SOAH DOCKET NO. 473-19-3864
PUC DOCKET NO. 49421

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

REBUTTAL TESTIMONY

OF

ROBERT B. McRAE

ON BEHALF OF

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC

June 2019

589

TABLE OF CONTENTS

LIST OF EXHIBITS

REBUTTAL TESTIMONY OF ROBERT B. MCRAE

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Robert B. McRae. My business address is 1111 Louisiana Street, Houston, Texas 77022.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?

A. I am employed by CenterPoint Energy Service Company, LLC as Assistant Treasurer.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am filing testimony on behalf of CenterPoint Energy Houston Electric, LLC ("CenterPoint Houston" or the "Company").

Q. ARE YOU THE SAME ROBERT B. MCRAE WHO FILED DIRECT TESTIMONY ON BEHALF OF CENTERPOINT HOUSTON IN THIS DOCKET?

A. Yes.

II. PURPOSE OF REBUTTAL TESTIMONY AND RECOMMENDATIONS

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the direct testimony and recommendations by Intervenor and Staff witnesses regarding the Company's capital structure and weighted average cost of capital ("WACC"). In particular, I respond to the cost-of-capital testimony filed by:

- Michael P. Gorman and Charles S. Griffey on behalf of Texas Industrial Energy Consumers ("TIEC");
- J. Randall Woolridge on behalf of Texas Coast Utilities Coalition ("TCUC");

- Anjuli Winker on behalf of the Office of Public Utility Counsel ("OPUC"); and
- Jorge Ordonez on behalf of the Public Utility Commission of Texas ("Commission") Staff.

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY AND RECOMMENDATIONS REGARDING THE COMPANY'S COST OF CAPITAL.

A. I recommend that the Commission approve a capital structure composed of 50% debt and 50% equity. Contrary to the assertions by Intervenor and Staff witnesses, CenterPoint Houston needs a 50% equity ratio to maintain its credit metrics at a level that will support the Company's current credit ratings. In contrast, the Intervenor and Staff witnesses' capital structure recommendations would likely lead to a ratings downgrade and higher capital costs for customers.

I also recommend that the Commission approve the Company's proposed 4.38% cost of long-term debt. That is CenterPoint Houston's actual embedded cost of long-term debt, and no party has requested that the Commission approve a different cost of long-term debt.

I also recommend that the Commission approve the Company's proposed 7.39% WACC, which is calculated using the Company's proposed 50/50 capital structure, the 4.38% cost of long-term debt, and the 10.40% return on equity ("ROE") supported by Company witness Robert B. Hevert.

In addition, I explain that the disallowance recommendations by the city groups would cause CenterPoint Houston's credit metrics to fall far below the level needed to sustain the Company's current credit ratings.

Finally, I address the effect of the Intervenor and Staff recommendations regarding Long-Term Incentive ("LTI") compensation.

Q. ARE YOU THE ONLY CENTERPOINT HOUSTON WITNESS FILING REBUTTAL TESTIMONY ON COST-OF-CAPITAL ISSUES?

A. No. As noted in the previous answer, Mr. Hevert is also filing rebuttal testimony regarding the Company's required ROE, and he addresses capital structure as well. In addition, Company witness Ellen Lapson addresses capital structure issues.

III. CAPITAL STRUCTURE

Q. WHAT CAPITAL STRUCTURE IS CENTERPOINT HOUSTON ASKING THE COMMISSION TO APPROVE?

A. I explained in my direct testimony that CenterPoint Houston is asking the Commission to approve a capital structure composed of 50% equity and 50% debt.[1] That capital structure is necessary for a number of reasons, including the Company's high level of forecasted capital expenditures, the risk of losses from hurricanes, and the reduced cash flow attributable to the Tax Cuts and Jobs Act of 2017 ("TCJA").[2]

[1] Dr. Woolridge mistakenly asserts that Company witness Charles W. Pringle is the Company witness that supports CenterPoint Houston's proposed capital structure. Woolridge Dir. at 17:6-8. In fact, I am the Company witness supporting CenterPoint Houston's proposed capital structure.
[2] McRae Dir. at 15:12-17.

Q. WHAT CAPITAL STRUCTURES ARE THE INTERVENOR AND STAFF WITNESSES ASKING THE COMMISSION TO APPROVE FOR PURPOSES OF SETTING CENTERPOINT HOUSTON'S RATES?

A. Dr. Woolridge, Mr. Gorman, and Mr. Ordonez propose a capital structure composed of 60% long-term debt and 40% common equity.[3] Ms. Winker proposes a capital structure composed of 54.5% long-term debt and 45.5% common equity.[4] I address those witnesses' capital structure arguments in the following subsections.

Q. BEFORE PROCEEDING TO THE SPECIFIC ARGUMENTS ADVANCED BY THE INTERVENOR AND STAFF WITNESSES, DO YOU HAVE ANY THRESHOLD OBSERVATIONS REGARDING THEIR TESTIMONY?

A. Yes, I have three. First, it appears that all of the Intervenor and Staff witnesses fail to recognize the detrimental effects that the TCJA has had on utilities' cash flows. As I mentioned in my direct testimony, Moody's Investors Service ("Moody's") placed the entire regulated utility sector on negative outlook in mid-2018 because of the effects of the TCJA on cash flows.[5] Moreover, in a recent presentation, Moody's confirmed that the tax reform legislation continues to weigh upon the utility sector. In Exhibit R-RBM-1, which is a PowerPoint presentation by Moody's on June 3, 2019 at the 2019 Power and Gas Issuers' Conference, Moody's noted that [redacted]

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[3] Gorman Dir. at 37, Table 7; Woolridge Dir. at 20:1-3. Dr. Woolridge also presents an alternative capital structure composed of 55.48% long-term debt, 0.90% short-term debt, and 43.62% common equity. Woolridge Dir. at 20:17-22.
[4] Winker Dir. at 43:5.
[5] McRae Dir. at 19:13-19 (citing to Moody's Investors Service, *Regulated Utilities – US: 2019 Outlook Shifts to Negative Due to Weaker Cash Flows, Continued High Leverage* (June 18, 2018)).

[redacted]."[6] Moody's further noted that [redacted].[7]

Q. IS ANY OTHER RATING AGENCY TAKING ACTION TO ADDRESS THE EFFECTS OF THE TCJA ON UTILITY CREDIT METRICS?

A. Yes. My Exhibit R-RBM-2 is a recent Standard & Poor's ("S&P") presentation. As that presentation shows, S&P currently has nearly four times as many utilities on negative outlook as it did in 2014.[8] In contrast, the number of utilities on positive outlook has fallen by 80% since 2014. And in 2019 alone, S&P has downgraded 18 utilities, as compared to upgrades for only nine utilities.[9]

Q. HAVE THE RATING AGENCIES IDENTIFIED STEPS THAT UTILITIES CAN TAKE TO MITIGATE THE RISK PRODUCED BY THE TCJA?

A. Yes. As I explained in my direct testimony, the rating agencies have focused on several tools to mitigate the risk, including an increase in the authorized equity ratio, an increase in the authorized ROE, and an increase in depreciation expense.[10] CenterPoint Houston is requesting an increase in the equity ratio because it mitigates the effects on cash flow at the lowest cost to customers.[11]

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[6] Exhibit R-RBM-1 at 4.
[7] *Id.* at 4.
[8] Exhibit R-RBM-2 at 9.
[9] *Id.* at 10.
[10] McRae Dir. at 21:7-13.
[11] *Id.* at 21:16-19.

Q. SOME OF THE INTERVENOR WITNESSES ASSERT THAT THE EFFECTS OF THE TCJA ARE TEMPORARY, AND THEREFORE THE COMMISSION NEED NOT CONCERN ITSELF WITH THOSE EFFECTS.[12] WHAT IS YOUR RESPONSE?

A. I believe that those witnesses have misconstrued the word "temporary." The rating agencies have stated that over the "longer term," the TCJA could be mildly credit-positive for utilities because lower deferred tax balances will increase rate base and because utilities retained the deductibility of interest expense.[13] But over the next several years, the TCJA will continue to erode key ratios used by the rating agencies. For example, in the June 2018 report placing the entire utility sector on negative outlook as a result of the TCJA, Moody's noted that the ratio of Cash from Operations to Debt ("CFO/Debt") is projected to continue declining through at least 2022, and perhaps longer.[14]

It is also important to note that the rating agencies have said they will view the effects of the TCJA on a utility-by-utility basis, with regulatory actions playing a key role in the rating agencies' evaluation of how the TCJA will affect a particular utility's credit rating.

[redacted]

[12] *E.g.*, Winker Dir. at 43:8-10.
[13] Fitch Ratings, *Tax Reform Impacts on the U.S. Utilities, Power & Gas Sector* at 1 (Jan. 24, 2018).
[14] Moody's Investors Service, *Regulated Utilities – US: 2019 Outlook Shifts to Negative Due to Weaker Cash Flows, Continued High Leverage* at 2 (June 18, 2018).

[redacted][15]

Thus, the Commission's capital structure decision in this case will help determine how the TCJA ultimately affects CenterPoint Houston's credit ratings. It will also influence the rating agencies' perceptions of whether the Texas regulatory environment remains constructive.

Q. YOU STATED EARLIER THAT YOU HAVE THREE THRESHOLD OBSERVATIONS REGARDING THE INTERVENOR AND STAFF CAPITAL STRUCTURE TESTIMONY. WHAT IS YOUR SECOND OBSERVATION?

A. My second observation relates to the effect of the Intervenor and Staff witnesses' capital structure recommendations on CenterPoint Houston's credit metrics. On June 17, 2019, Moody's issued a comment on CenterPoint Houston's rate case, so we have empirical evidence of how at least one of the rating agencies views the Intervenor and Staff witnesses' cost-of-capital recommendations. In that comment, Moody's expressly stated [redacted].”[16]

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[15] S&P Global Ratings, *U.S. Tax Reform: For Utilities' Credit Quality, Challenges Abound* at 5 (Jan. 24, 2018) (emphasis added); *see also* Fitch Ratings, *Tax Reform Impacts on the U.S Utilities, Power & Gas Sector* at 4 (Jan. 24, 2018) (“Fitch's rating actions will be guided by both the regulatory and management responses.”).

[16] Exhibit R-RBM-3 at 1.

Q. DID MOODY'S MAKE ANY OTHER STATEMENTS RELEVANT TO THE INTERVENOR AND STAFF WITNESSES' CAPITAL STRUCTURE RECOMMENDATIONS?

A. Yes. Moody's noted [redacted][17] As I will demonstrate, the Intervenor and Staff witnesses' capital structure recommendations would force CenterPoint Houston's credit ratios to fall even lower than the reduced levels that Moody's is predicting.

