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APPLICATION OF CENTERPOINT §
ENERGY HOUSTON ELECTRIC LLC, §
RELIANT ENERGY RETAIL §
SERVICES, LLC, AND TEXAS GENCO, §
LP TO DETERMINE STRANDED §
COSTS AND OTHER TRUE-UP §
BALANCES PURSUANT TO PURA §
39.262 §

PUBLIC UTILITY COMMISSION
BEFORE THE CLERK

PUBLIC UTILITY COMMISSION

OF TEXAS

**MOTION FOR REHEARING OF
THE HOUSTON COUNCIL FOR HEALTH AND EDUCATION**

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January 4, 2005

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PURSUANT TO PURA § 39.262	§	

**MOTION FOR REHEARING OF
THE HOUSTON COUNCIL FOR HEALTH AND EDUCATION**

TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

The Houston Council for Health and Education (“HCHE”) hereby respectfully submits this motion for rehearing of the Commission’s Order on Rehearing, dated December 17, 2004 (“Order”) which addresses the joint application of CenterPoint Energy Houston Electric, LLC (“CenterPoint”), Reliant Energy Retail Services, LLC (“RERS”), and Texas Genco, LP (“TGN”) to determine stranded costs and other true-up balances under Section 39.262 of the Texas Public Utility Regulatory Act (“PURA”), TEX. UTIL. CODE ANN. §§ 11.001-64.158 (Vernon 1998 & Suppl. 2005), and P.U.C. SUBST. R. 25.263.

**I.
ASSIGNMENTS OF ERROR AND DISCUSSIONS**

The Commission should amend its Order to correct the errors set forth below which are in violation of the Commission’s Constitutional and statutory authority, made upon unlawful procedure, not supported by substantial evidence, affected by errors of law, and are arbitrary, capricious and an abuse of discretion:

ASSIGNMENT OF ERROR NO. 1

The Commission erred by allowing CenterPoint and Texas Genco to recover any stranded costs whatsoever.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 1

Chapter 39 of PURA allows utilities to recover stranded costs resulting from deregulation. Under this chapter, a utility is able to “recover all of its net, verifiable, nonmitigable stranded costs.” PURA § 39.252(a). However, utilities are prohibited from over-recovering stranded costs. *Id.* Thus, PURA imposes certain obstacles to recovery, one of which is that utilities must undertake efforts to mitigate their stranded costs. PURA § 39.254.

Additionally, as the Commission noted, the utility bears “the burden to persuade the finder of fact of the existence of each element of [its claim],”¹ *i.e.*, “to prove every fact essential to [its] case.”² Thus, applicant also bears the burden of showing that it meets the statutory criteria to qualify for stranded cost recovery under the chosen method of determining stranded costs.

As such, in this proceeding, CenterPoint had the burden of showing that it satisfied the statutory criteria for stranded cost recovery under the partial stock valuation methodology. However, as the Commission correctly found, CenterPoint failed to satisfy the applicable criteria. Such a finding should have automatically disqualified CenterPoint from recovering stranded costs in this proceeding. Thus, the Commission erred by allowing CenterPoint to recover some of its claimed stranded costs.

¹ *Vance v. My Apartment Steak House*, 677 S.W.2d 480, 482 (Tex. 1984).

² *Id.* (citing *Shell Chemical Co. v. Lamb*, 493 S.W.2d 742, 744 (Tex. 1973)); *see also Trailways v. Clark*, 794 S.W.2d 479, 491 (Tex. App. – Corpus Christi 1990), *writ denied*.

More specifically, the Commission erred by ignoring the statutory mandate that in order to determine the market value of generation assets for stranded cost recovery purposes an applicant is required to utilize one of the four methods specified by PURA § 39.262(h), and inventing a fifth methodology for quantifying CenterPoint's stranded costs "*outside* of the methods specified in PURA." *See* Order at 18 (emphasis added). Such an action is impermissible because the Commission is a "creature of the legislature" and has no authority to independently create any extra-statutory method of recovery. Further, such an action is in direct contravention of the fact that "nothing in [section 39.262] authorizes the commission to substitute its judgment for a market valuation of generation assets determined under sections 39.262(h) and (i)," PURA § 39.252(d), a fact which the Commission itself freely acknowledges. *See* Order at 11. Thus, there is no basis in law to award CenterPoint stranded costs based upon any theory that falls outside the statutory framework, including the method the Commission invented for this proceeding.

Further, the Commission's "alternative holding," which assumes that CenterPoint had complied with the statutory requirements of the partial stock valuation methodology, is inconsistent with its "primary holding" that CenterPoint failed to meet such requirements and, like the Commission's primary holding, is in error.

