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APPLICATION OF CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC FOR AUTHORITY TO CHANGE RATES	**§ § §**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

TEXAS INDUSTRIAL ENERGY CONSUMERS' RESPONSE TO CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC'S OBJECTIONS TO AND MOTION TO STRIKE PORTIONS OF THE DIRECT TESTIMONY OF CHARLES S. GRIFFEY AND MICHAEL P. GORMAN

Texas Industrial Energy Consumers (TIEC) submits this response to CenterPoint Energy Houston Electric, LLC's (CEHE's) objections to and motion to strike (the "Motion to Strike") portions of testimony filed by TIEC witnesses Charles Griffey and Michael Gorman.

I. INTRODUCTION

CEHE has moved to strike testimony that is directly relevant to ensuring that its rates are just and reasonable, and that specifically responds to Preliminary Order Issue No. 9: "Are any protections, such as financial protections, appropriate to protect CenterPoint's financial integrity and ability to provide reliable service at just and reasonable rates?"

The Commission added this issue to allow parties to address the impacts of financial risk at CEHE's parent, CenterPoint Energy, Inc. (CNP), and its competitive affiliates on CEHE's financial integrity, rates, and service, and to propose appropriate protective measures. Referencing CNP's acquisition of Vectren earlier this year, which caused CEHE to be downgraded by rating agencies,[1] CEHE asked the Commission to explicitly exclude from the Preliminary Order any issues related to corporate governance or "other requirements on the Company's management or operations."[2] Rather than exclude these issues, the Commission explicitly ***added*** Issue No. 9. As Chairman Walker explained, "The next [issue] has to do with the Vectren acquisition. I would add an issue … 'Are any protections, such as financial protections, appropriate to protect

[1] *See* Direct Testimony of Charles S. Griffey at 10; Direct Testimony of Michael P. Gorman at 10, 11-15

[2] CEHE Proposed List of Issues at 11 (Apr. 24, 2019).

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CenterPoint's financial integrity and ability to provide reliable service at just and reasonable rates?'"[3]

The testimony CEHE seeks to strike from TIEC witness Mr. Charles Griffey recommends protections that would insulate CEHE from the financial exposure and potential operational risks created by its parent and competitive affiliates. Similarly, the testimony CEHE seeks to strike from TIEC witness Mr. Michael Gorman references Mr. Griffey's analysis in developing a recommended capital structure and return on equity for CEHE. Specifically, Mr. Gorman's testimony explains how some of the issues CEHE has raised to argue for a higher rate of return and richer capital structure would be better addressed through appropriate ring-fencing protections, such as those proposed by Mr. Griffey. Both sets of testimony respond directly to CEHE's application and the Commission's Preliminary Order Issue No. 9, and are also relevant to the general ratemaking requirements under Chapter 36 of PURA. Contrary to CEHE's arguments, the Commission may take actions in a Chapter 36 case beyond adjusting a utility's rates, and has broad statutory authority over an electric utility's business operations, management, and services. For these reasons, and as discussed in further detail below, CEHE's motion should be denied.

II. RESPONSE TO OBJECTIONS AND MOTION TO STRIKE

Under the Texas Rules of Evidence, relevant evidence is "evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence."[4] Mr. Griffey's and Mr. Gorman's testimony on CEHE's financial exposure to CNP and its competitive affiliates, and Mr. Griffey's recommended protections, prove facts that are consequential both in setting CEHE's rates, and in identifying appropriate financial or operational requirements that are responsive to the Commission's Preliminary Order Issue No. 9. The Commission has authority to address these issues by imposing financial or operational requirements in a Chapter 36 rate proceeding.

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[3] May 9, 2019 Open Meeting (http://www.texasadmin.com/tx/puct/open_meeting/20190509/, Item 12).

[4] Tex. R. Evid. 401.

A. The Commission has authority to impose financial or operational requirements on a utility's business in a Chapter 36 case.

