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PUC DOCKET NO. 28840
SOAH DOCKET NO. 473-04-1033

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

THE STATE OF TEXAS' EXCEPTIONS TO THE PROPOSAL FOR DECISION

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STATE OF TEXAS'
EXCEPTIONS TO THE PROPOSAL FOR DECISION

The Office of the Attorney General, Consumer Protection and Public Health Division, Public Agency Representation Section, on behalf of the State of Texas (the "State") representing state agencies, colleges and universities, respectfully submits these exceptions to the proposal for decision ("PFD") filed by the Administrative Law Judges ("ALJs") from the State Office of Administrative Hearings ("SOAH"). Pursuant to the deadlines set by the Policy Development Division of the Public Utility Commission ("the Commission" or "the PUC"), in the memorandum dated July 2, 2004, these exceptions are timely filed.

II. Overview of the Case

A. Introduction

The State commends the ALJs for their meticulous consideration of the many complex issues in this case and their well-reasoned and decisive recommendations. The State has only two exceptions to the PFD and three recommendations.

B. Exceptions

The State excepts to the ALJs' recommendations regarding FERC Account 903 and rate design. FERC Account 903 costs should be allocated on a non-weighted customer count basis. The

ALJs' decision to the contrary[1] erroneously failed to properly consider the Commission's known and measurable rule[2] and controlling case law[3].

The ALJs' rate design recommendation that gradualism be applied to the total Transmission and Distribution ("T&D") bill rather than at the functional level is inappropriate for unbundled cost allocation cases. The ALJs' proposed gradualism mechanism (setting a floor of zero and a ceiling of 2 times the system-wide change) is not adequate to mitigate the disparate rate impacts of the cost allocation studies among customer classes. The ALJs' proposed gradualism, if applied at the total customer T&D levels, will create intra-class cost allocation issues that will be left to TCC to address at its discretion through rate design for each component of the T&D rates for each of the six customer classes.

C. Recommendations

The State believes that the ALJs' recommendations will result in a justifiable rate decrease for the distribution, metering, and customer service functional costs. However, while the ALJs' recommendations in the PFD result in a decrease in TCC's transmission function costs, TCC's Texas retail transmission rates will increase. The ALJs' rate design recommendations do not appear to differentiate between an increase in rates and a decrease. However, the two have traditionally been treated differently by the Commission. Therefore, the State is addressing three rate design scenarios and recommendations for each scenario:

1. If the Commission orders a decrease in rates, the State recommends that the decrease be applied on an equal percentage basis to each customer class at functional levels instead of to the total T&D customer bill;

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1 PFD at 149.

2 P.U.C. Subst. R. 25.231(a).

3 *City of Alvin v. Pub. Util Comm.* 876 S.W. 2d 346, and *Central Power and Light Company/ Cities of Alice, et. al. v. Pub. Util. Comm. of Texas*, 36 S.W. 3d 547 (pet. den.).

2. If the Commission orders an increase in rates, the State recommends that gradualism be imposed at the functional level rather than to the total bill. The State also recommends that its entire proposed gradualism mechanism be adopted to ensure that any rate increase will have gradual rate impacts among customer classes; or
3. If the Commission orders an increase in rates and decides that gradualism should be applied only to the total T&D bill, the State recommends that the Commission provide directions to TCC as to how the final total T&D revenue requirement for each customer class should be broken into separate revenue requirements for each individual function (transmission, distribution, metering, and customer services).

VIII. Rate Design

B. Cost of Service Allocation

6. FERC Account 903 (Customer Service Billing and Record Costs)

TCC proposes to allocate costs included in FERC Account 903 to all Texas retail customers based on a weighted number of customers for each class.[4] Although no studies or written analyses were provided, TCC claims that the weight for each class was developed by comparing the amount of time it takes to bill customers in each class. The Company alleges that it takes ten times longer to process the billing for a customer with an interval demand recorder ("IDR")[5] meter than for a customer without an IDR.[6]

It is difficult to understand why it would take that much longer to process the billing for customers with an IDR meter. It is true that the IDR meters may record more data; however, a tenfold

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4 PFD at 149.

