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BEFORE THE

PUBLIC UTILITY COMMISSION OF TEXAS

SOAH DOCKET NO. 473-04-2459

PUC DOCKET NO. 29206

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

APPLICANTS' MOTION FOR REHEARING OF JUNE 3, 2005 ORDER ON REHEARING

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TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

Texas-New Mexico Power Company, First Choice Power, Inc., and Texas Generating Company, L.P. (collectively, "Applicants" or "TNMP") file this Motion 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. The Applicants move for a rehearing of the June 3, 2005 Order on Rehearing and would show the Commission as follows:

I. INTRODUCTION

The Applicants respectfully submit that the Commission made a number of errors in the June 3, 2005 Order on Rehearing ("June 3, 2005 Order") in this docket that unjustifiably reduced the true-up balance to which TNMP is lawfully entitled. The Commission's order contravenes the legislative scheme and contradicts the Supreme Court's clear directive. It leaves TNMP in a substantially worse position than it was before deregulation. Relying on concepts entirely foreign to Senate Bill 7 (1999) and by interpreting and applying provisions of S.B. 7 in a fashion that does violence both to the words and the spirit of the statute, the Commission's June 3, 2005 Order illegally appropriated TNMP's stranded costs.

The Commission's June 3, 2005 Order also has done serious violence to the Legislature's careful choice of a scheme for quantifying stranded costs. The Legislature carefully considered the various ways in which stranded costs could be calculated and specifically rejected estimates, analyses, and studies in favor of market-based transactions. The Commission's June 3, 2005 Order has turned the Legislature's choice on its head by rejecting a market-based transaction in favor of a series of inapplicable and unreliable estimates.

The Commission should grant rehearing and apply the statutory scheme in a manner that is fair and reasonable and consistent with the Legislature's intent and the Commission's authority.

II. GROUNDS FOR REHEARING

This June 23, 2005 Motion for Rehearing points out all errors in the June 3, 2005 Order. The motion will first focus on the determination and calculation of interest on stranded costs as that was the central issue during the hearing on remand. In that connection, the Commission committed errors in (i) performing the calculation to arrive at the actual interest amount, and (ii) substituting its judgment for that of the Administrative Law Judge's (ALJ) on the appropriate interest rate, without having reviewed the evidence. TNMP provides a description of these errors under headings Error No. 1 and Error No. 2 below.

Further, Applicants re-urge the errors identified in its first Motion for Rehearing (August 11, 2004) unrelated to those dealing with the calculation of interest. Applicants are entitled to a rehearing on nearly all findings and conclusions relating to the sales process and the determination of the standards by which that process is judged. The Commission has violated the Public Utility Regulatory Act (PURA) in the ways identified below and has abused its discretion in failing to reasonably interpret the true-up statutory provisions and in modifying the ALJs' proposed findings. Furthermore, the Commission's decisions on the amount of disallowances attributed to the auction process and TNMP's actions during the sale are affected by other error of law because the Commission failed to consider the vast amount of TNMP's relevant evidence critical to determination of the relevant issues in this case. These errors result in substantial harm to Applicants by illegally decreasing their stranded cost recovery.

Applicants filed a comprehensive set of exceptions to the ALJs' May 28, 2004 Proposal for Decision ("May 28, 2004 PFD").[1] With two minor exceptions, the Commission made no changes to that PFD based on Applicants' Exceptions.[2] Those exceptions have merit and Applicants incorporate them herein for all purposes. For purposes of explanation, TNMP provides below under the headings Error No. 3 through Error No. 32 a description of the errors contained in the July 22, 2004 Order, which were re-adopted and carried forward in the June 3,

[1] *See* Applicants' Exceptions to ALJs' Proposal for Decision (filed June 7, 2004); *see also* Errata to Applicants' Exceptions to ALJs' Proposal for Decision (filed June 7, 2004).

[2] The Commission corrected an issue of double counting and adopted TNMP's arguments (along with Staff's) concerning the rate for carrying charges on the fuel balance.

2005 Order, and describes additional errors and argument based on the Commission's June 3, 2005 Order, which modified but adopted the May 28, 2004 PFD and modified and approved the PFD on Remand ("March 11, 2005 PFD"). If a rehearing is not granted and these errors not corrected, substantial rights of the Applicants will be prejudiced by the Commission's erroneous findings, inferences, conclusions, and decisions.

Error No. 1: **The Commission erred in calculating the appropriate interest on TNMP's stranded costs.**

The Commission erred in its calculation of the interest on TNMP's stranded costs because it failed to account for the interest accrued during the month of January 2002. It is apparent that there has been a misapplication of certain exhibits. Attachments C and D attached to the June 3, 2005 Order rely upon the Excel spreadsheets developed by TNMP witness Stacy Whitehurst in his Direct Testimony and adopted by Staff witness Darryl Tietjen in his Supplemental Direct Testimony (compare Supplemental Exhibits DT-1 and DT-2, which uses 10.93%, with Attachments C and D of the June 3, 2005 Order).[3] After those testimonies were filed, the Applicants discovered a formulaic error in the spreadsheets which resulted in both Mr. Whitehurst and Mr. Tietjen filing errata and amended testimony.[4] A copy of these errata are attached to this Motion for Rehearing.

The June 3, 2005 Order overlooks these agreed errata. There is no dispute that to the extent the Applicants are entitled to interest they are entitled to it for January 2002. Yet, Attachments C and D to the June 3, 2005 Order do not calculate the interest on the January 1, 2002 balance for the month of January. This can be illustrated by looking at the amounts entered in Attachments C and D for "JAN 2002." Under the column heading "STRANDED COSTS PER FINAL ORDER" in Attachment C, the ***beginning*** balance is "$128,820,365." Under the far-right column heading "CUMULATIVE NET STRANDED COST & INTEREST RECOVERY," the identical balance is shown ***even though a full month of interest had accumulated.*** (Note also the "$0" entry under the column heading "INTEREST ON PREV. MONTH'S CUM. STRANDED COST AND INTEREST BAL.", which should be the amount of interest calculated for the month of January.) This same balance is carried forward and used to

[3] There is a slight difference in the total resulting interest in Mr. Tietjen's charts and the attachments to the June 3, 2005 Order, which is likely caused by rounding variations.

[4] *See* Errata and Amended Direct Testimony of Stacy R. Whitehurst, TNMP Ex. 1(R) (Nov. 29, 2004); Commission Staff's Errata to the Testimony of Darryl Tietjen, Staff Ex. 1(R) (Nov. 30, 2004).

calculate interest in the month of February. The failure to calculate and accumulate interest in the initial month caused each subsequent month, which relied upon the previous month's determination, to be in error as well. This same formulaic error occurs in Attachment D. Because of the errors in the attachments, Findings of Fact 194, 194A, 208, and 209 and Conclusions of Law 33 and 33A (and the related discussion on pages 37-38 of the June 3, 2005 Order) are arbitrary and capricious, constitute an abuse of discretion, and are not supported by substantial evidence.

Assuming that the Commission uses 10.93% to calculate the interest due TNMP, then the correct interest should be **$39,166,214** under the "No Bona Fide Transaction" theory and **$42,514,910** under the "Commercially Reasonable Means" theory, as calculated by Staff witness Darryl Tietjen in the Commission Staff's Errata to the Testimony of Darryl Tietjen.[5]

Error No. 2: **The Commission erred by rejecting the ALJ's proposed interest rate to determine carrying costs on TNMP's stranded costs.**

The Commission erroneously modified certain findings of fact and conclusions of law relating to the appropriate interest rate for stranded costs that were made by the ALJ after a hearing on remand. The ALJ considered all of the evidence at the hearing and found that "TNMP's UCOS WACC is the appropriate interest rate to apply to its stranded costs."[6] The ALJ, therefore, recommended that the Commission adopt TNMP's proposed 11.59% interest rate, based on its pre-tax UCOS WACC.[7]

The Commission erroneously rejected this finding based solely on the grounds that TNMP's proposed cost of debt in the UCOS proceeding "was neither evaluated by the Commission nor adopted by the Commission in its order in that proceeding [Docket No. 22349]."[8] As a result, the Commission rejected the resulting WACC (weighted average cost of capital) derived from TNMP's proposed cost of debt. The Commission, however, ignored all of the evidence and the ALJ's recommendation in this docket that TNMP's proposed WACC was "independently appropriate," regardless of whether or not the UCOS WACC was required by

[5] *See* Commission Staff's Errata to the Testimony of Darryl Tietjen, Staff Ex. 1(R) (Nov. 30, 2004) (see Exhibit A, attached hereto, at pages 24-25).

[6] March 11, 2005 PFD at 19.

[7] *Id.*

[8] June 3, 2005 Order at 40-41.

P.U.C. Subst. R. 25.263(l)(3).[9] The ALJ, after weighing the factual evidence, found that TNMP had proposed an appropriate interest rate "even if the entire rule was invalidated." Because the Commission rejected and changed the ALJ's findings and conclusions based on an erroneous reading of the March 11, 2005 PFD and without providing a legitimate means for doing so, the Commission violated Tex. Gov't Code § 2003.049(g). TNMP's proposal, as adopted by the ALJ, is supported by a preponderance of the evidence and it is an error to reject that proposal and adopt the alternative view espoused by the Staff, as described by TNMP in the following filings and incorporated herein for all purposes: (i) Applicants' Initial Brief on Remand at pages 1 through 17, Applicants' Reply Brief on Remand at pages 3 through 16, and Applicants' Response to Exceptions to Remand PFD at 2 through 16. Thus, Findings of Fact 203, 204, 205, 207, 208, and 209, Conclusions of Law 33 and 33A, and Attachments C and D are arbitrary and capricious, constitute an abuse of discretion, and are not supported by substantial evidence.

Error No. 3: **The Commission violated the Texas Government Code by changing or deleting findings and conclusions of the ALJs, including findings and conclusions to which no party filed exceptions.**

The Commission modified certain proposed findings of fact and conclusions of law of the ALJs to which no exceptions were filed (Findings of Fact 74A, 80A, 94A, 94B, 94C, 118A, 155A, 159A, 160A, 165A, 165B, 165C, 165D, 165E, 172A, 172B, 172C, 173A, and 173B and Conclusions of Law 6A, 6B, 6C, 6D, 6E, 6G, 18B, and 23A) and in some cases added findings and conclusions **directly contradicting** those reached by the ALJs (Findings of Fact 138A, 141A, 141B, 141C, 143, 143A, 155B, 155C, 160A, 160B, 166, 167, 168, 170, 184A, 184B, 184C, 184D, 184E, 185, and 185A and Conclusions of Law 6F, 18, 18A, 20, 20A, 20B, 22A, 24A, and 24B). Those modifications and additions are affected by error of law. The modification of these findings was error for **each** of the following reasons:

1. They violate Tex. Gov't Code § 2003.049(g), which provides:

   > the commission may change a finding of fact or conclusion of law made by the administrative law judge or vacate or modify an order issued by the administrative law judge only if the commission:
   >
   > (1) determines that the administrative law judge:

[9] March 11, 2005 PFD at 19.

(A) did not properly apply or interpret applicable law, commission rules or policies, or prior administrative decisions; or

(B) issued a finding of fact that is not supported by a preponderance of the evidence; or

(2) determines that a commission policy or a prior administrative decision on which the administrative law judge relied is incorrect or should be changed.

The Commission failed to make adequate findings supporting its compliance with these requirements, and there is not substantial evidence to support such findings if made.

2. They violate Tex. Gov't Code § 2003.049(h) because the Commission amended the proposal for decision without stating "the specific reason and legal basis" for making the amendments.

3. They violate Tex. Gov't Code § 2001.062(d), which permits a proposal for decision to be "amended in response to exceptions, replies, or briefs submitted by the parties." The Commission violated this provision by amending portions of the ALJs' proposal for decision sua sponte and not in response to any filings made by the parties.

4. They violate Tex. Gov't Code § 2001.062(a)(2) because, after making substantial revisions to the proposed order (July 9, 2004), the Commission failed to give TNMP an opportunity "to file exceptions and present briefs."