CEHE's motion is based on the false premise that the Commission may only adjust rates in a Chapter 36 rate proceeding, and may not take any other actions such as imposing requirements on the utility's actions through ring-fencing. Specifically, CEHE argues that because "the Commission has previously set rates without imposing ring-fencing conditions, such a power is not necessary to carry out the Commission's express responsibilities."[5] This argument proves too much and is contradicted by both the statute and prior Commission precedent. The Commission has general regulatory authority over a utility's operations and business, in addition to specific authority over ratemaking under Chapter 36. In a rate case, the Commission may select the most effective means to ensure that a utility can provide reliable service at a reasonable cost—whether that is setting a rate under Chapter 36 or ordering the utility to take affirmative actions under the Commission's broader authority to supervise and regulate. The Commission is not required to address all issues that arise in a rate case solely through rate adjustments. PURA does not force the Commission to use a hammer when a wrench would be more effective.

The legislature's stated purpose in enacting PURA was "to protect the public interest inherent in the rates and services of public utilities" and to "establish a ***comprehensive*** and adequate regulatory system for public utilities to assure ***rates, operations, and services*** that are just and reasonable to the consumers and to the utilities."[6] Consistent with this broad purpose, PURA § 14.001 gives the Commission the "general power to ***regulate and supervise the business*** of each public utility within its jurisdiction and to do ***anything specifically designated or implied*** ... that is necessary and convenient to the exercise of that power and jurisdiction."[7] These general powers to regulate and supervise a utility's business apply regardless of the type of proceeding a utility files, and are not diminished in the context of a Chapter 36 rate case.

Mr. Griffey's and Mr. Gorman's recommendations are relevant to Chapter 36 ratemaking requirements. PURA § 36.003 tasks the Commission with ensuring that each utility rate is just

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[5] CEHE Motion at 2.

[6] PURA § 11.002 (emphasis added). *See also* PURA § 31.001(a), restating this intent for electric utilities specifically.

[7] Emphasis added.

and reasonable,[8] and that every rate is "sufficient, equitable, and consistent."[9] Chapter 36 does not provide an exhaustive list of factors the Commission may consider when evaluating a utility's rate.[10] Under Chapter 36, the Commission must promote equity, justness, and reasonableness in utility rates.[11] Chapter 36 imposes specific methods and standards the Commission must follow when setting a utility's rates. However, the Commission may address an issue that arises in a Chapter 36 rate proceeding through ***either*** the ratemaking provisions outlined in that chapter ***or*** under its broader authority. Mr. Gorman's and Mr. Griffey's testimony offer ways to address financial factors raised by CEHE in its application, as well as other factors CEHE chose not to raise (such as parent-level financial risk). The purpose of these recommendations is to ensure that CEHE's rates are just and reasonable considering both ratepayer and shareholder interests, which is squarely within the Commission's authority.

Specific to CEHE's requested rate of return, Chapter 36 states that the Commission must "permit the utility a reasonable opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public in excess of the utility's reasonable and necessary operating expenses."[12] As to the factors the Commission must consider in establishing a reasonable rate of return, PURA provides the following, non-exhaustive list: "(1) the efforts and achievements of the utility in conserving resources; (2) the quality of the utility's services; (3) the efficiency of the utility's operations; and (4) the quality of the utility's management."[13] Chapter 36 does not restrict the Commission to adjusting the utility's rate of return as the ***sole*** means of addressing these factors. Rather, the Commission's authority under both Chapter 36 and PURA generally supports its ability to adopt financial and operational requirements, such as those proposed by Mr. Griffey and referenced by Mr. Gorman.

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[8] PURA § 36.003(a).

[9] PURA § 36.003(b).

[10] PURA § 36.052; *see also Reliant Energy, Inc. v. Pub. Util. Comm'n of Texas*, 153 S.W.3d 174, 193 (Tex. App.—Austin 2004, pet. denied) ("The Commission is not limited to considering these four factors; the statute merely includes these four factors among the applicable factors.").

[11] PURA § 36.003.

[12] PURA § 36.051.

[13] PURA § 36.052.