For these reasons, the Commission erred by allowing CenterPoint to recovery any stranded costs whatsoever in this proceeding. However, without conceding its position that the Commission's allowance of stranded costs in this proceeding was in error, HCHE discusses below additional errors in the Commission's holding with regard to stranded costs in this proceeding.

ASSIGNMENT OF ERROR NO. 2

The Commission erred by basing its determination regarding the value of TGN's common stock on the finding of the valuation panel.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 2

The Commission erred by basing its determination regarding the value of TGN's common stock on the findings of the valuation panel. First, the valuation panel's findings are not evidence in this proceeding. The valuation panel was not required to respond to data requests or to provide the parties to this proceeding with any evidence supporting its findings. Nor was the valuation panel subject to cross-examination at the hearing. As such, the panel's findings are not evidence and the Commission is not entitled to treat the findings as conclusive. Additionally, the valuation panel was not independent or free of conflicts of interest as required by PURA § 39.262(h)(3) and the original version of P.U.C SUBST. R. 25.263(f)(1)(C)(iv).

Furthermore, the valuation panel utilized the methodology set forth by Dr. Peavy to determine and quantify the detrimental impact of CenterPoint's activities on the market value of TGN's common stock. However, as mentioned above, the panel's findings are not, by themselves, evidence in this proceeding. Thus, to the extent that the Commission believes that the methodology used by the valuation panel should be used to determine CenterPoint stranded costs, the Commission also should have adopted Dr. Peavy's calculations and analyses as they constitute the only actual evidence regarding this matter submitted in this proceeding.

ASSIGNMENT OF ERROR NO. 3

The Commission erred by finding, under its primary holding, that no control premium should be added.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 3

The record in this case established that TGN has never functioned as an independent, stand-alone company with the goal of maximizing value for its shareholders. Instead, it has functioned as a company shackled by restrictions (some imposed by the original business separation plan for the benefit of Reliant Resources, Inc. (*i.e.*, those of the Genco Option Agreement) and others imposed by the policies CenterPoint, its majority owner (*e.g.*, its \$0 debt capital structure). As such, the maximum 10% control premium is appropriate in this case.

Virtually every intervenor witness shared this view, testifying that a control premium in a range from approximately 20% to 30% should be applied.³ Dr. Peavy, who was the only witness in this case with combined experience from both the academic and investment communities, also was the only witness that conducted a full financial analysis of the value of TGN and the implications of that valuation on the control premium issue. Dr. Peavy determined that the restrictions placed on TGN significantly depressed the value of TGN's shares, HCHE Exh. 3 (*Peavy*) at 27:28-35:20, 35:22-37:15, 38:27-44:2, 44:6-45:6 and 45:28-46:6, and that a control premium of approximately 30% of the fair market value of TGN would reasonable to compensate for these restrictions. *Id.* at 48:6-7.

However, given that the maximum control premium allowed by PURA § 39.262(h)(3) is just 10%, the full 10% allowable premium should have been applied in this proceeding. *Id.* at 48:9-12. This 10% premium is appropriately added to the fair market value of TGN shares as

³ See, *e.g.*, HCHE Exh. 3 (*Peavy*) at 48:6-7 (30%); TIEC Exh. 2 (*Gorman*) at 45 (30+%); State Exh. 1 (*Johnson*) at 30 (20-30%); TIEC Exh. 3 (*Mittag*) at 35 (30+%); COH Exh. 2 (*Purcell*) at 1 (25+%) and OPC Exh. 3 (*Rode*) at 41 (30%).

opposed to the publicly traded price which was deflated by the failure of TGN to exercise normal business practices. *Id.* at 48:24-49:2.

ASSIGNMENT OF ERROR NO. 4

The Commission erred by finding, under its alternative holding, that the control premium should only be applied to the market value of CenterPoint's retained shares of TGN's stock.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 4

As discussed above, the restrictions placed on TGN significantly depressed the value of TGN's shares. Thus, the maximum allowable control premium of 10% should appropriately be added to the fair market value of TGN's shares.

However, contrary to the Commission's holding in this proceeding, the control premium should be applied to 100% of the outstanding shares of TGN, rather than just those held by CenterPoint. This is true because when a buyout occurs, it will be for all of TGN's outstanding shares, not just those held by the majority owner. Thus, the Commission's holding in this proceeding is in error.

ASSIGNMENT OF ERROR NO. 5

The Commission erred by not decreasing the net book value of TGN's generation assets by a total of \$1,671,082 million to account for CenterPoint's failure to use normal business practices and to use commercially reasonable means to mitigate stranded costs.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 5

Pursuant to PURA § 39.252(a), CenterPoint is restricted to recovering only stranded costs that are net, verifiable, and nonmitigable. Thus, CenterPoint was required to undertake efforts to mitigate stranded costs by "pursu[ing] commercially reasonable means to reduce its potential stranded costs, including good faith attempts to renegotiate above-fuel and purchased power

contracts or the exercise of normal business practices to protect the value of its assets.” PURA § 39.252(d).