5. They are arbitrary and capricious because there is no reasonable basis for rejecting and modifying findings made by the ALJs after conducting the hearing.

Error No. 4: **The Commission erred in its interpretation and application of the burden of proof in this case.**

Several methods of quantifying stranded costs are provided in the statute. TNMP chose to quantify its stranded costs by selling its generation assets in a bona-fide third party transaction under a competitive offering, as allowed by the statute.

After-the-fact, the Commission imposes standards of proof on Applicants not found in the statute and well beyond those determined by the ALJs. This error of law has infected the entire determination of stranded costs in a manner adverse to the Applicants. In Conclusion of Law 6A, for example, the Commission now requires that Applicants prove they will "only" recover the net, verifiable, non-mitigable stranded costs. This is a negative burden not found in the statute and inconsistent with the intent of the Legislature as stated by the Texas Supreme Court. Further, the Commission also imposes an erroneous obligation to prove "every fact that is

essential to their recovery of stranded costs." Such a requirement imposes on an applicant a standard which is inherently unknowable until after the case is decided. This conclusion of law is therefore inconsistent with law, arbitrary and capricious, an abuse of discretion, and a violation of Applicants' constitutional guarantees of due process and protection from ex post facto legislation. Conclusions of Law 6B, 6C, and 6D (and the related discussion on pages 5-6 of the June 3, 2005 Order) are erroneous for the same reasons.

The Commission also misstates its role in determining stranded costs. Page 7 of the June 3, 2005 Order states that the Commission "is charged with ensuring that the joint applicants do not over recover stranded costs." The Commission, however, has it only half right. The Legislature also directed the Commission to ensure that utilities recover all of their verifiable stranded costs.

Similarly, Conclusion of Law 6E is erroneous because it misstates the statutory requirements. There is no provision in PURA that requires TNMP to "comply with the legislative incentives in Chapter 39 of PURA to mitigate stranded costs," as this conclusion states. Rather, Section 39.262 requires TNMP (and its affiliates) to "jointly file to finalize stranded costs," and Section 39.252 requires TNMP to "pursue commercially reasonable means" to reduce stranded costs.

Error No. 5: **The Commission erred in its interpretation of the applicable legal standard under PURA § 39.262(h) ("bona fide third party transaction under a competitive offering").**

Conclusions of Law 6F, 18A, 18B, 18C, 20, and 20A (and the related discussion on pages 9-21 of the June 3, 2005 Order, are erroneous because the Commission's interpretation and application of this standard (bona fide third party transaction under a competitive offering) is illogical, and thus arbitrary and capricious, and an abuse of discretion. The Commission's interpretation is contrary to law because it is inconsistent with the rules of statutory interpretation including those pertaining to construction with contemporary legislation, normal use of the words adopted by the Legislature, and the requirement that all parts of a statute be given effect. Conclusion of Law 6F improperly concludes that the Legislature intended that "market valuation" would not always be the means for determining stranded costs.

In addition, the Commission's findings and conclusions on the application of the "bona fide third party transaction" standard are erroneous because they change the ALJs' decisions on this issue, which were based on a finding that TNMP proved by a preponderance of the evidence

that it had met the standard. The Commission made these changes without adequately explaining its departure from the May 28, 2004 PFD, without having considered all of the relevant evidence, and after erroneously considering irrelevant evidence.

Findings of Fact 184B, 184C, 184D, and 184E (and the related discussion on pages 9-21 of the June 3, 2005 Order) are erroneous because they are arbitrary and capricious. They should be reversed on rehearing because they are based on conclusions of law that are themselves erroneous and are not supported by substantial evidence. In fact, no party offered any evidence contradicting the fact that the sale was a bona fide third party transaction. These conclusions of law are also legally erroneous because they are inconsistent with PURA and because they apply the statutory standard in a fashion not supported by normal rules of statutory construction. In addition, these findings are not supported by substantial evidence, are arbitrary and capricious, and are affected by other error of law because in many cases they are derived from Findings of Fact 155B, 157, 158, 160, 160A, and 161 and Conclusion of Law 24B, which are themselves all erroneous as discussed under Error No. 7. Further, to the extent these findings of fact are based on the retention of Laurel Hill and other activities related to the auction process, they are erroneous because they are affected by the erroneous findings discussed under Error No. 8 (Findings of Fact 80A, 86, 87, 88, 89, 90, 91, 92, 93, 94, 94A, 94B, 94C, and 95). In addition, Finding of Fact 184E is not supported by substantial evidence and is arbitrary and capricious because no one offered any evidence of the amount of appropriate fees that would have been charged by a different financial advisor and no one offered any evidence that a financial advisor would have been able to obtain a sales price of $180 million net of expenses. Moreover, the PUC's contrived value is based on a figure that was a "gross" value. The Commission must, therefore, deduct from this gross figure reasonable expenses which the Commission finds that TNMP would have incurred. It is arbitrary and capricious to treat the $180 million estimate as a market value "net of expenses." Because there is no evidence in the record to support such a finding, Conclusions of Law 18A and 18B are contrary to law and beyond the Commission's authority because they impose requirements beyond those in the statute. Finally, Conclusion of Law 20A is erroneous because it is too vague to be valid and therefore arbitrary and capricious.

A. **There is a commonly accepted definition of bona fide third-party transaction.**

Section 39.262(h) of PURA provides that a utility may quantify its stranded costs by selling all of its generating assets "in a bona fide third-party transaction under a competitive offering." The Legislature used commonly understood terms. Specifically, Black's Law Dictionary defines the term "bona fide" as "1. Made in good faith; without fraud or deceit. 2. Sincere; genuine."[10] The Commission's June 3, 2005 Order ignores this common understanding in violation of law. Conclusions of Law 18, 18A, and 18B are therefore arbitrary and capricious, contrary to law, and beyond the Commission's authority.

B. **The Commission creates definitions that have no support.**

Conclusion of Law 18A defines "bona fide third party transaction" as:

> One in which the Seller conducts itself in the manner that a reasonable person would set in an ordinary commercial transaction without the benefit of stranded-cost recovery to protect that person's financial interests. It is one in which the seller has a sincere and honest intent to obtain a price that reflects a true market value so as to minimize stranded costs; that is evidenced by the seller's faithfulness to these twin obligations; that observed reasonable commercial standards when viewed in its intensity; and in which the seller has not unduly relied upon stranded-cost recovery to the disadvantage of customers.[11]

There is no statutory support for this definition, it is contrary to the accepted meaning of the term, and it violates the normal rules of statutory construction for considering the circumstances surrounding statutory enactments and for giving effect to all parts of the statute. It, in effect, deletes the "commercially reasonable means" standard, thereby making that standard inapplicable and superfluous, and imposes a requirement in addition to that of the statute.

Conclusion of Law 18A is also arbitrary and capricious because it attempts to establish a standard under which the utility will be denied stranded costs if it is aware of the legislature's standard for the recovery of stranded costs. As Commissioner Smithermen expressed during consideration of the Commission's Order,[12] it is unfair (and therefore arbitrary, capricious, and contrary to established law) to expect a regulated utility to act without the regulations in mind

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[10] BLACK'S LAW DICTIONARY 168 (7th ed. 1999).

[11] Conclusion of Law 18A.

[12] *See* Docket No. 29206 Open Meeting Transcript at p. 27, line 25-p. 28, line 16 (July 1, 2004).

and, at the same time, expect the utility to comply with the regulations. More important, there is no legal basis and the Commission cites no legal basis for the imposition of such an impossible burden.

Similarly, Conclusion of Law 18B states the term "competitive offering suggest[s] there would be multiple entities operating under the same set of rules, seeking to preserve generating assets at the same time" and imposes duties ("Seller is negotiating with the highest bidder" and "Seller . . . must cease negotiations"). These suggestions and duties are nowhere found in the statute. The definition of competitive offering adopted by the Commission is contrary to accepted meaning as set forth by the testimony in this case and thus not supported by substantial evidence and is arbitrary and capricious.

Conclusion of Law 18C is additionally erroneous because it presumes that the Commission has unbridled authority ("as it deems appropriate") to adjust net book value. There is no basis in law for such a conclusion. It violates normal rules of statutory construction and due process because it requires no evaluation of a causal link. Moreover, Conclusion of Law 18C is also contrary to the statute and in excess of the Commission's authority because it permits the Commission to make an adjustment to the net book value of TNP One. There is no authority in PURA for making such an adjustment and doing so renders section 39.252(d)'s prohibition on the Commission substituting its judgment for the market value superfluous.

Conclusions of Law 20 and 20A are based on erroneous conclusions (Conclusions of Law 18A and 18B). They are therefore likewise erroneous as being inconsistent with PURA, not supported by substantial evidence, arbitrary and capricious, and based on a misconstruction of the statute.

Error No. 6: **The Commission's finding that the sale of TNP One was not a "bona fide third party transaction under a competitive offering" is not supported by substantial evidence and is arbitrary and capricious.**

A. **No one offered evidence that the deal was not a "bona fide third party transaction."**

There was no material evidence presented by any party supporting a finding that the sale was not a "bona fide third party transaction." Therefore, there cannot be substantial evidence to support Findings of Fact 184B, 184C, 184D, 184E and Conclusions of Law 20 and 20A (and the related discussion on pages 9-21 of the June 3, 2005 Order). They are therefore also arbitrary

and capricious. These findings are also erroneous to the extent they are based on the erroneous findings and conclusions discussed under Error Nos. 5 and 7.

B. **The record includes unrebutted evidence that the sale to Sempra was a bona fide third-party transaction.**

TNMP's sale of TNP One to Sempra Energy Resources was a bona fide third-party transaction under a competitive offering. Both Jack Chambers, President and CEO of TNMP, and Michael Niggli, President of Sempra Energy Resources, testified that TNMP and Sempra had no relationship either before or after the sale transaction.[13] Sempra had no relationships with TNMP, Laurel Hill Capital Partners, or any of their affiliates. The sale of TNP One to Sempra was indisputably a bona fide third party transaction under the common meaning of those terms.

C. **There is an overwhelming preponderance of the evidence that TNMP sold the plant in a competitive offering, involving direct participation from a broad group of potential buyers, and was competitive to the end of the process.**

The Commission's findings focus on what it believes the facts show during the last few days or weeks of negotiation between TNMP and Sempra for the sale of the plant. Finding of Fact 166, for example, states that Sempra was the only party with which TNMP was negotiating. This finding is erroneous because Sempra was not the only bidder still involved in the process. The ALJs who considered the evidence had proposed a Finding of Fact 166 that stated "Sempra believed that it had potential competitors who also sought to purchase the plant."[14] The Commission changed this finding, without explaining why, and it replaced it with the new Finding of Fact 166. Based on the Commission's "new" finding, it concludes that the process itself was not competitive. The basic premise is wrong and this new finding should therefore be rejected as erroneous.

The overwhelming preponderance of the evidence establishes that TNMP undertook multiple steps to assure that competition existed at each phase of the process. In Finding of Fact 123, the Commission ignores the critical, relevant evidence that TNMP presented and makes no findings regarding that evidence, which results in arbitrary and capricious agency decisions (Findings of Fact 124, 155C, 165B, 165E, 166, and 184A).

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[13] Direct Testimony of Jack V. Chambers, TNMP Ex. 13 at 12, lines 1-6; Rebuttal Testimony of Michael Niggli, TNMP Ex. 15 at 4, lines 9-14

[14] May 28, 2004 PFD at 178.

Finding of Fact 124 is not supported by substantial evidence and is arbitrary and capricious. At no time was Sempra the "only remaining bidder," and even if it were, the evidence is uncontroverted that at all times Sempra believed it was competing against other bidders at the end of the process.[15] In fact, during negotiations with Sempra, two parties expressed an interest in the plant – Austpro and Wiking. TNMP treated these parties' interest seriously.[16] Indeed, there is overwhelming evidence that TNMP vigorously pursued Austpro and no one offered any evidence to the contrary. Finding of Fact 155C is therefore not supported by substantial evidence and is arbitrary and capricious.