Q. WHAT IS YOUR THIRD OBSERVATION?

A. My third observation is that, although the Staff and Intervenor witnesses make capital structure recommendations, three of the four witnesses make no attempt to determine how their recommendations would affect CenterPoint Houston's credit metrics and credit ratings. The only effort who makes any effort to quantify the effect of this capital structure recommendation is Mr. Gorman, and his analysis is riddled with errors that render it useless. I describe those errors later in my testimony.

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[17] Exhibit R-RBM-3 at 1.

A. Response to Dr. Woolridge's Capital Structure Arguments

Q. PLEASE EXPLAIN YOUR UNDERSTANDING OF DR. WOOLRIDGE'S RECOMMENDATION ON CAPITAL STRUCTURE.

A. As I understand Dr. Woolridge's capital structure testimony, he is making a primary recommendation and a secondary recommendation. His primary recommendation is that the Commission authorize a capital structure composed of 60% debt and 40% equity.[18] In the alternative, Dr. Woolridge recommends that the Commission authorize a capital structure composed of 0.90% short-term debt, 55.48% long-term debt, and 43.62% common equity.[19]

Q. HAS DR. WOOLRIDGE PROVIDED ANY QUANTITATIVE ANALYSIS TO SUPPORT HIS CONTENTION THAT HIS CAPITAL STRUCTURE RECOMMENDATIONS WILL ALLOW CENTERPOINT HOUSTON TO MAINTAIN ITS FINANCIAL INTEGRITY?

A. No. As far as I can tell, he has made no effort to establish that CenterPoint Houston could maintain its current credit rating with a 40% equity ratio and his proposed ROE.

[18] Woolridge Dir. at 20:1-5.
[19] Woolridge Dir. at 20:10-16.

Q. DR. WOOLRIDGE NEVERTHELESS ASSERTS THAT "THE MEDIAN COMMON EQUITY RATIOS OF THE ELECTRIC AND HEVERT PROXY GROUPS ARE 45.2% AND 45.8%, RESPECTIVELY," AND FROM THAT PREMISE HE CONCLUDES THAT CENTERPOINT HOUSTON'S PROPOSED CAPITAL STRUCTURE CONTAINS MORE EQUITY THAN THE TWO PROXY GROUPS.[20] DO YOU AGREE WITH THAT ARGUMENT?

A. No. In direct testimony, Mr. Hevert demonstrated that the average equity ratio for the companies in his proxy group was 53.28% through the third quarter of 2018, based on data from S&P Global Market Intelligence.[21] And even if one relies on the Value Line data that Dr. Woolridge claims his Exhibit JRW-2 is based on, the equity ratios in that exhibit cannot be reconciled with the equity ratios listed for those utilities in the most recent versions of the Value Line reports:

Table 1

Utility	Equity Ratio Listed in Exhibit JRW-2	Equity Ratio Listed in Most Recent Value Line Report
ALLETE, Inc.	59.2%	59.0%
Alliant Energy Corporation	44.6%	48.0%
Ameren Corporation	46.2%	49.5%
American Electric Power Company, Inc.	42.7%	48.5%
AVANGRID, Inc.	70.8%	62.0%
Black Hills Corporation	42.1%	51.5%

[20] Woolridge Dir. at 17:11-14.
[21] Hevert Dir., Exhibit RBH-9 at 1.

Utility	Equity Ratio Listed in Exhibit JRW-2	Equity Ratio Listed in Most Recent Value Line Report
CMS Energy Corporation	28.9%	36.5%
Consolidated Edison, Inc.	44.8%	49.0%
DTE Energy Company	42.9%	46.5%
Duke Energy Corporation	43.1%	43.5%
El Paso Electric Company	44.8%	47.5%
Evergy	54.2%	47.0%
Eversource Energy	46.7%	47.5%
Hawaiian Electric Industries	51.2%	55.0%
NextEra Energy, Inc.	49.8%	54.0%
NorthWestern Corporation	47.8%	51.5%
OGE Energy Corp.	56.0%	54.5%
Otter Tail Corporation	54.5%	49.5%
Pinnacle West Capital Corp.	50.6%	57.0%
PNM Resources, Inc.	37.6%	42.0%
Portland General Electric Company	50.3%	53.0%
Southern Company	38.3%	41.5%
WEC Energy Group	45.3%	50.0%
Xcel Energy Inc.	41.5%	42.0%
Average	47.2%	49.4%

As the foregoing table shows, the average equity ratio reported by *Value Line* for the Hevert proxy group companies is much closer to my proposed 50% equity ratio than it is to Dr. Woolridge's proposed 40% equity ratio. Indeed, even if one assumes the equity ratios listed in Exhibit JRW-2 are accurate, the 47.2% average is far closer to my proposed equity ratio than it is to Dr. Woolridge's proposed equity ratio.

Q. **DR. WOOLRIDGE SUGGESTS THAT THE CAPITAL STRUCTURES HE REPORTS FOR THE PROXY GROUP COMPANIES INCLUDE SHORT-TERM DEBT.[22] SHOULD SHORT-TERM DEBT BE USED TO CALCULATE THE EQUITY RATIOS?**

A. No. The utility assets included in CenterPoint Houston's rate base are financed with long-term debt and common equity, not with short-term debt. Moreover, this Commission's long-standing precedent is to exclude short-term debt from utilities' authorized capital structures.[23] Therefore, including short-term debt in the proxy group capital structures skews the comparison in a way that makes it misleading.

Q. **DR. WOOLRIDGE ALSO ARGUES THAT CENTERPOINT HOUSTON IS PROPOSING A HIGHER EQUITY RATIO THAN IT AND CENTERPOINT ENERGY INC. HAVE MAINTAINED IN THE PAST.[24] WHAT IS YOUR RESPONSE?**

A. I have several responses. First, Exhibit JRW-3 shows that Dr. Woolridge is including short-term debt in his calculation of CenterPoint Houston's capital structure, which is incorrect for the reasons I discussed above. Second, Exhibit

[22] Woolridge Dir. at 17:14-18.

[23] *See, e.g.*, *Application of Southwestern Public Service Company for Authority to Change Rates*, Docket No. 43695, Order on Rehearing at 25, Finding of Fact No. 71 (Feb. 23, 2016) ("It is unreasonable and inconsistent with Commission precedent to include short-term debt in SPS's capital structure.").

[24] Woolridge Dir. at 17:22-26.

JRW-3 shows that the most recent equity ratios for CenterPoint Energy, Inc. and CenterPoint Houston are 47.0% and 45.5%, respectively, which are considerably higher than those reported by Dr. Woolridge. Finally, if Dr. Woolridge is suggesting that CenterPoint Houston needs to maintain an actual 50.0% equity ratio in order to obtain an authorized 50% equity ratio, I strongly disagree with his reasoning. CenterPoint Houston currently has an authorized equity ratio of 45.0%, which means that it receives an equity return on 45.0% of its rate base investment. Under Dr. Woolridge's suggestion that CenterPoint Houston should be maintaining an actual 50.0% equity ratio if it wants the Commission to approve a 50.0% equity ratio, CenterPoint's shareholders would earn a debt return on part of their equity investment. And if equity investors believe that they will receive a debt return on part of their equity investment, they will require a much higher equity return on the remaining investment to compensate them for that debt return.

Q. IF THE COMMISSION AUTHORIZES AN EQUITY RATIO OF 50.0%, WILL CENTERPOINT ENERGY, INC. INFUSE SUFFICIENT EQUITY TO BRING THE ACTUAL EQUITY RATIO IN LINE WITH THE AUTHORIZED EQUITY RATIO?

A. Yes. Within a reasonable time after the Commission's final decision in this docket, CenterPoint Energy, Inc. will ensure that CenterPoint Houston's equity ratio is generally consistent with the authorized equity ratio.

Q. IN ADDITION TO HIS PRIMARY RECOMMENDATION OF 60% DEBT AND 40% EQUITY, DR. WOOLRIDGE ALSO PROPOSES AN ALTERNATIVE CAPITAL STRUCTURE COMPOSED OF 55.48% LONG-TERM DEBT, 0.90% SHORT-TERM DEBT, AND 43.62% COMMON EQUITY.[25] SHOULD THE COMMISSION ADOPT THAT PROPOSED ALTERNATIVE CAPITAL STRUCTURE?

A. No. As I explained earlier, CenterPoint Houston finances its rate base investment with long-term debt and common equity, not short-term debt. Moreover, including short-term debt in CenterPoint Houston's capital structure would be contrary to long-standing Commission precedent. Therefore, the Commission should reject Dr. Woolridge's alternative proposal as well.

Q. DR. WOOLRIDGE ALSO TAKES ISSUE WITH YOUR TESTIMONY THAT A 50% EQUITY RATIO IS NECESSARY TO MITIGATE THE LOWER CASH FLOW CAUSED BY THE TCJA.[26] DO YOU AGREE WITH HIS ARGUMENT?

A. No. Dr. Woolridge argues that the TCJA does not warrant a higher equity ratio because CenterPoint Houston has been able to raise cash, as evidenced by its higher equity ratio, and because CenterPoint Houston's credit ratings are comparable to the average credit ratings of his proxy group and Mr. Hevert's proxy group. His argument is misguided for several reasons.

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[25] Woolridge Dir. at 20:17-22.

[26] Woolridge Dir. at 21:5-14. *In this question, Dr. Woolridge again mistakenly attributes my testimony to Mr. Pringle.*

First, as I explained in my direct testimony, CenterPoint Houston's projected credit metrics in the coming years will not support its current credit rating, even with a 45.0% equity ratio. Though Dr. Woolridge did not provide any quantitative analysis in his testimony, it is safe to assume that increasing the Company's leverage as a result of his recommended equity ratios would further lower credit metrics and accelerate their degradation.

Second, Dr. Woolridge ignores the impact TCJA has had on the utility companies he includes in his peer set. For example:

- On March 26, 2019, Moody's downgraded ALLETE, Inc.'s issuer rating to Baa1 from A3 as the result of an adverse general rate case outcome at its primary subsidiary, Minnesota Power, and the negative cash flow impact of TCJA.
- On May 23, 2018, Moody's placed Alliant Energy Corporation's Baa1 long term rating on negative outlook due to weakening financial ratios, sizeable capital expenditure program, and negative cash flow impacts associated with federal tax reform.
- On October 30, 2018, Moody's downgraded the long-term ratings of Consolidated Edison Inc. and its subsidiaries due to a weaker financial profile.
- On May 31, 2019, Moody's downgraded Oklahoma Gas & Electric Company from A2 to A3, due to higher debt levels and lagging cash flow from tax reform.
- On March 28, 2019, Moody's downgraded Xcel Energy Inc.'s long-term rating from A3 to Baa1 due to the negative impact of tax reform, an elevated capital program and limited plans to issue equity.
- On July 12, 2018, Moody's downgraded WEC Energy Group from A3 to Baa1 due to negative cash flow impact of tax reform and incremental debt to fund capital expenditures.