In turn, the Commission is required to “consider the utility’s efforts under this subsection when determining the amount of the utility’s stranded costs.” PURA § 39.252(d). The Commission has the authority, and the responsibility, to impose serious consequences for a utility’s failure to undertake commercially reasonable means to protect and enhance the value of its generation assets. Specifically, the Commission “may reduce the net book value of the [Company’s] generation assets or take other measures it deems appropriate in the true-up proceeding” based on its review of the applicants’ efforts to protect and enhance the value of the generating assets. P.U.C. SUBST. R. 25.263(e)(4).

Such measures are both necessary and appropriate in this proceeding as the evidence clearly established that CenterPoint and Texas Genco adopted policies and practices, through the Genco Option Agreement and otherwise, that were in direct contravention of the requirement that CenterPoint and Texas Genco use commercially reasonable means and normal business practices to reduce stranded costs. Those policies and practices, all of which had the effect of depressing the value of TGN stock during the valuation period, included, for instance: (i) the use of a debt-free capital structure that was diametrically different than of any other energy company, (ii) a dividend policy that focused on hoarding cash, (iii) the restrictions of the Genco Option Agreement that prevented TGN from undertaking normal business practices that would be undertaken by a prudent merchant generator, (iv) the failure to implement any kind of long-term business plan or otherwise function as an independent, stand-alone company with the goal of maximizing the value of its enterprise and (v) failing to consider selling its generating assets at a time when generating plants were selling around the country at multiples of net book value and

CenterPoint's predecessor, Reliant Energy, Inc., had in hand a valuation estimating the value of the generating assets at net book value.

These failures to mitigate stranded costs must be taken into consideration and, in the course of calculating stranded costs, these factors should have been used to reduce the net book value of TGN's generating assets. The Commission's failure to order such a reduction in this proceeding constitutes error. Accordingly, each of the factors which warrant a reduction in TGN's net book value in this proceeding are discussed below in Assignment of Error Nos. 6 through 11.

ASSIGNMENT OF ERROR NO. 6

The Commission erred by not finding CenterPoint's debt-equity ratio to be unreasonable and adjusting the net book value of TGN's generating assets accordingly.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 6

TGN's capital structure of almost 100% equity does not follow normal business practices. In fact, this debt-free capital structure differs substantially from the capital structures of comparable companies, *see* HCHE Exh. 3 (*Peavy*) at 27:28-28:23; Exh. JWP-15A at 715-16 thereto, and served to depress the value at which TGN's stock was traded. HCHE Exh. 3 (*Peavy*) at 23:18-30:10.

Dr. Peavy testified that if TGN had issued a reasonable amount of long-term debt, and used the proceeds to retire some of its outstanding equity, it effectively would have substituted low-cost long-term debt for much higher-cost equity with only a minor difference in TGN's risk profile. *Id.* at 24:1-6. As Dr. Peavy demonstrated at the hearing, the addition of debt to its capital structure can be beneficial for a company by increasing its after tax cash flows. *See* Peavy, Tr. 2220:5-2226:10; Exh. HCHE-12, Exh. HCHE-13.

Dr. Peavy was not alone in opining that TGN's failure to add a reasonable amount of debt to its capital structure was out of step with normal business practices. In fact, **REDACTED**

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See Int. Exh. 94 at 14; see also

HCHE Exh. 1 (*Kollen*) at 66:16-67:9; Exh. LK-34A thereto; Int. Exh. 107 at 17.

Furthermore, because, under PURA § 262(h)(3), stranded costs are calculated by subtracting from net book value the combination of market value, preferred stock and the book value of debt, McGoldrick, Tr. 597:20-598:8, had TGN undertaken to include a reasonable amount of debt in its capital structure, every dollar of debt issued would have mitigated stranded costs by an equivalent dollar.

Because CenterPoint's failure to consider issuing debt to reduce stranded costs is inconsistent with the requirement that it undertake normal business practices and use commercially reasonable means to mitigate stranded costs, adjustments to TGN's net book value are required to compensate for CenterPoint's failure to comply with the statutory requirements and should have been made in this proceeding.

ASSIGNMENT OF ERROR NO. 7

The Commission erred by not adjusting TGN's net book value to compensate for CenterPoint's dividend policy, the effect of which was to suppress the price at which TGN shares otherwise would have traded.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 7

CenterPoint also failed to utilize normal business practices and to use commercially reasonable means to mitigate stranded costs when it adopted a dividend policy which depressed the value at which TGN stock traded during the valuation period. TGN's dividend was kept artificially low. TGN declared an initial dividend of \$1.00 per share on an annual basis after the

stock was first issued. In contravention of specific recommendations concerning the dividend policy, this \$1.00 per share dividend was not increased, despite earnings per share of

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and cash flows that exceeded

TGN's needs. *See* Int. Exh. 10 at 15; Int. Exh. 14 at 3; *see also* HCHE Exh. 1 (*Kollen*) at 67:14-68:9.

