SOAH DOCKET NO. 473-04-1033
P.U.C. DOCKET NO. 28840

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

SOUTH TEXAS ELECTRIC COOPERATIVE'S INITIAL BRIEF

By its attorney:

Jo Campbell
State Bar No. 03707800
4514 Har4rison St.
P.O. Box 154415
Waco, Texas 76715
Telephone: (254) 799-2978
Telecopier: (254) 799-2217

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TO THE HONORABLE KATHERINE L. SMITH and PAUL D. KEEPER, ADMINISTRATIVE LAW JUDGES:

Comes Now South Texas Electric Cooperative, Inc. ("STEC") and files its initial brief concerning AEP Texas Central Company's ("TCC's") third party margin sharing proposal and would respectfully show the following:

VI. Cost of Service

18. Third Party Margin Sharing Proposal

TCC has provided transmission construction services for LCRA Transmission Services Corporation ("LCRA"), Magic Valley Electric Cooperative, Inc. ("MVEC") and Sharyland Utilities L.P. ("Sharyland") since the fall of 2001. In each instance, TCC provided the construction services for new transmission that the other party would finance and own. TCC classifies these services as "other services" under the Commission's business separation rules. Pursuant to its contract with MVEC, TCC upgraded a TCC 69KV transmission line to 138KV and transferred the line to MVEC. This project is now complete. Its contract with Sharyland calls for it to upgrade a TCC 69KV transmission line to 138KV and to build a new 138KV transmission line for which Sharyland obtained the CCN.

These two projects are on going. Its agreement with LCRA has been particularly troublesome. It has made a net profit in excess of $5 million from the provision of construction service under the agreement. During this same period it also recouped in excess of $9 million through its transmission rates because of its inclusion of some of the same construction projects for LCRA in rate base in its unbundling case.

Although PUC Subst. R. 25.342(f)(I)(D)(ii)(III) requires the utility to credit all revenue received from other services during the test year after known and measurable adjustments are made, TCC seeks a good cause exception to the rule so that it would credit only 50 percent of the revenue received during the test year. If the exception were granted TCC would provide only $1,354,061 as a revenue credit.

TCC's proposal is unacceptable. TCC and its shareholders have already made well over $14 million from the LCRA projects. Yet, the ratepayers in ERCOT can only look forward to being asked to bear excessive project costs in LCRA's transmission cost of service. As of December 31, 2003, the cost of construction by TCC for two of the LCRA projects—the Coleto Creek to Pawnee 345KV line and the Corpus Christi project—has escalated from an original estimated cost of $55,785,407 to $77,089,094. This is a 38 percent increase. Moreover, these costs are expected to escalate even further. LCRA must add its overhead and financing cost to TCC's construction cost. The final cost for the Coleto Creek project is now estimated to be in excess of $43 million.

Because of the egregious nature of the agreement between TCC and LCRA, STEC submits good cause exists for TCC to be required to credit total margins in the amount of $5,284,287 for the LCRA project plus revenues of $829,889.79, received from the MVEC and Sharyland projects during the test year for a total revenue credit of $6,112,176.80. STEC further requests that a moratorium as recommended by Cities' witness, Dr. Sarah Goodfriend, be placed on TCC performing any further third party transmission construction services.

A. TCC's Third Party Contracts

On July 12, 2001, LCRA and TCC became parties to a Joint Development Agreement (JDA). Under the agreement LCRA would finance and own a number of projects that would otherwise have been funded and owned by TCC. TCC would serve as project manager and build the projects and would provide field O&M services. TCC. Ex. 9 at 16:19-17:13.

TCC pursued the agreement with LCRA so that it could limit the capital outlays it would have to make in Texas. Id. at 21:17-18. The agreement has now been amended so that either TCC or LCRA can decide not to pursue other projects under the agreement after September 30, 2003. Id. at 18:4-7. However, new transmission projects are currently in the pipeline to be built in the future under the agreement.