My direct testimony provides solutions to avoid the downgrades that several utilities in Dr. Woolridge's utility peer group have experienced, and to ensure that CenterPoint Houston continues to have access to capital on reasonable terms.

Third, Dr. Woolridge's argument is directly contradicted by the June 17, 2019 Moody's issuer comment I discussed earlier. In that comment, Moody's expressly states tha[redacted].[27]

Finally, Dr. Woolridge's argument that CenterPoint Houston has been able to maintain adequate credit ratings with its current 45.0% equity ratio is disingenuous, because Dr. Woolridge is not asking the Commission to maintain CenterPoint Houston's current equity ratio. As I noted earlier, he is asking the Commission to reduce CenterPoint Houston's authorized equity ratio to 40.0%, a 500 basis-point reduction.

B. Response to Mr. Gorman's Capital Structure Arguments

Q. WHAT CAPITAL STRUCTURE IS MR. GORMAN RECOMMENDING THAT THE COMMISSION APPROVE?

A. Like Dr. Woolridge, Mr. Gorman is proposing that the Commission adopt a capital structure composed of 40% equity and 60% debt.[28]

Q. DO YOU HAVE ANY OVERARCHING COMMENTS ABOUT MR. GORMAN'S CAPITAL STRUCTURE ANALYSIS?

A. Yes. It appears that Mr. Gorman has developed a four-step argument to support his proposed 40% equity ratio and the ring-fencing protections advocated by TIEC:

1. CenterPoint Houston enjoys a supportive regulatory environment and low business risk, and therefore it would be rated higher by the rating agencies but for its association with CenterPoint Energy, Inc.[29]

[27] Exhibit R-RBM-3 at 1.
[28] Gorman Dir. at 37, Table 7.
[29] Gorman Dir. at 27:9-26.

2. The Commission should impose the financial ring-fencing measures proposed by Mr. Griffey, which would sever the link between CenterPoint Houston's rating and CenterPoint Energy, Inc.'s rating.[30]

3. After severing that link, CenterPoint Houston would be measured under the "low volatility" table used by S&P, rather than the "medial volatility" table that S&P currently uses for CenterPoint Houston.[31]

4. If S&P's "low volatility" table were used, CenterPoint Houston could maintain its current credit rating with a 40.0% equity ratio and a 9.25% ROE.[32]

Mr. Gorman's reasoning is flawed in numerous respects.

Q. WHY DO YOU ASSERT THAT MR. GORMAN'S REASONING IS FLAWED?

A. First, Mr. Gorman is wrong to the extent he assumes that S&P evaluates CenterPoint Houston in accordance with the medial volatility table. S&P has expressly stated that it evaluates CenterPoint Houston under the low volatility table.[33] Thus, the ring-fencing protections that Messrs. Griffey and Gorman advocate would make no difference to S&P's rating of CenterPoint Houston.

The actual reason that S&P rates CenterPoint Houston lower than Moody's and Fitch do is that S&P uses a "group rating" methodology in which a holding company and its subsidiaries are typically rated the same. Notably, however, S&P is revising its "group rating" methodology criteria and expects to publish its new criteria in mid-July 2019.[34] As I interpret S&P's guidance on this issue,

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[30] Gorman Dir. at 32:21-33:2.
[31] Gorman Dir. at 36:7-14.
[32] Gorman Dir. at 36:20-37:2.
[33] Exhibit R-RBM-4 at 4 (S&P stating about CenterPoint Houston, [redacted].")
[34] S&P Global Ratings, *Group Rating Methodology Guidance* at 2 (June 3, 2019).

CenterPoint Houston could experience an upgrade of at least one notch with its existing operations and protections, provided that increased financial risk resulting from the TCJA is mitigated. Thus, Mr. Gorman's conclusion that CenterPoint Houston needs financial ring-fencing protections to enhance its S&P credit rating is based on stale information.

Moreover, S&P is just one of the three major rating agencies, and the other two rating agencies—Moody's and Fitch—view operating company subsidiaries such as CenterPoint Houston on a more standalone basis. Thus, the ring-fencing provisions proposed by Mr. Griffey would not necessarily have any appreciable effect on the ratings from those rating agencies.[35] Moody's considers [redacted].

Finally, Mr. Gorman's assertion that CenterPoint Houston could maintain its current credit rating with a 40.0% equity ratio and a 9.25% ROE is based upon an erroneous analysis.

Q. WHY DO YOU STATE THAT MR. GORMAN'S ASSERTION THAT CENTERPOINT HOUSTON COULD MAINTAIN ITS CURRENT CREDIT RATING WITH A 40.0% EQUITY RATIO AND A 9.25% ROE IS BASED UPON AN ERRONEOUS ANALYSIS?

A. For his assertion that CenterPoint Houston could maintain its current credit metrics with a 40.0% equity ratio and 9.25% ROE, Mr. Gorman points to his Exhibit

[35] As Company witness Ellen Lapson states in her rebuttal testimony, CenterPoint Houston already has numerous financial protections in place, so even if Mr. Griffey's proposals were adopted, it is not clear that they would have any significant effect on the rating agencies' evaluations of CenterPoint Houston's financial risk.

MPG-5. That exhibit, however, contains several errors, which I have identified on my Exhibit R-RBM-5. One error, in particular, inflates Mr. Gorman's credit metrics, thereby rendering them unreliable.

Q. WHICH ERROR IN EXHIBIT MPG-5 INFLATES MR. GORMAN'S CREDIT METRICS?

A. On page 2 of Exhibit MPG-5, Mr. Gorman attempts to recreate CenterPoint Houston's income statement based on an equity ratio of 40.0% and an ROE of 9.25%. In calculating the tax expense, however, Mr. Gorman erroneously increased the amount of the tax expense by the amount of the tax adjustment on line 18 rather than reducing it by that amount, as he should have. If he had offset them properly, as I have done in my Exhibit R-RBM-6, the amount on line 22 would have been $289.6 million in 2019, instead of the $267.9 million shown on Mr. Gorman's Exhibit MPG-5.

Q. HOW DOES THAT ERROR AFFECT MR. GORMAN'S ANALYSIS?

A. The balance sheet reflected in Exhibit MPG-5 shows an equity balance of $2.9 billion dollars for CenterPoint Houston. When the $289.6 million of corrected net income is divided by the $2.9 billion, it becomes clear that Mr. Gorman is actually assuming an ROE of approximately 10.0% for 2019, not the 9.25% he claims to be using.

Q. HOW SHOULD MR. GORMAN'S EXHIBIT MPG-5 BE ADJUSTED TO ACHIEVE A 9.25% ROE?

A. The "Revenues Adjustment" on line 2 of page 2 of Exhibit MPG-5 must be changed from -$35 million to -$62 million, which reduces the net income used to calculate the ROE and reduces the EBITDA used in calculating CenterPoint Houston's S&P credit metrics.

Q. DOES THAT SAME ERROR OCCUR IN YEARS AFTER 2019?

A. Yes. Mr. Gorman repeats the mistake in every year from 2019 through 2023. As shown in my Exhibit R-RBM-6, Mr. Gorman's credit metric analysis implicitly assumes ROEs over 10.0% in 2021, 2022, and 2023.

Q. HAVE YOU RECALCULATED MR. GORMAN'S CREDIT METRICS USING HIS RECOMMENDED 9.25% ROE AND A 40.0% EQUITY RATIO?

A. Yes. In my Exhibit R-RBM-7, I recreated Mr. Gorman's Exhibit MPG-5, except that I increased the revenue adjustment in line 2 to a level that is needed to bring the ROE down to 9.25%. As noted above, that results in a revenue adjustment of $62 million, rather than the $35 million that Mr. Gorman shows in his Exhibit MPG-5. I have made the same adjustment for the remaining years.

Q. IF MR. GORMAN HAD ADJUSTED THE REVENUES PROPERLY, HOW WOULD THAT AFFECT CENTERPOINT HOUSTON'S CREDIT METRICS?

A. Correcting Mr. Gorman's error produces significantly lower ratios of Funds From Operations to Debt ("FFO/Debt") and Debt to Earnings Before Interest, Taxes, Depreciation, and Amortization ("Debt/EBITDA") than Mr. Gorman shows. For example, in Exhibit MPG-5 Mr. Gorman represents that CenterPoint Houston's FFO/Debt ratio would be 13.2% and that its Debt/EBITDA ratio would be 4.93x in 2019. But as shown in my Exhibit R-RBM-7, the actual FFO/Debt in 2019 would be 12.7% if Mr. Gorman had calculated the ratios correctly, and the Debt/EBIDTA ratio would be 5.08x.

Q. IN HIS TABLE 6, MR. GORMAN SUGGESTS THAT EVEN THOSE LOWER RATIOS WOULD BE SUFFICIENT TO MAINTAIN OR IMPROVE CENTERPOINT HOUSTON'S CREDIT RATINGS. IS HE CORRECT?

A. No. First, Mr. Gorman mistakenly uses the ratios for CenterPoint Energy, Inc. As shown on Exhibit R-RBM-4, S&P's targeted FFO/Debt ratio for CenterPoint Houston is 18%-20%, and its targeted Debt/EBITDA ratio is roughly 3.5x. Thus, the credit metrics produced by Mr. Gorman's ROE and capital structure recommendations are far below the S&P benchmarks.

Second, S&P's currently stand-alone rating for CenterPoint Houston is a+. Mr. Gorman's target of 13% FFO to Debt would actually represent a two-notch downgrade from its current position down to a-.

Third, 13% is at the bottom of the range for a company deemed to have "intermediate" financial risk. Targeting the low end of a credit metric range is imprudent as it provides little cushion against unexpected events, such as a hurricane or other extreme weather.

Q. HAS CENTERPOINT HOUSTON PERFORMED AN ANALYSIS OF HOW MR. GORMAN'S CAPITAL STRUCTURE AND ROE RECOMMENDATIONS WOULD AFFECT CENTERPOINT HOUSTON'S CREDIT METRICS UNDER THE METHODOLOGY USED BY MOODY'S?

A. Yes. Table 2 displays what CenterPoint Houston's ratios would be based on the Moody's methodology under Mr. Gorman's ROE and capital structure recommendations.

