Control Number: 38339

Item Number: 871

Addendum StartPage: 0

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PUBLIC UTILITY COMMISSION
FILING CLERK

January 31, 2011

Chairman Barry T. Smitherman
Commissioner Donna Nelson
Commissioner Kenneth W. Anderson, Jr.
Public Utility Commission of Texas
1701 North Congress Ave. Suite 700
Austin, Texas 78711

Re: Docket No. 38339, *Application of CenterPoint Energy Houston Electric, LLC for Authority to Change Rates*

Dear Chairman and Commissioners:

This letter is submitted in response to the letter filed last week by CenterPoint regarding whether its ROE should be set at 9.98% and whether the deferred tax riders are a "middle ground" approach to the recovery of uncertain tax positions.[1]

TIEC supports Staff's 9.67% ROE at a 55-45 capital structure.

CenterPoint wrongly claims that TIEC "proposed" a 9.98% ROE. TIEC's position in its exceptions, as it is now, is that ignoring the rigorous testimony of expert witnesses like Mr. Gorman and merely adopting the national average ROE is an unreasonable methodology because it does nothing to ascertain the specific risk (or lack of risk) associated with CEHE. In fact, TIEC said that "such a method is unreasonable, for it utterly fails to account for circumstances that distinguish CEHE from other utilities across the country."[2] TIEC went on to say, however, that *if* the Commission disagrees, then the best data point is that of the national average for T&D utilities, which was 9.98% in the first half of 2010.

CenterPoint's attempt to transform the 9.98% ROE into a 10.58% ROE by holding the equity portion of the ROR constant, while adjusting the capital structure,[3] is incorrect and

1 TIEC respectfully requests a good cause exception to the seven day rule since it received a copy of CenterPoint's letter on January 26, 2011.

2 TIEC's Exceptions at 14.

3 CenterPoint relies on the following computation:
9.98% ROE X 47.71% Equity = 4.76% Equity portion of ROR;
10.58% ROE X 45.0% Equity = 4.76% Equity portion of ROR.

871

potentially misleading. CenterPoint's equation implies that the weighted equity component of the ROR would remain constant if the equity ratio decreases. This is obviously false because it neglects the increased weighted cost of debt if the equity ratio declines. When the equity component decreases from 47.1% to 45%, the debt component increases from 52.9% to 55%. Because the actual cost of debt is what it is, the increased debt component results in a greater *weighted* cost of debt (and a *lower* weighted cost of equity).

To be clear, TIEC does *not* recommend a 9.98% ROE. TIEC recommends a 9.75% ROE at a 60-40 debt to equity capital structure as Mr. Gorman testified. If the Commission alters CenterPoint's capital structure to 55% debt and 45% equity, then CenterPoint's ROE should be lowered to reflect this change. The Commission appears poised to move toward a 55-45 capital structure in order to increase CenterPoint's credit rating. The reduced financial risk associated with reducing the amount of debt in the capital structure should be reflected in a lower ROE. Thus, TIEC's position in this case, that CenterPoint's ROE should be set at 9.75% at a 60-40 capital structure, now appears inflated. Staff's proposed 9.67% ROE, which assumed a 55-45 capital structure, is more reasonable. Thus, if the Commission moves to a 55% debt level in the capital structure, TIEC would support Staff's recommended 9.67% ROE.

The Tax Riders are no "middle ground." They are a "heads I win, tails you lose" proposition.

CenterPoint also mischaracterizes its proposed deferred tax riders as a "middle ground" position. Its proposal is not a middle ground—it would give CenterPoint a windfall. Every year CenterPoint collects *tens of millions of dollars* more to cover federal income tax expense than it truly pays. After the application of a $9.8 million CTSA (without gross-up) CenterPoint would collect an amount approaching one hundred million dollars every year in FIT expense. Yet, only a tiny fraction of this amount *will ever be used to pay federal income taxes.*[4] CenterPoint should first apply this excess recovery to any future tax reversals if they ever occur.

CenterPoint has claimed it needs the riders in order to have an incentive to take aggressive tax positions for the benefit of ratepayers. This argument is derisory and deserving no attention at all. CenterPoint *cannot* be further incentivized to lower its tax burden, and lowering its taxes *doesn't* benefit ratepayers for one simple reason: each dollar it saves by taking aggressive tax positions, it keeps. It doesn't pass those savings to ratepayers.

Though CenterPoint argues that it needs the riders to be "made whole," it has not shown that there has ever been an instance in which a tax reversal caused it to incur greater tax expense than it recovered from ratepayers. If CenterPoint really wants a "middle ground" rider that will "make it whole" then TIEC is open to a tax rider if it works both ways. That is, if total reversal, penalties, and interest exceed CenterPoint's excess tax expense recovery for a given tax year CenterPoint could recover that from ratepayers. However, if total reversal, penalties, and interest

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4 The total amount of federal tax CenterPoint incurred in 2010 is a confidential amount and appears on page seven of TIEC's confidential Reply to Exceptions.

are *less than* CenterPoint's total FIT expense recovery, CenterPoint should return the excess tax recovery with interest to ratepayers.

TIEC appreciates the care taken by the Commission in addressing these important issues. Unfortunately, I have a commitment at the Texas Supreme Court on Thursday morning and will not be in attendance at the open meeting. However, my colleague, Michael Boldt, will be there and will be prepared to answer any questions that arise. I will attend as soon as I am able after my morning commitment.

Respectfully Submitted,

Lino Mendiola
Attorney for Texas Industrial Energy Consumers

cc: Stephen Journeay
All Parties of Record