



Data Foundry, Inc.

1044 Liberty Park Dr.
Austin, Texas 78746
Tel: (512) 684-9700
Fax: (512) 684-9701

<http://www.datafoundry.com>

Testimony presented to the Senate Business and Commerce Committee

COMMITTEE: Business & Commerce
TIME & DATE: 10:00 AM, Tuesday, July 10, 2012
PLACE: E1.016 (Hearing Room)
CHAIR: Senator John Carona

Charge: Study the relationship between city governments and municipally-owned utilities, including any duplicative or redundant functions, the amounts and justifications required for transfer payments between entities, and the benefits and disadvantages of alternative governance structures.

Good Morning and thanks for allowing us to have input to the charge regarding municipally-owned utilities. My name is Shane Menking and I am Data Foundry's President and CFO. Data Foundry (DF) is a leading provider of data center outsourcing, secure collocation and disaster recovery. Last summer, we completed the initial phase of our 250,000 square foot data center in Austin. We use electricity, which is the main ingredient of our business, very efficiently and the cost of electricity affects our ability to compete with data centers all over the world. We are concerned that dramatic increases in Austin Energy's rates will affect our ability to grow and hire additional employees. We are currently on a contract rate, as is the State of Texas for their facilities in Austin, but these contracts will expire in 2015 and will be replaced by a 15% increase resulting from the Austin City Council's adoption of the rate ordinance on June 7. We believe that the rates are inflated because of inappropriate cost and due to the lack of AE's independence from the City of Austin and think **it is time to consider creating an independent board for AE similar to the CPS Energy Board.**

We believe that the costs shifting and duplication of services between the City government and AE is enabled because of the current governance structure. AE is a city department and AE's General Manager reports to City Manager who works at the pleasure of the City Council. This



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structure enables the City of Austin to use the most successful revenue producing function, the electric utility, of the city as a constant and ready source of funding above the amount of funding provided by the general fund transfer.

In an environment of limited fiscal resources the City will always look to AE to fund activities in lieu of using tax payer funded general funds and which in many cases have no apparent value to AE. Finally, the Council's political influences in many ways impact AE operations. AE needs to be shielded from these influences and independent to make day to day operating decisions. We are hopeful that the utility can be truly independent of the City and become efficient and competitive while providing representation from all areas of the service territory.

We have participated in the rate case proceedings for over eighteen months and worked with members of the environmental community, consumer support groups, business organizations and others as we went through this lengthy and complex process. We have made dozens of information requests to Austin Energy, a freedom of information request for opinion from the Attorney General and attended hundreds of hours of meetings.

We concentrated on the revenue requirement portion of the case and the validity of some of the items that Austin Energy included which we believe did not meet the rate making standards practices before the Public Utility Commission of Texas (PUCT). The Council's final ordinance reduced the revenue requirement from \$126 million originally requested by Austin Energy to \$71 million. The Mayor and Council did a good job working with the information before them but we think that the PUCT will find other expenses that do not meet its standards for inclusion in rates.

We have outlined some of the observations that are the subject of the charge and that led us to our recommendation.

Transfers—AE Transfers to the General Government

- **General Fund Transfer**—It is common for municipally owned utilities to transfer money to its owner municipality for compensation of ownership. To the extent the transfer amount (percentage) is not spelled out in trust indentures or Bond Ordinances, the transfer should be reasonable and comparable to amounts a private utility (IOU) would pay for franchise fees and property taxes to the local government. Additionally, AE (and City of Austin, as owner) should also be entitled to earn a reasonable return on equity.
- A survey paid for by AE and conducted by Navigant Consulting showed that the general fund transfers among municipally owned utilities in Texas are varied and range from a high in San Antonio of 14% of gross revenue from both the gas and electric utility to a low of 1% for Denton. The City of Austin transfer policy is set by City Council and allows for up to 12% of a three years rolling average of gross revenue. However, the Council opted to set the percentage at 9% since 1999. As a result of the rate review, the City of Austin will cap the transfer at \$105 million which was the amount of the transfer in this fiscal year.
- **Administrative and Services Transfers**—In addition to the general fund transfer, AE also transfers money to the general government for services performed for other city departments such as accounting, budgeting, fleet, information systems and Mayor and Council. We believe administrative transfers must be reasonable and justified based on third party (or City auditor) reviews assuring that payments are comparable to “arm’s length transactions” for similar services. Payments to the City that have no apparent value to AE should be discontinued and disallowed for rate making purposes. These transfers are not as common or as large in other municipally electric utilities. AE also maintains staff that is required to interface with the city departments that perform these functions.
- **Economic Development**—AE’s last fiscal year budget included a transfer to support economic develop of \$10 million. The funds go to another city department tasked with

conducting programs to encourage economic development. The theory behind electric utilities supporting economic development is that the new growth in kWh sales would offset funds expended. The amount of the transfer was included in the operations and maintenance level used to set the rates in the recent case. We would like to see if the level of annual expenditures in the test year and growth in kWh sales supports the theory that all ratepayers are benefiting through expanded electricity of this magnitude. The justification was not provided in the City case. At the end of the Council's work sessions, city staff was considering charging other city departments for supporting economic development efforts in next year's budget however the reduction of AE's support was not included in the rate ordinance.