Table 2

	2019	2020	2021	2022	2023
CFO pre-WC + Interest / Interest	4.21x	4.28 x	4.08x	4.03x	4.08x
CFO pre-WC / Debt	13.0%	13.2%	12.5%	12.6%	12.5%
CFO pre-WC – Dividends / Debt	12.0%	11.9%	9.4%	10.7%	9.3%
Debt / Capitalization	54.3%	55.0%	55.7%	56.6%	57.9%

Q. WOULD THE RESULTING METRICS BE CONSISTENT WITH AN "A" RATING UNDER THE MOODY'S METHODOLOGY?

A. No. As shown in Table 3, the resulting metrics for 2019 would map to a Baa rating under the Moody's methodology.

Table 3

Financial Strength Metric	Pro-forma 2019*	A	Baa	Ba
CFO pre-WC + Interest / Interest	4.21x	4.5x – 6.0x	3.0x – 4.5x	2.0x – 3.0x
CFO pre-WC / Debt	13.0%	19% - 27%	11% –19%	5% - 11%
CFO pre-WC – Dividends / Debt	12.0%	15% - 23%	7% - 15%	0% - 7%
Debt / Capitalization	54.3%	40% - 50%	50% - 59%	59% - 67%

* Source: Exhibit R-RBM-7

Q. HAS CENTERPOINT HOUSTON PERFORMED AN ANALYSIS OF HOW MR. GORMAN'S CAPITAL STRUCTURE AND ROE RECOMMENDATIONS WOULD AFFECT CENTERPOINT HOUSTON'S CREDIT METRICS UNDER THE METHODOLOGY USED BY FITCH?

A. Yes. Table 4 displays what CenterPoint Houston's ratios would be based on the Fitch methodology under Mr. Gorman's ROE and capital structure recommendations.

Table 4

	2019	2020	2021	2022	2023
Fitch FFO-adjusted leverage (x)	5.60	5.53	5.53	5.50	5.57
Total Adjusted Debt / Operating EBITDAR (x)	4.99	5.04	5.04	5.03	5.12
FFO Fixed-Charge Cover (x)	4.18	4.25	4.20	4.17	4.26

Q. WOULD THE METRICS RESULTING FROM MR. GORMAN'S RECOMMENDATIONS BE CONSISTENT WITH AN "A" RATING UNDER THE FITCH METHODOLOGY?

A. No. As shown in Table 5, the resulting metrics for 2019 would map to a bbb rating under the Fitch methodology.

Table 5

	Pro-forma 2019*	a	bbb	bb
Fitch FFO-adjusted leverage (x)	5.60	3.5	5.0	6.5
Total Adjusted Debt / Operating EBITDAR (x)	4.99	3.25	3.75	4.75
FFO Fixed-Charge Cover (x)	4.18	5.0	4.5	3.5

* Source: Exhibit R-RBM-7

Again, Gorman's proposed capital structure and ROE do not support CenterPoint Houston's current a- rating.

Q. ON PAGE 29 OF HIS DIRECT TESTIMONY, MR. GORMAN SETS FORTH FIVE REASONS WHY HE BELIEVES CENTERPOINT HOUSTON'S PROPOSED CAPITAL STRUCTURE IS UNREASONABLE. DO YOU HAVE ANY THRESHOLD RESPONSE TO HIS LIST OF REASONS?

A. Yes. Several of Mr. Gorman's reasons for opposing CenterPoint Houston's proposed 50.0% equity ratio are rooted in the proposition that CenterPoint Houston's currently authorized 45.0% equity ratio has served CenterPoint Houston and its customers well. Mr. Gorman, however, is not proposing to maintain the currently approved regulatory capital structure; instead, he is proposing to reduce it by 500 basis points. It is unclear why he touts the benefits of the currently approved capital structure at the same time he is proposing to reduce it so dramatically.

Q. TURNING TO THE INDIVIDUAL REASONS, MR. GORMAN'S FIRST ARGUES THAT CENTERPOINT HOUSTON'S PROPOSED CAPITAL STRUCTURE IS UNREASONABLE BECAUSE CENTERPOINT HOUSTON HAS NOT DEMONSTRATED A NEED TO INCREASE THE CURRENT EQUITY RATIO.[36] DO YOU AGREE?

A. No. I explained in my direct testimony that an increase in the equity ratio to 50.0%, along with a 10.4% ROE, would increase the ratio of FFO/Debt by roughly 200 basis points, which may be sufficient to maintain CenterPoint Houston's current credit ratings.[37] In contrast, a 45.0% equity ratio would drop CenterPoint Houston

[36] Gorman Dir. at 29:3-4.
[37] McRae Dir. at 25:3-4.

below the threshold for a downgrade,[38] and the 40.0% equity ratio recommended by Mr. Gorman would undoubtedly drive CenterPoint Houston's credit metrics below the level needed to maintain its current credit ratings.

Q. MR. GORMAN NEXT ASSERTS THAT CENTERPOINT HOUSTON'S CURRENTLY APPROVED REGULATORY CAPITAL STRUCTURE HAS SUPPORTED THE COMPANY'S CREDIT RATING AND FINANCIAL INTEGRITY FOR MANY YEARS.[39] WHAT IS YOUR RESPONSE?

A. I agree that the capital structure approved in Docket No. 38339 helped support CenterPoint Houston's credit rating and financial integrity for several years, but most of that time occurred prior to the enactment of the TCJA. As I demonstrated in my direct testimony, the 45.0% equity ratio is no longer adequate in light of the reduced cash flow produced by the TCJA. Moreover, it bears repeating that Mr. Gorman is not proposing to maintain that currently approved regulatory capital structure.

[38] McRae Dir. at 25:Table 6.
[39] Gorman Dir. at 29:5-6.

Q. NEXT, MR. GORMAN ARGUES THAT CENTERPOINT HOUSTON'S "RATEMAKING CAPITAL STRUCTURE IS IN LINE WITH PREDICTABLE AND CONSISTENT RATEMAKING PRACTICES USED BY THE COMMISSION IN SETTING OVERALL RATES OF RETURN FOR LOW-RISK ELECTRIC TDUs THAT OPERATE WITHIN ERCOT."[40] HOW DO YOU RESPOND?

A. As I understand the argument, Mr. Gorman is asserting that the 45.0% equity ratio currently authorized for CenterPoint Houston is consistent with the equity ratios authorized for other transmission and distribution utilities operating in the Electric Reliability Council of Texas ("ERCOT"). I have several responses. First, a number of the equity ratios currently authorized for ERCOT utilities were established before the enactment of the TCJA. Moreover, Mr. Gorman has not established that other utilities in ERCOT are forecasting the high levels of capital expenditures that CenterPoint Houston expects to incur. Thus, Mr. Gorman's reliance on the authorized capital structures of other utilities within ERCOT is misplaced.

Second, it is my understanding that the recently authorized capital structures for Oncor Electric Delivery Company, LLC and Texas New Mexico Power Company were based on non-precedential settlements. Thus, they shed little light on the appropriate capital structure for CenterPoint Houston.

Third, as I noted earlier, Mr. Gorman is not asking the Commission to approve a 45.0% equity ratio. He is asking the Commission to approve a 40.0% equity ratio, which would be a decrease of 500 basis points from CenterPoint

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[40] Gorman Dir. at 29:7-9.

Houston's currently authorized equity ratio. Moreover, Mr. Gorman has identified no material change in CenterPoint Houston's business and financial risk since the Commission established that 45.0% equity ratio for CenterPoint Houston. Therefore, if Mr. Gorman wants to foster "predictable and consistent" ratemaking practices in Texas, he should be supporting an equity ratio of no less than 45.0%.

Q. MR. GORMAN ALSO STATES THAT CENTERPOINT HOUSTON'S "APPROVED CAPITAL STRUCTURE HAS ALLOWED CEHE TO SUPPORT ITS CAPITAL INVESTMENT PROJECTS WHILE PROVIDING RELIABLE SERVICE."[41] DO YOU AGREE?

A. I agree that CenterPoint Houston has been able to support its capital investment projects, and I agree that CenterPoint Houston has provided reliable service. But again, much of that occurred prior to the enactment of the TCJA. As noted earlier, my direct testimony presented quantitative evidence showing CenterPoint Houston will not be able to do that in the future and maintain its existing credit metrics without an increase in its equity ratio.

Q. MR. GORMAN'S FINAL REASON FOR ASSERTING THAT CENTERPOINT HOUSTON'S PROPOSED CAPITAL STRUCTURE IS UNREASONABLE IS THAT A "CAPITAL STRUCTURE WITH A HIGHER COMMON EQUITY RATIO COMPONENT PLACES AN UNREASONABLE BURDEN ON RATEPAYERS."[42] DO YOU AGREE?

A. No. That is simply a conclusory statement with no support. In contrast, my direct testimony contains a quote from Dr. Roger Morin, a noted regulatory finance

[41] Gorman Dir. at 29:10-11.
[42] Gorman Dir. at 29:12-13.

expert, that both utilities and customers are best served by a utility with an A rating, which is what CenterPoint Houston is seeking to maintain by virtue of a 50.0% equity ratio. My capital structure recommendation will increase the chance of CenterPoint Houston maintaining an A rating, whereas Mr. Gorman's recommendation will not.

Q. MR. GORMAN ALSO SUGGESTS THAT CUSTOMERS WOULD BE BETTER OFF IF CENTERPOINT HOUSTON HAD A LOWER CREDIT RATING THAN THEY WOULD BE WITH A HIGHER EQUITY RATIO.[43] WHAT IS YOUR RESPONSE?

A. I disagree. Mr. Gorman takes a very short-term view involving only one debt issuance. When a utility's credit rating is downgraded, however, that rating typically does not rebound quickly, even in the face of improved financial metrics. Therefore, if CenterPoint Houston's credit ratings fall, they may remain at the lower level through many debt issuances, and customers will pay the higher costs associated with those debt issuances for the entire lives of the bonds, which may be two or three decades.

C. Response to Ms. Winker's Capital Structure Arguments

Q. WHAT CAPITAL STRUCTURE IS MS. WINKER RECOMMENDING ON BEHALF OF OPUC?

A. As I noted earlier, Ms. Winker is recommending that the Commission adopt a capital structure composed of 45.5% equity and 54.5% long-term debt.[44]

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[43] Gorman Dir. at 31:5-19.
[44] Winker Dir. at 43:5.

Q. MS. WINKER ARGUES THAT CENTERPOINT HOUSTON HAS BEEN ABLE TO IMPROVE ITS CREDIT RATINGS WITH ITS CURRENT AUTHORIZED CAPITAL STRUCTURE, WHICH IS COMPOSED OF 55% DEBT AND 45% EQUITY.[45] IS THAT A VALID REASON FOR THE COMMISSION TO APPROVE A SIMILAR CAPITAL STRUCTURE IN THIS CASE?