5 All customers having a demand equal to or greater than 1000kW are required by ERCOT to use IDR meters that record the amount of energy used in every 15-minute interval throughout a year. PFD at 135.

6 State's Ex. 1 at 7.

difference is inconceivable with today's advanced computer technology. In addition, TCC performed the same billing process for the same IDR customers before customer choice began and the Company did not previously charge these IDR customers more than it charged non-IDR customers.

Most importantly, as TCC witness Mr. Don Moncrief admitted during cross examination, the amount of time TCC alleges it takes to process a bill for an IDR-metered customer[7] is an estimate and is not based on any written, formal study or analysis.[8] Thus, as TCC admitted, the increased cost placed on customers with IDR meters is based on an arbitrary number.[9]

"Estimates" and "arbitrary" cost assignments are not recognized standards for establishing utility rates. The Company bears the burden of proving that its proposed rate changes are just and reasonable, known and measurable. P.U.C. Subst. R. 25.231(a) provides that rates are to be based upon a utility's cost of rendering service to the public during a historical test year adjusted for known and measurable changes. A utility's failure to meet this burden requires a disallowance.

It is long-established Commission practice to consider post-test-year adjustments for known and measurable changes to historical test-year data only where the attendant impacts on all aspects of a utility's operations can with reasonable certainty be identified, quantified, and matched. In the *City of Alvin* case, the Court held that the Commission appropriately denied post-test-year adjustments, because the Company had not identified or quantified the specific parts, training materials, tools, vehicles or equipment involved in its request. Rather, it merely represented that it would spend a sum certain on these expenses. This is analogous to the instant situation. The Company has not identified or quantified actual costs involved in computing bills for IDR-metered customers. It just alleges that it takes longer to process those bills and then tries to bootstrap that allegation into the realm of a known and measurable change.

It may indeed take longer to process an IDR meter bill, but the burden to prove exactly how much longer is on the Company and it cannot rely on estimates and arbitrary cost assignments as a substitute for an appropriate study.

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7 State's Exh. 1 at 7, lines 5-16.

8 Tr. 6 at 1196, line 13.

9 Tr. 6 at 1215, line 25 to 1226, line 3.

In the PFD, not only did the ALJs erroneously rely on Mr. Moncrief's testimony, they also relied on irrelevant arguments made by the Office of Public Utility Council ("OPC"). OPC argued that TCC's customer weighting factor for billing is actually low compared to the weighting factors used by Southwestern Public Service Company and CenterPoint.[10]

The issue that is never addressed by TCC , OPC or the ALJs is the issue of what is a known and measurable change for this utility in this Docket. Known and measurable does not involve guess work or comparisons with other utilities' costs but is the product of study and analysis of the Company's specific costs--both of which are absent here, because TCC performed neither.

The perplexing part of the ALJs' recommendation on this issue is that they obviously are well-versed in the requirements of the known and measurable rule, yet fail to apply it here. Beginning very early in the PFD, there is a recitation of the known and measurable rule.[11] Again, on page 83 of the PFD the ALJs present a detailed and historical analysis of the rule. Relying on this analysis, the ALJs apply the rule to the Company's request for an increase in pension expenses and find that because the proposed increase was supported only by projections based on uncompleted or uninitiated actuarial reports, the request should be denied. Had the same standard been applied to the proposed increase in IDR-metered billing costs, as it should have been, an increase to IDR billing costs would have been denied as well, because the costs were not based on any studies but were merely arbitrary estimates.

Beginning on page 90 of the PFD, in discussing demand side management ("DSM") costs, the ALJs once again apply the known and measurable rule and find that, "[T]he Applicant's second proposal would change the manner of measurement of the amount of the allowable costs by substituting estimated amounts for known and measurable amounts. Similarly, this is not permitted in the statutory or regulatory scheme."[12]

Here we have an unequivocal recognition by the ALJs that known and measurable does not mean estimated, yet when offered an "estimate"by the Company with regard to IDR billing costs the

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10 PFD at 149-150.

