Q PLEASE STATE YOUR NAME AND ADDRESS.

A My name is Robert M. Gross, Jr. My business address is 1000 Crescent Avenue, N.E., Atlanta, Georgia 30309.

Q WHAT IS YOUR EDUCATIONAL BACKGROUND?

A I graduated from Georgia Institute of Technology in 1965 receiving the degree of Bachelor of Industrial Engineering. I also attended Georgia State University and in 1971 received the degree of Master of Business Administration, majoring in finance.

Q PLEASE STATE YOUR PROFESSIONAL EXPERIENCE.

A I have been employed by Southern Engineering Company of Georgia for approximately ten years. During this time I have been involved in the preparation of cost of service studies of Class A and B investor-owned utilities, rural electric cooperatives and municipal electric systems and have participated in wholesale and retail electric rate consulting assignments in 23 states. I am a registered professional engineer in the State of Georgia.

Q HAVE YOU EVER TESTIFIED IN OTHER COMMISSION PROCEEDINGS?

A Yes, I have testified as a rate expert and cost of service witness before the State Commissions of Kentucky, Indiana, Michigan, Vermont, Virginia, and Arizona. I have also testified before the Federal Power Commission (now Federal Energy Regulatory Commission) in proceedings involving Mississippi Power Company, Appalachian Power Company, Duke Power Company, Gulf States Utilities Company, Gulf Power Company, Virginia Electric & Power Company, Arizona Public Service Company, Public Service Company of Indiana, Inc., Carolina Power and Light, and

7909260216

1 Southern California Edison Company.

2 Q WOULD YOU PLEASE EXPLAIN YOUR ASSIGNMENT CONCERNING THE ISSUES SUBJECT

3 TO REMAND?

4 A I have studied the costs included in Texas Power and Light Company's

5 (TP&L) monthly fuel cost adjustment charges resulting from payments

6 to affiliated companies. Specifically, I examined the costs which are

7 included in the monthly billings from Texas Utilities Generating Company

8 (TUGCO)and Texas Utilities Fuel Company (TUFCO) to Texas Power and Light

9 which in turn are passed on to the ultimate electric customer in the

10 form of automatic fuel adjustment charges.

11 Q MR. GROSS, BEFORE GOING INTO A DETAILED EXPLANATION OF THE MECHANICS

12 OF TP&L'S FUEL CLAUSE PROVISIONS WHICH ALLOW AFFILIATED COSTS TO BE

13 PASSED ON TO THE ULTIMATE CONSUMER, WOULD YOU PLEASE PROVIDE A BRIEF

14 SUMMARY OF HOW FUEL ADJUSTMENT PROVISIONS EVOLVED AS A RATEMAKING

15 DEVICE IN THE ELECTRIC UTILITY INDUSTRY?

16 A Automatic adjustment provisions have been used in electric utility

17 ratemaking periodically for the last fifty years. During periods of

18 fuel price stability, fuel clauses have tended to disappear, whereas

19 during periods of fuel price volatility, fuel adjustment provisions

20 reappear in electric utility rates for a number of sound reasons.

21 When the price of fuel becomes subject to volatile changes over short

22 time periods it becomes impractical, from a ratemaking standpoint,

23 to establish fixed electric charges because the charges either result

24 in a significant over recovery or a significant under recovery of

25 actual costs. In such cases, rates either would be too low or too high,

depending upon the level of fuel costs. When the price of fuel is a result of industry market pressures and thereby, beyond the direct control of a utility and when the price is subject to short term volatility, regulatory commissions have found it reasonable to incorporate fuel adjustment provisions in electric utility tariffs.

Recently, however, the rote application of automatic fuel adjustment clauses by utilities has been challenged by state regulators and consumer groups throughout the country. The primary reason for this opposition has been, I believe, because of the grass root opposition of electric ratepayers to spiralling electric utility bills caused by higher fuel costs. The knee jerk reaction of many people is to simply outlaw fuel adjustment provisions, as has been done in some states, hoping that the problem will disappear. Of course, it does not.

From a more practical standpoint, some state regulators have restricted the applicability of fuel adjustment provisions. For example, state commissions in North Carolina, Virginia, and Arizona, adopted regulations whereby the automatic flow through of fuel costs to the ultimate customer on a monthly basis was eliminated. The automatic adjustment feature was replaced by procedures which require a utility to forecast fuel costs from time to time (6 months to a year) in formal hearings; the fuel recovery component is thus included in the fixed rate, rather than being allowed to fluctuate from month to month. In these states, the commissions gave more weight to providing an incentive to utilities for efficient fuel acquisition and less weight to the ratemaking flexibility produced by automatic fuel

escalatory provisions.