To be sure, it became apparent by May 2002 that Sempra was the highest serious bidder remaining in the running for the plant and, as a result, TNMP negotiated directly with Sempra. That, of course, is the expected and typical result of a competitive process that continually focuses on fewer and fewer potential purchasers.[17] The entirety of this process makes it abundantly clear that it was a truly competitive process. That fact is not diminished in the least by the fact that, in the end, TNMP negotiated with Sempra to raise the price. It is therefore arbitrary and capricious to infer, as the Commission does in Finding of Fact 166, that there was no competition at the end of the process.

TNMP's expert witness, Mr. Coyne, expressed his conclusion that the auction process was competitive, based on conducting numerous auctions of generation assets, as follows: "TNMP's auction was a 'competitive offering' . . . . [T]he auction process . . . was successful in eliciting competition among potential buyers. . . . All of the available information indicates that the auction for TNP One was a competitive offering . . . ."[18] On rehearing, the Commission should adopt Mr. Coyne's conclusion and the overwhelming evidence on which it is based and find that TNMP's auction process was competitive.

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[15] *See* Rebuttal Testimony of Michael R. Niggli, TNMP Ex. 15 at 9, lines 1-7. *See also* Conformed Rebuttal Testimony of Jack V. Chambers, TNMP Ex. 18 at 10, lines 21-23.

[16] Direct Testimony of Rhonda L. Lenard, TNMP Ex. 4 at 29, lines 1-31.

[17] Conformed Rebuttal Testimony of James M. Coyne, TNMP Ex. 27 at 8, lines 95-102.

[18] Direct Testimony of James M. Coyne, TNMP Ex. 14 at 13, lines 311-320.

D. **The Commission misapplied the standard by finding that retaining Laurel Hill tainted the process to the extent that the process did not result in a bona fide third party transaction.**

The Commission based its finding that the sale was not a bona fide third-party transaction largely on a belief that Laurel Hill tainted the process so significantly that TNMP did not act in good faith (*i.e.* not bona fide). The Commission has abused its discretion as there is no evidence that TNMP acted in bad faith, and there is not substantial evidence that Laurel Hill's actions had any impact on the sales price received for TNP One. Accordingly, Findings of Fact 94A, 94B, 94C, 95, and 167 are not supported by substantial evidence and are arbitrary and capricious. Further, Finding of Fact 94A is arbitrary and capricious because it is irrelevant and too vague to be meaningful. Finally, to the extent Findings of Fact 94A, 94B, 94C, 95, and 167 and Conclusions of Law 21 and 22 are based on a finding that William Catacosinos was affiliated with both Laurel Hill and TNMP (*see* Findings of Fact 82 and 86), there is not substantial evidence to support a finding that the relationship rendered the retention commercially unreasonable or that it adversely affected TNMP's stranded costs. These findings and conclusions (specifically, Findings of Fact 95, 165, 184D, and 184E and Conclusions of Law 24 and 24B) are therefore arbitrary and capricious. Any adjustments based on these findings are impermissibly punitive and therefore contrary to the statute, arbitrary and capricious, and in violation of TNMP's rights under Texas Constitution Art. 1 §§ 16, 19 and the United States Constitution Fifth and Fourteenth Amendments.

Error No. 7: **There is not substantial evidence on which the Commission can conclude that a market valuation would have produced anything other than a $120 million sales price for the plant, rendering the adjustments to the sales price inconsistent with PURA, arbitrary and capricious, and based on the impermissible use of hindsight.**

A. **The $188 million figure on which the Commission relied was not included in any reliable bid, written or otherwise.**

Findings of Fact 155B and 160B refer to Austpro's interest in TNP One and uses a verbal comment by Austpro to assign a market value to TNP One (*see* related discussion in June 3, 2005 Order at pages 15, 22-24). The record is undisputed that Austpro never made a written bid and never deposited any money in escrow, as agreed upon by TNMP and Austpro.[19] There is

[19] *See* Direct Testimony of Rhonda L. Lenard, TNMP Ex. 4 at 29, lines 1-31.

also no dispute that mere indications of interest are inherently unreliable.[20] Use of this figure to assign a market value to TNP One or even to show that the market was improving is not supported by substantial evidence, is arbitrary and capricious, and is an abuse of discretion.[21]

B. **The $180 million figure was an early estimate distant in time from the sale and not related to any expression of interest or other market-based evaluation.**

Findings of Fact 160A, 172B, 184D, and 184E (and the related discussion on pages 15-16, 22-24 of the June 3, 2005 Order and pages 113-132 of the May 28, 2004 PFD) are not supported by substantial evidence and are arbitrary and capricious. There is not substantial evidence to support a finding that the $180 million figure represents an estimate of market value, and it is arbitrary and capricious to ignore the evidence that supports the source and meaning of the figure. The $180 million estimate was a non-market based guess prepared years before the actual sale. There is not substantial evidence on which the Commission could conclude that a reasonable seller would never sell below its own, informal estimate of value made years before the actual sale and there is no logical basis on which the Commission could reach such a conclusion. The Commission's related finding (Finding of Fact 160A) that TNMP failed to substantiate its claim that it asked Sempra for $180 million is not supported by substantial evidence and is arbitrary and capricious because the only evidence in the record directly contradicts that finding.[22] Conclusion of Law 24B is affected by other error of law because it is based on findings that are themselves erroneous. It is also a violation of the statutory provision (PURA § 39.252(d)) that prohibits the Commission from substituting its judgment for that of the market, and therefore is not relevant to the determination of stranded costs, and relies upon an

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[20] Conformed Rebuttal Testimony of James M. Coyne, TNMP Ex. 27 at 35, lines 811-818; 36, lines 842-844.

[21] Use of this figure to assign market value to TNP One is also inconsistent with the Commission's discussion on pages 16-17 of the June 3, 2005 Order and Finding of Fact 155C, which argue that TNMP's only leverage at the end of the process was to withdraw from the sale. If the $188 million figure were an indication of improving market conditions (Finding of Fact 155B) or an indication of a price that a bidder was willing to pay (Finding of Fact 160B), then TNMP had sufficient leverage during its negotiations with Sempra, contrary to the Commission's findings.

[22] *See* Conformed Rebuttal Testimony of Jack V. Chambers, TNMP Ex. 18 at 11, lines 4-15 ("No [I did not believe the plant was worth $180 million]. During the May 6, 2002 meeting we mentioned to Sempra that many parties had been expecting $180 million in an effort to get Sempra to raise its price . . . my view of the market-based value of the plant should not be confused with my statements concerning [the] value that I used as a negotiating tool."). *See also* TIEC Ex. 4 at 8.

impermissible use of hindsight. Consideration and reliance upon irrelevant evidence results in arbitrary and capricious agency action.

C. **The $174 million figure was used in an attempt to negotiate with Sempra and does not demonstrate market value.**

Findings of Fact 158, 160, 165, and 184D (and the associated discussion on pages 15-16, 22-24 of the June 3, 2005 Order and pages 113-132 of the May 28, 2004 PFD) are not supported by substantial evidence, are arbitrary and capricious, and violate the statute. The $174 million figure relied upon by the Commission represents an argument used by TNMP negotiators to attempt to convince Sempra to raise its price above the $105 million it was offering at the time. The specific manner in which the figure was determined is described on pages 37 and 38 of Applicants' Exceptions. That discussion is incorporated herein for all purposes. A review of the evidence supporting this figure shows that there is no substantial evidence to support the use of this figure to assign a market value to TNP One. It was a negotiating tool only, and the Commission's use of this figure to assign a market value to TNP One is arbitrary and capricious. Reliance on this figure is inconsistent with the prohibition (PURA § 39.252(d)) on the Commission substituting its own market valuation. In addition, Conclusion of Law 24 is affected by other error of law because it is based on the above findings, which are themselves erroneous. It is also a violation of PURA § 39.252(d), and is not relevant to a determination of stranded costs, and relies upon an impermissible use of hindsight. Consideration and reliance upon irrelevant evidence results in arbitrary and capricious agency action.

D. **The range of $127.7 million to $163 million is incorrect as a matter of fact and based on a faulty premise.**

Findings of Fact 157 and 161 claim that TNMP estimated the value of TNP One to be between $127.7 million and $163.3 million (see also May 28, 2004 PFD at 125-127). These findings are not supported by substantial evidence, are arbitrary and capricious, and rely upon an impermissible use of hindsight. This use is contrary to the PURA prohibition on the substitution of Commission judgment for market valuation. In addition, the Commission's use of this information to assign a market value to TNP One is arbitrary and capricious. Accordingly, Conclusion of Law 24B, which is based in part on Findings of Fact 157 and 161, is erroneous because it is not supported by substantial evidence, is arbitrary and capricious, and affected by error of law. The range of "values" stated in these findings was based on a discounted cash flow analysis conducted by a TNMP witness and given to TNMP negotiators during the negotiations.

However, the range used by the Commission is based on the input of the price of power at $32 per MWh. There is no evidence to support this value for the price of power, and the Commission is acting in an arbitrary and capricious manner by ignoring the correct evidence. Instead, the only evidence in the record is that the relevant market value of power at the time this analysis was conducted and used was $30 per MWh.[23] This is the value used by the TNMP witness. This price results in an estimated value of TNP One between $103.9 million and $123 million. There is not substantial evidence to support any other range, and the Commission's attempt to do so is arbitrary and capricious. Applicants provided this explanation in more detail in their June 7, 2004 Exceptions on pages 40 through 42 and incorporate those arguments herein for all purposes. Accordingly, TNMP is entitled to a rehearing on Findings of Fact 157 and 161 and Conclusion of Law 24B.

E. **The Commission ignored relevant evidence of comparable sales.**

In addition to basing its decisions on erroneous valuations (Findings of Fact 155B, 157, 158, 160, 160A, 160B, 161, 165, 172B, 184D, and 184E and Conclusions of Law 24 and 24B) that were never meant to represent a "market value," the Commission ignored the critical evidence of comparable sales.[24] The comparable sales support the market value TNMP obtained and disprove the accuracy of the figures the Commission uses as a prediction of market value. TNMP presented three experts to review the best evidence available today. They all concluded that the evidence shows that TNMP obtained a price consistent with the prices obtained for sales of capacity in ERCOT subsequent to its sale.[25] Nowhere in the Exceptions nor in the ALJs' May 28, 2005 PFD nor in the June 3, 2005 Order is there any dispute about the evidence presented by these experts. The Commission has acted in an arbitrary and capricious manner by ignoring the critical evidence that supports the market value that TNMP obtained for the plant.

F. **The Commission erred by concluding that any price greater than $120 million was achievable.**

Findings of Fact 155B, 157, 158, 160, 160A, 160B, 161, and 165 and Conclusions of Law 24 and 24B are not supported by substantial evidence and are arbitrary and capricious because no one offered any evidence of any serious bidder that was able to close the deal for the

[23] *See* Conformed Rebuttal Testimony of Patrick L. Bridges, TNMP Ex. 22 at 3-4. *See also* Applicants' Exceptions to ALJs' PFD at 41 (filed June 7, 2004).

[24] See evidence cited in Applicants' Exceptions to ALJs' PFD at 38-41 (filed June 7, 2004).

amounts in these findings and conclusions. Further, Sempra offered testimony that it would not have paid more than $120 million,[26] and no one offered any evidence that Sempra would have paid more. Indeed, the only evidence in the record concerning sales of plants in the restructuring process suggests that Sempra was the only active ERCOT buyer at the time. In addition, contrary to the Commission's finding that TNMP failed to show that its decision to proceed with the sale in May 2002 was based on existing data or market analyses (June 3, 2005 Order at 15-16 and Findings of Fact 94B, 165B, and 165E), the analysis conducted by TNMP witness Patrick Bridges as discussed on pages 40 through 42 of Applicants' June 7, 2004 Exceptions was exactly the sort of analysis one would expect. Findings of Fact 94B, 165B, 165E, and the associated discussion on pages 15-16 of the June 3, 2005 Order are therefore not supported by substantial evidence and are arbitrary and capricious.

