

MCRHOT TOPIC »

LEAVING TCOS DOLLARS ON THE TABLE: IS IT TIME TO FILE?

For the first time since the Public Utility Commission of Texas (PUCT) changed the non-investor-owned utility transmission cost of service (TCOS) rate filing package in 2021, transmission owners (TOs) in the Electric Reliability Council of Texas (ERCOT) now have clarity on calculating rates of return for TCOS filings.

Recent decisions in TCOS filings from the Lower Colorado River Authority and Lubbock Power & Light provide examples of successful requests for debt service coverage adders. In both cases, the PUCT approved the requested adder of 25 basis points to DSC based on the TOs' evidence of need for increased margins to protect credit ratings and fund substantial future transmission investments.

With this new roadmap for TOs to protect the rate of return on rate base earned in their TCOS rates, TOs should consider whether this is the right time to file a new rate case.

Two Avenues for Cost Recovery

TOs in ERCOT have two avenues to increase recovery of their transmission system costs: interim updates and full TCOS filings. Interim updates allow TOs to update their invested capital, return on rate base, and transmission depreciation expense by updating their net plant balances. In fact, 28 of the 35 municipal and cooperative TOs in ERCOT set their current TCOS rate via an interim update. Interim updates require less effort to obtain additional revenue for their transmission assets and do not require the TO to prove the necessity and reasonableness of the plant additions.

However, interim updates do not allow the TO to increase the amount of recovery for expenses. Only *full* TCOS filings can change administrative and general (A&G) or operation and maintenance (O&M) expenses in a TO's TCOS rate, set a new rate of return on rate base, or increase the amount of general plant to be recovered in rate base. On average, the ERCOT cooperative TO's last TCOS filing was approved in 2011, while on average the ERCOT municipal utility last filed a TCOS in 2015.

The Erosion of Returns and the Case for Full TCOS Filings

Many things have changed for cooperatives and municipal utilities between 2011 and now, including generation resources, physical security and cybersecurity requirements, and ERCOT’s reliability and load dispatching requirements, as well as load growth, inflation, aging equipment, and increased staffing.

Through detailed research into cooperative and municipal utility TCOS filings and ERCOT earnings reports, MCR has identified key data points regarding cooperative and municipal TCOS rates. For example, the median cooperative TO approved rate of return on rate base is 6.64%, but the median actual return earned by ERCOT cooperatives reported in 2024 earnings reports is only 4.17%, an under-earning of 2.47% on rate base. Similarly, the median municipal approved rate of return is 7.49%, while in 2024 the median municipal earned rate of return was 5.68%—an under-earning of 1.81%.

In the 10 to 15 years since most TOs have filed a full TCOS filing, many factors have combined to erode the earned return, including inflation’s impact on costs, increased head count for O&M teams, and recent increases in the cost of debt. Many TOs have also invested in new headquarters buildings and are not earning a return or receiving depreciation expense on these investments due to the inability to update general plant balances in interim filings.

O&M and A&G Rate Impacts

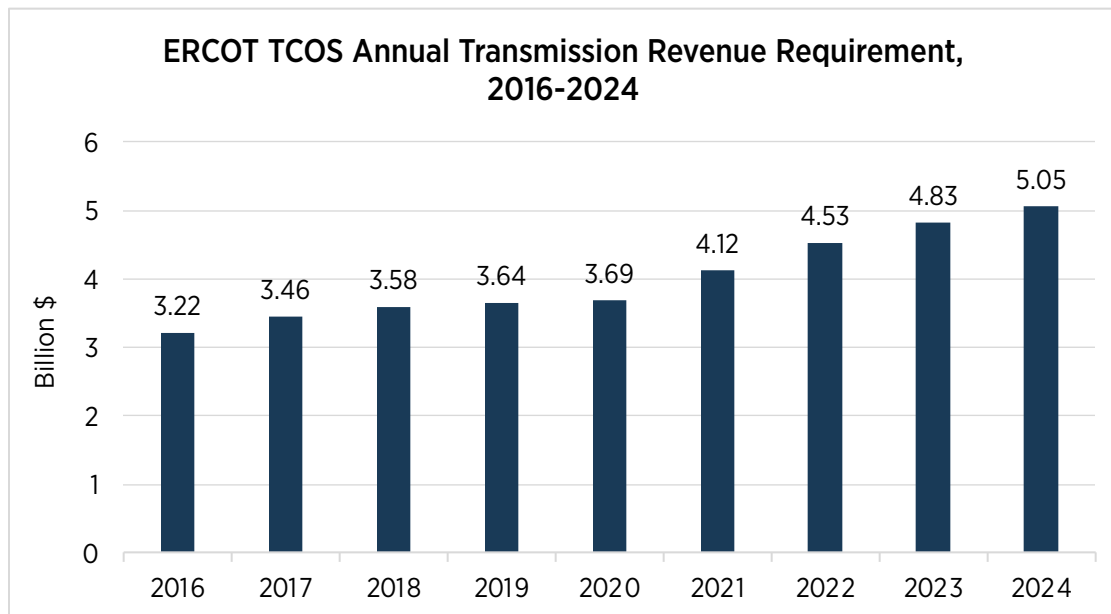
O&M and A&G expenses are a key driver of eroding TCOS returns. MCR recently researched O&M and A&G expenses in each ERCOT cooperative or municipal TO’s last TCOS filing and compared it to the values recorded in the 2024 earnings report. The results showed that cooperative TOs have seen a median increase of 172% in combined recoverable transmission O&M expenses and allocated recoverable distribution O&M expenses since their last filing. Cooperative TOs have also seen a median increase of 45% in allocated A&G costs over that period. These increased expenses are not being recovered in current TCOS rates. As indicated in the table below, accounting for these O&M and A&G increases in a new full TCOS rate case would result in an annual increase of \$319,732 in O&M and a \$27,490 increase in A&G dollars in TCOS recovery.

