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JOINT APPLICATION OF TEXAS GENCO, LP AND CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC TO RECONCILE ELIGIBLE FUEL REVENUES AND EXPENSES PURSUANT TO SUBST. R. 25.236	**§ § § § §**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

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March, 2003

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APPLICATION OF TEXAS GENCO, LP AND CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC TO RECONCILE ELIGIBLE FUEL REVENUES AND EXPENSES PURSUANT TO SUBST. R. 25.236	§ § § § § §	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

REBUTTAL TESTIMONY OF

CARLA J. MITCHAM

FOR

TEXAS GENCO, LP AND CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC

FUEL RECONCILIATION

MARCH 2003

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EXECUTIVE SUMMARY

CARLA J. MITCHAM

Ms. Mitcham defends payments to City Public Service Board of San Antonio (CPS) under a Joint Operating Agreement (JOA), noting that Mr. Norwood's analysis of the JOA (1) fails to distinguish between joint dispatch and block power purchases, (2) mischaracterizes the treatment of third-party transactions under the JOA, and (3) confuses limits on a utility's right to collect its own O&M costs through eligible fuel with its right to collect through eligible fuel the price it pays for power from others, who may consider their own O&M in pricing their product.

Ms. Mitcham also rebuts recommendations by Mr. Pollock and Mr. Falkenberg that the Commission impute a capacity component to many of HL&P's market power purchases. She explains that both witnesses confuse capacity costs – costs incurred to reserve capacity ahead of time – with high energy prices paid during short-term imbalances between supply and demand and when the utility elects to pay high energy prices for short periods rather than incur the expense of additional capacity payments for a much longer period.

REBUTTAL TESTIMONY OF CARLA J. MITCHAM

Q. PLEASE STATE YOUR NAME, BACKGROUND, AND QUALIFICATIONS.

A. My name is Carla J. Mitcham, and my business address is 1111 Louisiana, Houston, Texas 77002. I am President, Texas Region for Reliant Resources, Incorporated, a majority-owned subsidiary of Reliant Energy, Incorporated.

I received a Bachelor of Science degree in Industrial Distribution from Texas A&M University in 1980 and a Master of Science degree in Industrial Technology in 1982. I joined Houston Lighting & Power (HL&P), the regulated utility division of Reliant Energy, Incorporated, in 1985 and transferred into the Regulatory Department just prior to receiving my Doctor of Jurisprudence degree from the University of Houston College of Law in 1987. From 1987 to 1995, I coordinated HL&P's handling of engineering, planning, rate design, and fuel issues for rate case and fuel reconciliation dockets before the Public Utility Commission of Texas (PUC).

From April 1995 to December 31, 2001, I worked in the fuels and energy procurement area with increasing levels of responsibility. During the fuel reconciliation period I was responsible for overseeing fuel management and dispatch; generation system operations planning and analysis, including associated energy accounting functions: purchase of coal, lignite, natural gas, and oil supplies; and bulk power purchases and sales for HL&P.

In addition, I was responsible for separating the existing fuel and energy management group into two groups as part of the Company's business separation plan required by the Public Utilities Regulatory Act (PURA). This separation involved hiring additional staff, implementing new systems and processes to accommodate the market changes caused by Senate Bill 7, and successfully transitioning load from the traditional regulated utility to a new affiliated Retail Electric Provider (REP).

Q. HAVE YOU PREVIOUSLY FILED DIRECT TESTIMONY IN THIS DOCKET?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. My rebuttal testimony responds to testimony by various intervenors regarding HL&P's fuel and energy management. Specifically, my rebuttal testimony demonstrates the following.

(a) HL&P reasonably and prudently negotiated the joint operating agreement (JOA) with City Public Service Board of San Antonio (CPS) to produce benefits for both HL&P and its customers.

(b) With few exceptions (which have not been included in eligible fuel expense), HL&P entered into purchased power contracts to obtain energy only, not to reserve capacity; and no capacity payment should be imputed to those contracts.

A. <u>Joint Operating Agreement</u>

Q. HAVE YOU REVIEWED INTERVENOR AND STAFF TESTIMONY ON THE JOINT OPERATING AGREEMENT WITH CPS?

A. Yes. The only testimony filed regarding the JOA is that of City of Houston witness, Mr. Scott Norwood.

Q. HOW DO YOU RESPOND TO MR. NORWOOD'S TESTIMONY?

A. Mr. Norwood's testimony begins from an unstated – and false – premise, then uses innuendo and mischaracterization of both law and facts to reach the untenable conclusion that HL&P's customers should receive more than 13 million MWhs of power from CPS without having to pay a penny for it.

Q. WHAT IS THE PREMISE OF MR. NORWOOD'S TESTIMONY?

A. Mr. Norwood's testimony assumes from the outset that any benefit to the utility must necessarily come at the expense of its customers and that utility customers can only benefit at the expense of the utility. I reject that premise. The JOA is an excellent example of an agreement that benefited both the utility (by promoting the amicable resolution of litigation) and the utility's customers (by generating substantial and real savings through increased operational efficiency).

Q. ISN'T MR. NORWOOD CORRECT THAT THE JOA WAS SIMPLY "AN AGREEMENT DEVISED BY HL&P TO HAVE RATEPAYERS FUND SETTLEMENT PAYMENTS?"

A. Absolutely not. No ratepayer paid a penny more as a result of the JOA. On the contrary, HL&P's customers paid *less* than they would have without the JOA. Mr. Norwood's testimony readily acknowledges that both AEP and Entergy jointly operate the systems of their subsidiary utilities. Why? The answer is both simple and obvious: joint operation is more efficient and saves money. By agreeing to operate jointly with CPS, HL&P was able to create savings for CPS that CPS was willing to consider as offsets to settlement payments from HL&P. It is important to note, however, that HL&P's shareholders – not its ratepayers –

were responsible for those settlement payments. HL&P's shareholders paid $75 million in cash to CPS. HL&P's shareholders guaranteed another $150 million over ten years. HL&P's shareholders were able to avoid the additional $150 million in settlement payments if and only if the JOA produced sufficient savings for CPS; and the JOA cannot produce savings for CPS without also producing savings for HL&P's customers. Mr. Norwood may – and does – take issue with the relative sharing of the JOA benefits, but that is a different issue. His repeated references to ratepayers "funding" a settlement between HL&P and CPS are deliberately misleading and are intended to reinforce his assumption that any utility gain can come only from ratepayer loss and to create the mistaken impression that the JOA increased costs for HL&P's customers. Again, I disagree with his fundamental assumption. The JOA created a very real win-win situation for HL&P and its customers.

Q. WHY DIDN'T HL&P SEEK COMMISSION APPROVAL OF THE JOA AS MR. NORWOOD SUGGESTS IT SHOULD HAVE DONE?

A. As I stated in response to requests for information, there was no mechanism under either PURA or the Commission's rules for HL&P to seek prior approval of the JOA. Mr. Norwood purports to cite provisions that either required or allowed HL&P to seek Commission approval of the JOA; but he cites a provision (PURA §14.101) that applies only to transfers of utility assets or the merger of utilities – neither of which occurs under the JOA. Mr. Norwood attempts to obscure this fundamental flaw in his analysis by referring to the JOA as a "merging of the operations of CPS and HL&P over a long-term period."[1] Mr. Norwood knows

[1] Norwood at 11:9-10.

better. Indeed, the JOA specifically states that each party retains the right to operate its own system independently of the other.[2] CPS and HL&P "merged" their dispatch operations, but there was no transfer of assets from either utility to the other and no merger of the two utilities in any legal sense. As with HL&P's other fuel and power contracts, CenterPoint Energy seeks approval of the JOA and reconciliation of JOA costs and revenues in the context of a fuel reconciliation proceeding. HL&P originally presented the JOA for Commission approval in 1997 in Docket No. 18753, but that proceeding ended in a settlement. Therefore, the JOA is again before the Commission for review in this docket.

Q. MR. NORWOOD CHALLENGES THE CALCULATION OF BENEFITS UNDER THE JOA AND CONTENDS THAT THE BENEFITS ARE $46.8 MILLION LESS THAN CALCULATED BY HL&P AND CPS. DO YOU AGREE WITH HIS ANALYSIS?