The agreement between TCC and LCRA called for TCC to charge LCRA for its cost plus a margin. Services performed by AEPSC ("Service Company") would also be at cost including overhead plus a margin. TCC charged cost plus a margin for the purchase of materials, for the leasing of equipment, for the hiring of independent contractors. TCC also charged cost plus a margin for its oversight of the project. Tr. at 518:25-519-10. Margins are also charged for O&M services. STEC Ex. 2. A separate margin was applied at every stage of construction.

All labor costs included overhead cost plus a ten (10) percent margin. The cost for material included not only the cost of the material, but also the labor cost and overhead for the time involved in securing the material plus a 6.5% margin. If the material came from TCC's storeroom it included cost plus a fifteen (15) percent margin. Tr. at 522:11-523:14. Of course had TCC built the projects for itself, it would not have charged any margins. Tr. at 2721:16-17.

On top of TCC's cost, LCRA was also incurring costs for each project. It charged for providing oversight of TCC as the project manager. It also allocated its overhead expense and capitalized interest on the money used to finance the construction. Tr. at 2723:5-2724-14, STEC Ex. 7.

TCC included $29,352,500 for the LCRA projects in rate base in its unbundling rate case. STEC Ex. 3 at 3 of 6. The return on the rate base was 9.37%, which resulted in a $2,750,329 return. Tr. at 2734:15-25. It also received depreciation expense of approximately $978,489 on its LCRA project rate base items. Tr. at 2735:1-2736:5. Thus, it recouped $3,728,746 per year for the same projects upon which it also was making a profit under its agreement with LCRA. Tr. at 2736:11-15. The rates set in the unbundling case will be in effect for at least 2.5 years. Thus, TCC will net approximately $9,321,865 additional profit for the projects it constructed for LCRA at cost plus a margin.

Since the inception of the LCRA agreement, TCC has earned total margins for the construction of transmission lines for LCRA of $5,284,287.01 plus the $9,321,865 it recouped through rates for the same projects for a grand total of $14,606,152. It must also be presumed that its employee costs were included in its rates since TCC claims that it has used staff already on its payroll for the construction projects. Thus, it is likely that these costs have also been double counted by TCC. It has also been paid $393,518 by LCRA for AFUDC it charged on its books for the LCRA projects that were included in its rate base even though the unbundling rate case used a future test year. STEC Ex. 3, pg. 5 of 6. TCC could not explain why it would be booking AFUDC when it had included these projects in the rate base in a case using a future test year. Tr. at 846:19-14.

Ratepayers will certainly not benefit from the agreement reached between TCC and LCRA. As an example, the Coleto project was estimated to cost only $29,693,049 when the CCN for the project was sought. Garland Ex. 1. Under the agreement, it is now expected to cost in excess of $43 million. STEC Ex. 7, for which judicial notice was taken at tr. at 2726:4-8. The four transmission lines comprising the Corpus Project were estimated to cost $26,092,360 when the CCN for the lines in this project was sought. Garland Ex. 2, 3, 4, and 5; tr. at 2750:16-24. TCC has collected from LCRA $40,834,151 for the Corpus Christi project for their cost to date. LCRA's cost for overseeing the project, overhead, and financing the cost will be added to that amount. Tr. at 2752:1-5.

The very prudence of the contract must be called into question if the cost for building the total San Miguel to Coleto project is examined. TCC constructed the Coleto to Pawnee portion of the line. STEC constructed the Pawnee to San Miguel portion of the line. TCC's portion of the line was 53.9 miles; STEC's portion of the line was 35 miles. The TCC/LCRA cost is approximately $43 million; STEC's cost was $19,826,848. The TCC/LCRA portion of the line will cost approximately $797,774 per mile; STEC's portion of the line will cost $566,481 per mile. In other words, the cost for the TCC/LCRA portion of the line using lattice towers was $231,293 more per mile than STEC's portion of the line even though STEC used monopoles as the landowners for both portions of the line requested. Tr. at 2755:9-2762:13.