A. No. It is true that the Company has been able to improve its credit ratings since the 2010 rate case, but that is hardly surprising given that the Company had a capital structure composed of 60.0% debt and 40.0% equity before that time. The real question is whether CenterPoint Houston will be able to maintain its current credit metrics going forward with the large capital expenditure program and the reduced cash flow attributable to the TCJA. For the reasons I have set forth, it likely will not maintain those metrics absent measures such as an increase in its authorized equity ratio.

Q. MS. WINKER ALSO ASSERTS THAT CENTERPOINT HOUSTON'S CURRENT CREDIT RATING HAS ALLOWED IT TO ISSUE LONG-TERM DEBT AT REASONABLE RATES.[46] WHAT IS YOUR RESPONSE?

A. I agree, and that is why CenterPoint Houston is asking the Commission for an equity ratio that will support the Company's effort to maintain its current credit ratings. The mere fact that CenterPoint Houston has not yet been downgraded because of the TCJA's effects does not mean it is immune from such a downgrade. The rating agencies made it very clear in publications after the enactment of the

[45] Winker Dir. at 42:8-16.
[46] Winker Dir. at 42:16-43:2.

TCJA that they were awaiting the regulatory agencies' responses in individual utility cases before deciding whether to downgrade utilities.

Q. MS. WINKER STATES, "CENTERPOINT HOUSTON WILL CONTINUE TO BE ABLE TO ATTRACT FINANCIAL CAPITAL ON REASONABLE TERMS USING" HER RECOMMENDED CAPITAL STRUCTURE.[47] HAS SHE SUPPORTED THAT ASSERTION WITH ANY EVIDENCE?

A. No. As far as I can tell, her only justification for that statement is that CenterPoint Houston has been able to attract capital on reasonable terms since the enactment of the TCJA. But as I explained earlier, rating agencies are awaiting the outcomes of regulatory proceedings such as this one to determine how to rate utilities like CenterPoint Houston on a going-forward basis. Therefore, the Commission should not take any comfort from the fact that CenterPoint Houston has not been downgraded thus far because of the effects of the TCJA.

Q. DID MS. WINKER PERFORM ANY QUANTITATIVE ANALYSES TO DETERMINE WHAT CENTERPOINT HOUSTON'S CREDIT METRICS WOULD BE UNDER HER PROPOSED CAPITAL STRUCTURE?

A. No. She admitted in response to discovery that she did not.[48]

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[47] Winker Dir. at 14-16.

[48] OPUC's Response to CenterPoint Energy Houston Electric LLC's Third Request for Information, request 3-10.

D. Response to Mr. Ordonez's Capital Structure Arguments

Q. WHAT CAPITAL STRUCTURE IS MR. ORDONEZ RECOMMENDING ON BEHALF OF STAFF?

A. As I noted earlier, Mr. Ordonez is recommending that the Commission adopt a capital structure composed of 40.0% equity and 60.0% long-term debt.[49]

Q. WHAT IS MR. ORDONEZ'S RATIONALE FOR PROPOSING A CAPITAL STRUCTURE COMPOSED OF 40.0% EQUITY AND 60.0% DEBT?

A. His primary rationale appears to be that his capital structure recommendation is consistent with the Commission's ruling in Docket No. 22344, in which the Commission found that a capital structure with 60.0% debt and 40.0% equity was appropriate for the newly unbundled transmission and distribution utilities in ERCOT.

Q. IS MR. ORDONEZ'S RELIANCE ON THE DOCKET NO. 22344 ORDER REASONABLE?

A. No. His reliance on the Commission's order in Docket No. 22344 is misplaced for numerous reasons. First, in Docket No. 22344 the Commission established a generic capital structure that was intended to apply to all of the transmission and distribution utilities ("TDU") that would operate within ERCOT. The Commission did not consider any TDU's individual circumstances in setting that capital structure, in large part because the TDUs did not exist at that time in any real sense. The Docket No. 22344 order was issued on December 22, 2000, over a year before the then-integrated utilities were unbundled into TDUs, retail electric providers,

[49] Ordonez Dir. at 36:5-12.

and power generation companies. Thus, the generic capital structure established in that case was intended to be a placeholder until the TDUs came into existence and established their own standalone credit profiles. Indeed, the very order that Mr. Ordonez relies on states that the Commission's decision on capital structure and ROE "are made for ratemaking purposes for the newly unbundled TDUs during the transition period."[50] CenterPoint Houston and other TDUs within ERCOT now have their own standalone credit ratings and risk factors, and we are far beyond the transition period, so it is no longer necessary or reasonable to rely on the generic capital structure established in Docket No. 22344.

Second, Mr. Ordonez's reliance on the Docket No. 22344 order is highly selective. His analysis ignores the Commission's statement in the Docket No. 22344 order that its decision was based "on the close correlation between the ROE and capital structure."[51] As Mr. Ordonez correctly notes, the Commission concluded in Docket No. 22344 that TDUs would be less risky than vertically integrated utilities, but Mr. Ordonez overlooks the Commission's statement in that same order that the higher financial risk associated with greater leverage gave rise to the need for a higher ROE. Accordingly, the Commission approved an ROE of 11.25% for the TDUs, which reflected an upward adjustment of 50 basis points to account for, among other things, the "potential rating uncertainty due to higher debt, based on the adoption of 60% debt and 40% equity for capital structure in this

[50] *Generic Issues Associated with Applications for Approval of Unbundled Cost of Service Rates Pursuant to PURA § 39.201 and Public Utility Commission Substantive Rule § 25.344*, Docket No. 22344, Order No. 42, Interim Order Establishing Return on Equity and Capital Structure at 8-9 (Dec. 22, 2000).
[51] *Id.* at 9.

proceeding."[52] In contrast to the Commission's action in Docket No. 22344, Mr. Ordonez has not adjusted his ROE upward in this case to increase for the increased financial risk that his recommended capital structure would produce.

Third, Mr. Ordonez ignores a more recent precedent—the Commission's 2010 decision in Docket No. 38339 to authorize a capital structure composed of 55.0% debt and 45.0% equity for CenterPoint Houston. In that docket, the Commission expressly found that a "capital structure of 55% debt and 45% equity is reasonable in light of CenterPoint's business and regulatory risks."[53] Mr. Ordonez makes no effort to explain how CenterPoint Houston's business and regulatory risks have changed enough since 2010 to justify reducing the equity ratio by 500 basis points.

Q. IN HIS TESTIMONY, MR. ORDONEZ SETS FORTH TWO REASONS WHY HE BELIEVES THAT THE COMMISSION'S CONCLUSION IN DOCKET NO. 22344 "REMAINS RELEVANT."[54] DO YOU AGREE WITH HIS REASONS?

A. No. Mr. Ordonez's first reason for maintaining that the Docket No. 22344 order remains relevant is that the rating agencies have characterized the Texas regulatory environment as being "constructive" or "credit positive."[55] His second reason is that the Commission stated in Project No. 46046 that the ratemaking mechanisms

[52] *Id.* at 10.
[53] *Application of CenterPoint Electric Delivery Company, LLC for Authority to Change Rates*, Docket No. 38339, Order on Rehearing at 21, Finding of Fact No. 68 (June 23, 2011).
[54] Ordonez Dir. at 37:1-2.
[55] Ordonez Dir. at 37:4-5.

for TDUs in ERCOT are serving their intended purpose.[56] From those premises, he concludes that TDUs in ERCOT operate in a "low risk environment."

Q. DO THOSE REASONS JUSTIFY AUTHORIZING A CAPITAL STRUCTURE THAT THE COMMISSION ESTABLISHED 19 YEARS AGO FOR THE PERIOD IN WHICH TDUs WERE TRANSITIONING TO COMPETITION?

A. No. Under Mr. Ordonez's rationale, there would be no need to consider an individual utility's circumstances in establishing that utility's capital structure. The Commission could just set a generic capital structure for all utilities based on the existing regulatory framework. But that is not what the Commission has chosen to do. It instead reviews the facts and circumstances in each case. Thus, Mr. Ordonez's recommendation is directly contrary to Commission practice and precedent.

Moreover, it is ironic that Mr. Ordonez cites to the rating agencies' characterization of the Texas regulatory framework as being constructive and credit-positive to support his capital structure recommendation. The rating agencies would undoubtedly view it as non-constructive and credit-negative if the Commission were to lower CenterPoint Houston's authorized equity ratio by 500 basis points based on the rationale that the Commission established a generic debt ratio of 60% in a proceeding that occurred almost 20 years ago. Indeed, the Moody's report that I discussed earlier expressly states that [redacted].[57]

[56] Ordonez Dir. at 37:5-12.
[57] Exhibit R-RBM-3 at 1.

Q. MR. ORDONEZ ALSO ASSERTS THAT HIS RECOMMENDED CAPITAL STRUCTURE IS CONSISTENT WITH THE CAPITAL STRUCTURES AUTHORIZED BY THE COMMISSION FOR THE MAJORITY OF TDUs OPERATING IN ERCOT.[58] WHAT IS YOUR RESPONSE?

A. I have several responses. First, the capital structure analysis should be focused primarily on whether an individual utility's capital structure is set at a level that is appropriate for its business and financial risks and whether the capital structure would allow the utility to maintain access to the capital markets on reasonable terms. As I noted earlier, the Commission found in CenterPoint Houston's last rate case that the Company's business and regulatory risks justified a capital structure composed of 55.0% debt and 45.0% equity, and Mr. Ordonez has made no showing of changed circumstances that would justify a 500-basis-point reduction in the capital structure. On the other hand, I have presented a quantitative analysis showing that CenterPoint Houston needs an increase in its authorized equity ratio just to maintain its current credit metrics.

Second, even if it were appropriate to ignore business and financial risk and focus instead on a headcount of utilities in ERCOT with a particular capital structure, Mr. Ordonez's analysis would not stand up to scrutiny. His list of five utilities with a 40.0% equity ratio double-counts AEP Texas, which is no longer divided into AEP Texas North Company and AEP Texas Central Company. Moreover, Mr. Ordonez fails to note that AEP Texas has a currently pending rate case in which it is requesting an equity ratio of 45.0%. Mr. Ordonez's list of utilities

[58] Ordonez Dir. at 37:18-20.

with a 40.0% equity ratio also includes three transmission-only utilities, which have lower risk than a TDU. In contrast, his list of four utilities with an equity ratio higher than 40.0% includes three TDUs and only one transmission-only utility. More to the point, it includes CenterPoint Houston, which is the utility whose capital structure is at issue in this case.