A. No. Mr. Norwood's first adjustment – a $46.8 million reduction in the JOA calculated benefit[3] – is based on his misunderstanding of how the JOA accounts for short-term energy transactions. Mr. Norwood asserts that the JOA benefit calculations unrealistically assume that in the absence of joint operations, there would be no third party transactions. He maintains that in the absence of the JOA, HL&P could have bought and sold power from CPS and other parties through bilateral market transactions and that these third party transactions would have produced benefits that are not considered when calculating the JOA benefits. There are three problems with Mr. Norwood's theory.

[2] Norwood Ex. DSN-1 at 6 (JOA §§2.1 and 2.2).
[3] Norwood Ex. DSN-16.

First, Mr. Norwood incorrectly assumes that block power purchases from third parties could have duplicated the benefits of joint operations.[4] That assumption is not merely incorrect; it's ludicrous. Upon a moment's reflection, the error in Mr. Norwood's analysis is obvious. If CPS could have made the same sale and achieved the same savings at the same level of risks in the absence of the JOA, it would have had no incentive to sign the JOA. Joint dispatch creates savings by dispatching both utilities' units in the most efficient manner on a minute-by-minute basis. Joint dispatch occurs in real-time, based on actual load, actual operating conditions, and actual unit availability. Third party transactions such as those proposed by Mr. Norwood must be prearranged, for predetermined quantities and duration, based on forecasted load and operating conditions and would subject the selling party to financial risk for nondelivery in the event of a unit outage. That Mr. Norwood would even suggest that third party, block power purchases could duplicate joint-dispatch efficiencies reveals a serious misunderstanding of joint dispatch.

Second, the JOA benefit calculation *does* take into account third party transactions. As Mr. Norwood notes, the JOA benefits are calculated by comparing costs under joint operations (Study J) with costs under stand-alone operations (Study S). Study S includes third party transactions undertaken individually by either party, with the party consummating the transaction retaining all the benefit (and all the risk) of the transaction. These Study S transactions include any entered into 31 days in advance (prior to August 1, 2001) or more than two days in advance (beginning August 1, 2001). Study J includes

[4] "Block power purchases" refer to power purchased in fixed quantities (50MW, 100 MW, etc.) for set hours on a set

third party transactions that are based on the lower marginal cost of the joint system, and thus the benefit (and the risk) from these transactions is shared.

Third, it is not fair to assume, as Mr. Norwood does, that third party transactions undertaken jointly by CPS and HL&P would have been undertaken under stand-alone operations solely by HL&P. Joint operation produces a marginal cost that is lower than stand-alone marginal costs. Transactions entered jointly are based on the lower joint marginal costs. If a party can profit from a transaction at its stand-alone marginal cost, it has every incentive to undertake that transaction separately and keep the entire profit. Joint transactions are therefore reasonably excluded from the stand-alone cases, with their higher marginal cost. In addition, since the transactions are based on the joint system capabilities, it is logical to attribute 50% of the benefits to CPS as was done in HL&P's calculation of the JOA benefits.

Q. DO YOU AGREE WITH MR. NORWOOD'S USE OF THE ERCOT AVERAGE ENERGY PRICE TO REDUCE JOA SAVINGS BY $16.2 MILLION?

A. No. Mr. Norwood suggests that anytime the ERCOT average energy price was lower than HL&P's cost of generation, Study S should have assumed a third party purchase at that average energy price instead of using HL&P's own cost of generation. The problems with that analysis are numerous. The ERCOT market price relied upon by Mr. Norwood is the result of an extremely illiquid wholesale

number of days. For example, a 5x16 block of power refers to power purchased for the sixteen peak hours of each of the five business days of the week, Monday through Friday.

market. It is so illiquid, in fact, that the Commission is unwilling to use it for PTB adjustments.

> The commission continues to believe that it is appropriate to allow affiliated REPs to request changes in the price to beat fuel factor based upon changes in the price of electricity, once a sufficiently liquid and reliable index exists. However, the commission notes that such an index has yet to develop, and there appears to be a lack of standardized products traded in Texas that would aid in the development of such indices.[5]

There is absolutely no basis for Mr. Norwood's assumption that HL&P could have obtained the quantities required at the prices he uses. On the contrary, based on simple supply and demand economic principles, it is reasonable to assume that had HL&P sought significant additional quantities of purchased power, market prices would have risen in response.

Q. IS MR. NORWOOD CORRECT IN ARGUING FOR A $30.6 MILLION REDUCTION IN JOA BENEFITS TO REFLECT THE REMOVAL OF SHORT-TERM TRANSACTION BENEFITS?

A. No. As previously noted, short-term transactions are undertaken based on the lower marginal cost of the jointly dispatched system. It is reasonable, therefore, to attribute those transactions to joint operations and not stand-alone operations.

Q. EXPLAIN WHY IT IS REASONABLE TO ASSUME THAT SHORT-TERM TRANSACTIONS ARE BASED ON THE JOINT DISPATCH MARGINAL COST.

A. If CPS or HL&P believes that its own projected marginal costs support a third party purchase or sale, it can make that transaction on its own in advance and capture the entire benefit of the transaction. However, the party keeping all the

[5] *Rulemaking to Amend P.U.C. Subst. R. 25.41, Relating to Price to Beat*, Project No. 26556, "Proposal for Publication of Amendments to Sec. 25.41 as Approved at the November 7, 2002 Open Meeting" at 6 (November 8, 2002).

revenues in a separate transaction must also bear the costs of serving the transaction. That is exactly how Study S transactions are handled. The separate transactions are added to the appropriate party's Study S obligation to allocate the costs properly. When a party to the JOA instead enters a transaction on a short-term basis, thus requiring it to share the savings with the other JOA party, it is reasonable to assume that it entered the transaction not in reliance on its own projected marginal cost, but on the more near-term projected joint marginal cost.

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY ON MR. NORWOOD'S FIRST RECOMMENDED ADJUSTMENT.

A. Mr. Norwood's recommended $46.8 million reduction in JOA benefits is premised on his failure to appreciate the difference between joint dispatch and block power purchases. His recommendation also assumes incorrectly that no third party transactions are considered in calculating JOA benefits. Long-term, separate transactions are included in each party's Study S; short-term, joint transactions are reasonably shared by the parties. Mr. Norwood calculates his revised benefits using an illiquid market price that the Commission has previously rejected; and he assumes impractical volumes of energy flow from the market at the prices he proposes. As stated previously, had HL&P increased the demand in the market, the prices would have necessarily increased as well.

Q. HOW DO YOU RESPOND TO MR. NORWOOD'S SECOND RECOMMENDED ADJUSTMENT BASED ON HIS CHARGE THAT THE SHARING OF BENEFITS UNDER THE JOA IS UNREASONABLE?

A. Mr. Norwood's criticism of the 90/10 sharing between CPS and HL&P is based on an inappropriate hindsight analysis of the benefits realized. More importantly, however, Mr. Norwood's own analysis can be used to *support* the 90/10 split of benefits.

Q. IN WHAT SENSE IS MR. NORWOOD'S ANALYSIS BASED ON HINDSIGHT?

A. The 90/10 sharing of JOA benefits is a negotiated provision of the JOA. HL&P negotiated and agreed to that sharing formula in 1996 based on HL&P's reasonable expectation that most of the benefits of joint operations would be derived from the ability under joint operations to more fully dispatch CPS's coal units. Mr. Norwood asserts that the CPS coal units have accounted for less benefit than HL&P anticipated. That is the purest form of hindsight analysis and should not be permitted.

