Control Number: 29206

Item Number: 334

Addendum StartPage: 0

PUC DOCKET NO. 29206
SOAH DOCKET NO. 473-04-2459

2004 AUG 23 PM 1:52

PUBLIC UTILITY COMMISSION
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APPLICATION OF TEXAS-NEW MEXICO POWER COMPANY, FIRST CHOICE POWER, INC., AND TEXAS GENERATING COMPANY, L.P. TO FINALIZE STRANDED COSTS UNDER PURA § 39.262	§	**BEFORE THE PUBLIC UTILITY COMMISSION OF TEXAS**

APPLICANTS' REPLY TO INTERVENORS' MOTIONS FOR REHEARING

TABLE OF CONTENTS

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TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

COME NOW, Texas-New Mexico Power Company, First Choice Power, Inc., and Texas Generating Company, L.P. ("Applicants") and file this Reply to Intervenors' Motions for Rehearing in accordance with Tex. Gov't Code §§ 2001.145, 2001.146, Tex. Util. Code § 11.007, and P.U.C. Proc. R. 22.264.

I. RESPONSE TO CITIES' MOTION FOR REHEARING

A. Response to Point of Error No. 1 (ADFIT-Tax Depreciation, ADFIT-Tax Loss from Sale of TNP One, and ITCs)

1. *ADFIT-Tax Depreciation and ADFIT-Tax Loss from Sale of TNP One*

The Commission properly excluded the amounts in the accounts for ADFIT-Tax Depreciation and ADFIT-Tax Loss From Sale of TNP One from the calculation of stranded costs associated with TNP One. In summary, the Commission properly rejected the argument that stranded costs be adjusted for ADFIT-Tax Depreciation and ADFIT-Tax Los from Sale of TNP One because there is no statutory or regulatory support for such a reduction, and further the use of the ADFIT-Tax Depreciation in the ECOM model does not support an adjustment in this proceeding.[1]

Further, TNMP presented several reasons in its briefs supporting the Commission's decision.[2] Specifically, ADFIT is not included within the definitions of stranded costs or mitigation, the tax liability remains on the Company's books, and the tax loss did not occur until after December 31, 2001, the date on which Senate Bill 7 requires book value of the plant to be

[1] PFD at 77-78.

[2] Applicants' Initial Brief at 20-26; Applicants' Reply Brief at 18-26.

set.[3] Cities' claim that TNMP has "ignored, concealed, or failed to offset tax consequences and tax impacts associated with the sale of TNP One"[4] is without merit because TNMP has done everything that is specified in the statute, the rules, and the filing package for true-up proceedings. Without express statutory support, or at least the inclusion of ADFIT within the definitions of stranded costs or mitigation, the Commission has no authority to reduce TNMP's stranded costs by any ADFIT.[5] To grant relief would be contrary to law and arbitrary and capricious. It would also constitute a violation of due process and ex post facto imposition of an obligation in violation of the Texas Constitution Art. 1 §§ 16, 19 and the United States Constitution Fifth and Fourteenth Amendments.

2. *Investment Tax Credits (ITCs)*

The Commission should not have reduced TNMP's stranded costs by *any* amount of ITCs, as explained in Applicants' Motion for Rehearing.[6] In short, there is no authority in PURA or the Commission rules governing the computation of stranded costs to support such an adjustment. In addition, reducing stranded costs by ITCs is inconsistent with the definition of stranded costs in PURA § 39.251(7) and the use of ITCs described in PURA § 39.302(5) (in a securitization proceeding or in circumstances where there will be no normalization violation). It would therefore be a violation of due process and ex post facto imposition of an obligation in violation of the Texas Constitution Art. 1 §§ 16, 19 and the United States Constitution Fifth and Fourteenth Amendments.

Moreover, the Cities' argument that TNMP's stranded costs be reduced by $23,232,000 for ITCs is additionally plagued with the error of double counting.[7] The $23 million figured is comprised of TNMP's ITCs as of December 31, 2001 ($15 million), and a gross up of that figure to a pre-tax basis. The Commission has already disallowed the income tax gross up of the deferred taxes related to the ITCs by adopting the Staff's accounting adjustments.[8] If the Commission were to disallow an additional $8 million to account for federal taxes, it would be

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[3] Applicants' Reply Brief at 18-22.

[4] Cities' Motion for Rehearing at 4.

[5] *See* PURA § 39.252(a) (a "utility is allowed to recovery *all* of its net, verifiable, nonmitigable stranded costs") (emphasis added).