Third, if CenterPoint Houston's capital structure is to be based on a comparison to other utilities' authorized capital structure, that comparison should extend beyond the TDUs in ERCOT, because CenterPoint Houston competes for capital with utilities across the country, not just in ERCOT. Mr. Ordonez's own testimony demonstrates that the national average authorized equity ratio for delivery-only utilities such as CenterPoint Houston was 49.91% in 2018.[59]

Q. MR. ORDONEZ ATTEMPTS TO MINIMIZE THAT COMPARISON TO THE NATIONAL AVERAGE BY ARGUING THAT MOST OTHER DELIVERY COMPANIES PURCHASE AND SELL ELECTRICITY, WHEREAS CENTERPOINT HOUSTON DOES NOT.[60] IS THAT A VALID DISTINCTION?

A. No. That is simply one risk factor out of many for utilities, and Mr. Ordonez does not appear to have performed any analysis to determine areas in which CenterPoint Houston might have more risk than other utilities. For example, CenterPoint Houston has significant hurricane risk, whereas many of the other delivery-only companies do not. And as S&P has recognized, CenterPoint Houston has limited

[59] Ordonez Dir. at 36:2.
[60] Ordonez Dir. At 35:4-14.

geographic and regulatory diversity, given that its service area is limited to the Gulf Coast area around Houston.[61]

Q. MR. ORDONEZ DISCOUNTS CENTERPOINT HOUSTON'S HURRICANE RISK BY ARGUING THAT TEXAS LAW ALLOWS UTILITIES TO RECOVER STORM RESTORATION COSTS AND TO OBTAIN SECURITIZATION FINANCING FOR THOSE COSTS.[62] DO YOU AGREE THAT ADEQUATELY MITIGATES CENTERPOINT HOUSTON'S HURRICANE RISK?

A. No. Texas law does allow recovery of storm restoration costs and provides a securitization vehicle to do so, but as I pointed out in my direct testimony, the damage must exceed $100 million net of insurance proceeds in order to obtain securitization, and the delay in obtaining the securitization funds can be lengthy. Perhaps more importantly, the ability to recover storm restoration costs does nothing to compensate CenterPoint Houston for the lost energy sales during the time it takes to restore service after a hurricane. After Hurricane Harvey, for example, it took several weeks to restore service in parts of the CenterPoint Houston service area because those areas were simply underwater. CenterPoint Houston was not supplying electricity to those areas during that time, and therefore it was forgoing revenue as a result of the hurricane. Mr. Ordonez overlooks that risk completely.

[61] Exhibit R-RBM-4 at 4.
[62] Ordonez Dir. at 32:1-8.

Q. **MR. ORDONEZ ALSO TAKES ISSUE WITH YOUR OTHER REASONS FOR REQUESTING A CAPITAL STRUCTURE COMPOSED OF 50.0% EQUITY AND 50.0% DEBT – THE COMPANY'S LARGE CAPITAL EXPENDITURE PROGRAM AND THE TCJA EFFECTS.[63] WHAT IS YOUR RESPONSE?**

A. Mr. Ordonez is essentially quarreling with the rating agencies, which have identified those as risks for CenterPoint Houston. In its most recent report on CenterPoint Houston, S&P liste[redacted].[64] And as I noted earlier, the June 2019 Moody's report expressly cites [redacted].

Q. **MR. ORDONEZ FURTHER CONTENDS THAT CENTERPOINT HOUSTON IS ASKING THE COMMISSION TO "PROVIDE EXTRAORDINARY RELIEF IN HELPING CEHE MAINTAIN AN A- ISSUER RATING."[65] DO YOU AGREE WITH THAT CHARACTERIZATION?**

A. No. CenterPoint Houston is simply asking the Commission to authorize a capital structure that will allow the Company to continue having access to capital on reasonable terms. Ultimately, the beneficiaries of lower bond coupon rates are customers, not CenterPoint Houston, because the costs of debt are passed through

[63] Ordonez Dir. at 31:8-21.
[64] Exhibit R-RBM-4 at 2.
[65] Ordonez Dir. at 12-13.

in rates on a dollar-for-dollar basis. Moreover, if CenterPoint Houston experiences a downgrade, its cost of equity will rise as well, which will also affect customers. I do not view a request to control capital costs as a form of "extraordinary relief."

Q. DO YOU HAVE ANY CONCLUDING REMARKS REGARDING MR. ORDONEZ'S CAPITAL STRUCTURE RECOMMENDATION?

A. Yes. Mr. Ordonez has provided no cogent rationale for the Commission to reject CenterPoint Houston's proposed capital structure, and he certainly has provided no reason to reduce CenterPoint Houston's existing equity ratio by 500 basis points. Notably, he has not even attempted to determine how his capital structure recommendation would affect CenterPoint Houston's credit metrics, nor has he taken issue with my quantitative analysis showing that CenterPoint Houston needs an equity ratio containing 50.0% equity to maintain its current credit metrics. Therefore, the Commission should reject his capital structure recommendation.

IV. <u>WEIGHTED AVERAGE COST OF CAPITAL</u>

Q. WHAT WACC ARE YOU RECOMMENDING FOR CENTERPOINT HOUSTON IN THIS CASE?

A. I recommend that the Commission approve a WACC of 7.39%. That WACC is calculated using my recommended capital structure composed of 50.0% equity and 50.0% debt, the 4.38% cost of long-term debt, and the 10.40% ROE supported by Mr. Hevert.

Q. WILL A 7.39% WACC BE SUFFICIENT TO SUPPORT CENTERPOINT HOUSTON'S FINANCIAL INTEGRITY AND TO PRESERVE ITS CREDIT METRICS AT A LEVEL THAT WILL SUPPORT THE CURRENT CREDIT RATINGS?

A. I cannot say definitively how the rating agencies will react to a decision from the Commission, of course, but the 7.39% that CenterPoint Houston is requesting in this case will certainly increase the chances that CenterPoint Houston is able to maintain its current credit ratings.

Q. DO CUSTOMERS BENEFIT FROM A UTILITY THAT PERFORMS WELL FINANCIALLY?

A. Yes. A utility that performs well financially will attract capital more easily and at a lower cost, which can then be invested in the infrastructure needed to provide safe and reliable service, all to the benefit of customers.

V. <u>EFFECT OF CITIES' RECOMMENDATIONS ON CREDIT METRICS</u>

Q. HAVE YOU REVIEWED THE RECOMMENDATIONS OF LANE KOLLEN ON BEHALF OF GULF COAST COALITION OF CITIES?

A. Yes. In Table 1 of his direct testimony, Mr. Kollen provides a list of the cities' proposed revenue requirement adjustments, the amount of each adjustment, the sponsoring city group, and the witness proposing the adjustment. Taken together, those adjustments would result in a -$210.041 million change in rates.

Q. HAVE YOU CONDUCTED AN ANALYSIS TO DETERMINE THE IMPACT OF MR. KOLLEN'S ADJUSTMENTS ON THE CREDIT QUALITY OF CENTERPOINT HOUSTON?

A. Yes. The proposed changes would result in a material weakening of CenterPoint Houston's credit quality.

Q. WHAT ARE THE KEY ASSUMPTIONS OF YOUR ANALYSIS?

A. The key assumptions include the following:

- The $158 million of securitization excess accumulated deferred income tax liability is accrued by year-end 2019, with an offsetting equity infusion to maintain capital structure at 55% debt / 45% equity, and with no other changes to 2019.
- New rates are effective in 2020, and CenterPoint Houston is recapitalized to 60% debt / 40% equity by year-end 2020, consistent with other forecasts provided.
- CenterPoint issues an additional $500 million of long-term debt over the plan period, primarily as a result of the change to capital structure. The increase is assumed to begin in 2021.
- All other adjustments to the plan are derived from Mr. Kollen's testimony.

Q. WHAT IS THE RESULTING CREDIT METRICS?

A. As shown in Exhibit R-RBM-8, the assumptions produce a range of FFO/Debt of 10.0% to 11.6% in 2020-2023 under S&P's metrics.

Table 6

S&P Credit Metrics	2019	2020	2021	2022	2023
FFO/Debt	15.3%	10.3%	10.0%	10.6%	11.6%
Debt/EBITDA	4.36	6.46	6.59	6.35	5.99
Operating Cash Flow/Total Debt	14.5%	10.2%	9.1%	9.7%	10.8%

Q. DO THESE CREDIT METRICS SUPPORT CENTERPOINT HOUSTON'S CURRENT CREDIT RATINGS?

A. No. S&P's recent CenterPoint Houston credit update stated that S&P's base case assumption for FFO/Debt was 18%-20%, and the base case assumption for Operating Cash Flow to Debt is 18%-19%. The percentages in Table 6 are far below that expectation.

Q. HOW DOES S&P CURRENTLY DEFINE CENTERPOINT HOUSTON'S FINANCIAL RISK?

A. In that same report, S&P states that CenterPoint Houston has "Intermediate" financial risk.

Q. DO THE RESULTING CREDIT METRICS PROVIDED IN TABLE 6 SUPPORT CENTERPOINT HOUSTON'S INTERMEDIATE FINANCIAL RISK, AS DEFINED BY S&P?

A. No. S&P's corporate methodology provides the following ranges for financial risk for a utility on the low volatility table, which S&P currently uses to evaluate CenterPoint Houston.

Table 7

Financial Risk	FFO/Debt	Debt/EBITDA	CFO/Debt
Minimal	35%+	Less than 2x	30%+
Modest	23-35%	2-3x	20-30%
Intermediate	13-23%	3-4x	12-20%
Significant	9-13%	4-5x	8-12%
Aggressive	6-9%	5-6x	5-8%
Highly Leveraged	Less than 6%	Greater than 6x	Less than 5%

The FFO/Debt ratio of 10.0%-11.6% produced by Mr. Kollen's recommendations would fall below the Intermediate range into Significant financial risk; the Debt/EBITDA range of 6.46x in 2020 to 5.99x in 2023 would be considered Highly Leveraged; and the OCF/Debt range would be considered Significant. All three of these financial risk measures are below CenterPoint Houston's current Intermediate financial risk.

VI. LONG-TERM INCENTIVE COMPENSATION

Q. DO YOU HAVE A RESPONSE TO THE INTERVENORS' PROPOSALS TO REMOVE ALL LTI COSTS?

A. Yes. Company witness Lynne Harkel-Rumford explains that the portion of LTI related to restricted stock awards is purely time-based and not tied to the achievement of financial goals. The Company's requested LTI expenses related to restricted stock awards is $3.8 million. Therefore, even if the Commission were to adopt the Intervenors' recommendations to disallow LTI costs based on financial goals, it would not be appropriate to disallow costs related to the restricted stock awards. The mere fact that the LTI related restricted stock awards are not held on a cash basis should not determine whether the Company should be reimbursed for the cost of restricted stock awards. First, the Company is required to accrue expense for stock-based incentive awards under Generally Accepted Accounting Principles ("GAAP") because it's considered the most appropriate method to capture the costs associated with paying an employee with shares instead of cash. While it is a non-cash expense (due to the way the expense is calculated), it is meant to represent our costs under the accounting rules. Second, if CenterPoint Energy Inc. were to issue those shares in the public market, it would receive cash consideration. Since these shares are issued as a form of compensation without a cash inflow associated with them, CenterPoint Energy Inc. allocates a portion of that compensation expense to the Company in order to make itself whole. This expense is settled during intercompany settlement, thereby effecting a cash outflow by the Company. Without the ability for the Company to include these LTI costs in its cost of service, the Company will not be made whole for expenses it incurred.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.