Q. IS MR. NORWOOD CORRECT THAT ACTUAL BENEFITS WOULD NOT SUPPORT A 90/10 SPLIT TODAY?

A. No. HL&P's reasonable expectations have been largely confirmed by actual practice. As noted in responses to RFIs, roughly 75% of the JOA benefits were derived by more fully dispatching CPS's coal units. Mr. Norwood argues that this figure should be reduced to 67%; but this reduction to 67% is based on his flawed analysis of third party transactions and use of an illiquid and inappropriate ERCOT average market price. Even assuming that Mr. Norwood's 67% number were correct, however, the 90/10 split is still reasonable. It would have been reasonable for the parties to agree that CPS should retain all benefits created by its coal units (67%, according to Mr. Norwood) and split evenly the remaining benefits of joint dispatch (33%, according to Mr. Norwood). Doing so would produce a split of 83½% for CPS (67% + [½ * 33%]) and 16½% for HL&P (½ * 33%). That is not very far from the 90/10 split agreed to by HL&P on the basis of projected savings, and without the benefit of hindsight analysis. If one recognizes the problems with Mr. Norwood's first recommended adjustment and uses HL&P's estimate of CPS coal benefits as accounting for 75% of JOA savings, then the resulting split is even closer to 90/10 – 87½% for CPS (75% + [½ * 25%]) and 12½% for HL&P (½ * 25%). In either case, however, the difference between HL&P's original expectations and estimates of actual benefits is relatively small, further indicating that HL&P was relying on reasonable expectations when it negotiated the 90/10 split.

Q. HOW DO YOU RESPOND TO MR. NORWOOD'S ARGUMENT THAT THE PROVISION FOR THE 90/10 SPLIT TO CHANGE TO 50/50 ONCE BENEFITS EXCEEDED $200 MILLION AND THE RECENT AMENDMENT PROVIDING FOR 50/50 SHARING OF SHORT-TERM TRANSACTIONS BOTH INDICATE THAT THE 90/10 SPLIT WAS DRIVEN BY SETTLEMENT CONSIDERATIONS?

A. Mr. Norwood is incorrect. As Mr. Norwood is aware, HL&P's original estimates were that JOA benefits would never exceed $150 million, let alone $200 million. HL&P was able to negotiate a 50/50 split of JOA benefits after the $200 million mark in part because neither party viewed that as a likely scenario. Most importantly, however, CPS was willing to split JOA benefits 50/50, because, when JOA savings reach that $200 million mark, the provisions of the JOA regarding CPS long-term transactions become inapplicable and CPS is free to sell its coal generation to others.[6] For reasons outlined in my direct testimony, HL&P and CPS later mutually agreed to amend the JOA to split short-term transactions 50/50 and to extend the term of the JOA as requested by CPS. The logic behind these amendments is consistent with my earlier testimony that the JOA seeks to match the split of benefits to the ownership of the assets producing those benefits.

HL&P negotiated and agreed to the 90/10 split based on reasonable, contemporaneous expectations regarding the magnitude and source of JOA benefits. Mr. Norwood's second recommended adjustment is an exercise in improper, impermissible hindsight review based on his retrospective view of how the JOA actually produced savings. That view is undermined by Mr. Norwood's failure to appreciate the fundamental differences between third party block power purchases and joint dispatch and his further failure to consider and understand all of the explicit provisions of the JOA. Even so, Mr. Norwood's analysis suggests that a 90/10 split was well within the range of reasonable options available to HL&P in 1996 when it negotiated the JOA.

Q. PLEASE RESPOND TO MR. NORWOOD'S THIRD RECOMMENDED ADJUSTMENT – A $34.3 MILLION REDUCTION IN ELIGIBLE PAYMENTS TO CPS.

A. Mr. Norwood's third recommended adjustment is based on Mr. Norwood's assertion that $34.3 million in production cost adjustment (PCA) payments should

[6] JOA Section 5.3 states that CPS will receive 90% of the benefits until it receives cumulative payments totaling $200 million. Thereafter, the benefit will be split 50/50 and "the provisions of Sections 3.4.1 through 3.4.2 regarding Long Term Transactions by CPS will become inapplicable." Section 3.4.2 states, "With respect to Long Term Transactions entered into by CPS which are sales by CPS . . . cost reconstruction . . . will determine what the additional costs and benefits would have been under joint operation if the energy sold to third parties had remained available for dispatch. Ninety percent of the benefit thus calculated will be credited against Houston's obligation . . . ."

be excluded from eligible payments to CPS because they are either inaccurate or ineligible. I disagree with both of his positions.

Q. WHY IS MR. NORWOOD INCORRECT IN STATING THAT THE PCA COSTS ARE INACCURATE?

A. First, Mr. Norwood criticizes HL&P for failing to provide invoices "to verify the accuracy of fuel costs"[7] and "verifying the accuracy of charges incurred to supply energy."[8] On the contrary, the prices paid to CPS for power under the JOA are supported by a wealth of backup information, much more in fact than is ever received from a typical purchased power invoice. In response to several early RFIs from the City of Houston, CenterPoint Energy made available for review all of the backup documents supporting JOA cost reconstruction.[9] CenterPoint Energy was not required by the fuel reconciliation filing package instructions to include these documents in its original filing. Indeed, it would have been impractical to do so, because they exceed eight linear feet. Nevertheless, they were made available for review in response to City of Houston's Third Request for Information and have been available for Mr. Norwood to review since September 11, 2002. To my knowledge, Mr. Norwood has never asked to review any of those documents.

To provide an example of how a closer review of the JOA documentation might have prevented Mr. Norwood from making a baseless accusation, please refer to page 27, lines 10 through 21 of his testimony. In this section, Mr. Norwood attempts to provide an example of how modeling assumptions in the stand-alone cases (Study S) can produce apparent benefits that are not real. Mr. Norwood

[7] Norwood at 24:6.
[8] Norwood at 24:15.
[9] Examples of the documents made available for review are attached hereto as Exhibit CJM-1R.

refers to Section 4.4 of the JOA and states, "By forcing large gas-fired units to run for at least 30 days before shutting down only in the stand-alone case, these unsupported assumptions introduce unrealistic hypothetical inefficiencies in the Study S case modeling which will be translated into estimated "savings" when compared to the Study J (joint operations) case simulations." Ironically, I agree with Mr. Norwood, and that is exactly why Section 4.4 of the agreement was amended early on to remove the very terms Mr. Norwood is criticizing. Change Agreement #2, which, although signed July 1998, became effective prior to the start of the fuel reconciliation period, removed the wording that forced large gas-fired units to run for 30 days in the Study S case.[10] To more accurately reflect actual costs, the wording in Section 4.4 was modified to include in Study S the actual minimum up and down times used in real-time operations for all units. Had Mr. Norwood done more extensive research of the JOA documentation provided, he would have known Section 4.4 was modified and would not have made this unsubstantiated and inaccurate claim in his testimony.

The joint dispatch system and the cost reconstruction model use the same fuel prices for CPS. These prices are based on CPS's actual fuel contracts, which HL&P has reviewed and summarized. As part of the JOA cost reconstruction process, the calculated fuel costs are periodically trued-up based on CPS's actual fuel costs. Copies of CPS's fuel contracts and/or HL&P's summaries of those contracts, as well as fuel cost true-up documents, are all included among the documents made available for review in this docket.[11] Contrary to Mr. Norwood's assertion, there is significantly more information available to support the prices paid for power under the JOA than prices paid under any other purchase power contract. Mr. Norwood simply chose to ignore that

[10] A copy of Change Agreement #2 is attached hereto as Exhibit CJM-2R.
[11] *See*, Exhibit CJM-1R

documentation during the three and a half months between the time it was made available for review and the date Mr. Norwood filed his testimony.

Second, Mr. Norwood claims that "the Company should have presented benchmarking studies" for the production cost models used to calculate JOA benefits. In fact, the Company did, and Mr. Norwood knows it. His testimony states:

> . . . the only evidence HL&P has presented to demonstrate that it has benchmarked the models used for the JOA benefit calculations is a single number per month, which it refers to as "Dispatch Efficiency Factors."[12]

This "single number" is exactly the sort of benchmarking Mr. Norwood claims to seek, and was, in fact, described in CenterPoint Energy's original filing.[13] Every month, HL&P ran a Study J using actual historical operating conditions and compared the resulting production cost to that actually achieved under those actual conditions. The dispatch efficiency factor is the cost predicted by the model divided by actual costs. This is exactly the form of benchmarking once touted by Mr. Norwood's colleague, Ms. Pitchford.

