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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 PUBLIC UTILITY COMMISSION OF TEXAS
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**REPLY OF AEP TEXAS CENTRAL COMPANY TO JOINT RESPONSE
OF THE STATE OF TEXAS AND THE COALITION OF COMMERCIAL
RATEPAYERS TO AEP-TCC NUMBER RUNS, AND RELATED MOTIONS
REGARDING COST ALLOCATION**

TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

AEP Texas Central Company ("TCC"), Applicant herein, respectfully submits its Reply to the Joint Pleading of the State of Texas and the Coalition of Commercial Ratepayers (hereafter, the Joint Pleading) concerning the application of "gradualism" in designing T&D rates in this case. In support, TCC shows as follows:

A. Introduction

The Joint Pleading raises the issue of whether and how to apply principles of gradualism in establishing T&D rates. The allocation among customer classes of TCC's revenue requirement in the most recent number runs includes all of the Commission's decisions to date (plus the proposed settlement of affiliate costs), with TCC's overall revenue requirement allocated to each customer class based on the cost to serve that class. In general, gradualism is a rate design concept whereby this cost-based approach to allocation is altered, and a portion of a particular class's assigned costs are shifted to other classes, in an effort to moderate what may be seen as excessive rate impacts for a particular class. TCC believes that gradualism as proposed in the Joint Pleading is an unnecessary and unwise policy.

TCC believes that the Commission's current T&D rate design policy, reflected in its Order No. 40 from the UCOS generic docket, exhibits a preference for designing rates based on

the cost to serve each of the generic T&D customer classes, absent extraordinary impacts on an end use customer's ability to access the competitive market. The competitive market is best served when T&D rates are set so that REPs know the true cost of serving the various customer classes, and when no class of customers is subsidizing any other class. The REPs, not the T&D company, should be the ones to take steps regarding gradualism which they think are appropriate to provide competitive retail rates. REPs are in a much better position to utilize gradualism since they work with the total electricity bill, while T&D service is only about 25% of that bill.

In addition, the Joint Pleading applies gradualism principles in an inappropriate manner. Gradualism constraints have historically been applied to each rate class as a whole. The Joint Pleading instead proposes to create several new, additional sub-classes within the generic customer classes established for T&D service in the UCOS proceedings and to apply gradualism constraints to this novel, expanded set of customer classes. This approach is contrary to the generic classes established by the Commission for purposes of setting T&D rates. Adoption of this approach, moreover, could well open the door to future complex and contentious litigation regarding gradualism, as more and more perceived cost disparities become fair game for contention. For these reasons, the gradualism proposal in the Joint Pleading should be rejected.

B. Setting T&D Rates Does Not Require Imposition Of Gradualism Constraints

The approach of the Joint Pleading is to point out that primary customers with IDR meters receive a much larger percentage rate increase than do other customers, then to characterize this situation as "stark and disturbing" and ask the Commission to remedy it by reallocating some of the costs to serve these customers to other customer classes. The fact that customers with IDR meters have a change in base rates that is relatively larger than other customers in the rate class does not, per se, indicate that the change is inappropriate. The Joint

Pleading does not argue that the proposed rates for IDR customers are incorrect, nor does it challenge the fact that TCC's proposed rate design is based on more accurate, historical data than its current rate design, which was based on forecast data from the UCOS proceedings.¹ If anything, the change in IDR customers' rates may simply be remedying an inequity in the past where these customers were paying well less than the cost to serve them.²

This context is important to consider in light of the Commission's preference for cost based T&D rates.³ Order No. 40 in the UCOS Generic Docket (Docket No. 22344) establishes the Commission's unbundled T&D policy. It makes no mention of gradualism. Order No. 40 determines that exceptions to the generic customer classes and rate design adopted therein (which TCC has followed in this case) will be considered "only if necessary to address extraordinary impacts on the ability of customers to obtain service from a competitive provider...." The Joint Pleading does not raise such a concern.