STATE OF TEXAS §
§
COUNTY OF HARRIS §

AFFIDAVIT OF ROBERT B. McRAE

BEFORE ME, the undersigned authority, on this day personally appeared Robert B. McRae, who having been placed under oath by me did depose as follows:

1. "My name is Robert B. McRae. I am of sound mind and capable of making this affidavit. The facts stated herein are true and correct based upon my personal knowledge.

2. I have prepared the foregoing Rebuttal Testimony and the information contained in this document is true and correct to the best of my knowledge."

Further affiant sayeth not.

Robert B. McRae

Robert B. McRae

SUBSCRIBED AND SWORN TO BEFORE ME on this 17th day of June, 2019.

Alice S Hart

Notary Public in and for the State of Texas

ALICE S HART
Notary Public, State of Texas
My Commission Expires 07-17-2019
NOTARY PUBLIC
STATE OF TEXAS

My commission expires: 07/17/2019

Exhibits R-RBM-1 through R-RBM-4 are Confidential and will be provided pursuant to the terms of the Protective Order issued in Docket No. 49421.

CenterPoint Energy Houston Electric

Financials (2019-2023)

(For the Year Ended or As of December 31, Dollars in Millions)

Line	Income Statement	2018	2019	2020	2021	2022	2023
1	Revenues		$ 3,004.0	$ 2,984.9	$ 3,135.4	$ 3,275.6	$ 3,441.7
2	Revenues Adjusted		($35)	($24)	($44)	($46)	($51)
3	Total Revenues		$ 2,969.1	$ 2,961.2	$ 3,091.9	$ 3,229.1	$ 3,390.9
4	*Operating and Administrative*		1,503.4	1,532.3	1,599.5	1,662.6	1,770.5
5	Taxes Other Than Income		252.0	261.8	269.3	277.0	284.5
6	Depreciation and Amortization		650.9	592.3	622.7	640.0	652.3
7	Operating Income		562.7	574.8	600.4	649.6	683.5
8	Interest Income (intercompany)		20.5	14.5	7.7	2.6	0.1
9	Other Income		(9.9)	(9.2)	(5.8)	(6.6)	(8.5)
10	EBIT		573.2	580.0	602.4	645.6	675.2
11	Securitization Interest		39.7	28.0	20.8	13.4	7.6
12	Int External		163.5	174.4	185.2	203.0	211.2
13	Additional						
14	Other Interest (external)		163.5	174.4	185.2	203.0	211.2
15	Additional Long-term Debt Interest		16.6	18.2	18.9	20.3	21.4
16	Other Interest (intercompany)		-	-	0.1	2.2	5.3
17	EBT		353.5	359.5	377.4	406.8	429.7
18	Tax Adjustment		(10.8)	(8.8)	(13.1)	(14.0)	(15.2)
19	Tax Expense		74.7	60.7	61.2	70.1	77.9
20	Net Income before Non-Recurring Items		267.9	290.0	303.0	322.8	336.7
21	Non-Recurring Items		-	-	-	-	-
22	Net Income		$ 267.9	$ 290.0	$ 303.0	$ 322.8	$ 336.7
23	Credit Metrics						
24	S&P						
25	Funds From Operations / Total Debt		13.2%	13.0%	13.3%	13.6%	13.6%
26	Total Debt / EBITDA		4.93	5.01	4.98	4.97	5.04
27	Operating Cash Flow / Total Debt		13.3%	13.8%	13.4%	13.4%	13.3%
28	ROE		9.23%	9.27%	9.26%	9.24%	9.23%
29	CEHE Model ROE		10.1%	9.6%	10.2%	10.2%	10.3%
30	ROE Change		-0.9%	-0.4%	-1.0%	-1.0%	-1.1%

Error #1: subtracts negative tax adjustment from EBT not tax adjustment IE for 2019 NI 353.5-(74.7-10.8) = 289.5

Error #2: Net Income on Income Statement does not match Net Income on the Cash Flow

Line	Cash Flows	2018	2019	2020	2021	2022	2023
31	Net Income		$ 330.2	$ 340.8	$ 378.6	$ 403.5	$ 424.0
32	Non-Recurring Items, net of tax		-	-	-	-	-
33	Net Income before Non-Recurring Items		330.2	340.8	378.6	403.5	424.0
34	Depreciation and Amortization		650.9	592.3	622.7	640.0	652.3
35	Amortization of Deferred Financing Costs		10.5	10.2	9.9	8.6	6.9
36	Deferred Taxes		(69.2)	(61.3)	(65.3)	(54.2)	(43.8)
37	Funds From Operations		922.5	882.0	945.8	997.8	1,039.4
38	Changes in Working Capital		(48.7)	(23.5)	(68.9)	(74.4)	(84.6)
39	Operating Cash Flow		873.8	858.5	876.9	923.4	954.8
40	Capital Expenditures		(979.1)	(1,027.9)	(1,177.9)	(978.8)	(980.0)
41	Other Investing Activities		-	-	-	-	-
42	Investing Cash Flow		(979.1)	(1,027.9)	(1,177.9)	(978.8)	(980.0)
43	Increase (decrease) in Intercompany Notes Payable		(589.8)	123.8	503.7	77.2	220.3
44	Increase (decrease) in Securitization Debt		(264.3)	(176.4)	(181.6)	(169.3)	(148.7)
45	Increase (decrease) in Other Long Term Debt		700.0	300.0	197.6	300.0	200.0
46	Dividends		259.4	(77.9)	(218.7)	(152.5)	(246.4)
47	Other Financing Activities		-	-	-	-	-
48	*Financing Cash Flow*		105.3	169.4	301.0	55.4	25.1
49	Total Cash Flow		$ -	$ -	$ -	$ 0.0	$ 0.0

Error #3: Gorman did not update Financing section to reflect rebalancing the capital structure or to reflect lower revenue or lower net income

FYE or As of December 31, Dollars in Millions)

Red Text = Gorman Edits to CEHE Financials Blue Text = CNP adjustments to MPG-5

		2019	2020	2021	2022	2023	
40	Capital Expenditures	(979.1)	(1,027.9)	(1,177.9)	(978.8)	(980.0)	
41	Other Investing Activities	-	-	-	-	-	
42	Investing Cash Flow	(979.1)	(1,027.9)	(1,177.9)	(978.8)	(980.0)	
43	Increase (decrease) in Intercompany Notes Payabl	(589.8)	123.8	503.7	77.2	220.3	
44	Increase (decrease) in Securitization Debt	(264.3)	(176.4)	(181.6)	(169.3)	(148.7)	
45	Increase (decrease) in Other Long Term Debt	700.0	300.0	197.6	300.0	200.0	
	Additions to long term debt	369.1	36.2	15.1	29.1	25.2	X
	Total Long Term Debt	1,069.1	336.2	212.6	329.1	225.2	X
46	Dividends	259.4	(77.9)	(218.7)	(152.5)	(246.4)	
	Additions to dividends	(328.4)	(3.0)	34.2	23.6	31.8	X
	Total Dividends	(69.0)	(80.9)	(184.4)	(128.8)	(214.6)	X
47	Other Financing Activities	-	-	-	-	-	
48	Financing Cash Flow	146.0	202.6	350.3	108.1	82.1	X
49	Total Cash Flow	$ -	$ -	$ -	$ 0.0	$ -	
		(1,000.1)	(255.3)	(28.2)	(200.2)	(10.6)	

Error #3: Gorman did not update Financing section to reflect rebalancing capital structure or lower income

Adjustment 3#: Added rows for "Additions to Long Term Debt" and "Additions to Dividend" as well as totals for clarity.

Line	Balance Sheet	2018	2019	2020	2021	2022	2023
50	**ASSETS**						
51	Cash/Temporary Investments	$ (0.2)	$ 588.4	$ 464.6	$ (0.2)	$ (0.2)	$ (0.2)
52	Current Assets	949.5	998.1	1,021.3	1,045.2	1,070.4	1,096.8
53	**PP&E, net**	8,401.7	8,993.4	9,604.9	10,341.4	10,849.4	11,325.6
54	Other Assets	1,156.1	928.5	771.4	625.4	493.2	388.5

FYE or As of December 31, Dollars in Millions)

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			2019	2020	2021	2022	2023	
55	Total Assets	$ 10,507.1	$ 11,508.4	$ 11,862.2	$ 12,011.8	$ 12,412.8	$ 12,810.8	
56	**LIABILITIES AND EQUITY**							
57	Facility/Intercompany Debt	$ 1.2	$ -	$ -	$ 38.9	$ 116.1	$ 336.4	
58	Other Current Liabilities	630.3	655.6	679.8	696.2	715.6	731.4	
59	Total Current Liabilities	631.5	655.6	679.8	735.1	831.7	1,067.8	
60	Non-Recourse Securitization Debt	**1,435.4**	**1,171.8**	**995.9**	**814.7**	**645.6**	**497.0**	
61	Other Long Term Debt (external)	**3,577.8**	**4,353.8**	**4,693.3**	**4,909.3**	**5,241.7**	**5,470.2**	
62	Other Long-Term Debt	**3,281.5**	**3,984.7**	**4,288.0**	**4,489.0**	**4,792.2**	**4,995.6**	
63	Additional LTD	**296.3**	369.1	405.3	420.4	449.4	474.6	X
64	Deferred Income Taxes	1,022.9	953.7	892.4	827.1	772.9	729.1	
65	Other Liabilities	1,454.4	1,471.5	1,472.1	1,452.1	1,425.5	1,398.8	
66	Total Liabilities	8,121.9	8,606.4	8,733.5	8,738.3	8,917.3	9,162.9	
67	Common Equity Adjustment	(296.3)	(328.4)	(331.4)	(297.2)	(273.6)	(241.8)	X
68	Common Equity	2,681.5	3,230.4	3,460.1	3,570.7	3,769.1	3,889.6	
69	Common Equity, Adjusted	2,385.2	2,902.0	3,128.7	3,273.5	3,495.5	3,647.9	
70	Total Equity	2,385.2	2,902.0	3,128.7	3,273.5	3,495.5	3,647.9	
71	Total Liabilities and Equity	$ 10,507.1	$ 11,508.4	$ 11,862.2	$ 12,011.8	$ 12,412.8	$ 12,810.8	
72	*Balance check*	*(0.0)*	*(0.0)*	*(0.0)*	*(0.0)*	*(0.0)*	*(0.0)*	
73	Equity	2,385.2	2,902.0	3,128.7	3,273.5	3,495.5	3,647.9	
74	Long-Term Debt	3,577.8	4,353.8	4,693.3	4,909.3	5,241.7	5,470.2	