> . . . it is my opinion that the PROMOD computer program produces a reasonable model of how LCRA's generating system will be operated during the rate year. First, PROMOD is a program used by many utilities across the country for modeling economic dispatch and forecasting production costs, including fuel costs. *Second, PROMOD has been tested by LCRA staff by putting historical data into PROMOD and comparing the resulting PROMOD output with the actual historic LCRA generation data. This type of benchmark test* has shown that PROMOD does create a reasonably accurate model of how LCRA operates its electric generation system.[14]

[12] Norwood at 25:18-21.
[13] Confidential Schedule FR-7, Bates pages 1216-17.
[14] *Application of the LCRA to Change Rates*, Docket No. 8032, Direct Testimony of Eileen Pitchford at 8 (March 2, 1988) (testimony prepared by or under the supervision of Ms. Pitchford and subsequently adopted by another witness) (emphasis added).

HL&P's model is benchmarked. That benchmarking indicates that the JOA model is 98.6% accurate.[15]

Third, Mr. Norwood attacks the production cost model as too complex and claims that changes in the algorithms used or errors in input assumptions could produce errors. Mr. Norwood does not provide a single example of any error in the JOA modeling. Moreover, Mr. Norwood's professed concern over the use of a production cost model is less than compelling. Production cost models are a standard industry tool, and Mr. Norwood himself has used them.[16] The Commission relied on just such a model to calculate ECOM. HL&P's and CPS's systems are complex, and any useful model must reflect that complexity. While no one has ever claimed the models are perfect, they are a proven tool, based on real cost information, and they are certainly superior to the haphazard, "back of the envelope" calculations relied upon by Mr. Norwood. Complexity alone, without evidence of any specific modeling error, is no basis for rejecting HL&P's modeling.

Fourth, Mr. Norwood testifies that there is no way to verify the Miscellaneous Variable Costs (MVC) component of the PCA under the JOA. Mr. Norwood does not deny that CPS incurs costs other than fuel in supplying power to HL&P. Mr. Norwood does not suggest that CPS (or any other purchase power supplier for that matter) would be willing or able to supply power for a price that did not take into account all of its costs of producing and supplying that power. Instead, Mr. Norwood simply complains that because HL&P and CPS have agreed upon

[15] *See*, CenterPoint Energy's Response to COH 10-7 (attached hereto as Exhibit CJM-3R).
[16] *See*, COH's Response to CNP 2-108 (attached hereto as Exhibit CJM-4R).

an amount to cover these costs, the amount is somehow necessarily unreasonable. The Commission should not be fooled. Any seller of power will price its product to recover all costs of producing and supplying that power. The only thing that distinguishes the energy supplied under the JOA from other purchased power contracts is the Commission's ability, in the case of the JOA, to see *exactly* how the power is priced. The PCA uses a $1.20 charge per MWh for miscellaneous variable costs for energy produced. This is the exact same charge paid to qualifying facilities and previously approved by the Commission under HL&P's NEP tariff.[17] An additional charge of $0.25 per MW per hour on-line is included to reflect additional miscellaneous variable costs resulting from changes in the commitment pattern of a unit. This is, in my opinion, a reasonable estimate of such costs, and Mr. Norwood never claims otherwise. There is nothing new or unusual about a power supplier pricing its product to account for non-fuel costs, and nothing in the Commission's fuel rule prohibits the reconciliation of purchased power expenses that include such costs. Mr. Norwood does not, and cannot, argue that the prices paid for power under the JOA were unreasonable. They are not. Consequently, he is left to contend that because HL&P cannot precisely trace every individual component of the price, it should be denied recovery. That has never been the standard at the Commission and should not be now.

Moreover, Mr. Norwood misapplies these costs in his own calculations in the sixth column of his Exhibit DSN-18. As mentioned above, the JOA includes a miscellaneous variable cost component of $1.20/MWh for energy actually

[17] A copy of HL&P's NEP Tariff is attached hereto as Exhibit CJM-5R).

produced, and a cost component of $0.25/MW per hour on line to reflect additional/reduced miscellaneous variable costs resulting from changes in the commitment pattern of a unit. Please note that the first component is in units of MWh and the second is in units of MW. They have different units because they are not the same thing. Mr. Norwood either ignores or does not understand this fundamental difference and incorrectly adds the two amounts together ($1.45) and applies the incorrectly combined charge to all of the energy received (MWhs) from CPS.

Q. WHAT ABOUT MR. NORWOOD'S CLAIM THAT THE PCA INCLUDES INELIGIBLE NON-FUEL O&M AND CAPACITY COSTS THAT ARE BARRED BY THE FUEL RULE?

A. Mr. Norwood is wrong. The fuel rule bars HL&P from including its *own* non-fuel O&M costs in eligible fuel, but does not preclude HL&P from recovering the costs of purchase power that may have been priced to recover such costs incurred by the supplier. As previously noted, the $1.20 miscellaneous variable cost component of the PCA for energy produced is identical to that included in HL&P's NEP tariff, paid to QFs for non-firm energy, and routinely recovered as eligible fuel. None of the payments under the PCA are made to reserve either CPS or HL&P capacity. In fact, in 2000, HL&P entered into a separate capacity contract with CPS to ensure that CPS's capacity would remain available to HL&P under the JOA. HL&P has properly excluded the costs of that capacity contract from this fuel reconciliation. No such costs are included in the PCA, which is designed only to compensate CPS and HL&P for the costs of producing and supplying energy under the JOA.

B. Purchased Power

Q. HAVE YOU REVIEWED THE RECOMMENDATIONS OF MR. POLLOCK AND MR. FALKENBERG THAT A PORTION OF THE ENERGY PAYMENTS FOR POWER PURCHASED BY CENTERPOINT DURING THE FUEL RECONCILIATION PERIOD SHOULD BE TREATED AS IF THEY WERE CAPACITY PAYMENTS?

A. Yes, I have reviewed the recommendations.

Q. DO YOU AGREE WITH THEIR CLAIM THAT A PORTION OF THE ENERGY PAYMENTS WERE, IN FACT, CAPACITY PAYMENTS?

A. No. I do not agree with Mr. Falkenberg's and Mr. Pollock's claims that a portion of the energy payments should be treated as capacity payments.

Q. WHY NOT?

A. Mr. Falkenberg and Mr. Pollock rely on an incorrect interpretation and application of a single PUC decision. I disagree with their premise that whenever the market price of energy purchases increases above an arbitrary level, a portion of the purchases should be deemed to be a "capacity payment" and excluded from eligible fuel. Their contention that the purchases made by CenterPoint were made to acquire capacity is factually incorrect and inconsistent with a position taken in past proceedings by Mr. Pollock's client, Texas Industrial Energy Consumers (TIEC). I also disagree with their claim that the Commission's regulations were designed to exclude from reconcilable fuel an after-the-fact, arbitrarily determined portion of the total payments made for energy purchased in market based transactions.

Q. HOW WOULD YOU DIFFERENTIATE BETWEEN CAPACITY AND ENERGY?

A. The essential difference between a capacity and an energy purchase is the rights obtained by the buyer. The essential element of a capacity purchase is that it is made as part of the system planning process to provide flexibility to meet expected future requirements of the system. This flexibility is obtained through the right to call on energy from the reserved capacity if and when needed. In 2000, for example, HL&P determined that it wanted to ensure that CPS's excess capacity was available for joint dispatch, so HL&P entered into a capacity purchase contract that ensured the availability of that CPS generating capacity in future months. In contrast, an energy only purchase is designed to obtain just that – energy – without creating any corresponding rights to reserve capacity ahead of time, allowing the flexibility to call or not call on that capacity depending on system needs. Mr. Falkenberg briefly recognizes this distinction in his own testimony.

> Energy is the ability to do useful work. It powers the air conditioner, television or personal computer. Capacity is *the ability to obtain that energy at any time desired.*[18]

Energy only contracts do not include any such reservation of or right to control capacity. In sharp contrast to capacity purchases, the buyer under a block energy purchase obtains a set amount of energy for a set duration.