11 PFD at 28.

12 PFD at 93.

estimate was inappropriately considered good enough to support the requested increase in costs with a total disregard of the known and measurable standard.

Additionally, under cross examination, Mr. Moncrief admitted that the Company had failed to take into account the benefits it receives from the information it gets through IDR meters.[13] The fact that IDR meters provide benefits to the Company is recognized by the ALJs in their discussion of Load Data, beginning on page 135 of the PFD.

In a recent case involving TCC's predecessor Company, Central Power and Light Company, the Court addressed the issue of considering Company benefits vis-á-vis cost of service when establishing customer costs.[14] The Court upheld the Commission's decision to deny post-test-year adjustments. The Commission had held that a high-voltage, direct-current project put into service shortly after the close of the test year did not qualify for inclusion in rate base, because the project enabled CPL to serve more customers and "the impact on CPL's revenues of that load growth is not taken into account."

The same is true in the instant situation: the value to the Company of precise load data information the Company derives from IDR data is not taken into account when calculating billing costs.

Because they abandoned the known and measurable standard, and failed to follow well-established case law, which requires the Company to take into account, in calculating costs, the benefits it derives from the information gathered through the cost-generating activity, FERC Account 903 costs should be allocated on a non-weighted customer count basis and the findings of fact and conclusions of law submitted by the State in Appendix B should be adopted instead.[15]

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13 Tr. 6 at 1213, line 7 to 1214, line 16.

14 Ibid. at 3.

15 Proposed Findings of Fact and Conclusions of Law are attached in Appendix B.

VIII. Rate Design

I. Gradualism

1. When to Apply Gradualism

The Commission has traditionally applied gradualism in rate increase situations to avoid rate shock.

2. When to Apply an Equal Percentage Decrease to Rates at the Functional Cost Level in Lieu of Gradualism

When a decrease in rates is ordered, an equal percentage decrease should be applied to each customer class. In the past, in cases in which decreases were ordered, the Commission either applied an equal percentage reduction to all customer classes or applied a special allocator to distribute the rate decrease among customer classes. The decrease percentage should be applied among customer classes on a functional basis because:

- Under deregulation costs are unbundled into separate functions and adjustments applied at that level would have the most significant impact;

- The transmission function is not determined solely by a given utility's customer count and load, but is, instead, intertwined with the Electric Reliability Council of Texas Transmission Cost of Service ("ERCOT TCOS"). Therefore, it should not be subject to adjustment as it would be if adjustments were applied to the total T&D customer bill; and

- It would create class revenue requirements for each function thereby providing appropriate information to design rates for each customer class.

3. Proposed Rate Design if There is a Decrease in Rates (An Equal Percentage Decrease Should Be Applied at the Functional Level)

The State recommends that the rate decrease in this case be applied equally to all the rate classes at the functional level so that if, for example, the distribution functional costs experience a 10% system-wide decrease, each customer class would experience a 10 % decrease in distribution rates. Because each function will experience a different percentage of the decrease, it is reasonable and appropriate to apply that percentage equally among customer classes for that function. So that although a 10% decrease may apply to the distribution function in each customer class, a 7% decrease may apply to the metering function in each customer class. Precise percentages cannot be determined until the final revenue requirement is determined and the numbers have been run.

If the Commission orders a decrease in TCC's costs, the decrease would be distributed disparately among the Company's six customer classes if the distribution of the decrease is based on a uniform rate of return ("ROR") cost allocation study, as proposed by TCC. Some classes would experience an increase in costs even though the entire system experiences a decrease. Therefore, the decrease should not be distributed based on the result of a uniform ROR cost allocation study.

The ALJs, in Finding of Fact No. 283, recommend applying a floor of zero and a maximum of 2 times the system change at the total T&D level to achieve a rate change moderation among customer classes.[16] The State disagrees with this recommendation.

