries more risk than being a wires company.[47] The evidence demonstrated that the burden on TCC pales in comparison to the burden on ratepayers resulting from the ABD contracts.

Weighing the evidence in the record against the explanations provided by TCC for a good cause exception, it is clearly apparent that the record cannot support a determination that TCC is entitled to a good cause exception enabling it to keep half of its test year profits. In fact, because the entire amount of profits collected under the third party contracts are known and measurable, all revenues associated with the contracts should be applied as a revenue credit to transmission customers as required by rule.

Conclusion

Garland respectfully requests that the Administrative Law Judges recommend inclusion of a total revenue credit of $6,112,176.80 for profits received under TCC's third party contracts with LCRA, MVEC, and Sharyland. TCC has not demonstrated good cause to entitle it to an

[45] *Id.*

[46] *Id.*

[47] *Id.*

exception to the rule requiring a full revenue credit. Further, TCC improperly failed to adjust the test year to include known and measurable changes to the net revenue amounts for profits collected from LCRA through 2003. Transmission ratepayers should receive this rate relief to prevent them from subsidizing the profits of TCC and the third parties with whom it contracted to accumulate profit to the detriment of transmission customers.

Respectfully submitted,

CHARLES M. HINTON, JR.
State Bar No. 09710500
City Attorney
CITY OF GARLAND
200 North 5th Street, Suite 125
Garland, Texas 75040
(972) 205-2380
Fax: (972) 205-2389

ATTORNEY FOR THE
CITY OF GARLAND

LLOYD, GOSSELINK, BLEVINS,
ROCHELLE, BALDWIN & TOWNSEND, P.C.
111 Congress Avenue, Suite 1800
Austin, Texas 78701
(512) 322-5830
Fax: (512) 472-0532

LAMBETH TOWNSEND
State Bar No. 20167500

MELISSA E. RAMIREZ
State Bar No. 24027645

ATTORNEYS FOR THE CITY OF GARLAND

CERTIFICATE OF SERVICE

I, Melissa Ramirez, attorney, certify that a copy of this document was served on all parties of record in this proceeding on this 5th day of April, 2004, in the following manner: by first class mail, hand delivery, or facsimile.

MELISSA RAMIREZ