[6] Applicants' Motion for Rehearing at 30-31.

[7] Cities' Motion for Rehearing at 8-9.

[8] PFD at 58-70; Order at 45 (Findings of Fact 45 and 47). *See also* Applicants' Exceptions at 17-20.

disallowing the grossed up amount for a second time and would amount to nothing other than an impermissible penalty in violation of TNMP's constitutional rights.

B. Response to Point of Error No. 2 (Accelerated Depreciation)

The Cities' argument that TNMP take an additional $60 million in accelerated depreciation should be rejected because, first, it is based on the faulty premise that TNMP is obligated to apply $60 million in depreciation under the order in Docket No. 17751. As TNMP stated in its motion for rehearing, the Commission has misinterpreted the final orders in Docket Nos. 17751, 21112, and 22349 (and violated several provisions of PURA) in finding that TNMP is required to take additional accelerated depreciation of $19 million (for a total of $60 million).

In addition, the Commission has properly rejected Cities' argument that TNMP must take an additional $60 million deduction without any credit for the $40.2 million in excess earnings stranded cost mitigation that TNMP has taken. Accelerated depreciation has a direct effect on excess earnings. Any obligation to record additional accelerated depreciation would have correspondingly reduced excess earnings. Thus, the only net change in the actual mitigation TNMP undertook would be the $19 million, which the Commission has ordered TNMP to record.[9] Granting Cities the relief they request would be inconsistent with PURA §§ 39.254 and 30.257, arbitrary and capricious, and violate accepted principles of res judicata because it would be a result directly inconsistent with the Commission's final orders in Docket Nos. 22276, 23806, and 25593.

C. Response to Point of Error No. 3 (Carrying Costs on Accelerated Depreciation)

As discussed in section I.B. above, TNMP was not required to record the additional accelerated depreciation urged by Cities. As a result, there should be no adjustment for carrying costs associated with the additional accelerated depreciation.

D. Response to Point of Error No. 4 (Carrying Costs on Excess Earnings)

The Commission properly found that TNMP appropriately applied carrying charges on its excess earnings mitigation. TNMP presented direct testimony from its Chief Financial Officer, Scott Forbes, that it mitigated its stranded costs for the reduced carrying costs associated with excess earnings recorded in 1999-2001 through a reduction to rate base/stranded costs in each

[9] TNMP disputes the Commission's requirement to take this additional $19 million in accelerated depreciation. *See* Applicants' Motion for Rehearing at 25-28.

year by the cumulative excess earnings from prior years.[10] Mr. Forbes also supported Schedule III of TNMP's True-up Application and the associated workpapers, which include relevant portions of the Annual Reports. That information is contained behind Tab 3 of the workpapers and bear the prefix WP/III-F.[11] It is in the record of this case as TNMP Exhibit 2. Schedule VIII of each Annual Report contains the journal entry that has been recorded on the Company's books to apply the excess earnings determined on Schedule I of the Annual Report.[12] According to the Instructions for filing annual reports under PURA § 39.257, Schedule VIII must include all journal entries related to all attendant impacts of applying excess earnings.[13] Those excess earnings have been applied to reduce the rate base/stranded costs in each year in accordance with PURA § 39.254.[14] The Cities' motion for rehearing on this issue should be denied as having no support.

E. Response to Point of Error No. 5 (Interest on Fuel Balance)

The Commission properly applied P.U.C. SUBST. R. 263(h)(4) in calculating the interest on the final fuel balance. Commission Staff, who coordinated the efforts drafting this rule,[15] agrees with the Commission.[16] Cities, on the other hand, is the only party in this proceeding who disputes the Commission's application of this rule. The Commission's application is correct

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[10] Rebuttal Testimony of Scott Forbes, TNMP Ex. 24 at 7-8; *see also* Rebuttal Testimony of Patrick L. Bridges, TNMP Ex. 22 at p. 10, ln. 26 – p. 11, ln. 29 – p. 12, ln. 5; p. 12, ln. 24 – p. 13, ln. 2.

[11] *See* Workpapers, TNMP Ex. 2 at WP/III-F, Bates No. TNMP TU 01762 – TNMP TU 01775.

[12] *See* Workpapers, TNMP Ex. 2 at WP/III-F-2.2, Bates No. TNMP TU 01767; WP/III-F-3.3, Bates No. TNMP TU 01771; WP/III-F-4.3, Bates No. TNMP TU 01775.

[13] General Instructions to Annual Report of Electric Utilities Pursuant to § 39.257 of the Public Utility Regulatory Act at 9, available at http://www.puc.state.tx.us/electric/forms/index.cfm.