In the past, in most rate reduction cases, the Commission either applied an equal percentage reduction to all customer classes or applied a special allocator to distribute the rate decrease among customer classes.

The equal percentage approach is still the most appropriate approach to distribute rate decreases, because the method has been used by the Commission, it is a simple approach, and most importantly, it would provide the most reasonable and equitable distribution of rate decreases among customer classes.

Precedent for this decrease methodology can be found in *Inquiry into Reasonableness of the Rates and Services of Gulf States Utilities Company*, Docket No. 12852, 1995.

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[16] Finding of Fact No. 283 is set out in Appendix A.

Therefore, the State recommends the Commission apply an equal percentage reduction to all customer classes on a functional basis.

In an unbundled cost of service study, the Company's adjusted test-year cost of service is first allocated across four business functions:[17]

Transmission,

Distribution,

Transmission and Distribution Utility Metering System, and

Transmission and Distribution Utility Customer Service.

Each function's adjusted [18] test-year cost of service is then allocated among the customer classes to determine a revenue requirement for each class.[19] TCC has six customer classes:[20]

Residential

Secondary GS<=10kW

Secondary GS>10 kW (W/IDR and w/o IDR)

Primary (W/IDR and w/o IDR).

Transmission

Lighting

The transmission customer class should not be confused with the transmission function. The class refers to those customers who take power at the transmission voltage level. The transmission function refers to the portion of TCC's operating business that provides transmission services. The transmission function is part of the cost of service applicable to every customer class including the transmission class.

Customer class base rate revenues are the revenues that base rates are designed to recover from each rate class.[21] Ideally, the results of a cost of service study, at a uniform ROR, should be

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17 Ibid. at 6.

18 Adjustments to test-year cost data are based on known and measurable changes.

19 State's Ex. 1 at 6.

20 State's Ex. 1 at 9.

21 State's Ex. 1 at 14.

adopted as targeted revenues to be collected from each class. However, accepting a cost of service study "as is" and applying it directly to a rate design can produce widely disparate results inflicting rate shock on one or more customer classes.[22] (This is illustrated by the Chart on page 13.)

When utilities were regulated they were integrated. All operational costs were bundled together and recovered from customers in a bundled rate. The cost allocation studies performed to determine the revenue requirement for each customer class were never unbundled into different functional costs. As a result, it made sense to apply gradualism to total bundled costs at the total bundled bill level.

This is not true under deregulation. Under deregulation, a transmission and distribution utility, such as TCC, has no generation costs; and its costs are required by the Commission to be broken down into the four different functions listed above: transmission, distribution, metering, and customer service. [23] The Commission now requires utilities to perform class cost allocation studies at a functional level. [24] A cost allocation study must be performed for each function to determine the revenue requirement for each customer class. As a result of the new functional unbundled and class cost allocation structure, established by the Commission pursuant to deregulation in 2002, it is reasonable and more appropriate to adjust rates at the functional level.

There are additional reasons compelling adjustments at a functional level. Transmission costs, recovered from customer classes through TCC's Texas retail transmission rates, should not be adjusted and should continue to be allocated based on the average 4 coincident peak ("CP") demand. Transmission costs recovered through TCC's Texas retail transmission rates are not determined and recovered in the same way as other functional costs. The costs for the distribution, metering, and customer services functions are incurred for providing these services only to a given utility's customers. Therefore, the costs related to these functions are and should be directly recovered from the utility's customers.

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22 Ibid. at 15.

23 P.U.C. Subst. Rule 25.344(c)(1) and P.U.C. Approved Unbundled Cost of Service Rate Filing Package (UCOS-REP).

24 P.U.C. Subst. R. 25.344(g)(2).

However, TCC's transmission function costs are inter-related with other transmission utilities' costs in ERCOT and imposed on all distribution utilities pursuant to a complex methodology which involves using an individual distribution utility's coincident peak load to determine its responsibility as part of the total ERCOT TCOS. Therefore, the recovery of the ERCOT TCOS, through TCC's retail transmission rates, should be treated separately from costs related to other regulated functions and should be based on the average 4 CP allocation methodology, similar to the manner in which the total ERCOT TCOS is recovered (based on the average 4 CP).