Q DO YOU BELIEVE THAT SPECIAL CONSIDERATION SHOULD BE GIVEN TO TRANSACTIONS BETWEEN ELECTRIC UTILITIES AND THEIR FUEL SUBSIDIARIES AND AFFILIATES?

A Yes, because transactions between affiliated companies are not arms length transactions. In this case, for instance, managements of TP&L and its sister operating companies directly control the price structure of TUFCO's own oil and gas and of TUGO's lignite, and thus, the transactions which ultimately impact the fuel adjustment provision. Because of this direct control, the price of owned fuel and fuel services from the fuel subsidiaries will not be subject to the same market pressures that would exist if TP&L were buying that fuel and those fuel services from non-affiliated fuel suppliers.

Q WILL YOU DESCRIBE HOW TUFCO AND TUGCO BILL TP&L AND THE OTHER OPERATING COMPANIES FOR THE FUEL SERVICES RENDERED?

A Texas Utilities Fuel Company (TUFCO) prorates its costs to the three operating companies on three bases. Non-assigned lignite exploration costs, credits for gains on off-system sales of excess gas and a minimum monthly fee of $480,000 are prorated to the operating companies on an equal basis of 1/3 to each. Oil acquisition costs and certain other specifically identified items are billed in proportion to the service rendered each company. The remaining costs incurred by TUFCO are prorated to the operating companies based upon their proportional takes of gas.

As shown on Exhibit 1, costs prorated on a proportional basis include fuel gas purchases, operation and maintenance expense, depreciation and

1 depletion expense, taxes, and interest expense (net of the $480,000 minimum)
2 incurred by TUFCO and advance payments to TUFCO for exploration and
3 development. All of these costs, once billed to the operating companies,
4 are in turn recovered from the ultimate customer through the operating
5 companies' fuel adjustment clauses. I find this aspect of the treatment
6 of TUFCO's charges to be improper and inconsistent with the rationale
7 for fuel adjustment provisions because these costs are relatively
8 non-volatile. TUFCO's monthly costs incurred in operating and maintaining
9 its facilities, depreciating its facilities, and owning such facilities,
10 i.e., taxes and interest expense, are the type of expenses that should
11 not be flowed through an automatic fuel adjustment provision. These
12 costs are known and measurable and are not subject to significant short
13 run unknown changes. To the extent that these costs are the result of
14 management prerogative and are closely controlled, they are no different
15 from fixed costs incurred by TP&L itself.
16 Q IF THESE TUFCO CHARGES TO THE OPERATING COMPANIES ARE NOT RECOVERED
17 THROUGH THE OPERATING COMPANIES' FUEL ADJUSTMENT PROVISION, HOW WOULD
18 THEY BE RECOVERED?
19 A These charges should be recovered in the same manner that TP&L's own
20 fixed costs are recovered: through the base rates, and as a result of
21 a properly justified cost of service study.
22 Q DO YOU BELIEVE THAT RECOVERY OF THESE COSTS THROUGH BASE RATES WOULD
23 IMPOSE A HARDSHIP ON TP&L WHICH COULD ULTIMATELY RESULT IN LESS THAN
24 COMPENSATORY RATES?
25 A No. Any cost changes should be known by TP&L in advance and thus be

1 includable in its filed cost of service study supporting base rate
2 charges on the same basis that TP&L now reflects other known and measure-
3 able changes of its operations in its filed cost of service study.
4 I would suggest that cost recovery through base rates be applied
5 to TUFCO's operation and maintenance expense, depreciation expense,
6 tax expense and interest expense. The only item of TUFCO's expenses
7 that should continue to be reflected in the fuel adjustment provision
8 of the operating companies is TUFCO's fuel gas purchases from non-
9 affiliated producers. This item apparently is subject to market pressures
10 and some volatility and, therefore, is not fixed or subject to the
11 exclusive control of TP&L management as are the other TUFCO expenses
12 and it alone varies with fuel consumption.
13 Q WILL YOU DISCUSS TUGCO'S BILLING PRACTICES?
14 A Texas Utilities Generating Company (TUGCO) in engaged in a multi-
15 faceted operation which includes fuel related operations and transactions.
16 TUGCO is responsible for the mining and transportation of lignite fuel
17 required for th operation of the jointly owned lignite units at
18 Big Brown, Monticello and Martin Lake.
19 Exhibit 2 shows a typical TUGCO monthly bill. This particular bill
20 is for TP&L's share of TUGCO's costs at the Martin Lake Steam Electric
21 Station during October, 1977. It can be seen from this bill that TUGCO
22 uses the FERC Uniform System of Accounts to itemize its costs for billing
23 purposes, including the cost of fuel charged to Account 501. These TUGCO
24 Account 501 costs are in turn passed on by TP&L through its fuel adjustment
25 provision to the ultimate customer.