	O&M, Filed	O&M, 2024	Change (\$)	Change (%)	A&G, Filed	A&G, 2024	Change (\$)	Change (%)
Cooperative, Average	1,623,547	2,851,904	1,228,357	86%	994,287	1,549,950	452,429	56%
Cooperative, Median	103,762	423,494	319,732	172%	60,529	88,019	27,490	45%

The pain that many cooperatives and municipal TOs feel while falling behind in cost recovery is compounded by rising transmission costs driven by investor-owned utilities as they continue to invest in transmission across the ERCOT region. Investor-owned utilities view transmission as an attractive investment due to predictable cost recovery coupled with attractive allowed returns. Indeed, investor-owned utility TOs can capitalize on many drivers for increased transmission investment, including upgrades to aging or retired facilities, load growth, data centers, increased reliability requirements, plant retirements, and renewable



generation. Therefore, as the chart below shows, transmission investment and TCOS revenue requirements in ERCOT have continued to rise, with total TCOS revenue requirements rising more than \$1.8 billion from 2016 to 2024, a 57% increase with a 5.81% compound annual growth rate.



Given this evidence, MCR believes public power and cooperative utilities will continue to experience rising transmission bills for the foreseeable future.

Are You Leaving Money “On the Table”?

Transmission ownership is a strategic business opportunity for public power utilities. By investing in transmission, not only can public power utilities increase reliability at the local load level, but also the utility can earn margin on the investment through a rate of return while sharing the cost with customers other than their own. Even if a TO is not currently investing in new transmission, it is critical to ensure optimum recovery of costs for the transmission systems they currently own.

TOs have many opportunities to increase TCOS revenue recovery. They should start by comparing actual costs to their existing TCOS rate. Then, they should work to recover every dollar of revenue they are entitled to. This will help ensure returns on transmission rate base do not erode. Utilities should also evaluate their rate of return to ensure they are recovering their full cost of debt plus the appropriate margin.

Increasing a utility’s transmission recovery provides an additional benefit to members and ratepayers due to ERCOT’s transmission cost recovery rules. Under the load ratio share rules, a utility pays its load ratio share of its TCOS revenue requirement, meaning that a utility with 0.5% of the ERCOT 4 Coincident Peak load will only pay 0.5% of its own TCOS revenue requirement, while other utilities pay the remaining 99.5%. In this case, the utility’s own ratepayers see all the benefits of increased transmission reliability while only paying a tiny fraction of the increased cost recovery for the utility’s own transmission system.



Is It Time for a New TCOS Filing?

Public power decision makers should ask themselves some important questions as they evaluate their TCOS rates and recovery:

- What amount of transmission and distribution O&M expense was recovered in the last TCOS case?
 - » Has the utility added significant transmission O&M expenses, including head count, increased costs due to inflationary pressures, or new services like a transmission operations center, since the last TCOS case?
 - » Do distribution substations receive service at 60 kilovolts or greater, and if so, are O&M expenses shared between distribution and transmission accounts?
- How much have A&G expenses increased over the amount included in the last TCOS case?
- Has the utility moved to a new headquarters building or expanded its existing facility since the last TCOS case?
- Has the utility's debt service increased with the issuance of new debt at higher interest rates since the last TCOS case?

MCR has years of experience working with public power clients in ERCOT to set transmission rates and ensure optimum transmission cost recovery. MCR has successfully assisted clients in ERCOT by developing and testifying to both full TCOS filings and interim updates, as well as developing analytics in support of and testifying to the reasonableness and necessity of adders to increase the utility's minimum debt service coverage ratio.

MCR has developed an organized review of transmission rates focusing on three pillars of the transmission rate review: (1) cost integrity, (2) revenue optimization, and (3) staff education. This approach allows MCR's clients to identify costs that should be recovered through transmission rates, optimize business practices to increase transmission cost recovery, and train staff to make decisions that maximize the value of their transmission systems.

In ERCOT, transmission rates continue to increase. Now more than ever, it is critical for ERCOT cooperative and municipal TOs to recover every dollar in their TCOS rate and ensure they are not leaving any money "on the table."



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