If adjustments were made to the total T&D bill, then it would be applied to transmission rates as well, since they are part of the total bill, and the transmission function allocation would be in-appropriately altered and no longer synchronized with ERCOT costs. Therefore, transmission rates have to be "carved out" of the gradualism application and adjustments should be applied only to the other functions.

4. Proposed Rate Design if There is an Increase in Rates

Gradualism has traditionally been applied to the total customer class revenue requirement when rates are increased so that no class will experience a severe increase in rates. This Commission-approved methodology includes other guidelines: the class that experiences the highest increase in the uniform ROR cost allocation should receive no more than a capped maximum increase set by the Commission; no customer classes should receive a rate decrease if the system experiences a rate increase; and the remaining classes (classes excluding the class that receives the maximum increase and the classes that receive no rate decreases) should be assigned rate increases based on their cost relationship as indicated by the uniform cost allocation study.

The ALJs have correctly stated that, in this case, for the first time, the State is proposing that gradualism be applied directly to the cost of service functions rather than to the total T&D bill.[25] The State appreciates the ALJs' comments that the process "...may not be inappropriate at some time..." because the generation function is no longer a part of base rates, looking at the separate parts of the

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[25] PFD at 178.

transmission and-distribution rates and making adjustments function by function might establish a more appropriate basis for assigning cost-of-service.[26]

The State believes that, if an increase is ordered in this case, now is the time to apply gradualism at the functional level. This is the first post-deregulation T&D rate case. Now we are clearly able to see that applying gradualism only to the total T&D bill does not mitigate rate shock as well as applying it at the functional level. In addition, applying gradualism only to total T&D bills would be inconsistent with the basic intent of deregulation and the purpose of unbundling T&D utility functional costs.

The State strongly urges that, if a rate increase is approved in this case, the Commission adopt the concept of applying gradualism on a functional basis.

The application of gradualism to each function is the optimal methodology, because it enables gradualism to be applied only to the functions that show disparate cost impacts on customer classes, while allowing other functions to directly reflect their cost of service.

In this Docket, because the costs allocated to customer classes based on the cost of service cost allocation studies for the distribution and meter functions result in disparate cost impacts on customer classes, the State submits that gradualism should be applied directly to these two functions.[27] The following table illustrates the disparate rate impacts on customer classes for these two functions based on TCC's proposed increases:

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26 PFD at 180.

27 Because there is no disparate impact on the customer charge function, the State recommends that the cost of service cost allocation study results be directly applied to that function.

TCC's PROPOSED PERCENTAGE INCREASE TO EXISTING RATES [28]

CLASS	DISTRIBUTION FUNCTION	METERING FUNCTION
Residential	18	23
Secondary GS<=10kW	29	24
Secondary GS>10kW W/IDR	19	12
Secondary GS>10kW W/O IDR	19	-15
Primary W/IDR	35	67
Primary W/O IDR	35	36
Transmission	91	48
Lighting	19	0
TOTAL	21	30

[28] TCC'S Rate Filing Package, Schedule II, Comparison Between Present and Proposed Revenues.

The distribution function comprises the largest part of customer T&D bills. The following table illustrates the percentage of costs attributable to each function by TCC: [29]

FUNCTION	PERCENTAGE OF COST TO TOTAL T&D BILL
Transmission	17
Distribution	69
Metering	8
Customer Service	5

As one can readily see from looking at these two charts, because the uniform ROR class cost allocation study for the distribution function results in disparate cost impacts among customer classes and the distribution function represents the largest component of a customer's bill, applying gradualism at the core distribution functional level would be the most effective way to avoid rate shock, particularly to the transmission class.

The application of gradualism at the functional level would create the class revenue requirement for each of the four functions. A class revenue requirement must be established so that different rate components can be designed for each customer class.