Instead of increasing the dividend level, which would have increased TGN's stock price and attracted additional investors, HCHE Exh. 1 (*Kollen*) at 68:11-12, CenterPoint chose to hoard cash and keep TGN's dividend policy and earnings guidance artificially low. Thus, CenterPoint missed valuable opportunities to enhance TGN's valuation and mitigate stranded costs. McGoldrick, Tr. 597:6-13. Therefore, adjustments to TGN's net book value should have been made to compensate for CenterPoint's dividend policy, the effect of which was to suppress the price at which TGN shares otherwise would have traded.

ASSIGNMENT OF ERROR NO. 8

The Commission erred by not finding CenterPoint's communications with investors to be commercially unreasonable and reducing the net book value of TGN's generating assets accordingly.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 8

CenterPoint failed to follow normal business practices and to use commercially reasonable means to mitigate stranded costs by failing to properly inform investors regarding TGN's financial outlook and other aspects relevant to the stranded cost filing.

For example, TGN kept its earnings guidance artificially low, which had a depressive effect on TGN's stock price and left investors and equity analysts wondering why the earnings guidance was not increased to reflect more realistic guidance. *See* Int. Exh. 145 at 63.

Moreover, the earnings guidance was

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and TGN

and CenterPoint failed to keep investors fully informed regarding important aspects such as TGN's earnings and potential increases in valuation.

When information was communicated to analysts, TGN and CenterPoint chose to keep beneficial information from investors and instead focus on aspects, such as CenterPoint's continued control over TGN, that had the effect of depressing the value at which TGN's shares were traded, thus preventing investors from receiving fair and balanced guidance as to the financial outlook of TGN.

Such action was commercially unreasonable and the Commission should have reduced the net book value of TGN's assets accordingly.

ASSIGNMENT OF ERROR NO. 9

The Commission erred by not finding that CenterPoint's 19% float made TGN illiquid and had a depressive effect on TGN's stock price and adjusting TGN's net book value accordingly.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 9

The 19% float lowered the value of TGN's shares because the float: (i) was not large enough to attract significant interest from institutional investors; (ii) was not large enough to attract research coverage from securities analysts; (iii) caused TGN to be effectively categorized as a "low-cap" stock; and (iv) was not large enough to provide trading liquidity. *See* HCHE Exh. 3 (*Peavy*) at 38:27-44:2. Had CenterPoint distributed just under 51% of TGN's outstanding common shares, the highest part of the range permitted by § 39.262(h)(3), rather than 19%, the lowest part of the permitted range, more institutional investors would have been attracted to the stock, the stock would have generated research coverage, and its liquidity would have improved, thereby allowing more active trading in the stock. *See* HCHE Exh. 3 (*Peavy*) at 43:11-19.

Because CenterPoint's distribution of only 19% of TGN's outstanding common shares was, under the circumstances, inconsistent with the requirement that it undertake normal business practices and use commercially reasonable means to mitigate stranded costs, adjustments to TGN's net book value should have been made in this proceeding to compensate for CenterPoint's failure to undertake commercially reasonable means to mitigate stranded costs.

ASSIGNMENT OF ERROR NO. 10

The Commission erred by not finding CenterPoint's Operations/Business Plan and Management unreasonable and adjusting TGN's net book value accordingly.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 10

Instead of providing TGN with a long-term business plan and treating it as a long-term investment with the goal of profit maximization, CenterPoint positioned TGN as a short term stranded cost recovery vehicle. HCHE Exh. 1 (*Kollen*) at 46:7-17. This is contrary to normal business practices and represents another failure to properly mitigate stranded costs.

Moreover, rather than establishing an independent management team for TGN, CenterPoint retained control over TGN through shared officers and directors **REDACTED**

REDACTED thus creating a clear conflict of interest in mitigating stranded costs by increasing the valuation of TGN on the one hand, and increasing the amount of stranded costs recovered through a diminution in the value of TGN on the other. *See* HCHE Exh. 1 (*Kollen*) at 53:1-54:15 and Exhs. LK-25 and LK-28A thereto.

The lack of a long-term business plan coupled with the lack of an independent management team for TGN are further examples of CenterPoint's failure to utilize normal business practices to enhance the value of TGN's assets and failure to use commercially reasonable means to mitigate stranded costs. Thus, the Commission should have reduced TGN's net book value accordingly.