1 Q WOULD YOU PLEASE D. CRIBE THE "COSTS" WHICH ARE INCLUDED IN TUGCO'S
2 ACCOUNT 501?
3 A Exhibit 3 shows a detailed breakdown of the lignite component of
4 Account 501 for the Big Brown station which is typical. This exhibit
5 shows that included in Account 501 are amounts for fuel production,
6 operation, maintenance, depreciation, federal income tax credits, taxes,
7 interest expense, plus additional amounts for fuel handling, ash disposal,
8 fuel treatment, and rail transportation, if applicable. While some of
9 these expenses such as rail transportation may vary directly with the
10 quantity of lignite fuel that is consumed at the station, it is certain
11 that some of these costs do not vary at all with consumption and are,
12 therefore, fixed. Others, such as labor, may vary either directly with
13 production or be fixed. Examples of more-or-less fixed costs are
14 maintenance expense, depreciation expense, federal income tax credits,
15 property taxes, and interest expense. All are unrelated to the month
16 to month consumption of fuel at the plant. Since these costs are
17 unrelated to the level of commodity usage and monthly consumption,
18 they at least should be separated from Account 501 and recovered through
19 TP&L's base rates rather than through the fuel adjustment provision.
20 Q DO YOU FORESEE ANY DIFFICULTY IF PORTIONS OF TUGCO'S ACCOUNT 501 WERE
21 RECOVERED THROUGH TP&L'S BASE RATES RATHER THAN THROUGH THE MONTHLY
22 FUEL CLAUSE PROVISION?
23 A No. TUGCO's costs associated with operation and maintenance of the lignite
24 units do not flow through the fuel adjustment provision but are included
25 in the operating companies base rate. For exactly the same reasons,

1 TUGCO's fixed cost incurred in its lignite operations should also be
2 included in the base rates rather than added into the amounts to be
3 recovered through the automatic fuel adjustment provision.
4 Q MR. GROSS, ARE THERE OTHER REASONS WHY THESE AFFILIATED COMPANY FIXED
5 COSTS SHOULD NOT BE FLOWED THROUGH TP&L'S FUEL CLAUSE?
6 A Yes. Since TUFCO and TUGCO are closely controlled by TP&L's management,
7 it is totally inconsistent to allow their fixed costs to flow through
8 unregulated to the ultimate customer through an automatic escalatory
9 clause while TP&L's own fixed costs are allowed to be recovered only
10 through regulated base rates. The customer should not be subjected to
11 rate increases caused by increases in TUFCO's and TUGCO's fixed costs
12 when such costs are not scrutinized by the Commission through the normal
13 cost of service filing requirements. It is obvious that the existence
14 of the fuel affiliates presently provides TP&L with an opportunity to
15 avoid regulation with respect to portions of its operations because
16 affiliated fixed costs are now being recovered through an automatic
17 fuel adjustment provision. TP&L has an open ended ability to pass on
18 TUFCO and TUGCO fixed fuel costs.
19 Q MR. GROSS, WHAT IS YOUR OPINION OF TP&L'S COMMENT THAT AS LONG AS THE
20 PRICE OF FUEL FROM THE AFFILIATES IS LESS THAN THE MARKET PRICE, THEN
21 THE COMMISSION SHOULD HAVE A "HANDS OFF" ATTITUDE TOWARD AFFILIATED
22 COMPANIES?
23 A The affiliated costs that we have been discussing are items within the
24 control of TP&L and as such certainly there should be some incentive for
25 TP&L to closely manage them. The rather nebulous market measure espoused

in the company's rationale does not provide this incentive. From a rate-payers standpoint, there should be as much incentive as possible given to TP&L to keep these fixed costs to a minimum. In my opinion, this incentive can be best employed through the elimination of the fuel clause that allows TP&L automatic rate increases for cost items that should be the subject of commission hearings.

Q DOES THAT CONCLUDE YOUR TESTIMONY?

A Yes.