In Docket No. 22344, [30] the Commission decided that the generic rate design structure for all the customer classes would be comprised of a rate structure for each customer class which would contain a customer charge, a metering charge, a distribution charge, and a transmission charge. The transmission function's class revenue requirements are for the design of the transmission charge for each class. The distribution function's class base rate revenues are used to design the distribution charges for each class. The class revenues for the metering function and the customer service function are used to design the metering charges and the customer charges for each class. If gradualism were to be applied only to the total T&D rates, the T&D revenue requirement for each

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29 State's Ex. No. 1, Schedule-State-KP-1.6-Total: Comparison of Proposed Functional Rates to Total.

30 *Generic Issues Associated with Applications for Approval of Unbundled Cost of Service Rate Pursuant to PURA Sec. 39.201 and Public Utility Commission Subst. R. 25.344.*

class would not provide adequate information for the rate design of each of the T&D charges for each customer class.

The Gradualism Methodology

In the PFD, in Finding of Fact No. 283, the ALJs recommend a floor of zero and a cap equal to 2 times the system change. Setting a cap will not be adequate to mitigate disparate rate impacts among classes. In order to mitigate disparate rate impacts among classes, an additional step is needed: a distribution of the remaining amount of increase among the remaining classes (classes excluding the classes that receive the maximum and minimum limits of the increase).

From the inception of the PUC, in all of the rate cases before the unbundling cases,[31] the gradualism methodology used by the Commission to address rate shock issues always included three steps: (1) setting a maximum limit on the amount of an increase to be imposed on the class that experiences the highest percentage of the revenue increase in the uniform ROR cost allocation studies; (2) assigning no decrease to any class, when the overall system is experiencing an increase, even if some classes may experience decreases in the uniform ROR cost allocation studies; and (3) ensuring that the revenue increases for the remaining classes (classes excluding the class that experiences the highest percentage of the revenue increase and the classes that experience decreases in the cost allocation studies) would be set according to the relative ranking of the revenue increase, attributable to them, consistent with the uniform ROR cost allocation studies.

This entire methodology results in a gradual change in customers' bills and still maintains the same cost relationship among customer classes as shown in the uniform ROR cost allocation studies. Most importantly, this methodology has been used by the Commission to successfully address rate shock concerns in the past.

The State has proposed the same methodology in this case to be used in mitigating the disparate rate impacts as shown in the uniform ROR cost allocation studies based on TCC's proposed increases for its T&D rates. The State urges that, if there is an overall rate increase in this proceeding, the Commission use the complete methodology that was used by the Commission in the past and is

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31 *Application of Texas Electric Service Co.*, Docket No. 527, 3 P.U.C. Bull. 514 (Nov. 2, 1977).

proposed by the State in this proceeding to mitigate the disparate rate impacts among customer classes.

The following table demonstrates the rate impacts among customer classes for the distribution and metering functions that would be imposed by the implementation of the State's proposed gradualism methodology.[32]

CLASS	DISTRIBUTION FUNCTION	METERING FUNCTION
Residential	20	36
Secondary GS<=10kW	18	24
Secondary GS>10kW W/IDR	20	18
Secondary GS>10kW W/O IDR	20	18
Primary W/IDR	26	16
Primary W/O IDR	26	16
Transmission	62	3.2
Lighting	16	0
TOTAL	21	30

The State's methodology would result in a gradual change in customers' distribution and metering charges but would still maintain the same cost-causation relationship among customer classes as indicated by the cost allocation studies. [33]

The State submits that its rate design, based on gradualism, is more desirable and reasonable than that proposed by TCC, which is based strictly on cost of service allocations without applying

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32 This methodology includes all the steps described earlier and a maximum cap of 3 times and 1.5 times the system-wide increase for the distribution and metering functions, respectively. State's Ex. No. 1.