Basing T&D class cost allocations on the actual cost of serving each class, without gradualism constraints, is conducive to the efficient operation of the competitive retail market. The REPs, not the end use customers, are the entities that TCC is charging for T&D utility service. The REPs need to know the true cost of serving their various classes of end use customers. For example, providing metering services is competitive. If the T&D meter charge does not reflect the true cost to serve, the market for that service may be distorted. If gradualism is to be employed, it should be employed only by the REPs, as they establish their retail rates in pursuit of their diverse marketing and business objectives. They, not the T&D companies, are

¹ TCC Exh. 90 at 21.

² See Transcript 10 at 2137-38 (Pevoto Cross).

³ See, e.g., OPC Exh. 3 at 15 ("During the UCOS cases in 2001, the Commission emphasized the need to set cost-based TDU rates. The Commission considered exceptions only for headroom exceptions.").

the entities that know the impact of the overall electricity bills on their various customer classes and, accordingly, are best situated to determine if gradualism is needed or desirable.

Keep in mind that gradualism by its very nature is designed to result in some classes (the ones to whom costs are shifted) subsidizing others (the ones from whom costs are shifted). The Joint Pleading, for instance, proposes shifting an additional \$1.05 million to residential customers above the cost of providing T&D service to those customers. An undesirable impact of applying gradualism thus could be that REPs are drawn more to providing service to customer classes who appear attractive because the cost of their T&D service is being subsidized by other customer classes.

C. The Joint Pleading Improperly Applies Gradualism Principles

As established in Order No. 40, the Commission's existing policy for T&D ratesetting involves allocating the cost of T&D service, and designing rates, for the Commission-designated generic customer classes set out in that order. The Joint Pleading's gradualism proposal runs contrary to this policy, by splitting both the "primary" and "secondary > 10kW" generic classes into two sub-classes (those customers with and without IDR meters). Then, the Joint Pleading applies principles of gradualism to reallocate the overall revenue requirement among the customer classes, including the four new sub-classes.⁴

As far as TCC is aware, the Commission has in the past applied gradualism constraints only on an overall class-by-class basis.⁵ The proposal in the Joint Pleading to create new sub-classes is inconsistent with the Commission's policy that T&D rates be standardized, and creates new T&D customer classes not authorized by existing Commission precedent and policy.

⁴ See graphs attached to Joint Pleading.

⁵ The ALJs' Proposal For Decision applies a "Two times" gradualism constraint based on the existing Commission-designated generic classes, not the sub-classes added by the Joint Pleading. PFD at 180-181.

Moreover, the approach of the Joint Pleading is a recipe for unwarranted complexity and increased litigation in the area of T&D rate design. If the generic rate classes can be expanded in this case in the name of gradualism, then who is to say that in the next T&D case, parties may not propose multiple sub-divisions of the T&D rate classes as necessary to address gradualism concerns; or, as an alternative approach, parties could seek to impose gradualism only on selected T&D functions or categories of costs.⁶ Such complexity and departure from cost of service principles should not be invited by the Commission. For all these reasons, TCC respectfully submits that the gradualism proposal in the Joint Pleading should be rejected.

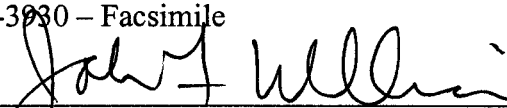
⁶ Indeed, the State initially made this type of proposal, which was rejected by the ALJs. PFD at 180.

Respectfully submitted,

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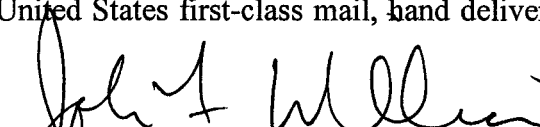
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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document was served on all parties of record on this 13th day of June, 2005 by United States first-class mail, hand delivery, and/or facsimile.


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