On occasion, unusually high demand or an unexpected outage may leave HL&P unable to generate all the power it needs and force HL&P into the market to buy that power. At times, HL&P must pay a steep price for such power. But the reason HL&P pays a high price is precisely because it did *not* have a capacity

[18] Direct Testimony of R. Falkenberg at 14:5-7.

contract in place to call on. In fact, to meet short-term, unpredictable energy shortfalls, it is more economical to pay high *energy* prices for only the period needed rather than buying *capacity* for long periods when it may or may not be needed. Despite Mr. Falkenberg's and Mr. Pollock's rhetoric, the test of whether a given transaction is a "capacity purchase" is not whether the energy happens to be needed at the time it is purchased or delivered or whether the price is higher or lower than the cost of energy from some other source.

Q. FOR WHAT KIND OF CONTRACTS DO MR. FALKENBERG AND MR. POLLOCK PROPOSE TO IMPUTE A CAPACITY COMPONENT?

A. All of the contracts are market priced contracts for the purchase of power at energy only prices. By energy only prices, I mean prices applied on a $/MWh basis to the energy actually delivered. These contracts do not contain a capacity charge. But more importantly, the contracts did not give HL&P "capacity rights."

Q. DOES THE FACT THAT THE PURCHASES MAY BE FIRM INDICATE THAT A PORTION OF THE PAYMENT IS FOR CAPACITY?

A. No. The designation that a purchase is firm does not indicate whether the purchase was made to acquire capacity. It simply reflects the buyer's legal recourse if the energy is not delivered as promised.

Consider an example. Assume that HL&P's load for a week is forecast to be 5,000 MW each day and that HL&P has 8000 MW of generation available and ready to run. Further assume that HL&P's marginal cost to serve the last 500 MW of load is $40.00 but that a market-priced 500 MW block of 5 x 16 power is available at $38. HL&P will buy the 5 x 16 block to reap the $2 savings. HL&P does not need additional capacity and reserves no right to control the capacity.

Nevertheless, HL&P will buy the power as firm. Otherwise, HL&P would have no legal recourse if market prices rose and the seller decided not to deliver to HL&P and sell to someone else at a higher price. Mr. Falkenberg and Mr. Pollock understand this concept. Although both witnesses testify that a "firm" power purchase implies a capacity component, neither suggests that the Commission impute capacity costs to admittedly firm contracts that obtained power at a savings off of HL&P's own cost of generation. In the end, their own recommendations are not consistent with their theory that firm contracts imply capacity.

Q. HOW DO MR. FALKENBERG AND MR. POLLOCK DETERMINE WHETHER A PARTICULAR PURCHASE INVOLVES A CAPACITY PAYMENT?

A. Mr. Falkenberg and Mr. Pollock begin with the price paid by CenterPoint under its various firm purchased power agreements. They only recommend imputing a capacity cost, however, if the price for a given transaction exceeds some arbitrary level.

Q. WHY DO YOU CONSIDER THE PRICE LEVELS USED BY MR. FALKENBERG AND MR. POLLOCK TO BE ARBITRARY?

A. The simplest answer is to note that Mr. Pollock and Mr. Falkenberg use different price levels to determine how much of a given energy payment is for the alleged "capacity" component. Mr. Pollock computes a capacity component for five transactions on Exhibit JP-4. At least four of these transactions are included in Mr. Falkenberg's analysis underlying Exhibit RJF/2. While CenterPoint Energy obviously paid only one price under each contract, the amounts Mr. Pollock treats as "capacity" differ materially from the amounts that are treated as capacity under Mr. Falkenberg's analysis. For example, Mr. Pollock treats 53% of the payments made by CenterPoint to AEP in August 2000, as "capacity payments" while Mr. Falkenberg's methodology treats only 41% of the same transaction as a "capacity payment."[19]

Indeed, taken individually, Mr. Falkenberg's and Mr. Pollock's treatments are not even *internally* consistent for single transactions! For a single July-August 2001 transaction with Avista, Mr. Falkenberg's methodology treats $4.73 of the $61 energy price in July as a payment for capacity, but only $3.97 of the same $61 energy price in August as a capacity payment.[20] Similarly, for a July-August 2001 purchase from Tractebel Energy, Mr. Falkenberg recommends that $1.73 of the $58/MWh price be treated as imputed capacity in July; but he only recommends that 97¢ of the same $58/MWh price be treated as imputed capacity in August.[21]

Even more perversely, Mr. Falkenberg imputes capacity payments to individual, multi-month contracts in one month of the contract but not in another. For example, he imputes capacity to power contracts with Entergy in July 2000, but not in August of 2000. Yet 80,000 MWHs (80%) of the 100,280 MWHs HL&P purchased from Entergy in July (and to which he imputes capacity payments) were purchased under two contracts, each of which covered not only July but also

[19] *See*, Exhibit JP-4, line 4 and Exhibit CJM-6R, line 177 (55.57/137 = 41%). Exhibit CJM-6R reproduces the workpapers underlying Mr. Falkenberg's Exhibit RJF/2 and separately identifies the twelve transactions that are neither day-of nor day-ahead transactions and calculates the portion of Mr. Falkenberg's recommended disallowance associated with those transactions.
[20] *See*, Exhibit CJM-6R, lines 219 and 227.
[21] *See*, Exhibit CJM-6R, lines 223 and 229.

August (for which he imputed *no* capacity). Mr. Falkenberg does the same thing with another contract. Nearly all of the power that HL&P purchased from Mirant in July 2001 (95%) was purchased under a single contract covering July *and August*. Yet Mr. Falkenberg imputes capacity payments to the energy purchased in July, but not to the energy purchased under the very same contract at the very same price in August.

Mr. Pollock's testimony is no better. His Exhibit JP-4 portrays a pair of two-month purchases for July and August 2000 (one from AEP and one from Entergy) as four one-month purchases. He then imputes to the Entergy contract capacity payments of $16.00 in July and $18.10 in August and imputes to the AEP contract capacity payments of $71.00 in July and $73.10 in August.

Capacity costs are a base rate item because they are stable and predictable; yet Mr. Falkenberg and Mr. Pollock reach very different results from each other, and neither can even produce internally consistent results when starting with identical transactions in consecutive months.

Q. DID HL&P MAKE ANY CAPACITY PURCHASES DURING THE FUEL RECONCILIATION PERIOD?

A. Yes. However, none of the actual capacity purchases is in dispute. CenterPoint Energy has not included its actual capacity purchases in eligible fuel.

Q. WERE ANY OF THE TRANSACTIONS FOR WHICH MR. FALKENBERG OR MR. POLLOCK WOULD IMPUTE A CAPACITY CHARGE ACTUALLY CAPACITY PURCHASES?

A. No.

Q. **PLEASE DESCRIBE THE TRANSACTIONS THAT MR. FALKENBERG AND MR. POLLOCK WOULD TREAT AS CAPACITY PURCHASES.**

A. The transactions fit into two broad categories, neither of which falls within an appropriate definition of a capacity purchase. The first general category is what I will call "price-based purchases." These are purchases made because the market price is lower than the expected price of generating equivalent energy from a marginal unit. Neither Mr. Falkenberg nor Mr. Pollock contends that any portion of purchases to displace more expensive energy from a marginal unit should be treated as a capacity payment, even when such purchases are for firm energy.

The other general category is what I will call "need-based purchases." These are purchases made to respond to outages or other unusual conditions that make it necessary to acquire additional energy to serve loads. The vast majority of the need-based purchases are purchases made the same day, or the day before, the energy is actually taken and used. Often the purchase lasts only a few hours on the given day. These day-of and day-ahead contracts are the antithesis of capacity purchases. As explained above, "need-based" purchases often entail paying a higher-than-usual price for *energy* precisely because there was *not* a prior reservation of *capacity*. A relatively brief period of high energy prices is accepted in lieu of attempting to pay capacity reservation charges over a longer period of time at what is reasonably expected to be a higher total cost. Put differently, it is reasonable and prudent to forego buying a month of capacity which may or may not be needed and instead buy expensive energy for a few hours if it is needed.