Error No. 8: **The Commission's findings and conclusions with respect to the retention of Laurel Hill are not supported by substantial evidence, are arbitrary and capricious, are irrelevant, and result from an improper application of the statute.**

The Commission has made an adjustment to stranded costs without making required findings that the retention of Laurel Hill led to TNMP obtaining less for the plant than it would have otherwise, and there is no substantial evidence to support such findings. In addition, there is not substantial evidence to support any finding that the retention of Laurel Hill led to an increase in stranded costs or the finding of a lack of a bona fide third party transaction under a competitive offering. There is not substantial evidence to support this causal connection. In fact, the only evidence in the record directly contradicts the Commission's conclusions. One of TNMP's expert witnesses, Mr. Coyne, made this point clearly:

> The vast majority of power market transactions in recent years have been driven, either directly or indirectly, by restructuring legislation or regulatory guidelines (as has been the case in Texas). I have not seen financial advisors play a meaningful role in the determination of market timing . . . .[27]

The Commission's adjustment based on the retention of Laurel Hill (Findings of Fact 95, 184D, and 184E, Conclusions of Law 22, 24, and 24B, and the related discussion on pages 11-

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[25] *See* Applicants' Exceptions to ALJs' PFD at 38-41 (filed June 7, 2004).

[26] *See* Rebuttal Testimony of Michael R. Niggli, TNMP Ex. 15 at 9, lines 8-13.

24, 28-29 of the June 3, 2005 Order and pages 107-112 of the May 28, 2004 PFD) is therefore not supported by substantial evidence, is arbitrary and capricious, and is in excess of the Commission's authority. The only reasonable authority granted by PURA—assuming the Commission has determined that retaining Laurel Hill was commercially unreasonable—is to disallow the amount of the fee charged by Laurel Hill.[28] As described below, this assumption is not supported by substantial evidence and is arbitrary and capricious.

Findings of Fact 80A,[29] 89, 90, 91, 92, 94A, 94B, 94C, and 95 and Conclusions of Law 21, 22, 24, and 24B are not supported by substantial evidence, are inconsistent with the uncontroverted evidence, and are arbitrary and capricious for, among other reasons, there is no basis on which to conclude that the retention of Laurel Hill adversely affected the price of TNP One. There is ample evidence of Laurel Hill's experience and its efforts on behalf of TNMP. Detailed arguments and description of the evidence showing that Laurel Hill had significant pertinent experience to act as TNMP's financial advisor in the sale of TNP One and that the selection of Laurel Hill was commercially reasonable is contained on pages 25 through 27 of Applicants' June 7, 2004 Exceptions and are incorporated herein for all purposes. In addition, Findings of Fact 86, 87, 88, 89, 90, 91, 92, 93, and 94 are irrelevant to the determination of stranded costs and should not have been used as a basis for finding that hiring Laurel Hill was commercially unreasonable. The consideration of these findings was based in part on the erroneous Preliminary Order as described under Error No. 28. Findings of Fact 94B, 94C, 95, 184D, and 184E and Conclusions of Law 21, 22, 24, and 24B are affected by error of law because they result from an improper application of the statute.

In addition, Finding of Fact 94A is not supported by substantial evidence, is inconsistent with law, and is arbitrary and capricious. There is not substantial evidence to support a causal link between the hiring of Laurel Hill and any price obtained for the plant. There is also not substantial evidence of the assumed factual conclusion (*i.e.* that Laurel Hill was neither qualified

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[27] Conformed Rebuttal Testimony of James M. Coyne, TNMP Ex. 27 at 34, lines 792-795 (footnote omitted).

[28] *See* PURA § 39.252(d) ("the Commission shall consider the utility's efforts [to pursue commercially reasonable means] when determining the amount of the utility's stranded costs; provided, however, that nothing in this section authorizes the Commission to substitute its judgment for a market value of generation assets determined under Sections 39.262(h) and (i)").

[29] Finding of Fact 80A is erroneous to the extent it concludes that TNMP was required to retain a financial advisor other than Laurel Hill.

nor independent); in fact, the overwhelming evidence is to the contrary. Finally, Finding of Fact 94A is also arbitrary and capricious because it is too vague to be meaningful.

Finding of Fact 94B is not relevant, not supported by substantial evidence, arbitrary and capricious, and should not have been used as a basis for finding that retaining Laurel Hill was commercially unreasonable because there is ample evidence of the advice provided. This finding is also erroneous because it implicitly relies upon consideration of timing issues that are impermissible under PURA (see also pages 26 and 27 of Applicants' June 7, 2004 Exceptions).

Findings of Fact 94C and 95 are not supported by substantial evidence, are arbitrary and capricious, and are affected by other error of law because the underlying facts (Findings of Fact 89, 90, 92, 94A, and 94B) are erroneous as discussed above. These findings are also inconsistent with law because they are based upon an incorrect interpretation and application of the term "commercially reasonable" as described under Error No. 9.

Conclusions of Law 21, 22, 22A 23, 23A, and 24 are affected by other error of law because they are based on findings which are themselves erroneous (as discussed above), because they are not supported by substantial evidence, because they are arbitrary and capricious, and because they were evaluated under the wrong interpretation of "commercially reasonable." In addition, Conclusions of Law 21 and 23A also violate PURA because they are based on an erroneous standard ("used" instead of "pursued" [CoL 23A] and "protect and enhance the value" instead of "protect the value" [CoL 21]). Finally, Conclusion of Law 23A is erroneous because it is too vague to be valid and therefore arbitrary and capricious.

Error No. 9: **The Commission misinterprets the term "commercially reasonable means" as used in PURA § 39.252(d).**

The Commission erred in its interpretation of "commercially reasonable means" because it improperly found that the standard applies to the sales process, including an implicit requirement to "time" the sale, it failed to consider properly the meaning of the term as provided by the Texas Business & Commerce Code, and it failed to consider all of the circumstances surrounding the sale, including the actions TNMP pursued which increased the market value of the plant.

Most significantly, when interpreted in conjunction with PURA § 39.262(h), it is not reasonable to interpret the "commercially reasonable means" standard to apply to the auction process. Under the ALJs' correct determination that TNMP met the requirement of PURA §

39.262(h) by selling TNP One in a bona fide third party transaction under a competitive offering,[30] the Commission should have found that TNMP met its burden with respect to the auction process. Thus, Findings of Fact 138A, 141, 141A, 141B, 141C, 145, 155, 155A, 155B, 155C, 156, 159A, 160A, 160B, 165A, 165B, 165C, 165D, 165E, 166, 167, 168, 170, 173A, 173B, 184A, 184C, and 185A and Conclusions of Law 19, 22A, 23, and 23A (and related discussion on pages 6-30 of the June 3, 2005 Order and pages 99-148 of the May 28, 2004 PFD) are contrary to the law because they are only relevant, if at all, under an erroneous interpretation of the standard. They are also not supported by substantial evidence and are arbitrary and capricious.

In addition, for the reasons stated herein and for those stated on pages 20 through 25 of Applicants' June 7, 2004 Exceptions, TNMP is entitled to a rehearing on Conclusions of Law 19, 19B, and 19C. Specifically, Conclusion of Law 19 misapplies PURA §§ 39.252(d) and 39.262(h), and is therefore arbitrary and capricious because it impermissibly permits consideration of the sales process and market timing.[31] Conclusions of Law 19B and 19C are arbitrary and capricious and inconsistent with law to the extent they conclude that the PUC is not required to consider the meaning of commercially reasonable under the Texas UCC.

Conclusion of Law 21 is affected by other error of law because it misinterprets the statute. It states that TNMP failed to meet its burden of proof because it failed to "protect and enhance" the value of TNP One. There is no requirement to "enhance" the value of the plant. It is arbitrary and capricious and beyond the Commission's statutory authority to hold TNMP to a standard that is not in the statute.

Finding of Fact 184A is not supported by substantial evidence and is arbitrary and capricious because it ignores significant evidence to the contrary and because it is inconsistent with common sense. There is not substantial evidence that "TNMP did not make a sincere effort to obtain the full market value of TNP One; its sales process did not conform to ordinary commercial practices; and it ignored improving market conditions." And, there is no mention by the ALJs or the Commission of the significant evidence to the contrary.

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[30] May 28, 2004 PFD at 8-9.

[31] To the extent Conclusion of Law 19A implies that the commercially reasonable means standard applies to the sales process, then it is erroneous for the same reasons that Conclusion of Law 19 is erroneous (i.e., it misapplies PURA §§ 39.252(d) and 39.262(h), is therefore arbitrary and capricious, and it impermissibly permits consideration of the sales process and market timing).

In addition, the Commission's interpretation of "commercially reasonable means" is arbitrary and capricious because it results from the consideration of irrelevant evidence. Intervenor witnesses Lane Kollen, Scott Norwood, Jeffrey Pollock, and Steve Weyel all presented evidence on the meaning of "commercially reasonable means." TNMP objected to the admission of these witnesses' testimony on the grounds that the witnesses were claiming to have an expert opinion outside their areas of expertise, they were offering testimony on a question of law on which a witness is not permitted to testify, and they applied an incorrect legal standard, thus depriving the witnesses of relevance and reliability.[32] TNMP objected to the consideration and admission of this testimony, but those objections were erroneously overruled. Admission of this evidence was error and substantially prejudiced TNMP.

Error No. 10: **The Commission's findings and inferences that the timing of TNMP's sale was commercially unreasonable violate PURA §§ 39.252, 39.262, are not supported by substantial evidence, and are arbitrary and capricious.**

The Commission adopted several findings and conclusions of the ALJs in which they concluded that TNMP was commercially unreasonable because it did not properly time the sale of TNP One. (See also the related discussion on pages 11-30 of the June 3, 2005 Order and pages 113-132 of the May 28, 2004 PFD.) As a general matter, these findings and conclusions violate PURA § 39.252(d) because the Commission substitutes its judgment for the market value. Finding of Fact 138A is both irrelevant and inconsistent with law because it is implicitly a determination of market timing inconsistent with PURA § 39.252(d), is not supported by substantial evidence, and is arbitrary and capricious. The argument that TNMP believed there was little risk the price would decline is unsupported by the record. Among other things, that statement referred to the $105 million price and is irrelevant to the $120 million sales price.

Findings of Fact 132, 133, and 134 are not relevant to this proceeding because they are implicitly a consideration of market timing inconsistent with PURA § 39.252(d) and are arbitrary and capricious. Similarly, Finding of Fact 140 is both irrelevant and inconsistent with law because it is implicitly a determination of market timing inconsistent with PURA § 39.252(d), is not supported by substantial evidence, is arbitrary and capricious, and is not relevant to the determination of whether TNMP pursued commercially reasonable means to reduce stranded

[32] *See* Applicants' Objections to Intervenors' Testimony and Motion to Strike at 8-11 (LK Objection 4), 12 (SN Objection 1), 19-20 (JP Objection 5), and 20 (SW Objection 2).

costs. When TNMP decided to sell the plant or whether natural gas prices were rising is irrelevant. Consideration of these irrelevant issues resulted in an arbitrary and capricious decision.

Findings of Fact 141, 143, 143A, 145, 146, 148, 153, 154, 155, 155A, 156, 157, 158, 161, and 162 are irrelevant (and thus arbitrary and capricious), inconsistent with law (because they are implicitly a determination of market timing inconsistent with PURA § 39.252(d)), are not supported by substantial evidence, and are arbitrary and capricious. Consideration of the timing of the sale violates the mandate of S.B. 7. The lack of substantial evidence supporting Findings of Fact 141, 141A, 141B, and 141C is discussed below in Error No. 30. Findings of Fact 142 and 144 are irrelevant to any determination of stranded costs and thus arbitrary and capricious. Findings of Fact 143 and 143A are not supported by substantial evidence and are arbitrary and capricious because TNMP provided information on the impracticality of operating TNP One as a stand-alone entity in its direct and rebuttal cases. This testimony came from persons whose qualifications as persons knowledgeable in the operation of the plant and the market were uncontroverted.