[14] Rebuttal Testimony of Scott Forbes, TNMP Ex. 24 at 7-8; *see also* Rebuttal Testimony of Patrick L. Bridges, TNMP Ex. 22 at 10, line 26 – 11, line 4; 11, line 29 – 12, line 5; 12, line 24 – 13, line 2.

[15] *See* Applicants' Exceptions at 54-55. *See also* Memorandum from Darryl Tietjen, to Chairman Max Yzaguirre, Commissioner Brett A. Perlman, and Commissioner Rebecca Klein, Project No. 23571—Rulemaking Concerning True-up Proceeding under PURA § 39.262, Staff Recommendation for Adoption of rule (November 13, 2001) (available at PUC Interchange, Docket No. 23571, Item No. 43).

[16] Staff's Post Hearing Initial Brief at 39-40; Direct Testimony of Darryl Tietjen, Staff Ex. 2 at 7.

because its interpretation is the only one that gives effect to all parts of the rule.[17] Cities' interpretation, on the other hand, renders subparagraph 25.263(h)(4)(B) meaningless.[18]

Cities argue that they are entitled to a rehearing on this issue because their interpretation of 25.263(h) is (1) consistent with the treatment proposed by CenterPoint Energy in its pending final fuel reconciliation case and final true-up proceeding; and (2) in accord with the stipulation entered in Docket No. 27576 regarding post-reconciliation interest.

Cities' arguments fail for two reasons. First, another entity's interpretation of the application of a rule in another case is irrelevant. This is particularly true in the context of very different factual circumstances. CenterPoint faces significantly different factual circumstances – it faces an underrecovery of fuel costs.

Second, Cities is absolutely incorrect that their position is in accord with the stipulation entered in Docket No. 27576.[19] The *Notice of Agreement Regarding Post-Reconciliation Interest*[20] states expressly that "For purposes of this agreement, 'post reconciliation interest' refers to the carrying costs accrued after the close of the reconciliation period on the positive or negative fuel balance as of the close of the reconciliation period. . . The parties agree that the . . . interpretation of P.U.C. Subst. R. 25.263(h)(4) [is an] issue more appropriately determined by the Commission during the true-up proceeding described in P.U.C. Subst. R. 25.263." TNMP did not agree that the interpretation of "the period" referenced in P.U.C. Subst. R. 25.263 would be the period from the end of the fuel reconciliation period until the final true-up order. In fact, the Agreement provided that "the parties to this final fuel reconciliation proceeding take no position regarding the calculation of post-reconciliation interest or the interpretation of P.U.C. Subst. R. 25.263(h)(4) by entering into this agreement." Thus, the Agreement referred to by Cities does not support their claim, and their request for a rehearing on this issue should be

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[17] *See Broadhurst v. Employees Retirement System of Texas*, 83 S.W.3d 320, 323 (Tex. App.—Austin 2002, writ denied). *See also Texas Workers' Comp. Comm'n of Texas v. Harris County*, 132 S.W.3d 139, 144 (Tex. App.—Houston [14th Dist.] 2004, no pet.) (regulations should be construed in the same manner as statutes).

[18] *See* Applicants' Initial Brief at 83-85; Applicants' Reply Brief at 65-66; Commission Staff's Exceptions at 3-5.

[19] It is also odd that Cities make this claim since their witness, Scott Norwood, agreed that TNMP's agreement in the fuel reconciliation case has no bearing on the decision that the Commission will make in this case. *See* Tr. at 463, lines 9-12 (April 15, 2004).

[20] *Application of Texas-New Mexico Power Company for Reconciliation of Fuel Costs*, Docket No. 27576, Notice of Agreement Regarding Post-Reconciliation Interest at 1 (September 5, 2003); Tr. at 465, line 18 – 466, line 11 (April 15, 2004).

denied. Acceptance of Cities claim would thus violate a prior Commission order, be arbitrary and capricious, and not supported by substantial evidence.