Q. HOW MANY OF THE PURCHASES LISTED ON MR. POLLOCK'S EXHIBIT JP-2 AND UNDERLYING MR. FALKENBERG'S EXHIBIT RJF/2 INVOLVE DAY-OF OR DAY-AHEAD TRANSACTIONS?

A. All but twelve (12) of the more than 120 purchases underlying Mr. Falkenberg's Exhibit RJF/2 are either day-of or day-ahead purchases. My Exhibit CJM-6R identifies the twelve purchases which were not day-of or day-ahead transactions. Nearly 80% of Mr. Falkenberg's proposed disallowance ($18,726,343 of $24,005,467) is attributable to these day-ahead or day-of purchases. One of the transactions on Mr. Pollock's list (the August 29th Enron purchase on Line 5) was a Friday purchase for Sunday delivery, for all practical purposes a day-ahead transaction.

It is clear that neither Mr. Falkenberg nor Mr. Pollock has carefully reviewed or attempted to understand the few transactions that were made more than a day ahead. For example, on July 2, 2000, HL&P bought a 50 MW, 5 x 16 block of energy from American Electric Power Services for July and August. The price of the energy was high – $137/MWh – so Mr. Falkenberg recommends imputing a capacity component. However, a quick review of HL&P's daily wholesale power reports – available for Mr. Falkenberg's and Mr. Pollock's review since July 1, 2002 – indicates that this $137/MWh purchase was entered not to obtain capacity, but to obtain the energy to support a $140/MWh sale in the same quantity (50 MW) and for the same duration (July-August 2000).[22] HL&P took advantage of an opportunity to buy a block of energy and resell it for a $3/MWh profit. Neither transaction has anything to do with capacity. On the other hand, the two

[22] *See*, (Power) CONFIDENTIAL Testimony Workpapers of Carla J. Mitcham, bates page 5114.

transactions are both included in HL&P's reconcilable fuel expense, thus reducing eligible fuel expense by the amount of the profit obtained. This illustrates the danger of relying, as Mr. Falkenberg and Mr. Pollock do, on prices alone – without regard to the purpose of the transaction – to justify imputing a capacity component.

Q. YOU STATED EARLIER THAT IMPUTING A CAPACITY COMPONENT TO HL&P'S POWER PURCHASES IS INCONSISTENT WITH A POSITION PREVIOUSLY TAKEN BY TIEC. PLEASE EXPLAIN.

A. TIEC has, in the past, actively and successfully opposed the ability of utilities to interrupt interruptible customers for economic reasons. Due in large part to TIEC's urging, HL&P was prohibited from interrupting interruptible, energy-only customers when power was available in the market (at any price) to serve those customers.[23] Consequently, on days when HL&P had adequate generation capacity to serve its own non-interruptible customers, but not its non-interruptible *and* interruptible customers combined, HL&P had to buy market power – at whatever price it was available – to cover the interruptible, energy-only customers rather than interrupting those customers.

Q. WHY DO YOU REFER TO INTERRUPTIBLE CUSTOMERS AS "ENERGY-ONLY" CUSTOMERS?

[23] *Application of Houston Lighting & Power Co. for Authority to Change Rates*, Docket No. 8425, 16 TEX. P.U.C. BULL. 2684, 2754 (Final Order, Finding of Fact No. 371) (June 20, 1990).

A. Unlike most large customers, interruptible customers taking service under HL&P's tariff schedules IS-10 and IS-I pay no demand charge as part of their rates. They pay only for energy.

Q. WHY IS THAT SIGNIFICANT?

A. TIEC wants to have its cake and eat it, too. As a result of TIEC's earlier efforts, its members were able to take advantage of lower interruptible, energy-only rates, but without any risk of interruption so long as power was available (at any price) to HL&P. Now, in an effort to avoid the higher energy prices that were the inevitable result of the policy it advocated, TIEC wants to recharacterize much of the cost of acquiring energy to serve its members as "capacity" costs. Such treatment is flatly inconsistent with the testimony of Mr. Pollock's colleague, Maurice Brubaker, on behalf of TIEC in Docket No. 8425.

> *The capacity-related cost associated with interruptible service was, and is, zero.* Since HL&P does not include the loads of interruptible customers in its capacity planning process, *no capacity costs are attributable to these loads.*
>
> ****
>
> The primary justification for offering interruptible service at a price significantly below the price for firm service, is *the avoidance of a capacity commitment.*
>
> ****
>
> So long as the pricing approach, when applied consistently over a long period of time, produces a reasonable result, there is no reason to institute economic curtailments on the basis of *short-term periods of higher than average energy cost.*[24]

Having prevented economic interruption by successfully arguing that short-term periods of high energy-only costs do not involve capacity commitments, TIEC now wishes to avoid those very same costs by arguing the exact opposite and

[24] Docket No. 8425, Direct Testimony of Maurice Brubaker (Rate Design) at 7-9 (emphasis added).

imputing capacity to energy-only purchases. If the Commission falls for this ploy, TIEC will be permitted to escape the economic consequences of the very policy it previously advocated.

Q. ARE YOU FAMILIAR WITH THE TEXAS, LOUISIANA AND GEORGIA CASES CITED BY MR. FALKENBERG AND MR. POLLOCK AS AUTHORITY FOR DETERMINING AN IMPUTED CAPACITY PAYMENT FOR ENERGY PURCHASES?

A. Yes.

Q. DID ANY OF THOSE CASES INVOLVE DAY-AHEAD OR DAY-OF PURCHASES?

A. The decisions in those cases do not suggest that a capacity payment was imputed for any day-ahead or day-of transactions.

Q. DID THE TRANSACTIONS INVOLVED IN THOSE CASES FIT THE DEFINITION YOU HAVE GIVEN OF CAPACITY PURCHASES?

A. Yes. While the details of the individual transactions are not discussed in the Commission orders, the orders indicate that the purchases were being made expressly to acquire capacity as part of the utility's system planning process. The purchases in the Entergy case in Louisiana involved longer term purchases that were made pursuant to a request for proposals to acquire capacity for the summer months. Indeed, the Louisiana case was for authorization to enter into capacity contracts for the summer months. The EGSI case in Texas, involved the same contracts. The Georgia case cited by Mr. Pollock involved contracts the utility had not yet executed. The purchases at issue were included as part of the Georgia utility's capacity in its Integrated Resource Planning process.

Q. DO YOU AGREE WITH MR. FALKENBERG'S ASSERTION THAT HIS PROPOSED DISALLOWANCE IS CONSISTENT WITH THE LOUISIANA COMMISSION'S ACTION IN THE ENTERGY CASE?

A. No. First, the Louisiana Commission's action affected only longer term contracts Entergy entered into expressly to acquire capacity. In sharp contrast, Mr. Falkenberg's proposed disallowance in this case relates primarily to day-of or day-ahead contracts. Second, the Louisiana Commission's action did not involve a disallowance of any costs. Because of the different regulatory structure in Louisiana, both of the Entergy companies were able to recover the imputed capacity component through other filings.

Q. DO THE COMMISSION RULES IN EFFECT DURING THE FUEL RECONCILIATION PERIOD REQUIRE PARTIES TO EXCLUDE FROM RECONCILABLE FUEL AN IMPUTED CAPACITY COMPONENT FOR ENERGY PURCHASES?