ASSIGNMENT OF ERROR NO. 11

The Commission erred by not finding the restrictions on TGN's ability to hedge unreasonable and adjusting TGN's net book value accordingly.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 11

TGN was prohibited from engaging in hedging transactions or contracts or financial instruments under which it would be exposed to market risk related to commodity prices, interest rates, or currency exchange rates except in compliance with RRI's policies. HCHE Exh. 1 (*Kollen*) at 32:12-15.

The ability to hedge transactions can be a valuable tool in managing earnings volatility, and, since investors seek the highest return at the lowest possible risk and earnings volatility is a key measure of risk, investors would not look favorably upon, or value highly, the reported limited ability to engage in hedging transactions.

By placing the hedging restrictions on TGN, CenterPoint failed to follow normal business practices and use commercially reasonable means to mitigate stranded costs and the Commission should have adjusted the net book value of TGN accordingly.

ASSIGNMENT OF ERROR NO. 12

The Commission erred by not reducing the net book value of TGN's generation assets by \$27.082 million⁴ to reflect the uprating of TGN's Limestone 2 Unit.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 12

TGN is currently engaged in an uprate project at the Limestone 2 Unit that will increase its capacity from 830 mW to 930 mW. HCHE Exh. 1 (*Kollen*) at 75:6-10. TGN expects that this project will be complete in 2006. *Id.* at 75:10-11. Yet TGN has made no mention of this uprate or the estimated net present value benefits from this uprate in any of its SEC filings through

⁴ This number is included in the \$1,671,082 million reduction for failure to mitigate.

March 31, 2004. *Id.* at 75:13-18. However, in response to a request for information in this proceeding, TGN quantified the net present value benefit of the uprate at \$27.082 million. HCHE Exh. 1 (*Kollen*) at 75:20-76:6, Exh. LK-43. Therefore, TGN's net book value should have been reduced by \$27.082 million to account for the uprating and \$1,644 million for the depressive effect on the price at which TGN stock was traded, for a total net book value reduction of \$1,671.082 million.

ASSIGNMENT OF ERROR NO. 13

The Commission erred by not finding CenterPoint's failure to consider the sale of generating assets in 2000 or 2001 unreasonable and adjusting TGN's net book value accordingly.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 13

CenterPoint refused to consider the sale of some or all of TGN's generation assets in 2000 and early 2001, when market prices were at their peak. During this period, when generating assets were selling at multiples of book value, TGN's generating and related assets were valued at **REDACTED**. HCHE Exh. 1 (*Kollen*) at 23:6-26:12 and Exh. LK-6 thereto.

This failure to consider the sale of the generation assets, **REDACTED**
REDACTED was patently unreasonable under the circumstances and, as such, the Commission should have decreased TGN's net book value accordingly.

ASSIGNMENT OF ERROR NO. 14

The Commission erred by allowing CenterPoint to recover its claimed non-environmental Construction Work in Progress ("CWIP") as stranded costs in this proceeding.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 14

The Commission held that the joint applicants are not required to comply with the statutory requirements for traditional rate recovery, *i.e.*, a showing that the inclusion of CWIP is necessary to the financial integrity of the utility; and that the "major projects under

construction have been efficiently and prudently planned and managed,” in this proceeding. P.U.C. SUBST. R. § 25.231(c)(2)(D). However, this holding is clearly in error.

PURA § 39.260(a) makes clear that invested capital only can be considered as stranded costs in accordance with regulatory principles. *See* PURA § 39.260(a)(invested capital “shall be treated in accordance with generally accepted accounting principles as modified by regulatory accounting rules generally applicable to utilities”). CWIP is defined as a component that can, in extremely limited circumstances, be treated as invested capital, *i.e.*, as part of rate base. Thus, utilities can recover CWIP, but only to the same limited extent that it would have been recoverable in rates under traditional rate regulation. The fact that under traditional regulation a utility would be allowed to file a rate case on a recurring basis, whereas this proceeding will only result in recovery of costs once, does not change the regulatory principles set forth in PURA. Thus, if the costs were not recoverable under traditional regulation, then the costs by definition are not stranded and cannot be recovered in this proceeding.

Because CenterPoint did not provide any evidence to show that the \$110 million of claimed CWIP costs are necessary to its financial integrity, it failed to make the showing required under P.U.C. SUBST. R. 25.231(c)(2)(D) to enable CWIP to be treated as a rate base item. Therefore, CenterPoint’s net book value should have been reduced by the \$110 million CenterPoint claimed as CWIP.

ASSIGNMENT OF ERROR NO. 15

The Commission erred by not reducing the net book value claimed by CenterPoint by \$37.5 million to remove “plant held for future use” costs (“PHFU”).

DISCUSSION OF ASSIGNMENT OF ERROR NO. 15

For the reasons discussed above in Assignment of Error No. 14, the Commission’s determination that rate-case principals do not apply to the present proceeding is in error.