Mr. Griffey's and Mr. Gorman's testimony illustrate why adjusting a utility's return is often an ineffective means of ensuring that a utility's rates are just and reasonable. A utility's financial risk, including risk imposed by a parent and affiliates, directly impacts financial metrics, debt costs, access to capital markets, and in turn, utility rates. It also affects other areas of a utility's business and the utility's overall ability to provide reliable service at a reasonable cost. As Mr. Gorman explains, utility customers should not have to fund an equity-rich capital structure and high return on equity (ROE) if it will not improve the utility's financial health and reduce debt costs because of actions taken by the utility's parent and competitive affiliates. Likewise, customers should have assurance that the rates they pay will be used first and foremost to provide reliable utility service, and not to pay dividends to upstream shareholders or support competitive lines of business that do not benefit utility customers. Merely adjusting CEHE's capital structure and rate of return is an ineffective regulatory tool when upstream activities are a primary driver in CEHE's credit rating and access to capital. This demonstrates why the Commission must necessarily have the authority to impose ring-fencing measures if needed to fulfill the Commission's statutory mandate to ensure that an electric utility's rates are just and reasonable under Chapter 36.

B. Precedent confirms the Commission's authority to impose non-rate requirements on a utility in a Chapter 36 rate case.

The Commission has previously gone beyond merely adjusting rates within a Chapter 36 rate case, ordering specific non-rate actions for utilities. For example, the Commission has imposed conditions on utilities during rate cases using its authority to audit and inspect the utility's books under PURA §§ 14.203–14.204.[14] In Docket No. 28813, *Petition to Inquire into the Reasonableness of the Rates and Services of Cap Rock Energy Corporation*, the Commission adopted the Administrative Law Judge's recommendation that Cap Rock perform and pay for a management audit because the commission questioned Cap Rock's business, accounting, and project-management practices.[15] The Commission required Cap Rock's management audit to investigate a number of areas, including bonuses to Cap Rock managers, and the quality of internal auditing and regulatory accounting given Cap Rock's failure to discover it was double-recovering

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[14] *See id.*

[15] *Petition to Inquire into the Reasonableness of the Rates and Services of Cap Rock Energy Corporation*, Docket No. 28813, Final Order at 11 (Aug. 5, 2005).

a true-up surcharge for two years.[16] Similarly, in *Matter of El Paso Elec. Co.*, the Commission required the city to hire an independent auditor to review its books and records.[17]

The Commission has also used its general authority to regulate the operations of utilities in a utility rate proceeding.[18] In Docket No. 16705, a rate case filed by Entergy Gulf States, Inc. (EGSI), the Commission identified certain service quality issues that were severed into a separate docket, Docket No. 18249, *Entergy Gulf States, Inc. Serv. Quality Issues*. In the severed docket, the Commission chose to address these service quality issues by ordering Entergy "to develop and implement, within the six months of the effective date of this Order, a media campaign to inform and educate customers in its Texas service territory about the importance and proper procedure for reporting to the Company malfunctioning or broken street lights."[19] The Commission also required Entergy to hire an independent consultant to "assess the distribution system, develop strategies for improvement, revise data-collection practices, establish evaluation criteria, and perform any additional work set out in the non-unanimous stipulation."[20] Nothing in PURA grants the Commission explicit power to require Entergy to develop a media campaign. Rather, the Commission relied on its broad grants of authority to regulate Entergy's business, even in the context of a Chapter 36 rate case. Similarly, in Docket No. 16705 (EGSI's underlying rate proceeding), the Commission conducted an entire evidentiary hearing on "competitive issues" surrounding how and when EGSI should be transitioned to retail competition and how its stranded costs would be calculated.[21] Again, there was no Chapter 36 (or other) provision specifically addressing EGSI's transition to competition at that time. Instead, this inquiry was conducted under the Commission's general grant of authority in the context of a Chapter 36 rate case.

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[16] *Id.*

[17] Docket No. 8363, *Application of El Paso Electric Company for Authority to Change Rates*, 14 Tex. P.U.C. Bull. 2834 (Tex. P.U.C. May 5, 1989).

[18] *See* Docket No. 18249, *Entergy Gulf States, Inc. Serv. Quality Issues (Severed from Docket No. 16705)*, Final Order at 49-50, Ordering Paragraph (OP) 6, 12 (Feb. 13, 1998) (requiring the city to hire an independent consultant and establish a media campaign).

[19] *Id.* at 50, OP 12.

[20] *Id.* at 49, OP 6.

[21] *See, e.g.*, Docket No. 16705, *Application of Entergy Gulf States, Inc. for Approval of its Transition to Competition Plan and the Tariffs Implementing the Plan, and for the Authority to Reconcile Fuel Costs, to Set Revised Fuel Factors, and to Recover a Surcharge for Underrecovered Fuel Costs*, Second Order on Rehearing at 109 (section on "Competitive Issues").