A. No. Fairly read, the rules in effect during the fuel reconciliation period require only the exclusion of "demand or capacity" costs from reconcilable fuel.[25] The use of the word "demand" underscores the intent to refer to agreements and costs that provide the utility with rights to call on and control capacity. The rules were written in the context of a regulatory structure in which "capacity costs" were included in base rates and "energy costs" were included in reconcilable fuel. For example, in Docket No. 8425, HL&P's last fully contested rate case, the Commission included in base rates several "contracts for the purchase of firm cogenerated capacity" from various cogeneration facilities.[26] HL&P has never included such capacity expenses in eligible fuel. The prohibition against

[25] P.U.C. Subst. R. 25.236(a)(4).
[26] 16 TEX. P.U.C. BULL. 2199, 2354 (Examiner's Report at 130-131) (June 20, 1990).

inclusion of capacity costs in reconcilable fuel was to prevent double recovery of the costs, not as Mr. Falkenberg and Mr. Pollock are using it to preclude *any* recovery of the costs. CenterPoint's base rates have never included any "imputed capacity costs" for energy purchases. Nor is there any reason to believe the Commission ever intended to permit or require that base rates include an imputed portion of energy payments. Thus, contrary to Mr. Pollock's and Mr. Falkenberg's allegations, the inclusion in eligible fuel of the full amount of CenterPoint Energy's purchased power expenses will not result in the double recovery of any costs. Double recovery of these costs is impossible, because HL&P's base rates were established to recover the embedded costs of HL&P's generating assets and the costs of certain long-term capacity purchases that are distinct from the costs of energy purchases HL&P made during this fuel reconciliation period and included in eligible fuel.

Q. WHY DO YOU BELIEVE THE RULES WERE NEVER INTENDED TO EXCLUDE FROM RECONCILABLE FUEL THE KIND OF IMPUTED CAPACITY COSTS MR. FALKENBERG AND MR. POLLOCK CALCULATE?

A. As Mr. Falkenberg recognizes, base rate treatment is designed for non-volatile costs that vary with growth in load and are not subject to extreme market volatility. He correctly recognizes that "fluctuation in cost is one of the primary reasons for a fuel reconciliation and pass-through process." He adds that "an important reason why fuel (or the fuel component of purchased power) is recovered separately [from base rates]" is that fuel costs fluctuate independently of load growth. The very reasons Mr. Falkenberg gives as the historical reasons for treating some costs as "base rate" items and other costs as "reconcilable" explain why his and Mr. Pollock's method of imputing capacity costs was never used, or intended to be used in setting base rates. In stark contrast to the Commission's rules for setting base rates, which require that capacity be priced on an "original cost" basis, Mr. Falkenberg and Mr. Pollock are suggesting that fluctuating, market-based prices for energy are somehow intended to be dissected so that an arbitrary portion can be included in the base rates.

Q. UNDER THE METHODOLOGIES USED BY MR. FALKENBERG AND MR. POLLOCK, WOULD THE IMPUTED CAPACITY COMPONENT RESEMBLE OTHER BASE RATE COSTS?

A. No. As Mr. Falkenberg acknowledges, base rate costs are non-volatile. The methodologies used by Mr. Falkenberg and Mr. Pollock result in capacity components that are as volatile or more volatile than the underlying cost of fuel. Exhibit CJM-7R shows the extreme volatility of the imputed capacity costs under Mr. Falkenberg and Mr. Pollock's proposals. The graphs presented in Exhibit CJM-7R show quite clearly that Mr. Falkenberg's and Mr. Pollock's imputed capacity costs are much more volatile than gas prices. The incredible volatility of the recommended imputed capacity costs is not surprising. Both power and fuel are purchased at market based prices driven by the laws of supply and demand. At any given time the factors affecting the two markets differ. Because power prices and fuel prices do not move in lock-step, any methodology which imputes a capacity component based on the relationship of those costs will necessarily be volatile.

Q. UNDER THE METHODOLOGIES USED BY MR. FALKENBERG AND MR. POLLOCK WOULD THE IMPUTED CAPACITY COSTS FLUCTUATE INDEPENDENTLY OF LOAD GROWTH?

A. Yes. The methodologies used by Mr. Falkenberg and Mr. Pollock create imputed capacity costs that fluctuate with changes in energy and fuel prices, both of which move independently of the rate of growth in load on the CenterPoint system. This is graphically demonstrated on Exhibit CJM-7R which plots the volatility of the imputed capacity costs recommended by Mr. Falkenberg and Mr. Pollock and of natural gas costs.

Q. WOULD IT HAVE MADE SENSE FOR THE COMMISSION TO ESTABLISH PROCEDURES REQUIRING THAT A PORTION OF ENERGY PAYMENTS BE IMPUTED AS CAPACITY?

A. No. The methodologies used by Mr. Falkenberg and Mr. Pollock to determine imputed capacity costs can be applied only after the fact. Base rate treatment is designed for costs that are reasonably predictable and repeatable. It is difficult to imagine how imputed capacity costs could be reasonably determined in any base rate proceeding. Because the imputed capacity amounts are dependent on relationships among volatile purchased power and fuel costs as well as such unpredictable events as timing of outages and weather induced load spikes, the imputed capacity costs for any given historical period are unlikely to be representative of the likely imputed capacity costs for any future period.

Q. MR. FALKENBERG PURPORTS TO HAVE CALCULATED HIS THRESHOLD COST FOR IMPUTING CAPACITY USING "THE

COMPANY'S LEAST EFFICIENT COMBUSTION TURBINE," AND MR. POLLOCK ASSERTS THAT HE HAS COMPARED PURCHASED POWER PRICES TO HL&P'S "MOST EXPENSIVE PEAKING UNITS." DID THEY DO SO?

A. No. Mr. Falkenberg purports to use "the Company's least efficient combustion turbine."[27] In fact, he based his calculation on a combustion turbine with an assumed heat rate of 17,000 Btu/kWh. In fact, the Company's least efficient combustion turbines have heat rates of just over 20,000 (H.O. Clarke Gas Turbines).[28] If he had actually used the 20,000 heat rate of the least efficient combustion turbine, his imputed capacity costs would have been $17,626,867 instead of 24,005,467 ($6,378,600, or more than 25%, lower).[29] Mr. Pollock states that HL&P's purchased power prices were higher than the cost of generating an equivalent amount with the Company's "most expensive peaking units."[30] Mr. Pollock, however, uses an even lower heat rate – 15,000 – than Mr. Falkenberg used. Had Mr. Pollock used a 20,000 heat rate, his $4,864,200 imputed capacity cost on Exhibit JP-4 would have been reduced to only $1,753,120 and his calculation of 30.3% imputed capacity costs would have fallen to only 11%.[31]

[27] Direct Testimony of R. Falkenberg at 14:22 – 15:1.
[28] *See* Confidential Schedule FR-4.2a to CenterPoint Energy's filing package, pages 23-24 (Actual Heat Rates by Month).
[29] *See*, Confidential Exhibit CJM-8R.
[30] Direct Testimony of J. Pollock at 17:18-20.
[31] *See*, Confidential Exhibit CJM-9R.

Q. DO YOU AGREE WITH MR. FALKENBERG'S SUGGESTION THAT, BY DEFINITION, ANY AMOUNTS PAID FOR POWER PURCHASES AT RATES HIGHER THAN THE COST OF THE HIGHEST COST COMBUSTION TURBINE WERE EITHER TO PURCHASE "CAPACITY" OR WERE "IMPRUDENT"?

A. Absolutely not. Mr. Falkenberg confuses instantaneous need for energy with concepts of capacity. As explained above, capacity purchases are related to anticipated future requirements not actual, instantaneous needs. Many of the highest cost purchases, and consequently many of the greatest imputed capacity costs under his methodology, occur under day-of transactions to deal with short-term imbalances in supply and demand. Certainly the power acquired in those transactions was needed, but it was immediate energy and not the future right to call on reserved capacity that was being purchased.

His alternative conclusion that high cost purchases are imprudent if made for reasons other than to acquire capacity is doubly faulty. First, as I just described, the fact that additional power was needed from time to time does not mean that HL&P was acquiring capacity as intended by the Substantive Rules; and the fact that the price paid for that power was higher than some arbitrary "capacity" price determined by Mr. Falkenberg does not mean the power was not cheaper than other alternatives actually available for obtaining *power*. Second, and more important, his contention requires an after the fact analysis of the transactions. A high price may reflect a purchase prudently made under conditions where the price was expected to be lower than the company's marginal cost of generating energy but because of subsequent unexpected movement of fuel prices, the actual cost of the energy when delivered may be higher than the marginal cost of generating energy. HL&P had to make purchased power decisions based on projections of marginal costs. Because actual marginal costs could be different, actual savings might be greater than or less than those anticipated. A determination of imprudence, however, requires an analysis based on information available at the time the decision was made, not a hindsight analysis of conditions months later.