- Municipal Street Lighting-- AE proposed and the City Council adopted eliminating the municipal "Traffic Signal and Street Lighting" tariff and rate class. Instead of billing the City of Austin and other municipalities for this service, "Service Area Street Lighting" is included as a "Community Benefit". As of October 1st, the cost to provide street lights will be billed to all customers as a per kilowatt hour charge. \$10.6 million in cost will be transferred from the City of Austin and other municipal governments to all AE customers. AE's new rates allocate \$4.4 million of this cost to the residential class and an additional \$3.3 million to commercial accounts with greater than 50 kW. This includes schools, medium size retail and small to medium-sized office buildings. All the other customers will pay the remaining \$2.9 million in street lighting costs.

AE has not been paid for the street lighting service by the City of Austin, but they have been billing the rest of the municipalities in their service area receiving street lighting and traffic signal service from AE. AE's proposed street lighting treatment is another, although less apparent benefit (transfer), to the City of Austin and is not a common practice among private or public utilities in Texas. CPS Energy (San Antonio) deducts the cost of street lighting service from its general fund transfer to the City of San Antonio. City governments should be responsible for street lighting as is the case in every other major



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metropolitan area in Texas. AE will be charging customers that may not even have access to street lighting services, much less be able to decide if they want that service or not.

Other Charges for Expenses Not Related to Electricity

General rate making principles require that only the expenses and expenditures related to the provision of electricity are to be included in the rates to electricity customers. AE has funded many programs that benefit various civic and charitable activities. AE has also funded employees in other city departments that do not have to perform duties related to the provision of electricity.

In addition, AE has constructed and maintains assets that do not directly benefit the general ratepayers of Austin. During the city case, AE refused to provide any information concerning the district cooling facility, or the distributed generation facilities at the Dell Children's Hospital and the Domain. AE's reason was that these assets and expenses were not related to its core business. It is clear however, that funding for these activities is from AE but past bonds or cash investments in these assets were not disclosed.

These are examples of cost shifting and duplication of services between the City government and AE. We believe these transactions and activities are enabled because of the current governance structure. AE is a city department and AE's General Manager reports to City Manager who works at the pleasure of the City Council. AE must act as a city department and as such must follow city accounting, budgeting and purchasing rules. The utility functions and needs are very different than a general fund department such as public safety or public works. AE needs to have accounting, finance, purchasing and salary systems comparable to the best



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municipal owned utilities in order to compete with the best for talent and customers in an increasingly competitive environment in Texas.

Currently, the Austin City Council serves as the board of directors for AE. The City has an appointed Electric Utility Commission which serves as advisor to the City Council for purchasing equipment and contracts and during this rate review, the first since 1994. The Mayor and City Council did a remarkable job trying to become electric rate experts in a 6 month time frame. However, the Texas electric market is now very complex and the City Council must manage many more complex issues dealing with general government. **It is time to consider creating an independent board for AE similar to the CPS Energy Board.** Several current members of the current Electric Utility Commission have stated their support for this move.

CPS Energy Board has five members, Mayor and four members from four geographic quadrants of the service area. CPS must seek Council approval of rates, bonds, eminent domain and approval of Board nominated Board candidates. CPS Board candidates must meet minimum qualifications for business and accounting and finance experience. (CPS Board has an audit and finance committee and Chair of committee must have accounting and finance background). CPS staff conducts searches and assures that candidates meet minimum qualifications. The Board screens and interviews candidates and then nominates a Board candidate for the Mayor to take to the City Council for final approval. If Council denies two consecutive selections then the City Council can then select a Board member. The Board is responsible for the day to day operations of the utility and is not a City department subject to City pay, purchasing, accounting and budgeting practices.

We appreciate the Committee's review of these important matters. We understand that there will be differences between AE and CPS Energy but are hopeful that the utility can be truly independent of the City and become efficient and competitive while providing representation



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from all areas of the service territory. Please let us know if we can provide additional information.

Thank you for your time and consideration.