33 State's Ex. No. 1, Schedule-State-KP-1.6 - Total.

gradualism. The chart below shows the difference, on a percentage basis, between the gradualism increase proposed by the State and the direct cost of service application increase proposed by the TCC:

DISTRIBUTION FUNCTION			METERING FUNCTION	
CLASS	**TCC**	**STATE**	**TCC**	**STATE**
RESIDENTIAL	18	20	23	36
SECONDARY GS<=10kW	29	18	24	24
SECONDARY GS>10kW W/IDR	19	20	12	18
SECONDARY GS>10kW W/O IDR	19	20	-15	18
PRIMARY W/IDR	35	26	67	16
PRIMARY W/O IDR	35	26	36	16
TRANSMISSION	91	62	48	3.2
LIGHTING	19	16	0	0
TOTAL	21	21	30	30

5. Proposed Rate Design Methodology if the Commission Orders an Increase in Rates and Decides to Apply Gradualism Only to the Total T&D Bill

The State respectfully recommends that if the Commission orders a rate increase and decides to apply gradualism to the total T&D bill, without first applying it at the functional level, that the Commission provide directions to TCC delineating how the final total T&D revenue requirement for each customer class should be broken into separate revenue requirements for each individual function (transmission, distribution, metering, and customer services).

Applying gradualism only to the total T&D bill, would only create a total T&D revenue requirement for each class to be collected from that class' customers. However, each class's total T&D

revenue requirement, as discussed above, needs to be further broken into four revenue requirements functions: transmission, distribution, metering, and customer services. This is an intra-class cost allocation issue.

In the PFD, the ALJs did not address this issue when recommending the application of gradualism to the total T&D bill. The State strongly urges the Commission to address this issue if it orders a rate increase and decides to apply gradualism only to the total T&D bill. Otherwise, the Company would have unbridled discretion to design rates for each customer class that could affect different subgroups of customers (customers with different load factors) within the same class in disparate ways.

The danger in allowing this to happen is that the rate design for each class will remain controversial between the Company and parties even after the Final Order is signed.

The parties would most likely challenge the Company's proposed rate design when the Company files its compliance tariff to implement the Final Order. To avoid prolonged litigation on this issue, the State urges the Commission to address this issue if it orders a rate increase and decides to apply gradualism only to the total T&D bill.

For the Commission's consideration to address this intra-class rate design issue, the State recommends that the following process be used to determine the revenue requirement for each rate component for each class:

1. The transmission rate should be based on the cost allocation calculated using the 4 CP allocator;
2. The metering charge and the customer charge should be increased no more than 2 times the system average percentage increase for the metering function and the customer function respectively; and
3. The distribution rate revenue requirement should be determined by subtracting the revenues collected from the transmission rate, the metering charge, and the customer charge (as determined in steps 1 and 2 above) from the total revenue requirement for the customer class.

The first step ensures that the allocation of TCC's transmission rates for each class is based on the 4CP allocator. The second step limits the maximum increase that can be imposed on metering and customer charges. The last step determines the revenue requirement for the distribution rate for

each class. The State respectfully submits that this process should be adopted by the Commission so that TCC will have a clear direction regarding rate design for each function.

Conclusion

Based on the arguments made above, the State respectfully submits that the ALJs' treatment of FERC Account 903 should be rejected and the State's methodology accepted, and that the Commission should implement a rate decrease and apply it at the functional level to the customer classes on an equal percentage basis, pursuant to the methodology recommended by the State. In addition, the State respectfully submits that Finding of Fact Nos. 239, and 281-283 should be rejected, and the Findings of Fact and Conclusions of Law related to FERC Account 903 and the rate design for a rate decrease submitted by the State, as reflected in Appendix B, should be adopted instead. Dated July 21, 2004.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the State's Exceptions to the Proposal for Decision in Docket No. 28840 has been served upon all parties of record by hand delivery, facsimile, e-mail, or First Class U.S. Mail, on or before July 21, 2004.

Amalija J. Hodgins

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APPENDIX A

ALJs' FINDINGS OF FACT 281-283

281. The Commission has traditionally applied gradualism constraints in setting rates by limiting the increase in base rates to a range of 1.25 to 2.0 times the system average increase to avoid rate shock.