Q. DO YOU AGREE WITH MR. POLLOCK'S ASSERTION THAT CENTERPOINT REFUSED TO FULLY RESPOND TO TIEC'S DATA REQUEST?

A. Absolutely not. CenterPoint made available to Mr. Pollock and all other parties, records containing all of the information TIEC requested. It did not have the information summarized in the particular form Mr. Pollock preferred and was in no better position to convert the information to Mr. Pollock's preferred format than was Mr. Pollock. Mr. Pollock chose not to expend the time to aggregate the information in the format he wanted.

Q. DO YOU AGREE WITH MR. POLLOCK'S CLAIM THAT TIEC DID NOT HAVE THE RESOURCES TO CONDUCT A COMPREHENSIVE REVIEW OF THE DOCUMENTS CENTERPOINT MADE AVAILABLE?

A. No. TIEC claims that the following companies are participating in the TIEC group for purposes of this proceeding: Air Products & Chemicals, Inc.; The Dow Chemical Company; ExxonMobil Power & Gas Services; FMC Corporation; and Occidental Chemical Corporation.[32] A number of those companies individually,

[32] TIEC Response to CNP 2-72 (attached hereto as Exhibit CJM-10R).

and certainly all as a group have far greater financial resources than does CenterPoint. Mr. Pollock's firm has numerous consultants and staff who presumably could have been assigned to the review. Their website boasts that "BAI's seventeen professionals are experts in more than fifty areas of energy consulting," and that "BAI support staff provides analytical services in the form of computer analysis and modeling, research, graphic arts and database management."[33] If, for some reason, Mr. Pollock's firm was too committed on other matters, there are other consultants who could have been employed. Finally, the law firm employed by the TIEC group is among the largest in the state with a large number of attorneys who regularly practice before the Commission. TIEC's failure to conduct a comprehensive review of the documents made available by CenterPoint is the result of TIEC's own decision not to commit the resources necessary to conduct a timely review.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.

[33] Sample pages from BAI's website are attached as Exhibit CJM-11R.

AFFIDAVIT

THE STATE OF TEXAS §
§
COUNTY OF HARRIS §

Before me, the undersigned notary public, on this day personally appeared Carla J. Mitcham, to me known, who being duly sworn according to law, deposes and says:

"My name is Carla J. Mitcham. I am of legal age and a resident of the State of Texas. The foregoing rebuttal testimony and exhibits offered by me on behalf of CenterPoint Energy are true and correct, and the opinions stated therein are, in my judgment and based upon my professional experience, true and correct."

Carla J. Mitcham

Carla J. Mitcham

SUBSCRIBED AND SWORN BEFORE ME ON THIS 28th day of February 2003.

Alice S. Hart

Notary Public

My commission expires:

7/17/2003

ALICE S. HART
Notary Public, State of Texas
My Commission Expires 7/17/2003

EXHIBIT CJM-1R

CONFIDENTIAL

EXHIBIT CJM-2R

CONFIDENTIAL

CENTERPOINT

DOCKET NO. 26195

CITY OF HOUSTON

Q. Please provide the Dispatch Efficiency Factor for each month of the RP.

A. Please see attached.

Attachments: Dispatch Efficiency Factor

Sponsor: C. J. Mitcham

DISPATCH EFFICIENCY FACTOR

Attachment to Docket No. 26195
COH10 -7
Page 1 of 1

Aug-97	100.95%	Jan-00	100.99%
Sep-97	100.87%	Feb-00	100.81%
Oct-97	100.84%	Mar-00	101.18%
Nov-97	100.68%	Apr-00	101.30%
Dec-97	100.68%	May-00	101.52%
		Jun-00	101.56%
Jan-98	100.67%	Jul-00	101.68%
Feb-98	100.54%	Aug-00	101.44%
Mar-98	100.74%	Sep-00	102.13%
Apr-98	101.07%	Oct-00	101.62%
May-98	100.85%	Nov-00	102.70%
Jun-98	100.85%	Dec-00	102.82%
Jul-98	100.89%		
Aug-98	100.86%	Jan-01	104.35%
Sep-98	100.97%	Feb-01	103.68%
Oct-98	100.75%	Mar-01	103.12%
Nov-98	100.80%	Apr-01	102.59%
Dec-98	100.59%	May-01	102.67%
		Jun-01	102.18%
Jan-99	100.61%	Jul-01	102.72%
Feb-99	100.60%		
Mar-99	100.74%		
Apr-99	100.91%		
May-99	101.35%		
Jun-99	101.33%		
Jul-99	101.30%		
Aug-99	101.25%		
Sep-99	101.44%		
Oct-99	100.69%		
Nov-99	100.85%		
Dec-99	101.51%		

HL&P stopped calculating a dispatch efficiency factor when ERCOT began single control area operation.

SOAH DOCKET NO. 473-02-3473
PUC DOCKET NO. 26195

THE CITY OF HOUSTON'S RESPONSE TO CENTERPOINT ENERGY'S SECOND REQUEST FOR INFORMATION

2-108 For each JOA EXPERT, please provide a detailed description of the JOA EXPERT's experience negotiating, reviewing, evaluating, or implementing joint operating agreements among other electric utilities. Identify the utilities involved, the nature of the JOA EXPERTS activities related to the joint operating agreement and any documents in the JOA EXPERT's possession relating to the joint operating agreement.

Response: Mr. Norwood reviewed and evaluated Houston Lighting & Power Company's (HL&P) testimony and discovery responses related to its joint operating agreement with City Public Service Company of San Antonio (CPS) in this case and in PUC Docket No. 18753. Mr. Norwood also reviewed the joint operating agreements of Central and Southwest Company, American Electric Power Company (AEP), Xcel Energy Company and Entergy in conjunction with past fuel reconciliation cases filed by various affiliate operating companies of those utilities. See Mr. Norwood's supplemental direct testimony in PUC Docket No. 26000 for a discussion of issues related to the AEP JOA. In late 1995 and early 1996, Mr. Norwood directed an analysis of the potential economic benefits of implementing a power pool for several public utilities in ERCOT. This work was performed on behalf of Austin Energy. The utilities included in this power pool analysis were Austin Energy, City Public Service Company of San Antonio, Brazos Electric Power Cooperative, and the Texas Municipal Power Agency. The work entailed production cost modeling to determine the potential production cost savings that could be achieved by these parties forming a power pool, under a range of future gas-price and market scenarios. Due to the relatively low level of projected savings, and other factors, the formation of a power pool for these public entities was not pursued; therefore, a joint operating agreement was not developed.

Attachments: None
Sponsor: Scott Norwood

NONFIRM ENERGY PURCHASE FROM QUALIFYING FACILITIES - NEP

AVAILABILITY

To all Qualifying Facilities with design capacity in excess of 100 Kw wishing to sell Nonfirm Energy in accordance with provisions and procedures contained in this tariff.

APPLICATION

The rate shall apply to the purchase by the Company of Nonfirm Energy from the Customer's Qualifying Facility (QF). This schedule does not require or provide for any electric service by the Company to the Customer. The Customer may request such service from the Company and, if required by the Company, shall enter into separate contractual agreements with the Company in accordance with the applicable electric tariff(s) on file with and approved by the regulatory authorities having jurisdiction thereof. The rules under which small power production and cogeneration facilities can obtain "Qualifying" status are set forth in the rules of the Federal Energy Regulatory Commission implementing the Public Utility Regulatory Policies Act of 1978.

PAYMENT DETERMINATION

The monthly payment to QF for Nonfirm Energy shall be 99% of the sum of the calculations under (1) and (2) below. Each month RELIANT ENERGY HL&P will prepare and make this payment based on estimated fuel price components which will be reconciled in the second succeeding month based on actual fuel price components.

(1) Fuel Payment	The monthly Fuel Payment will be the sum of the products of the period Energy Rate times the period Nonfirm Energy Kwh times the period Enhancement Factor for each period in the month.
(2) O & M Expense	$.001204 per Nonfirm Energy Kwh for variable operations and maintenance expenses.