These examples demonstrate that the Commission may take actions beyond merely setting CEHE's rates in this case, including imposing financial and operational requirements to address the issues raised by Mr. Griffey and Mr. Gorman in response to Preliminary Order Issue No. 9.

C. CEHE's arguments related to the sale/transfer/merger statutes are inapposite and a red herring.

Finally, the sale/transfer/merger (STM) statutes[22] raised by CEHE address an entirely different set of circumstances and are inapposite to the issues raised by Mr. Griffey and Mr. Gorman. The STM statutes give the Commission explicit authority to require conditions on utility transactions ***before they close***, rather than limiting the Commission's ability to address any issues created by a utility transaction in a subsequent rate case.

Prior to the STM statutes, PURA § 14.101 allowed the Commission to review utility transactions, but included no ***pre-approval*** requirement. As a result, the Commission's only remedy was to attempt to mitigate the effects of a transaction in a subsequent utility rate case under PURA § 14.101(c), which states: "If the commission finds that a transaction is not in the public interest, the commission shall take the effect of the transaction into consideration in ratemaking proceedings and disallow the effect of the transaction if the transaction will unreasonably affect rates or service." Further, because not all parties involved in a utility STM are regulated entities (the acquiring entity often is not), the Commission had insufficient authority under PURA § 14.101 to effectively redress all potential risks created by a utility STM. When the first leveraged buyouts of utilities were proposed in the mid-2000s, the legislature recognized that there could be burdens placed on a utility through upstream transactions that could not be fully redressed in a subsequent rate case. The STM statutes therefore gave the Commission new authority to review transactions affecting utility assets and ownership ***beforehand***, and to limit these types of burdens before they were put in place. This new authority did not diminish the Commission's distinct authority to impose operational and financial requirements on an existing, fully regulated utility in any other proceeding. The Commission's authority to impose operational restrictions on a utility is not limited to prescribing conditions in an STM case. Rather, for existing regulated utilities, this authority already existed ***and continues to exist*** outside of an STM.

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[22] These are PURA § 39.262(l)-(o) and 39.915(a)-(d).

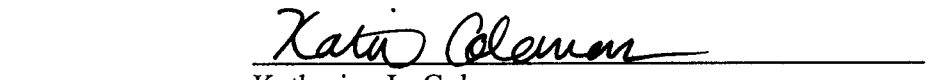
Similarly, the provisions referenced by CEHE that allow the Commission to enforce conditions adopted in an STM stipulation (§§ 39.262(o) and 39.915(d)) gave the Commission authority to enforce conditions on parties that may not be a regulated utility—*i.e.*, upstream parents. This authority is different from the Commission's pre-existing, comprehensive authority over regulated electric utilities. As a result, these provisions do not support CEHE's claim that the Commission lacks authority to impose "ring-fence" requirements in a utility rate case.

III. CONCLUSION

For the reasons discussed above, the Commission has the authority to impose financial and operational requirements on a regulated utility under both Chapter 36 and its general grant of authority to regulate and supervise electric utilities. CEHE's objections and motions to strike Mr. Griffey's and Mr. Gorman's testimony should be denied. This testimony is directly responsive to Preliminary Order Issue No. 9, and is directly relevant to establishing just and reasonable rates under the requirements of Chapter 36. TIEC also requests any other relief to which it may be entitled.

Respectfully submitted,

THOMPSON & KNIGHT LLP



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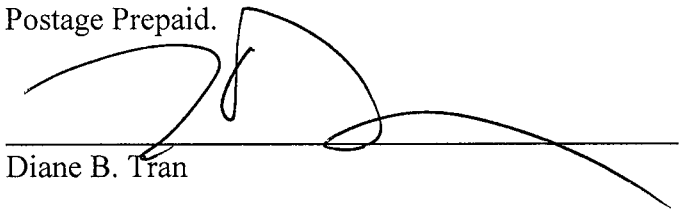
CERTIFICATE OF SERVICE

I, Diane B. Tran, Attorney for TIEC, hereby certify that a copy of the foregoing document was served on all parties of record in this proceeding on this 13th day of May, 2019, by facsimile, electronic mail and/or first Class, U.S. Mail, Postage Prepaid.



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