Finding of Fact 145 is error as described above because it implicitly imposes a standard not found in the statute and ignores the advice given by Laurel Hill. Findings of Fact 146 and 148 are erroneous for the reasons given above because they are both irrelevant and implicitly impose a requirement not found in the statute. Whether natural gas prices "had firmed up" or what the forecast for those prices were at the time is irrelevant. Consideration of these irrelevant issues resulted in an arbitrary and capricious decision. Findings of Fact 155 and 155A are not supported by substantial evidence and are arbitrary and capricious because the evidence of comparable sales after this time demonstrates that TNMP could not have expected a better price (see discussion in Error No. 7 above). Finding of Fact No. 154 is not supported by substantial evidence and is arbitrary and capricious because it makes a comparison between two unrelated numbers—indicative bids and final bids.

Findings of Fact 165, 165A, 165B, 165C, 165D, and 165E are not supported by substantial evidence and are arbitrary and capricious because they are not relevant to quantifying TNMP's stranded costs. Further, Finding of Fact 165 is erroneous for the reasons outlined under Error No. 11. There is not substantial evidence to support findings that TNMP "would not have concluded its sale to Sempra under ordinary commercial considerations" (Finding of Fact 165B),

"concluded its sale to Sempra because its financial condition was protected by stranded cost recovery" (Finding of Fact 165C), or "was unduly focused upon stranded cost recovery" (Finding of Fact 165D). Similarly, TNMP presented uncontroverted evidence disputing Findings of Fact 165 and 165E.

Conclusion of Law 19 is in violation of the statute because it inappropriately requires the consideration of the timing of the sale. Conclusion of Law 20B is arbitrary and capricious because it imposes a standard that was not relied upon by the ALJs during the hearing and results in the modification of findings on evidentiary issues without the Commission having reviewed the entire record. Conclusions of Law 19 and 20B are also objectionable for the reasons outlined in Error Nos. 9 and 30 respectively above.

In addition, all of the findings listed under this point of error are arbitrary and capricious because they are based on the consideration of irrelevant evidence. TNMP objected to the admission of portions of testimony of Intervenors' witnesses, which the ALJs erroneously overruled. Admission and consideration of the testimony of Lane Kollen, Scott Norwood, Jeffrey Pollock, and Steve Weyel as the testimony relates to the timing of the sale was erroneous.[33] Admission of this evidence was error and substantially prejudiced TNMP.

Error No. 11: **Several findings and inferences that TNMP failed to pursue commercially reasonable means during the auction process violate PURA, are not supported by substantial evidence, and are arbitrary and capricious.**

The Commission makes several findings and conclusions that TNMP's decision to sell to Sempra was not commercially reasonable based upon the inadequacy of the sales process.[34] Many of those findings are erroneous.

Specifically, Finding of Fact 124 is not supported by substantial evidence and is arbitrary and capricious. At no time was Sempra the only remaining bidder. Further, even if it were, that finding is not relevant to the determination of whether TNMP pursued commercially reasonable means to reduce its stranded costs and therefore results in arbitrary and capricious decisions (Findings of Fact 165B, 165E, and 184A). Findings of Fact 165B, 165E, and 184A are affected

[33] *See* Applicants' Objections to Intervenors' Testimony and Motion to Strike at 11-12 (LK Objection 5), 13-14 (SN Objection 3), 18-19 (JP Objection 3) and 20 (SW Objection 1).

[34] *See also* June 3, 2005 Order at 11-30; May 28, 2004 PFD at 107-138.

by error of law because they were decided under the wrong legal standard and because they are not supported by substantial evidence and are arbitrary and capricious.

Finding of Fact 166 is not supported by substantial evidence, is arbitrary and capricious, affected by other error of law, and is an abuse of discretion. While TNMP did not negotiate the non-price terms for the sales agreement with several parties at the same time, the evidence is uncontraverted that Sempra believed it was not the only party seeking to purchase TNP One. The Commission revised a finding proposed by the ALJs and replaced it with this one which purports to support a conclusion that the process was not competitive. The Commission arbitrarily changed a finding to meet its desired end result as discussed herein and under Error No. 3. This is clearly an abuse of discretion.

Similarly, Findings of Fact 167 and 168 are not supported by substantial evidence and are arbitrary and capricious. There is an overwhelming preponderance of the evidence that TNMP properly managed the auction process. The Commission improperly revised the ALJs' findings on these issues in violation of Tex. Gov't Code §§ 2003.049 and 2001.062.[35] Further, there is not substantial evidence of a causal link between any of TNMP's actions or Laurel Hill's actions during the auction process and any increase in stranded costs. The findings are, therefore, arbitrary and capricious.

Finding of Fact 170 is affected by other error of law because it was modified in violation of Tex. Gov't Code §§ 2003.049 and 2001.062 and is arbitrary and capricious because it is an insufficient "finding of fact." Further, there is not substantial evidence of a causal link between any of TNMP's actions during the auction process and any increase in stranded costs.

Conclusion of Law 22A is inconsistent with PURA because it applies the "commercially reasonable means" test to the sales process rather than to mitigation. It is also inconsistent with PURA because it attempts to apply the "commercially reasonable means" standard even though, as set forth above, TNMP proved that its process was competitive and it sold the plant to a bona fide third party. As a result, it is also arbitrary and capricious because it is based on irrelevant considerations. It is also not supported by substantial evidence and therefore arbitrary and capricious because, as found by the ALJs, there is overwhelming evidence that TNMP exercised

[35] It is an especially noteworthy example to consider that the Commission changed Proposed Finding of Fact 168 from "TNMP adequately controlled the auction process" to "TNMP did not adequately control the auction process" (emphasis added) without reviewing the record or stating the specific reason or legal basis for doing so. *Compare also* Proposed Findings of Fact 166, 167, and 170 with Findings of Fact 166, 167, and 170.

commercially reasonable means in the conduct of the auction and because many of the underlying facts are not supported by substantial evidence as outlined herein and under Error Nos. 6, 8-10.

In addition, the Commission's findings on the auction process are arbitrary and capricious because they are based on the consideration of irrelevant evidence. TNMP objected to the admission and consideration of the testimony of Lane Kollen, Kathryn Iverson, Scott Norwood, Jeffrey Pollock, and Steven Weyel on several grounds. First, the witnesses lack the qualifications to be experts on the auction process. Second, their testimony on the chronology of events during the auction process lacks a proper foundation and is therefore unreliable. Third, they applied an incorrect legal standard, depriving the testimony of relevance and reliability.[36] The ALJs overruled those objections. Admission of this evidence was error and substantially prejudiced TNMP.

Error No. 12: The Commission erred in its quantification of the stranded costs associated with TNP One.

The Commission's quantification of the value of TNP One is inconsistent with law (PURA § 39.252), not supported by substantial evidence, and is arbitrary and capricious. Specifically, Finding of Fact 130 is not supported by substantial evidence, is arbitrary and capricious, is not relevant to this proceeding, and is based on the Commission acting outside its statutory authority by substituting its judgment for the market value. (*See* PURA § 39.252(d).) The "estimated value" in this finding has absolutely no relation to the market value of TNP One. Further, Findings of Fact 132, 133, and 134 are not relevant to this proceeding, and should not be used as a basis for finding that TNMP acted in a commercially unreasonable manner. In doing so, the Commission acted in a manner inconsistent with its statutory authority and contrary to PURA § 39.252(d).

Findings of Fact 155A, 155B, 155C, 156, 157, 158, 159A, 160, 160A, 160B, and 161 are not supported by substantial evidence, are affected by other error of law, and are based on arbitrary and capricious agency action. They are not relevant to determining the market value of TNP One because they are inconsistent with PURA § 39.252(d). Further, Finding of Fact 155A is inconsistent with the uncontradicted evidence of subsequent sales discussed in Error No. 7, is

[36] *See* Applicants' Objections to Intervenors' Testimony and Motion to Strike at 8-11 (LK Objection 4), 12 (SN Objection 1), 14-16 (KI Objection 1), 19-20 (JP Objection 5), and 20 (SW Objection 2).

not supported by substantial evidence, and is arbitrary and capricious. In addition, it is irrelevant and too vague to be meaningful. Finding of Fact 155B has no basis in the record and is erroneous for the reasons stated under Error No. 7. One potential buyer's unwritten "expression of interest" has no bearing on the strength of the market, which is in itself irrelevant to this proceeding. Finding of Fact 155C is not only not supported by substantial evidence and is arbitrary and capricious but is also directly contrary to the evidence in the record as discussed in Error No. 7. Finding of Fact 156 is directly contrary to the evidence. The uncontradicted evidence was that the market did not improve. Findings of Fact 157, 158, 160, 160A, 160B, and 161 are also affected by error of law, arbitrary and capricious, and not supported by substantial evidence for the reasons stated under Error No. 7. Conclusion of Law 24 is affected by other error of law because it is based on fact findings that are themselves erroneous.

In addition, the Commission's disallowance of $54 million (Findings of Fact 158, 160, and 165 and Conclusion of Law 24) is not supported by substantial evidence, is arbitrary and capricious, and effected by error of law (PURA § 39.252(a)). The Commission adopts the ALJs' May 28, 2004 PFD on this issue. A detailed argument explaining the error related to this quantification is contained on pages 37 through 42 of Applicants' June 7, 2004 Exceptions and is incorporated herein for all purposes. In short, the Commission's June 3, 2005 Order quantifying this disallowance is erroneous as not supported by substantial evidence, affected by error of law (PURA § 39.252), and arbitrary and capricious because it adopts the May 28, 2004 PFD which demonstrates a misunderstanding of the only evidence on which it relied ($174 million figure),[37] ignored the critical evidence that established that TNMP would not have received more for the plant if it had delayed the sale, failed to identify any causal link between TNMP's actions and the $174 million non-market-based estimate, and ignored the critical evidence that was used to estimate a market valuation of the plant.

Finally, the Commission's quantification of stranded costs are not supported by substantial evidence and are arbitrary and capricious because they are internally inconsistent. Specifically, Conclusion of Law 24 and Finding of Fact 165 are not supported by substantial evidence and are arbitrary and capricious because they are inconsistent with Conclusion of Law 19A. Conclusion of Law 19A states that commercial reasonableness must be determined from

[37] The source of this figure is explained under Error No. 7 of this Motion and on pages 37 and 38 of Applicants' June 7, 2004 Exceptions.

"the entirety of all facts and circumstances" surrounding the sale. In Finding of Fact 165 and Conclusion of Law 24 the Commission made a downward adjustment of $54 million. In making this adjustment the Commission did not follow its own test enunciated in Conclusion of Law 19A. TNMP undertook numerous positive activities to protect the value of its asset. Some of these activities are described in Findings of Fact 97 and 98 for which the Commission has improperly made no positive adjustment. It was an abuse of discretion to make isolated downward adjustments based on findings of alleged unreasonable actions without consideration of all activities made in compliance with PURA § 39.252(d) and corresponding upward adjustments.

Error No. 13: **The Commission erred in requiring that additional accelerated depreciation be recorded against the book value of TNP One.**

The Commission erroneously interpreted previous orders and PURA in a manner that requires TNMP to record an additional $19 million in accelerated depreciation:

A. **Conclusions of Law 7 and 8 are erroneous because Docket No. 17751 does not require TNMP to apply $60.0 million in additional depreciation.**

Conclusion of Law 7 is contrary to law because TNMP is not obligated to apply $60.0 million in additional depreciation under the Order in Docket No. 17751. The Commission's imposition of such a requirement of additional depreciation is error. The Restated Stipulation approved in Docket No. 17751 requires that its terms be conformed to any legislation deregulating the electric industry in Texas. S.B. 7 contains no provisions for accelerated depreciation and, as described below, S.B. 7's provisions for excess earnings mitigation are inconsistent with the application of accelerated depreciation. Thus, this finding is inconsistent with law, not supported by substantial evidence, and arbitrary and capricious. In addition, Conclusion of Law 8, which is based on the conclusion that Docket No. 17751 requires $60.0 million in accelerated depreciation (in Conclusion of Law 7), is erroneous for the same reasons (*see also* May 28, 2004 PFD at 10-37).