282. A gradualism constraint should be applied to the total system revenue requirement, not on a function-by-function basis.

283. If TCC is allowed to change rates, then the rates charged to each customer class should move to cost of service, unless the required change falls outside the range of zero to 2.0 times the system average. This gradualism constraint should be applied to the total system revenue requirement.

APPENDIX B

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

Proposed Findings of Fact

FERC Account 903 (Customer Service Billing Costs)

1. The amount of time TCC alleges it takes to process a bill for an IDR-metered customer is an arbitrary estimate and is not based on any written, formal study or analysis.

2. The increased cost proposed to be placed on IDR-metered customers is based on an estimated arbitrary number.

3. The benefits the Company receives from data it acquires through IDR-meters were not taken into account by TCC when it arbitrarily assigned estimated costs to IDR customers.

4. TCC has not identified or quantified actual costs involved in computing bills for IDR-metered customers. It just alleges that it takes longer to process those bills then tries to bootstrap that allegation into the realm of a known and measurable change.

Rate Design Proposed Finding of Fact if a Rate Decrease is Ordered

5. The decrease to TCC's rates should be applied at the functional level on an equal percentage basis to each customer class. This equal percentage application is appropriate, because the result is reasonable and equitable to all customers.

Revenue Allocation and Gradualism (if a rate increase is ordered)

6. Customer class base rate revenues are the revenue levels that base rates are designed to recover from each rate class.

7. The customer class base rate revenue assignment is the process by which the class base rate revenues are determined for each class.

8. Ideally, the results of a cost of service study at a uniform rate of return should be adopted as targeted revenues to be collected from each class. However, accepting the cost of service study "as is" could produce significant adverse impacts on some classes. Therefore, cost of service adjustments may be required.

9. In this Docket, it is necessary to perform customer class base rate revenue assignments for the distribution function and the metering function, because the results of the cost of service studies at a uniform Rate of Return for these two functions produce uneven increases among classes. Adjustments are needed to mitigate disparate impacts among customer classes.

10. In almost all of the rate cases decided by the Commission during the last decade, until the UCOS cases filed in 2000, the performance of class base rate revenue assignments has been a significant part of the cost allocation and rate design process.

11. In prior rate case, rate impacts, rate shock and gradualism were always of primary concern in designing rates.

12. Customer class base rate revenue assignments were not done in the UCOS cases, because those cases were primarily intended to unbundle and determine the transmission and distribution rates that previously had been bundled into one rate along with the generation rate.

13. There were no benchmark transmission and distribution rates to use for comparison purposes in the UCOS cases.

14. The transmission and distribution rates established in the UCOS cases have now become the benchmark case.

15. Rate shock and the avoidance of large increases relative to system-wide increases are still of concern to the Commission..

16. In light of the uneven bill impacts shown in the State's cost allocation study in this Docket, it is reasonable for the Commission to perform customer class base rate revenue assignments to determine final class revenue requirements in this Docket.

17. Until new load data is developed, to mitigate rate shock to a number of customer classes and to promote gradualism, it is reasonable for the Commission to adopt the revenue requirements assignments proposed by the State.

18. Controversial assumptions are made in cost of service studies. When cost of service studies result in disparate impacts among customer classes revenue requirement reassignments are required to avoid rate shock and ensure reasonable rates.

19. Gradualism should be applied at the functional level.

20. The entire gradualism methodology proposed by the State should be adopted.

Proposed Conclusions of Law

1. P.U.C. Subst. R. 25.231(a) provides that rates shall be based upon a utility's cost of rendering service to the public during a historical test year adjusted for known and measurable changes. The adjustment TCC proposes to make to FERC Account 903 is not based on a known and measurable change and should therefore be denied.
2. Applying an equal percentage increase to each customer class, pursuant to the methodology proposed by the State, will result in just and reasonable rates consistent with the requirements of PURA §