“Plant held for future use” concerns costs for “plant,” or tracts of land, that are not currently used for electric service but may be used for electric service in the future. *See* Brian, Tr. 3300:24-25, 3301:1-6. As Mr. Brian admitted, if the intended use of the plants or tract of land is more than 10 years beyond the test year used to set rates, PHFU will not be included in rate base.⁵ CNP Exh. 36 (*Brian*) at 13.

Mr. Brian admitted that the assets that constitute the PHFU will not be in service until after 2011, more than ten years from the date that competition began. Brian, Tr. 3302:12-22, *see also* TIEC Exh. 49. He also admitted that nothing in the record indicates that the tracts of land that have been included in PHFU will be put to service within 11 years from December 31, 2001. Brian, Tr. 3303:10-14. Additionally, CenterPoint cannot guarantee when or if the purchasers of Texas Genco ever will put the land to use. Therefore, CenterPoint failed to satisfy its burden of proof and the net book value claimed by CenterPoint should have been reduced by \$37.5 million to remove PHFU.

ASSIGNMENT OF ERROR NO. 16

The Commission erred by not reducing CenterPoint’s claim for environmental reduction costs by \$90,218,875.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 16

CenterPoint’s claim for environmental reduction costs includes approximately \$92.2 million that has not yet been expended for NOx emission reduction systems on Cedar Bayou Units 1 and 3, P.H. Robinson Units 1, 2 and 3, W.A. Parish Unit 4, San Jacinto Units 1 and 2, and T.H. Warren Unit 2. COH Exh. 3 (*Walter*) at 19:7-11 and Exh. BWV-10 thereto. Only the San Jacinto units are anywhere near completion, *id.* at 19:14-15 and Exh. BWV-11 thereto, and

⁵ *See also* Application of Houston Power and Lighting Company for Authority to Change Rates, Docket No. 9850, Order, Finding of Fact 36.

a number of the foregoing units either are not operational or have been forecasted to cease operation. *Id.* at 20:1-21:14.

Thus, it is very unlikely that it will be economically beneficial to complete the NOx reduction projects at Parish Unit 4 or P.H. Robinson Units 1, 2 and 3 and the economic viability of at least one of the Cedar Bayou projects is in doubt. *Id.* at 22:6-9. As such, the Commission's determination that the joint applicants may recover environmental expenditures up to the cap of \$698,704,600 imposed by Docket No. 24835 is in error. Rather, CenterPoint's claim for environmental reduction costs should have been reduced by \$90,218,875 associated with these projects that are unlikely to be built. *Id.* at 24:18-22.

ASSIGNMENT OF ERROR NO. 17

The Commission erred by not reducing CenterPoint's stranded cost claim by \$356.5 million reflecting EMCs.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 17

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HCHE Exh. 1 (*Kollen*) at 101:4-18 and Exh. LK-57 thereto. According to CenterPoint, the

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EMCs passed through to all retail electric providers during that same time period. HCHE Exh. 1 (*Kollen*), Exh. LK-57. CenterPoint's stranded cost claim reflects \$469.7 million, excluding interest, in refunds through August 28, 2004. *See* HCHE Exh. 1 (*Kollen*) at 101:13-14. Assuming that the same **R** ratio to affiliated REPs continues to apply from March 1, 2004 through August 28, 2004, the total EMCs passed through to affiliated REPs will be **R** **R** *Id.* at 101:14-17; Exh. LK-57.

CenterPoint's failure to pass these benefits on to price to beat customers will result in the over-recovery of stranded costs. Because such an over-recovery is prohibited by PURA § 39.262(a), CenterPoint's stranded cost claim should have been reduced by **REDACTED**. See HCHE Exh. 1 (*Kollen*) at 11:17-12:5, 102:1-8.

ASSIGNMENT OF ERROR NO. 18

The Commission erred by permitting CenterPoint to recover any of its capacity auction true-up request.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 18

PURA § 39.153 provides that “[e]ach electric utility subject to this section, shall sell at auction . . . entitlements to at least 15% of the electric utility’s Texas jurisdictional installed generation capacity.” However, TGN failed to sell at least 15% of its jurisdictional capacity in the Commission-mandated auctions and, as a result, did not satisfy the statutory requirement for recovery, nor did CenterPoint comply with the Commission’s safe-harbor provisions. Thus, CenterPoint should be barred from recovering any amount associated with the statutorily mandated capacity auction.