F. Response to Point of Error No. 6 (Over-Recovery of Stranded Costs)

The Commission erred by finding that TNMP did not sell TNP One in a bona fide third party transaction under a competitive offering and that TNMP did not pursue commercially reasonable means to reduce stranded costs.[21] As a result, any reduction of stranded costs based on these findings in an error. Cities further claim that the Commission is compelled to award no stranded costs based on its finding that TNMP did not sell the plant in a bona fide third party transaction. Cities cite no legal authority to support their claim. Moreover, as the Commission stated in the final order, a crucial part of protecting the public interest during the transition to and in the establishment of a fully competitive electric power industry is permitting a utility to recover its stranded costs.[22] The Supreme Court has confirmed the Legislature's intent by stating that it is "in the public interest for utilities to be made whole by recovering their full investment in those [uneconomic] generation assets . . . utilities should not be required to forfeit their investments in generating plants with the advent of deregulation."[23] Cities' seek to upset that intent by arguing, inconsistent with the language of the statute and without any support, that the Commission may not allow TNMP to recover its stranded costs. The Commission considered this interpretation of the statute and properly rejected it.[24] Further, such an extraordinary outcome, which deprives a utility of all of its stranded costs, requires express statutory authority. Without such authority, a finding requiring TNMP to forfeit its stranded costs would violate due process, the prohibition of ex post facto laws, and the protections against deprivation of property without compensation (Texas Constitution Art. 1 §§ 16, 17, and 19; United States Constitution Fifth and Fourteenth Amendments).

In addition, the other arguments in Cities' motion for rehearing contain misstatements and flawed reasoning. Cities claim that the "market value of TNP One on December 31, 2000" was $310 million.[25] Contrary to this claim, the stated figure does not represent a "market value"

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[21] Applicants' Motion for Rehearing at 4-11.

[22] *See* Order at 21 (citing PURA §39.001(b)(2)).

[23] *Centerpoint Energy, Inc. v. Pub. Util. Comm'n*, No. 03-0396, 2004 WL 1386192, at *2 (Tex. June 18, 2004).

[24] *See* Order at 21.

[25] Cities' Motion for Rehearing at 16.

as defined and required by PURA. Rather, the uncontroverted evidence is that the figure is an accounting impairment valuation and has no relationship to any actual transaction or any market-based offer for the plant.[26] An impairment analysis is an accounting tool that yields a value significantly higher than fair market value.[27] As TNMP witness Mr. Meehan explained, the study that yielded the $310 million figure was a version of the ECOM Model study[28] and therefore an inappropriate substitute for a market-driven valuation.

II. RESPONSE TO TIEC'S MOTION FOR REHEARING

A. Response to Argument That TNMP Should Have Delayed the Sale

Section 39.252(d) of PURA prohibits the Commission from substituting its judgment for the market price obtained by the sale of TNP One. Yet, that is exactly what TIEC would have the Commission do by arguing that TNMP should have delayed the sale of TNP One in May 2002 and better "time" the market based entirely on hindsight analysis.[29] The Commission has properly found that TNMP's decision to sale the plant in May 2002 was commercially reasonable.[30] Moreover, the record does not support the conclusion that TNMP should have delayed the sale in May 2002. TNMP agreed to sell TNP One to Sempra in May 2002 because (1) contemporaneous evidence shows that Sempra was offering a reasonable price for the plant,[31] (2) there was a substantial risk of further degradation of the market,[32] and (3) contemporaneous evidence shows that a delay of the sale in May 2002 could have had a negative impact on the

[26] Rebuttal Testimony of Scott Forbes, TNMP Ex. 24 at 9, lines 7-15.

[27] Conformed Rebuttal Testimony of James M. Coyne, TNMP Ex. 27 at 28, lines 619-630.

[28] Rebuttal Testimony of Eugene T. Meehan, TNMP Ex. 26 at 20, line 22 – 22, line 5.

[29] *See* Applicants' Reply Brief at 27-36.

[30] Order at 23.

[31] TNMP carefully analyzed various market factors and concluded that a reasonable price for the plant would be between $103.9 million and $123 million. *See* Conformed Rebuttal Testimony of Jack V. Chambers, TNMP Ex. 18 at 11, lines 4-15; Rebuttal Testimony of Patrick L. Bridges, TNMP Ex. 22 at 2, line 1 to 5, line 11, Exhibit PLB-2R.