B. AEP's Margin Sharing Proposal Is Not In The Public Interest

TCC seeks a good cause exception to P.U.C. Subst. R. 25.342(f)(I)(D)(ii)(III) which requires a utility offering "other services" during the test year to credit all revenues received from offering the service during the test year after adjustments for known and measurable adjustments are made. TCC Ex. 12 at 24:21-35:11. TCC proposes only a credit of $1,354,061. TCC Ex. 12 at JCC-Ex. 3.

TCC offers three reasons why it should be granted a good cause exception. TCC states that because of the nature of the service, costs that would normally be capitalized can no longer be capitalized, thereby eliminating the cost for employees used for the projects from being included in rates. TCC also claims that the service benefits end-use customers and that a sharing of the revenues provides an incentive for TCC to find opportunities to provide such service.

TCC's reasons for a good cause exception must fail. TCC should not be able to both capitalize the cost of construction being provided a third party and earn profit from the third party for conducting the construction. Moreover, TCC did not show that the employee costs plus overhead that it recouped from LCRA, MVEC, and Sharyland were not also included in the rates set in its unbundling case. The end-use customer gains no benefit from the construction service provided by TCC because of the excessive costs of the projects under the agreements. STEC believes a moratorium on such projects should be imposed. Certainly, TCC should not be provided an incentive to enter into additional construction projects.

STEC does believe a good cause exception to the rule exists to require TCC to provide a credit to its revenue requirement in the amount of $6,112,176.80 for its transmission construction service. This would include total margins of $5,284,287.01 earned by TCC under its LCRA agreement through December 31, 2003. STEC Ex. 4, Attachment A. It is only equitable that TCC be required to credit the total margins earned under its LCRA agreement since it has already earned in excess of $9 million through its rates for these projects plus the money paid to it by LCRA for AFUDC. The credit would also include the test year revenues of $827,889.79 that TCC earned for the MVEC and Sharyland projects during the test year as shown on JCC Ex. 12 at TCC Ex. 3, as is required by the rule.

C. A Moratorium Should Be Placed On AEP's Third Party Construction Projects

STEC supports Dr. Goodfriend's recommendation that a moratorium be placed on TCC's acceptance of new transmission construction contracts. Cities Ex. 8 at 9:11-12. As discussed by Dr. Goodfriend, TCC has hired at least one additional person solely for the purpose of providing such services. This, of course, results in TCC's share of the allocation of Service Company's cost being increased for TCC's transmission. Id. at 85:8-9, 86:4-9. Moreover, the facts show that TCC's agreement with LCRA is not in the public interest. Instead, it has provided a license for TCC to increase its profits at will at the expense of ratepayers.

D. Proposed Findings of Fact

1. TCC has provided transmission construction services for LCRA Transmission Services Corporation ("LCRA"), Magic Valley Electric Cooperative, Inc. ("MVED"), and Sharyland Utilities L.P. ("Sharyland") since the fall of 2001. TCC. Ex. 9 at 16:1-22.

2. TCC pursued the agreement for transmission construction services with LCRA so that it could limit the capital outlays that it would have to make in Texas. TCC Ex. 9 at 21: 17-21.

3. Under the agreement LCRA would finance and own a number of projects that would otherwise have been funded and owned by TCC. TCC would serve as project manager and build the projects as well as provide field O&M services. TCC Ex. 9 at 16:19-17:13.

4. Since the inception of the LCRA agreement, TCC has earned total margins of $5,284,287.01 for the construction of transmission lines. STEC Ex. 4, Attachment A. At the same time, it has recouped through its rates $9,321,865 attributable to some of the same projects financed by LCRA and built by TCC. Tr. at 2738:5-11. It also recovered $393,518 for AFUDC even though its last rate case used a future test year. STEC Ex. 3, pg. 5 of 6.