However, although the Commission acknowledged CenterPoint’s failure to comply with the Commission rules, it held that it was “appropriate to examine other methods to properly true up the capacity auction proceedings.” Order at 105. Such a holding is in error. In order to recover costs pursuant to PURA § 39.153, the applicant either must “sell at auction . . . entitlements to at least 15 percent of the electric utility’s Texas jurisdictional installed generation capacity” or comply with the Commission’s safe-harbor provisions. The Commission does not have authority to change these requirements. Further, P.U.C. SUBST. R. 25.381, which governs capacity auctions, conforms to the statutory requirements, providing that “electric utilities and their affiliated PGCs shall sell at auction entitlements to at least 15% of the affiliated PGC’s

Texas jurisdictional installed generation capacity.” Accordingly, there is no basis in law to grant CenterPoint any recovery on its capacity auction true-up claim.

ASSIGNMENT OF ERROR NO. 19

The Commission erred by not rejecting the entire amount of CenterPoint’s claimed regulatory assets.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 19

As part of its true-up balance, CenterPoint sought to recovery regulatory assets in the amount of \$150,473,181. *See, e.g.,* CNP Exh. 18 (*McGoldrick*) at 9:23 and CNP Exh. 28 (*Hriszko*) at 10:25. However, as discussed below, such a recovery is inappropriate. In fact, \$55,932,601, an amount equal to the difference between the outstanding regulatory asset upon which CenterPoint basis is claim and an outstanding regulatory liability that is due and payable to ratepayers, should have been used to offset any other amounts which CenterPoint otherwise is entitled to recover as part of its true-up claim.

First, even if CenterPoint otherwise were entitled to collect the regulatory assets as a conceptual matter, the claim should have been reduced by CenterPoint’s positive adjustment of \$30,945,011 (reflecting an order in Docket No. 22355 that reduced 1998 book depreciation expense and related accumulated depreciation of generation assets) because the adjustment is barred by PURA § 39.302. In relevant part, that section defines regulatory assets as:

The generation-related portion of the Texas jurisdictional portion of the amount *reported by the electric utility in its 1998 annual report on Securities and Exchange Form 10-K* as regulatory assets and liabilities....

Emphasis added. Because the Commission’s Order in Docket No. 22355 was not issued until October 4, 2001, it is clear that the \$30,945,011 sought by CenterPoint was not in fact reported

to the SEC on Reliant Energy's 1998 Form 10-K. As a result, the maximum amount CenterPoint could claim as regulatory assets within the statutory parameters is \$119,528,817.⁶

Furthermore, the entire amount of the claimed regulatory assets should have been rejected in any event. In seeking recovery of the regulatory assets, which before adjustment were in the amount of \$175,460,771, CenterPoint ignored the fact that as of December 31, 1998, Reliant Energy had on its books an offsetting regulatory liability in an equal amount. *See* HCHE Exh. 14; *see also* HCHE Exh. 1 (*Kollen*) at 92:8-13; COH/COC Exh. 5 (*Blumenthal*) at 12:13-13:7. When the regulatory liability is offset against the regulatory asset, the net amount is \$0. *Id.*

Even if the regulatory asset and regulatory liability in equal amounts are unrelated, CenterPoint still owes the regulatory liability to ratepayers. And the regulatory asset reflects the full overpayment by ratepayers for amounts that never will be due to the federal or state government. Thus, CenterPoint's request for recovery of regulatory assets should have been reduced to \$119,528,817 to account for the elimination of Texas franchise tax liability. Then rate payers should have been given the benefit of their full overpayment of taxes consisting of the regulatory liability of \$175,460,771, leaving a net balance of \$55,932,601, which should have been used to offset any other amounts that CenterPoint otherwise is entitled to recover as part of its true-up claim.

⁶ $\$175,460,771 - \$55,932,601 = \$119,528,817$.

ASSIGNMENT OF ERROR NO. 20

The Commission erred by failing to use ADIT to reduce TGN's net book value.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 20

The Commission historically has used ADIT in general rate proceedings to reduce a utility's rate base. Hriszko, Tr. 3192:10-14. Thus, ADIT has traditionally provided a benefit to ratepayers. *Id.* at 3192:10-17. Accordingly, the ADIT should appropriately have been used to reduce the stranded costs in this proceeding. Such a position is consistent with the fact that it was not the intent of SB7 to place ratepayers in a worse position than they would have been under traditional rate regulation.

ADIT is a regulatory liability because it is created by the regulatory process, COH/COC Exh. 5 (*Blumenthal*) at 18:14-20, *i.e.*, the Commission sets the rates that are paid by ratepayers and there is no federal law that dictates that the Commission set rates in one manner or another. Hriszko, Tr. 3190:5-23. Thus, the fact that there is an accumulation of deferred taxes on CenterPoint's books arises from the fact that the Commission previously determined that the tax component in CenterPoint's predecessors' rates should be based upon book, rather than accelerated, depreciation. Absent such a determination, there would be no accumulated deferred taxes. Thus, it cannot be seriously argued that deferred taxes were created by anything other than the regulatory process.

As such, the Commission should have used the ADIT to reduce net book value just as it traditionally used ADIT to reduce rate base.