[32] Conformed Rebuttal Testimony of Jack V. Chambers, TNMP Ex. 18 at 6, line 31 to 7, line 2; Conformed Rebuttal Testimony of James M. Coyne, TNMP Ex. 27 at 17, lines 351 to 19, line 383.

value of the plant.[33] TNMP's decision not to delay the sale of the plant was reasonable and any finding to the contrary should be rejected.[34]

B. Response to Argument Regarding Quantification of Disallowances

The Commission properly rejected use of both the $255 million figure and the $287 million figure as any indication of market value. TIEC claims that if TNMP had delayed the sale for six months, it could have sold TNP One for $255 million.[35] Similarly, according to TIEC, if TNMP had delayed the sale until 2003, it could have sold TNP One for $287 million.[36] As the Commission stated, however, this analysis presumes a delay in the sale of TNP One, which was not necessary, and no penalty should be imposed on TNMP based on its decision to sell the plant in May 2002.[37]

Further, these figures are based on an analytical approach to value that does not even purport to be based on market events. The spark spread analysis, used by Mr. Weyel to arrive at these figures, is useful to determine how a change in a single input might hypothetically affect the value but is otherwise unreliable for valuation purposes.[38] Finally, this claim is inconsistent with the evidence demonstrating that the price TNMP obtained was consistent with the prices obtained by other entities who sold their plants during the period following the sale of TNP One.[39] TIEC's request for a rehearing based on these quantifications should be rejected.

C. Response to Argument That TNMP is Entitled to No Stranded Costs.

Finally, TIEC argues that the Commission is without power to grant TNMP recovery of any stranded costs based on its finding with respect to PURA §39.262(h). This argument has no

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[33] Direct Testimony of William J. Catacosinos, TNMP Ex. 6 at 11, lines 7-12, 8, line 20 to 9, line 5; Direct Testimony of Jack V. Chambers, TNMP Ex. 13 at 8, line 15 to 9, line 47; Conformed Rebuttal Testimony of James M. Coyne, TNMP Ex. 27 at 19, line 387 to 20, line 415; Conformed Rebuttal Testimony of Jack V. Chambers, TNMP Ex. 18 at 7, lines 20-21.

[34] *See* Conformed Rebuttal Testimony of James M. Coyne, TNMP Ex. 27 at 16, lines 326-328.

[35] TIEC's Motion for Rehearing at 2.

[36] TIEC's Motion for Rehearing at 2.

[37] Order at 23.

[38] Conformed Rebuttal Testimony of James M. Coyne, TNMP Ex. 27 at 27, lines 607 to 28, line 618. *See also* Rebuttal Testimony of Eugene T. Meehan, TNMP Ex. 26 at 16, line 8 to 18, line 14.

[39] *See* Applicants' Exceptions at 38-41.

merit for the reasons that are set forth under section I.F. in response to Cities' Point of Error No. 6.[40]

III. RESPONSE TO PRG'S MOTION FOR REHEARING

PRG's motion for rehearing is without merit. PRG failed to demonstrate that it has a sufficient justiciable interest in this proceeding to permit it to intervene. To be entitled to intervene, a party must establish that it has a "justiciable interest which may be adversely affected by the outcome of the proceeding."[41] The Commission has interpreted this rule as requiring a would-be intervenor to demonstrate "interests that merit relief which is sought and which is within the Commission's power to grant."[42] None of the reasons given by PRG in its motion to intervene or its motion for rehearing rise to that level.[43]

IV. CONCLUSION AND PRAYER

WHEREFORE, PREMISES CONSIDERED, Applicants pray that the Commission deny the motions to intervene of TIEC, Cities, and PRG.

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[40] TIEC cites *Cobra Oil & Gas Co. v. Sadler*, 447 S.W.2d 887, 892 (Tex. 1668) and *Cofer v. Pub. Util. Comm'n*, 754 S.W.2d 121, 124 (Tex. 1988) as standing for the proposition that an agency may not create an exception in a statute when none exists. These cases are not applicable to this situation where a strict interpretation of the statute and consideration of the Legislature's intent yields the opposite result.

[41] P.U.C. PROC. R. 22.103.

[42] *Application of Dallas Power and Light Company, Texas Service Company and Texas Power and Light Company for Rate/Tariff Revisions,* Docket Nos. 4782, 4783 and 4784, 9 P.U.C. BULL. 169, 173 (June 1, 1983).

[43] *See* Applicants' Opposition to Motion to Intervene of Power Resource Group, Inc. (Item No. 125); Texas-New Mexico Power Company's Surreply to PRG's Response to TNMP's Opposition to PRG's Motion to Intervene (Item No. 162); Applicants' Reply to Power Resource Group, Inc.'s Appeal of Denial of Motion to Intervene (Item No. 213); Applicants' Response to Motion for Rehearing of Power Resource Group, Inc. (Item No. 285).

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CERTIFICATE OF SERVICE

Counsel for Texas-New Mexico Power Company hereby certifies that a true and correct copy of this Reply to Intervenors' Motions for Rehearing was served on all parties of record on August 23, 2004, by hand delivery, facsimile transmission, electronic transmission, and/or first class mail.

James Guy