Adjustment 4#:

1. Modified Common Equity to equal "Prior common equity" + Net Income (line 31) - Dividends (line 46).

2. Modified Common Equity Adjustment to adjust for the change in revenue and to balance to 60/40 debt/equity cap structure

FYE or As of December 31, Dollars in Millions)

Red Text = Gorman Edits to CEHE Financials Blue Text = **CNP adjustments to MPG-5**

		2019	2020	2021	2022	2023
75	Total	5,963.00	7,255.76	7,821.98	8,182.85	8,737.17	9,118.06
76	Debt Ratio	**60.00%**	**60.00%**	**60.00%**	**60.00%**	**59.99%**	**59.99%**
		3,578	4,353	4,693	4,910	5,242	5,471
		296	345	16	(15)	(3)	(9)

FYE or As of December 31, Dollars in Millions)

Red Text = Gorman Edits to CEHE Financials Blue Text = CNP adjustments to MPG-5

	2019	**2020**	**2021**	**2022**	**2023**
S&P					
Core Ratios	**2019**	**2020**	**2021**	**2022**	**2023**
FFO / Total Debt	13.2%	13.0%	13.3%	13.6%	13.6%
Total Debt / EBITDA	4.93	5.01	4.98	4.97	5.04
Supplemental Ratios					
OCF / Total Debt	12.4%	13.1%	12.4%	12.5%	12.4%
FOCF / Total Debt	-9.1%	-7.9%	-10.5%	-5.1%	-3.9%
DCF / Total Debt	-3.4%	-9.5%	-14.7%	-7.8%	-8.0%
EBITDA Interest Coverage	4.83	4.77	4.75	4.74	4.88
FFO Interest Coverage	4.14	4.11	4.15	4.19	4.35

FYE or As of December 31, Dollars in Millions)

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	2019	**2020**	**2021**	**2022**	**2023**
Moody's (excluding Securitization)					
CFO pre-WC + Interest / Interest	4.32	4.37	4.21	4.15	4.21
Debt / Capitalization	54.3%	55.0%	55.7%	56.6%	57.9%
CFO pre-WC / Debt	13.5%	13.6%	13.0%	13.1%	13.0%
Total Debt / EBITDA	4.99	5.06	5.00	4.98	5.05
(FFO - Dividends) / Total Debt	12.0%	11.9%	9.4%	10.7%	9.4%
(FFO - Dividends) / Capital Expenditures	54.9%	56.0%	40.6%	60.0%	56.5%
Moody's (including Securitization)					
Funds From Operations Interest Coverage	4.92	4.74	4.72	4.68	4.71
Total Debt / Capital	59.9%	59.6%	59.4%	59.3%	59.8%
Funds From Operations / Total Debt	15.4%	14.3%	14.3%	14.5%	14.3%
Total Debt / EBITDA	4.71	5.03	4.84	4.77	4.83
(FFO - Dividends) / Total Debt	14.2%	12.9%	11.2%	12.4%	10.9%
(FFO - Dividends) / Capital Expenditures	115.4%	73.5%	53.1%	74.8%	68.4%

FYE or As of December 31, Dollars in Millions)

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	2019	2020	2021	2022	2023
Fitch					
FFO Fixed-Charge Cover (x)	4.29	4.34	4.33	4.29	4.38
Debt as % of Total Capitalization	60.0%	60.0%	60.2%	60.5%	61.4%
FFO / Debt	14.1%	14.2%	14.3%	14.4%	14.3%
Total Adjusted Debt / Operating EBITDAR (x)	4.84	4.92	4.87	4.87	4.96
EBIT Interest Coverage	2.76	2.69	2.70	2.70	2.72
EBITDA Interest Coverage	4.83	4.78	4.77	4.71	4.78
Fitch FFO-adjusted leverage	5.45	5.42	5.37	5.34	5.41
Common Equity as % of Total Capitalization	44.5%	44.2%	43.4%	42.6%	41.1%
Covenant Calculation					
Covenant Debt / Capital	60.0%	60.0%	60.2%	60.5%	61.4%

CenterPoint Energy Houston Electric
FYE or As of December 31, Dollars in Millions)

Red Text = Gorman Edits to CEHE Financials **Blue Text = CNP adjustments to MPG-5**

Line	Income Statement	2018	2019	2020	2021	2022	2023	
			2019	2020	2021	2022	2023	
1	Revenues		$ 3,004.0	$ 2,984.9	$ 3,135.4	$ 3,275.6	$ 3,441.7	
2	Revenues Adjusted		($62)	($47)	($77)	($82)	($88)	
3	Total Revenues		$ 2,942.2	$ 2,938.1	$ 3,058.4	$ 3,193.8	$ 3,353.3	
4	Operating and Administrative		1,503.4	1,532.3	1,599.5	1,662.6	1,770.5	
5	Taxes Other Than Income		252.0	261.8	269.3	277.0	284.5	
6	Depreciation and Amortization		650.9	592.3	622.7	640.0	652.3	
7	Operating Income		535.8	551.7	567.0	614.3	646.0	
8	Interest Income (intercompany)		20.5	14.5	7.7	2.6	0.1	
9	Other Income		(9.9)	(9.2)	(5.8)	(6.6)	(8.5)	
10	EBIT		546.3	557.0	568.9	610.3	637.7	
11	Securitization Interest		39.7	28.0	20.8	13.4	7.6	
12	Int External		163.5	174.4	185.2	203.0	211.2	
13	Additional							
14	Other Interest (external)		163.5	174.4	185.2	203.0	211.2	
15	Additional Long-term Debt Interest		16.6	18.2	19.0	20.3	21.5	
16	Other Interest (intercompany)		-	-	0.1	2.2	5.3	
17	EBT		326.6	336.4	343.8	371.5	392.1	
18	Tax Adjustment		(16.5)	(13.7)	(20.1)	(21.4)	(23.1)	
19	Tax Expense		74.7	60.7	61.2	70.1	77.9	
20	Net Income before Non-Recurring Items		268.3	289.4	302.8	322.9	337.3	X
21	Non-Recurring Items		-	-	-	-	-	
22	Net Income		$ 268.3	$ 289.4	$ 302.8	$ 322.9	$ 337.3	1

Comment #1: "Revenues Adjusted" lowered to adjust to ROE of 9.25% on line 28

FYE or As of December 31, Dollars in Millions)

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Line		2019	2020	2021	2022	2023
23	Credit Metrics					
24	S&P					
25	**Funds From Operations / Total Debt**	**12.7%**	**12.6%**	**12.7%**	**12.9%**	**13.0%**
26	Total Debt / EBITDA	5.08	5.13	5.15	5.13	5.21
27	Operating Cash Flow / Total Debt	11.9%	12.8%	11.9%	12.0%	11.9%
28	ROE	**9.25%**	**9.25%**	**9.25%**	**9.24%**	**9.25%**
29	CEHE Model ROE	10.10%	9.64%	10.25%	10.23%	10.29%
30	ROE Change	-0.8%	-0.4%	-1.0%	-1.0%	-1.0%

Comment #2:
GAAP ROE now at Gorman's proposed limit

Line	**Cash Flows**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
		prior Gorman	$ 330.2	$ 340.8	$ 378.6	$ 403.5	$ 424.0
		delta	$ (61.9)	$ (51.4)	$ (75.8)	$ (80.6)	$ (86.7)
31	Net Income	From I/S	$ 268.3	$ 289.4	$ 302.8	$ 322.9	$ 337.3
32	Non-Recurring Items, net of tax		-	-	-	-	-
33	Net Income before Non-Recurring Items		268.3	289.4	302.8	322.9	337.3
34	Depreciation and Amortization		650.9	592.3	622.7	640.0	652.3
35	Amortization of Deferred Financing Costs		10.5	10.2	9.9	8.6	6.9
36	Deferred Taxes		(69.2)	(61.3)	(65.3)	(54.2)	(43.8)
37	Funds From Operations		860.6	830.6	870.0	917.2	952.7
38	Changes in Working Capital		(48.7)	(23.5)	(68.9)	(74.4)	(84.6)
39	Operating Cash Flow		811.9	807.1	801.1	842.8	868.1

FYE or As of December 31, Dollars in Millions)

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		2019	2020	2021	2022	2023
40	Capital Expenditures	(979.1)	(1,027.9)	(1,177.9)	(978.8)	(980.0)
41	Other Investing Activities	-	-	-	-	-
42	Investing Cash Flow	(979.1)	(1,027.9)	(1,177.9)	(978.8)	(980.0)
43	Increase (decrease) in Intercompany Notes Payabl	(589.8)	123.8	503.7	77.2	220.3
44	Increase (decrease) in Securitization Debt	(264.3)	(176.4)	(181.6)	(169.3)	(148.7)
45	Increase (decrease) in Other Long Term Debt	700.0	300.0	197.6	300.0	200.0
	Additions to long term debt	369.2	35.8	16.5	29.4	26.0
	Total Long Term Debt	1,069.2	335.8	214.0	329.4	226.0
46	Dividends	259.4	(77.9)	(218.7)	(152.5)	(246.4)
	Additions to dividends	(307.2)	15.6	59.3	51.2	60.7
	Total Dividends	(47.9)	(62.4)	(159.3)	(101.2)	(185.7)
47	Other Financing Activities	-	-	-	-	-
48	Financing Cash Flow	167.2	220.8	376.8	136.0	111.8
49	Total Cash Flow	$ (0.0)	$ -	$ -	$ 0.0	$ 0.0
		(1,021.3)	(273.5)	(54.7)	(228.1)	(40.3)

Line	Balance Sheet	2018	2019	2020	2021	2022	2023
50	**ASSETS**						
51	Cash/Temporary Investments	$ (0.2)	$ 588.4	$ 464.6	$ (0.2)	$ (0.2)	$ (0.2)
52	Current Assets	949.5	998.1	1,021.3	1,045.2	1,070.4	1,096.8
53	**PP&E, net**	8,401.7	8,993.4	9,604.9	10,341.4	10,849.4	11,325.6
54	Other Assets	1,156.1	928.5	771.4	625.4	493.2	388.5