ASSIGNMENT OF ERROR NO. 21

The Commission erred by not grossing up to revenue requirement basis the EDIT and ITC balances to be offset against CenterPoint's stranded costs.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 21

The ITC and EDIT balances used to offset CenterPoint's stranded costs should be grossed up to a revenue requirement basis. HCHE Exh. 1 (*Kollen*) at 79:14-17; COH/COC Exh. 5 (*Blumenthal*) at 18:4-5, 20:18-19.

It is necessary to gross up the ITC and EDIT balances from the tax bases to revenue requirement bases to ensure consistency among all components of CenterPoint's stranded cost claim, which in fact are stated on a revenue requirement basis. HCHE Exh. 1 (*Kollen*) at 79:14-17. Grossing up the ITC and EDIT balances to revenue requirement levels also would be consistent with the methodology the Commission has used in general rate cases to see that ratepayers received the full benefit of ITCs and EDITs to which they were entitled. *See* Hriszko, Tr. 3197:13-24. Thus, the ITC and EDIT balances should have been grossed up to ensure that ratepayers receive a benefit equal to the actual amount they paid that was included in CenterPoint's predecessors' revenue requirements.

ASSIGNMENT OF ERROR NO. 22

The Commission erred in holding that the average weighted costs of capital, established in Docket No. 22355, was the appropriate rate to use for carrying costs on stranded costs.

DISCUSSION OF ASSIGNMENT OF ERROR NO. 22

In *CenterPoint Energy v. Public Utility Commission*, 143 S.W.3d 81, 99 (Tex. 2004), the Supreme Court stated "we hold that Rule 25.263(1)(3) [which required the use of pre-tax weighed average cost of capital ("WACC") in setting the rate of interest] is invalid" That ruling unambiguously invalidated P.U.C. SUBST. R. 25.263(1)(3) in its entirety.

Rather, a rate of 7.5%, as suggested by Mr. Kollen, should have been used in this proceeding. HCHE Exh. 17 (*Kollen*) at 11:6-14. As Mr. Kollen discussed,

the use of the 7.5% for the interest rate in this proceeding would be consistent and symmetrical with the use of that same rate in Docket No. 22355 to quantify the interest paid to ratepayers. The Company currently is required to utilize that interest rate as it amortizes the excess mitigation credits to reduce its nonbypassable TDU rates. The time period for both the computation of the stranded cost interest and the interest on the excess mitigation credits is the same, i.e., January 1, 2002 through the date of the final order in this proceeding. Clearly, it would be inequitable to charge ratepayers interest at the utility's much higher cost of capital while the Company is required to pay interest at only 7.5%.

HCHE Exh. 17 (*Kollen*) at 11:6-14.

The use of the 7.5% rate also is appropriate because PURA § 39.252(a) essentially guarantees CenterPoint recovery of the stranded costs ordered by the Commission. Staff Exh. 7 (*Tietjen*) at 8:13-15. Thus, "the typical risks associated with a regulated environment – such a regulatory lag, imprudence disallowances, and deviations in sales – do not exist. Accordingly, it is economical and financially appropriate to use a lower rate to reflect the lower risk." *Id.* at 8:25-28; *see also* Tietjen, Tr. 4413:22-4414:2 ("if the UCOS cases had generated positive ECOM amounts, the companies would have securitized a long time ago, and they would have been getting a rate of return reflecting the risk of securitization, essentially would have been getting a rate of 5 to 6 percent").

Thus, the Commission erred in holding that the average weighted costs of capital, established in Docket No. 22355, was the appropriate rate to use for carrying costs on stranded costs; the appropriate rate of interest should have been determined to be 7.5%.

**II.
CONCLUSION**

WHEREFORE, for the foregoing reasons, the Houston Council for Health and Education moves that the Commission sustain this motion for rehearing and, upon rehearing, amend the December 17, 2004 Order on Rehearing consistent with the Assignments of Error set forth herein. The Houston Council for Health and Education additionally prays for such other further relief to which it may be justly entitled.

Respectfully submitted,

ANDREWS KURTH LLP

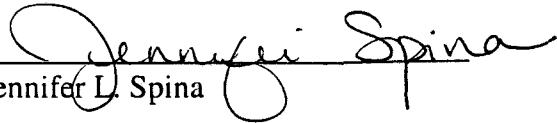
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**ATTORNEYS FOR HOUSTON COUNCIL
FOR HEALTH AND EDUCATION**

Dated: January 4, 2005

CERTIFICATE OF SERVICE

I, Jennifer L. Spina, an attorney for HCHE, hereby certify that a copy of the foregoing document was served on all parties of record in this proceeding on this 4th day of January, 2005 by E-mail, Facsimile, or First Class, U.S. Mail, Postage Prepaid.


Jennifer L. Spina