B. **Conclusion of Law 8 and Findings of Fact 28, 29, 30, 31, 32, 33, and 34 are erroneous because they are inconsistent with the order of the Commission in Docket No. 21112, are inconsistent with provisions of S.B. 7, and are inconsistent with the orders of the Commission in three Annual Report Dockets.**

1. **The Commission's action violated the Final Order in Docket No. 21112.**

The final order in Docket No. 21112 expressly defined TNMP's mitigation obligation under S.B. 7 at $37.8 million, and not $60 million as the Commission has imposed with the June 3, 2005 Order in this case. TNMP used $40.2 million of excess earnings to mitigate its stranded costs and therefore complied with the order in Docket No. 21112.[38] There is direct evidence from Staff and TNMP that TNMP's actions fully comported with the requirements of Docket No. 21112, and there is not substantial evidence to the contrary.

The Commission has in effect rendered a valid order of an earlier Commission meaningless by imposing a different standard on the same facts. It has impermissibly subjected Applicants to changing legal standards after-the-fact. As a result, the Commission findings violate due process, impose an impermissible ex post facto obligation on the Applicants in violation of the Fifth and Fourteenth Amendments to the United States Constitution and Article 1 §§ 16 and 19 of the Texas Constitution, and is arbitrary and capricious agency action.

The Commission's findings on this issue were further affected by other error of law by adopting the ALJs' May 28, 2004 PFD, which was based on the ALJs' erroneous admission and consideration of comments made by Commissioners at open meetings held to discuss the otherwise unambiguous final orders in the relevant dockets. TNMP objected to the ALJs' consideration of these transcripts, but the ALJs nevertheless overruled TNMP's objections[39] and based their decision on those ambiguous comments (*see* May 28, 2004 PFD at 12-16). Admission of this evidence was error and substantially prejudiced TNMP.

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[38] Rebuttal Testimony of Scott Forbes, TNMP Ex. 24 at 7.

[39] *See* Tr. at p. 856 line 10 – p. 859 line 12, p. 866 line 19 – p. 867 line 5, p. 868 lines 3-12 (April 17, 2004) (objection to the admission of Staff Ex. 7 and testimony related to the decision makers comments at the final order meeting for Docket No. 21112); Tr. at p. 881 line 18 – p. 882 line 2 (April 17, 2004) (objection to the admission of Staff Ex. 10 and testimony related to the decision makers comments at the final order meeting for Docket No. 22349).

2. The Commission's findings on the required accelerated depreciation violate PURA §§ 39.254 and 39.257.

The Commission violated PURA §§ 39.254 and 39.257 by imposing a method of mitigation different from and inconsistent with the Annual Reports required under the statute and approved by the Commission. The requirements of those provisions and the requirements under the Restated Stipulation in Docket No. 17751, and how TNMP complied with both, are discussed in detail on pages 4, 5, 6, and 8 of Applicants' June 7, 2004 Exceptions and are incorporated herein for all purposes.

TNMP complied with the mandatory language of the statute and previous orders and applied $40,199,598 in mitigation. The Commission's findings requiring TNMP to record an additional $19.2 million (for a total of $60 million) denies the mandatory language of these provisions.

3. The Commission's findings and conclusions on the required accelerated depreciation are inconsistent with the final orders approving TNMP's Annual Reports.

Not only is the Commission's decision in direct contravention of the statute and its clear order in Docket No. 21112, it is also inconsistent with prior Commission action in three dockets approving TNMP's Annual Reports. TNMP filed its required Annual Reports for 1999, 2000, and 2001 in Docket Nos. 22276, 23806, and 25593, respectively. In each of those Annual Reports, TNMP determined its excess earnings in accordance with PURA § 39.257 and the Commission rules. In none of those Annual Reports did TNMP apply accelerated depreciation. All of these cases were docketed as contested cases. In all three cases the Commission approved TNMP's determination. The Commission's conclusions of law effectively conclude after-the-fact that TNMP misfiled its Annual Reports and that the Commission improperly approved those reports as filed. As a result, these findings and conclusions are inconsistent with PURA, violate accepted principles of res judicata and collateral estoppel, violate due process and the prohibitions against ex post facto legislation (Texas Constitution Art. 1 §§ 16 and 19; United States Constitution Fifth and Fourteenth Amendments) and are arbitrary and capricious.

4. Other Points of Error

In accordance with the arguments above and those contained in Applicants' June 7, 2004 Exceptions, Findings of Fact 28 and 29 are not supported by substantial evidence, are arbitrary and capricious, and are affected by other error of law because the Commission erroneously

applies the final orders in Docket Nos. 17751 and 21112. There is direct evidence that Applicants properly interpreted the Commission Order in Docket No. 21112 and no substantial evidence to the contrary. The final order in Docket No. 21112 is unambiguous and should be applied in a manner that is consistent with its clear terms. Finding of Fact 30 is based on an erroneous interpretation of the final order in Docket No. 22349. The order in Docket No. 22349 did not specify TNMP must fulfill the obligation in Docket No. 22349, instead it used accelerated depreciation as a surrogate for the calculation of excess earnings under S.B. 7, which at that time were not complete. Similarly, Findings of Fact 31, 32, 33, and 34 (and the related discussion on pages 10-42 of the May 28, 2004 PFD), for the same reasons identified above for Findings of Fact 28, 29, and 30, are affected by error of law because they are based on an erroneous interpretation of the final orders in Docket Nos. 17751, 21112, and 22349 and because they are not supported by substantial evidence and are arbitrary and capricious.

Error No. 14: **The Commission's Finding of Fact 36 and Conclusion of Law 9 that there be a reduction of stranded costs for reduced carrying charges associated with additional accelerated depreciation violates PURA § 39.251(7).**

It is improper to reduce the net book value for reduced carrying charges for two reasons. First, it is directly contrary to the statute and the Commission rules, which provide that book value be established as of December 31, 2001 (PURA § 39.251(7) and P.U.C. Subst. R. 25.263(g)(1)). Second, it is directly contrary to the facts. TNMP had more than $15 million in excess earnings in both 1999 and 2000, so even under the Commission's finding that there be a minimum of $15 million mitigation in each of those years, TNMP met those obligations. TNMP did not have $15 million of mitigation in 2001. The book value was also established at the close of 2001, thus there was no period against which carrying costs associated with mitigation in 2001 could be applied.

There should not be any additional adjustment to account for carrying charges associated with the additional amount of accelerated depreciation ordered by the Commission. The reduced carrying charges are realized the year after the excess earnings and/or accelerated depreciation is recorded. In issuing the June 3, 2005 Order, the Commission adopts the May 28, 2004 PFD which accepted Staff's argument that TNMP should have recorded an additional $19,340,031 in

accelerated depreciation in the year 2001.[40] Staff's position was based in part on an interpretation of orders that requires TNMP to record additional accelerated depreciation in each year (1999, 2000, 2001) in which excess earnings did not reach $15 million, up to a total mitigation of $60 million. It is undisputed that TNMP recorded excess earnings in the amount of $20,585,174 in 1999 and $19,461,950 in 2000.[41] It is further undisputed that TNMP had no excess earnings in 2001. To implement Staff's position, TNMP would have had to record additional accelerated depreciation in 2001 to reach the "required" $60 million. As a result, any reduction in carrying charges would have been realized in the next year, 2002. The book value to be used in the true-up proceeding is that as of December 31, 2001. Any changes to the book value after December 31, 2001, cannot be considered for the purposes of the true-up.

Accordingly, Finding of Fact 36 and Conclusion of Law 9 (and the related discussion on pages 32-34 of the June 3, 2005 Order and pages 38-42 of the May 28, 2004 PFD) are erroneous because they are not supported by substantial evidence, are arbitrary and capricious, and are inconsistent with PURA § 39.251(7) which sets the determination of book value on December 31, 2001.

Error No. 15: **The Commission erred by disallowing from stranded costs the deferred debit associated with the HL&P Settlement.**

The Commission's Findings of Fact 51, 52, and 53 and Conclusion of Law 11 (and related discussion on pages 42-53 of the May 28, 2004 PFD) denying TNMP the right to recover the deferred debit associated with the HL&P Settlement are in error. TNMP is entitled to recover this deferred debit because it arose from TNMP's discontinuance of Statement of Financial Accounting Standard (SFAS) 71 and is part of stranded costs as that term is defined in PURA § 39.251(7). Eliminating this from the calculation of stranded costs is inconsistent with PURA. A detailed description of this issue and the reasons for the Commission's error are contained on pages 11 and 12 of Applicants' June 7, 2004 Exceptions and are incorporated herein for all purposes. TNMP is entitled to a rehearing on Findings of Fact 51, 52, and 53 because those findings are inconsistent with PURA to the extent they deprive Applicants of a "deferred debt" which is an express element of stranded costs. Moreover, those findings are not supported by substantial evidence, and are arbitrary and capricious. Conclusion of Law 11 is

[40] *See* May 28, 2004 PFD at 31.

[41] *See* Schedule III-F, TNMP Ex. 1.

affected by error of law because it is based on unsupportable findings of fact and is inconsistent with the directive of PURA that "deferred debits" be accounted for in the calculation of stranded cost.

Error No. 16: **The Commission erred by reducing stranded costs by the net present value of TNMP's ITCs.**

Finding of Fact 79, Conclusion of Law 17, and the related discussion on pages 81-94 of the May 28, 2004 PFD are in excess of the agency's statutory authority, are arbitrary and capricious, and are in violation of PURA. First, there is no authority in PURA or the Commission rules governing the computation of stranded costs for the adjustment made by this finding and conclusion. Second, this adjustment is inconsistent with the definition of stranded costs provided in PURA § 39.251(c). Third, adjusting stranded costs for investment tax credits (ITCs) is inconsistent with PURA § 39.302(5), which permits such activity only (i) in a securitization, and (ii) in circumstances where there will be no normalization violation.

Finding of Fact 79 is also arbitrary and capricious because reducing stranded costs by the amount of the ITC subjects TNMP to a normalization violation and a double loss of the amount involved (once in this docket and once as a tax liability). To the extent this Finding of Fact is based on PURA § 39.302(5), it is not supported by substantial evidence and is arbitrary and capricious because there are insufficient findings to conclude that an offset for ITCs is "permitted" under the Internal Revenue Code.[42]

In addition, Findings of Fact 75, 76, 77, and 78 are arbitrary and capricious and affected by other error of law because they are based on the consideration of irrelevant evidence. TNMP objected to the admission of any evidence on taxes as irrelevant and those objections were erroneously overruled.[43] Admission of this evidence was error and substantially prejudiced TNMP.

Finally, Findings of Fact 75, 76, 77, 78, and 79 and Conclusion of Law 17 violate due process, the prohibition of ex post facto laws, and the protections against deprivation of property

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[42] *See* May 28, 2004 PFD at 93 ("the ALJs cannot determine with any confidence whether offsetting TNMP's stranded cost in this case with its ITCs will result in an IRS normalization violation").