5. As of December 31, 2003, the cost of construction by TCC for just two of the LCRA projects---the Coleto Creek line and the Corpus Christi project---has escalated from the original estimated cost of $55,785,407 to $77,089,094. These costs will further escalate when LCRA adds its overhead and financing costs to TCC's construction cost. The Coleto line, which was originally estimated to cost only $29,693,049, is now estimated to cost in excess of $43 million. STEC Ex. 7.

6. The prudence of the agreement between AEP and LCRA is questionable when its per mile cost for its portion of the Coleto to San Miguel line is approximately $797,774 per mile and STEC's per mile cost for its portion of the line is only $566,481 per mile even though STEC used monopoles as was requested by landowners rather than lattice towers. Tr. at 2755:9-2762:13.

7. TCC's construction agreement with MVEC calls for it to upgrade a TCC 69 KV line to 138 KV and transfer the line to MVEC. TCC will charge MVEC cost plus a ten percent margin.

8. TCC's construction agreement with Sharyland calls for it to upgrade a TCC 69 KV line to 138 KV and build a new 138 KV transmission line. The transmission projects will be constructed at cost plus a ten (10) percent margin.

9. TCC seeks a good cause exception to P.U.C. Subst. R. 25.342(f)(i)(D)(ii)(III) so that it shares 50/50 the net revenue it received in the test year for transmission construction projects.

10. TCC's margin sharing proposal should be denied since it is not equitable or in the public interest.

11. A good cause exception should be granted to P.U.C. Subst. R. 25.342(f)(i)(D)(ii)(III) to require TCC to credit its transmission cost of service in the amount of $6,112,176.80 for its transmission construction service. This amount includes total margins of $5,284,287.01 earned by TCC under its LCRA agreement through December 31, 2003. STEC Ex. 4, Attachment A. It also includes $827,889.79 TCC earned in revenues during the test year from MVEC and Sharyland as is required by the Rule. TCC Ex. 12 at TCC Ex. 3.

12. It is in the public interest to place a moratorium on TCC's acceptance of new transmission construction contracts.

Proposed Conclusions of Law

1. TCC's request for a good cause exception to P.U.C. Subst. R. 25.342(f)(I)(D)(ii)(III) should be denied as contrary to the public interest.

2. STEC's request for a good cause exception to P.U.C. Subst. R. 25.342(f)(I)(D)(ii)(III) should be granted to require TCC to not only credit its transmission cost of service with the revenues received from MVEC and

Sharyland during the test year in the amount of $827,889.79 as required by the rule but to also credit total margins of $5,284,287.01 earned by TCC pursuant to its LCRA agreement through December 31, 2003. The requirement to credit its total margins pursuant to the LCRA agreement is equitable because it will have recouped in excess of nine (9) million dollars for the same projects from the rates established for transmission service in its unbundling rate case.

E. Conclusion

STEC respectfully requests that TCC's request for a good cause exception to P.U.C. Subst. R. 25.342(f)(I)(D)(ii)(III) be denied; that STEC's good cause exception to the same rule be granted; that a credit in the amount of $6,112,176.80 be used to reduce TCC's revenue requirement for its transmission cost of service; and that a moratorium be placed on TCC accepting new transmission construction contracts.

Respectfully submitted,

Jo Campbell
Attorney for STEC
State Bar No. 03707800
PO Box 154415
Waco, Texas 76715
(254) 799-2978
(254) 799-2217 (facsimile)
E-mail: jocampbell@stec.org

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the foregoing upon all parties of record by facsimile and/or first class mail on this 5th day of April 2004.

Jo Campbell

Jo Campbell

Appendix

Credit to TCC's Transmission Cost of Service

Total margins earned under LCRA agreement[1]	$5,284,287.01
Test year revenue from MVEC[2]	291,284.00
Test year revenue from Sharyland[2]	536,605.79
Total Credit	$6,112,176.80

1. STEC Exhibit 4, Attachment A
2. TCC Exhibit 12, JCC Exhibit 3