[43] *See* Applicants' Objections to Intervenors' Testimony and Motion to Strike at 3-4 (EB Objection 1), 6-7 (LK Objection 1 and LK Objection 2), 18-19 (JP Objection 1, JP Objection 2, and JP Objection 4). *See also* Tr. at p. 382 lines 1-9 (April 15, 2004) (re-assertion of objection to admission of TIEC Ex. No. 3 and No. 17—Testimony and Errata of Jeffrey Pollock); Tr. at p. 392 lines 18-25 (April 15, 2004) (re-assertion of objection to admission of Cities Ex. No. 1 and No. 4—Testimony and Errata of Lane Kollen); Tr. at p. 177 line 11—p. 178 line 18 (April 14, 2004) (objection to the relevancy of the tax-related testimony of Kim Andrews).

without compensation because they impose obligations in this case not found in the statute (Texas Constitution Art. 1 §§ 16, 17, and 19; United States Constitution Fifth and Fourteenth Amendments) and because they directly contradict the Commission's rule establishing the true-up filing package and the Commission's other decisions in Docket No. 26892.[44]

Error No. 17: **The Commission erred when it adjusted TNMP's deferred debt claim from $29,458,665 to $0.**

Findings of Fact 53 and 57 (and the related discussion on pages 42-69 of the PFD) are affected by error of law because disallowance of the deferred debit associated with the HL&P settlement is inconsistent with Applicants' right to recover "deferred debits" under PURA as set forth under Error No. 15. Findings of Fact 51, 52, 54, 55, 56, and 57 and Conclusions of Law 11, 12 and 13 are affected by other error of law because they are based on these erroneous findings, are not supported by substantial evidence, and are arbitrary and capricious.

In addition, Finding of Fact 45 is not based on substantial evidence, is arbitrary and capricious, and is contrary to law. There is no substantial evidence to support a finding that this amount is "based on an income tax benefit realized by TNMP," and it is contrary to the statutory definition of stranded costs to include this figure in the determination of stranded costs.

Error No. 18: **The Commission erred when it grossed up disallowances for federal income taxes because such an adjustment exceeds the Commission's statutory authority, is not supported by substantial evidence, and is arbitrary and capricious agency action.**

The Commission committed several errors related to its findings and conclusions (and the related discussion on pages 30-32 of the June 3, 2005 Order and pages 5, 78, 97-99, 171 of the May 28, 2004 PFD) that gross up various disallowances. First, Findings of Fact 66,[45] 67, 73, 74, and 74A and Conclusion of Law 16 are not supported by substantial evidence, are arbitrary and capricious, and are an abuse of discretion because they are based on the assumption that TNMP's future tax obligations will be reduced in an amount equivalent to the Commission's disallowance of stranded costs. There is no basis for such an assumption, and the evidence is uncontroverted that no tax obligation of the Company is extinguished by the Commission's disallowance.

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[44] *See* Applicants' June 7, 2004 Exceptions to ALJs' PFD at 15.

[45] Finding of Fact 66 is objectionable for the reasons stated herein because of the addition of the last phrase "to the extent TNMP recovers its stranded costs;" otherwise, it is not objectionable.

Second, Findings of Fact 74 and 74A and Conclusion of Law 16 are contrary to law, in excess of the Commission's authority, and an abuse of discretion. There is no provision in S.B. 7 granting the Commission authority to make such an adjustment. Further, the adjustment is inconsistent with the definition of "stranded cost" provided in PURA § 39.251(7) and the adjustment is inconsistent with judicial precedent defining the authority of the Commission to make such an adjustment.[46] Moreover, imposition of the adjustment made by Findings of Fact 74 and 74A and Conclusion of Law 16 without express statutory authority is a violation of TNMP's due process rights, constitutes impermissible ex post facto agency action, and a constitutionally impermissible taking (Texas Constitution Act 1 §§ 16, 17, and 19; United States Constitution Fifth and Fourteenth Amendments). For the same reason, Findings of Fact 66, 67, 72, and 73 are irrelevant and therefore arbitrary and capricious.

Third, the evidence offered in support of the gross-up adjustment was legally irrelevant, including the evidence supporting Findings of Fact 64 and 65, making those findings erroneous in addition to the findings identified above. TNMP objected to all tax-related testimony on the grounds that tax-adjustment issues were beyond the statute and inconsistent with Commission order and those objections were erroneously denied.[47] Admission of that testimony was error and substantially prejudiced TNMP.

Fourth, based on the evidence in the record, the ALJs determined that only after-tax amounts should be grossed up.[48] Despite the ALJs' determination, the Commission arbitrarily calculated a true-up balance that grossed up three pre-tax disallowances. As a result, Findings of Fact 74 and 74A and Conclusion of Law 16 are contrary to law by violating Tex. Gov't Code §§ 2003.049 and 2001.062, are not supported by substantial evidence, and are arbitrary and capricious.

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[46] *See Pub. Util. Comm'n v. GTE Southwest, Inc.*, 901 S.W.2d 401, 412 n. 16 (Tex. 1995); *Gulf State Util. v. Pub. Util. Comm'n*, 947 S.W.2d 887 (Tex. 1997).

[47] See Applicants' Objections to Intervenors' Testimony and Motion to Strike at 3-6 (EB Objection 1, EB Objection 2, and EB Objection 3), 6-8 (LK Objection 1, LK Objection 2, and LK Objection 3), 18-19 (JP Objection 1 and JP Objection 4). *See also* Tr. at p. 382 lines 1-9 (April 15, 2004) (re-assertion of objection to admission of TIEC Ex. No. 3 and No. 17–Testimony and Errata of Jeffrey Pollock); Tr. at p. 392 lines 18-25 (April 15, 2004) (re-assertion of objection to admission of Cities Ex. No. 1 and No. 4–Testimony and Errata of Lane Kollen); Tr. at p. 177 line 11—p. 178 line 18 (April 14, 2004) (objection to the relevancy of the tax-related testimony of Kim Andrews).

[48] May 28, 2004 PFD at 5, 97.

Finally, Findings of Fact 74 and 74A and Conclusion of Law 16 are contrary to law because "grossing up" the disallowances, in effect, prevents TNMP from recovering "all" of its stranded costs as permitted under PURA § 39.252(a). Findings of Fact 74 and 74A and Conclusion of Law 16 are also contrary to law, arbitrary and capricious, and an abuse of discretion because it is clear that they are meant to impermissibly penalize TNMP in violation of PURA. The Commission states, for example, that "it is appropriate to gross up the adjustments to market value" to account for TNMP's commercially unreasonable actions.[49] The Commission has already reduced TNMP's stranded costs by various amounts to account for those actions found to be commercially unreasonable, but believed it was also "appropriate" to penalize TNMP further for those same actions. Neither this nor any other penalty is authorized by PURA and is contrary to the Texas Constitution Art. 1 §§ 16, 17, and 19 and the Fifth and Fourteenth Amendments to the United States Constitution.

Error No. 19: **The Commission's finding that the sharing provision was commercially unreasonable is not supported by substantial evidence, is arbitrary and capricious, and is contrary to PURA.**

Findings of Fact 173, 173A, and 173B (and the related discussion on pages 138-140 of the May 28, 2004 PFD and pages 15, 29-30 of the June 3, 2005 Order) are inconsistent with PURA because they improperly apply the "commercially reasonable means" test to the sales transaction, because they are legally irrelevant, particularly 173A, and because they rely on the concept of market timing which is irrelevant under PURA § 39.252(d). As a result, the Commission's decision is inconsistent with PURA § 39.252 and is arbitrary and capricious. Findings of Fact 173, 173A, and 173B are not supported by substantial evidence and are arbitrary and capricious because, among other reasons, the uncontradicted evidence is that TNMP sought this provision as a conservative method of responding to the inherent uncertainties in the market.[50] Indeed, no one offered any evidence that TNMP included the "take-back" provision because it thought the price was too low (Finding of Fact 173A). It was clearly a commercially reasonable step to include provisions that reduced the risks associated with market uncertainty, and the only evidence in the record is that TNMP included this provision for the benefit of customers.

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[49] June 3, 2005 Order at 31.

[50] *See* Rebuttal Testimony of Bill Catacosinos, TNMP Ex. 6 at 12; Rebuttal Testimony of Mike Niggli, TNMP Ex. 15 at 9; Rebuttal Testimony of Jack Chambers, TNMP Ex. 18 at 13.

Moreover, the Commission recognizes that it is commercially reasonable to include terms in a sales contract for a power plant to protect both the buyer and the seller from risks inherent in an ever-changing market.[51] TNMP presented evidence supporting a finding that the take-back provision was such a provision,[52] and no one offered any evidence suggesting that a different contract provision would have achieved the same purpose or was even achievable. The Commission is acting arbitrarily and capriciously and has abused its discretion by finding that TNMP was not commercially reasonable by including the take-back provision in the sales contract.

Error No. 20: **The Commission's findings and conclusions on the good faith standard as it applies to the renegotiation of the Walnut Creek Mining Company contract violates PURA, are not supported by substantial evidence, are arbitrary and capricious, and are affected by other error of law.**

The Commission adopts the ALJs' May 28, 2004 PFD on the renegotiation of the Walnut Creek contract. The ALJs based their decision that "the good faith standard does not apply" on the fact that "TNMP is not seeking to recover stranded costs associated with its Walnut Creek fuel contract."[53] That premise (and Conclusion of Law 25) is not supported by substantial evidence, is arbitrary and capricious, is inconsistent with the statute (PURA §§ 39.251(7) and 39.252(d)), and is affected by other error of law.

The Walnut Creek fuel contract was included as an asset sold as part of TNP One. The "good faith" standard is the standard specified by statute for renegotiation of fuel contracts under PURA § 39.252(d). The uncontroverted evidence in the record shows that TNMP complied with the statutory standard and therefore pursued commercially reasonable means to mitigate its stranded costs. In fact, no one offered any evidence contradicting a conclusion that TNMP made good faith attempts to pursue mitigation of stranded cost.

The Commission, however, in making the adjustment for the Walnut Creek contract, relied on the findings in Docket No. 27576. Reliance on findings from that docket are contrary to law, an abuse of discretion, and affected by error of law because such reliance is inconsistent with both the doctrines of res judicata and/or collateral estoppel. The prior decision in TNMP's

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[51] June 3, 2005 Order at 29.

[52] Conformed Rebuttal Testimony of James M. Coyne, TNMP Ex. 27 at 37, line 873 to 38, line 876.

[53] May 28, 2004 PFD at 143.

fuel reconciliation proceeding does not dictate the conclusion here because there is not sufficient identity of issues and findings and because the fuel reconciliation order is still on appeal.

The Commission's finding of imprudence in TNMP's fuel reconciliation case has no impact on the issue of good faith negotiations to be applied in this case pursuant to PURA §39.252(d). Nevertheless, the Commission erroneously relied upon those findings and the imprudence standard in evaluating TNMP's good faith attempts to renegotiate the fuel contract. As a result, Findings of Fact 176, 177, 178, and 179 are irrelevant, contrary to PURA § 39.252(d), and arbitrary and capricious. Further, Findings of Fact 180, 181, 182, 183, and 184 are irrelevant to a determination of whether TNMP used good faith attempts to negotiate the fuel contract. Conclusions of Law 25 and 26 are affected by other error of law, are not supported by substantial evidence, and are arbitrary and capricious, because they are based on the above-described erroneous findings and the related erroneous discussion on pages 140-148 of the May 28, 2004 PFD. In addition, they are affected by other error of law because of the Commission's erroneous Preliminary Order and the exclusion of additional evidence of good faith offered by TNMP witness Larry Dillon. Admission of the irrelevant evidence and exclusion of related evidence was error and substantially prejudiced TNMP. As a result, TNMP is entitled to a rehearing on Finding of Fact 17 because it memorializes the erroneous Preliminary Order and the ALJs' denial of TNMP's Motion for Clarification and/or Reconsideration.

Lastly, reliance on the findings in the fuel reconciliation is arbitrary and capricious because in that case, the Commission expressly found that TNMP acted to maintain the value of the plant. In the June 3, 2005 Order in this case, however, the Commission inexplicably found that TNMP failed to act to maintain the value of the plant. The Commission's unexplained reversal of its earlier decision is arbitrary and capricious and not in accordance with law.

Error No. 21: **The Commission erred by reducing stranded costs by $30 million for the finding of imprudence in Docket No. 27576.**

Findings of Fact 179, 182, 183, and 184, Conclusion of Law 26, and the related discussion on pages 140-148 of the May 28, 2004 PFD are not supported by substantial evidence, are arbitrary and capricious, and are affected by other error of law because they are based on the use of an improper standard (as discussed above under Error No. 20) and because they result in double counting reductions in stranded costs. Under either of the Commission's theories (Conclusions of Law 20A and 24B or Conclusions of Law 23A and 24), an additional

reduction to stranded costs of any amount is arbitrary and capricious. Under both theories, the Commission estimates a "market value" of the plant by using figures that were designed for other purposes (see Error No. 7). In both cases, the disallowance used or the market value estimated is a number which already takes into account any effect the Walnut Creek fuel contract has on the value of the plant. The $54 million disallowance used by the Commission in Findings of Fact 158, 160, and 165, and Conclusion of Law 24 is based on findings that are after the fuel contract negotiations had ended (see Finding of Fact 180). Similarly, Findings of Fact 155B, 157, 159, 160A, 160B, 161, 184D, and 184E and Conclusion of Law 24B are based on figures derived after the fuel contract negotiations had ended. The additional deduction of $30 million is a double count of the presumed effect of TNMP's alleged imprudence in managing the fuel contract on market value of TNP One. In other words, by finding that a $30 million adjustment to stranded costs should be imposed for TNMP's failure to realize a decrease in the price of lignite, the Commission has in essence concluded that the actual market price of TNP One, without the Walnut Creek contract, would have been $30 million higher and that TNMP would have realized $204 million or $210 million for the plant. Yet, there are no findings to support this conclusion and no evidence in the record that would support such findings. Thus, the commission has made two adjustments of the same amount based on the same fact. The impact of the Walnut Creek contract is included within the overall impact of TNMP's activities on the value of the plant. Deducting this amount twice is an abuse of discretion because it is entirely punitive and without reasoned justification, is not supported by substantial evidence, and is arbitrary and capricious.

In addition, Findings of Fact 179, 182, 183, and 184 (the $30 million difference) are not supported by substantial evidence, are arbitrary and capricious, are affected by error of law because those figures were derived either from erroneous findings from Docket No. 27576 or from unreliable bids. To the extent that the calculation was derived from "expert" calculations, it is not based on substantial evidence because those "expert" opinions failed to take into account normal operating assumptions actually considered by the eventual purchaser. There was direct and uncontraverted evidence that the effect on the actual purchaser of the failure to achieve a lower lignite price from Walnut Creek was $14 million.[54] There exists no basis in the record on which to reach a different conclusion.

[54] *See* Applicants' June 7, 2004 Exceptions to ALJs' Proposal for Decision at 49-51.

Finally, the Commission's findings on this issue are based on the consideration of irrelevant evidence. TNMP objected to the testimony of Intervenors' witnesses on relevancy grounds.[55] The ALJs overruled those objections and considered that testimony, making the Commission's findings and conclusions arbitrary and capricious. It was error to admit that testimony.

Error No. 22: **The Commission misinterprets the Final Order in Docket No. 27576 by adjusting TNMP's final fuel balance by $422,491.**

The Commission adopted the ALJs' May 28, 2004 PFD on this issue. The PFD at pages 148 through 150 contained significant error as described on pages 52 through 53 of Applicants' June 7, 2004 Exceptions and incorporated herein for all purposes. Accordingly, TNMP is entitled to a rehearing on Findings of Fact 186, 187, 188, 189, 190, and 193 and Conclusions of Law 27 and 28 because they are contrary to law, are not supported by substantial evidence, and are arbitrary and capricious. These findings and conclusions misinterpret the final order in Docket No. 27576. In summary, the Commission erred because it failed to give effect to the plain language of the order which mandated a total amount for TNMP's over-recovered fuel balance.

Error No. 23: **The Commission's calculation of a true-up balance based on erroneous disallowances is likewise erroneous and therefore contrary to PURA.**

Conclusions of Law 33 and 33A are affected by other error of law because they are based on multiple findings which are themselves erroneous and because they violate PURA § 39.252 by not permitting full recovery of stranded costs. Findings of Fact 74A (and the referenced Attachments A and B), 185, 185A, 194, and 194A are affected by multiple errors of law (including violation of PURA § 39.252), represent an abuse of discretion, are not supported by substantial evidence, and are arbitrary and capricious as outlined in Error Nos. 1-22 and 24-32.

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[55] *See* Applicants' Objections to Intervenors' Testimony and Motion to Strike at 12-13 (SN Objection 2), 17 (KI Objection 3), and 18 (JP Objection 1).

Error No. 24: **The Commission's Supplementary Preliminary Order denying TNMP the right to proceed with its claim for a capacity auction true up was inconsistent with PURA § 39.262 and P.U.C. SUBST. R. 25.263.**

By Order dated March 3, 2004, the Commission denied those parts of TNMP's Application dealing with the capacity auction true up under PURA § 39.262 and P.U.C. Subst. R. 25.263.[56] The Commission erred in failing to consider and grant Applicants' request as required under these provisions. This decision (memorialized in Finding of Fact 16) was therefore contrary to PURA § 39.262 and P.U.C. Subst. R. 25.263, was arbitrary and capricious, and was not supported by substantial evidence. In addition, it is contrary to law and arbitrary and capricious as clarified by the Supreme Court in *Centerpoint Energy, Inc. v. Public Utility Commission of Texas.*[57]

Consistent with PURA and Commission rules, a power generation company is required to reconcile capacity auction prices with power cost projections regardless of whether that company auctioned capacity. PURA § 39.153(a) imposes a mandatory obligation on each electric utility to conduct a capacity auction and then provides entities owning less than 400 MWs, like TGC with an exemption from the obligation to conduct an actual auction. PURA § 39.262(d) states that all affiliated power generation companies (without exception) "shall" reconcile the difference in capacity auction prices and power cost projections and the difference must be billed or credited depending on how the reconciliation turns out. There are no exceptions for entities not participating in capacity auction. P.U.C. Subst. R. 25.263(i)(1) requires that entities file a true up of capacity auction proceeds and provides a procedure. P.U.C. Subst. R. 25.263(i)(2) provides the method for those entities, like TNMP, that did not auction capacity.

The Texas Supreme Court has recognized the mandatory or guaranteed nature of PURA 39.262 for utilities and customers of utilities alike when it wrote:

> The first [objective of the capacity auction true up] is that a generation company is limited to a set margin that it will receive for sales of power, no matter how high or how low gas prices and fuel costs might be during 2002 and 2003. The second is that a generation company is permitted to earn a return on its generation assets during this period.

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[56] Supplemental Preliminary Order at 6.

[57] 141 S.W.3d. 81 (Tex. 2004).

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> This essentially guarantees consumers and power companies that the power company will receive no more and no less than a margin predetermined by the Commission in 2001 when the ECOM model was run in compliance with section 39.201.[58]

To hold a power generator ineligible to participate in the capacity auction because it did not auction capacity, as the Commission has done, renders P.U.C. Subst. R. 26.263(i)(2) entirely superfluous. Construction of a statute or regulation that renders a provision superfluous is error.[59] On its face P.U.C. SUBST. R. 23.263(i) applies to entities without regard to whether they were required to have capacity auctions.

The Commission's exclusion of TNMP's application for a capacity auction true up has upset the delicate balance of obligations and benefits allocated among the stakeholders (e.g., consumers, utilities, independent power producers) when the legislature decided that Texas would undertake the difficult and disruptive task of transforming a regulated industry into an unregulated one. The legislature directed this effort because it was convinced that ultimately the consumer would achieve great benefits through competition.

The capacity auction provisions were part of the legislature's effort to assure that obligations arising from deregulation were balanced. The legislature wanted to assure that its expectations concerning offsetting rights and obligations were met. In the case of the capacity auction true-up, the expectation was that the price of wholesale power during the relevant period would be the same as the ECOM power cost projections. The Supreme Court recently discussed the legislative intent as follows:

> The Legislature recognized that on the first day of deregulation, January 1, 2002, there was no way to validly quantify stranded costs, if any, because a market for electricity, both wholesale and retail, would need time to develop, and there would be interim distortions and fluctuations, perhaps severe ones. The Legislature was also concerned that distortions and fluctuations in the market price of power during the first two years of deregulation could harm consumers and generation companies alike. The Legislature accordingly designed the capacity auction true-up proceeding

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[58] *CenterPoint Energy, Inc. v. Pub. Util. Comm'n,* 143 S.W.3d 81, 96 (Tex. 2004).

[59] Administrative regulations are construed in the same manner as statutes. *See e.g. Lewis v. Jackson Bldg. And Loan Assn.*, 540 S.W.2d 307, 310 (Tex. 1976). A construction that makes a provision superfluous is error. *See e.g. Board of Adjustment of City of San Antonio v. Wende*, 92 S.W.3d 424, 432 (Tex. 2002); *Spradin v. Jim Walter Homes*, 34 S.W.3d 578, 580 (Tex. 2000).

> because of the likelihood that no stable market would exist until up to two years after the first day of deregulation.[60]

Further, the Court found that one objective accomplished by the capacity auction true up is that a generation company is permitted to earn a return on its generation assets during the first two years after deregulation.[61]

For the reasons discussed above, TNMP is therefore entitled to a rehearing on the March 3, 2004 Supplemental Preliminary Order and Finding of Fact 16, and is entitled to a hearing on its capacity auction true up.

Error No. 25: **The Commission's June 3, 2005 Order deprives Applicants of property without due process and constructively condemns its property for a public purpose without due compensation in violation of Texas law, the Texas Constitution, and the United States Constitution.**

S.B. 7 required utilities to unbundle their companies at significant expense and loss and to subject their investments made in a regulated environment to an unregulated environment. This was done for a public purpose as defined by the Texas Legislature. When private property is dedicated for a public purpose the requirements of due process must be met and there must be provision for due compensation. Neither was obtained by Applicants under the June 3, 2005 Order of the Commission. For those reasons, the June 3, 2005 Order violates constitutional and statutory provisions including United States Constitution Fifth and Fourteenth Amendments and the Texas Constitution Art. 1 §§ 16, 17, and 19 and is thus error.

Error No. 26: **The Commission failed to comply with PURA § 39.262(j).**

Section 39.262(j) of PURA requires that the Commission issue a final order not later than the 150th day after the date the utility and its affiliates file their true-up application. The Commission did not comply with that requirement and therefore has no authority to deny any of the Applicants' stranded costs.

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[60] *CenterPoint Energy, Inc. v. Pub. Util. Comm'n,* 143 S.W.3d 81, 96 (Tex. 2004).

[61] *Id.*

Error No. 27: **The Commission failed to comply with Tex. Gov't Code § 2001.141.**

Applicants filed proposed findings of fact in accord with the direction of the ALJs. The Commission has failed to rule on each of its proposed findings and failed to provide an explanation of its reasons for doing so.

Error No. 28: **The Commission's Preliminary Order contains errors of law.**

The Preliminary Order issued on February 13, 2004, was erroneous for each of the following reasons:

A. **The Commission erred in unreasonably interpreting PURA § 39.252(d) to exclude consideration of TNMP's "good faith attempts" to renegotiate its fuel supply agreement.**

The effect of this error is discussed under Error No. 20 above. Properly construed, Section 39.262(d) equates "commercially reasonable means" in the context of renegotiating contracts to a "good faith" standard.

B. **Issue 3.b of the Preliminary Order misstates the statutory standard set out in PURA § 39.252(d) and the regulatory standard set out in P.U.C. Subst. R. § 25.263(e)(4) by asking whether TNMP had undertaken "all commercially reasonable means."**

Issue 3.b of the Preliminary Order states as follows:

> b. Did TNMP undertake **all** commercially reasonable means to mitigate its potential stranded costs, including good faith attempts to renegotiate above-cost fuel and purchased power contracts or the exercise of normal business practices to protect the value of its assets? (Emphasis added).

This is a correct statement of the statutory and regulatory standard except for the qualifier that TNMP undertake "all" commercially reasonable means. The word "all" does not appear in the statute, and its inclusion thus imposes a burden not contained in the statute, which anticipates that TNMP's actions taken as a whole will be evaluated against the statutory standard. This error resulted in substantial harm to TNMP by placing a burden on TNMP greater than that imposed by the statute.