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June 25, 2019

Hon. Meaghan Bailey
Hon. Steven D. Arnold
Hon. Elizabeth Drews
Administrative Law Judges
State Office of Administrative Hearings
300 West 15th Street
Austin, Texas 78701

Re: SOAH Docket No. 473-19-3864; PUC Docket No. 49421; *Application of CenterPoint Energy Houston Electric, LLC for Authority to Change Rates*

Dear Judges Bailey, Arnold and Drews:

Attached please find CenterPoint Energy Houston Electric, LLC's Errata 6 in the above-referenced proceeding. The Errata corrects the rebuttal testimony of Company witness Robert B. Hevert consistent with errors discovered this week. Please do not hesitate to contact our office if you have any questions or concerns.

Best regards,

Mark A. Santos

cc: All Parties of Record

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CEHE Errata 6

Rebuttal Testimony of Robert B. Hevert

emphasis applied to a particular method in a prior proceeding or under different market conditions is not appropriate in the current instance.

Regarding the Company's Cost of Equity, none of the analyses provided or positions taken by the Opposing Witnesses have caused me to revise my recommended range (10.00 percent to 10.75 percent), or my specific recommendation (10.40 percent). For example, certain of the Opposing Witnesses support their recommendations by reference to authorized ROEs, suggesting those returns have trended downward over time. If we consider individual cases over a relevant timeframe (rather than annual averages over long periods), there is no downward trend.

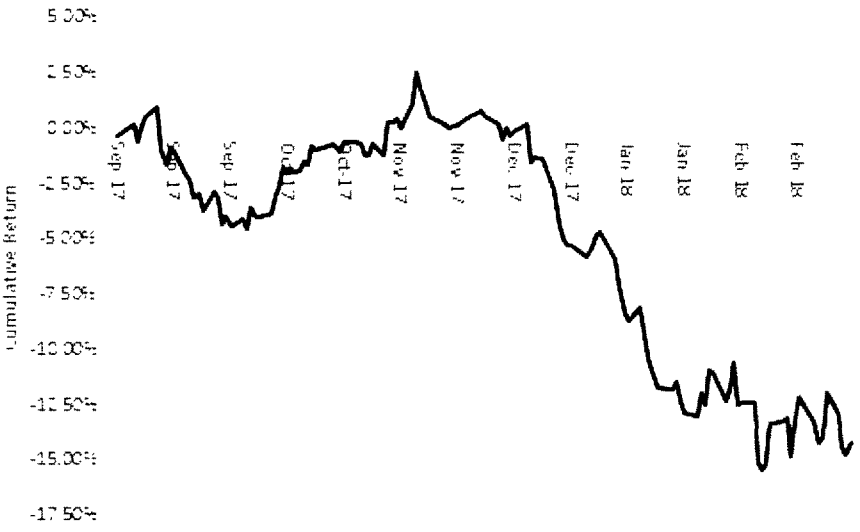
As to the Company's capital structure, certain of the Opposing Witnesses recommend capitalization ratios that include more leverage (that is, contain more debt) than those in place at utility operating companies. As discussed below (*see* Section IV.F), the capital structure ratios in place at the ~~at~~ electric utility operating companies continue to support the Company's proposed capital structure of 50.00 percent Common Equity, and 50.00 percent Long-Term Debt.

Q. PLEASE NOW PROVIDE AN OVERVIEW OF YOUR RESPONSE TO THE ROE RECOMMENDATIONS MADE BY THE OPPOSING WITNESSES.

A. In this proceeding, certain of the Opposing Witnesses give considerable weight to the DCF method, even though it produces ROE estimates 275 basis points (and more) below the returns authorized for other electric utilities.[1] For example, Mr.

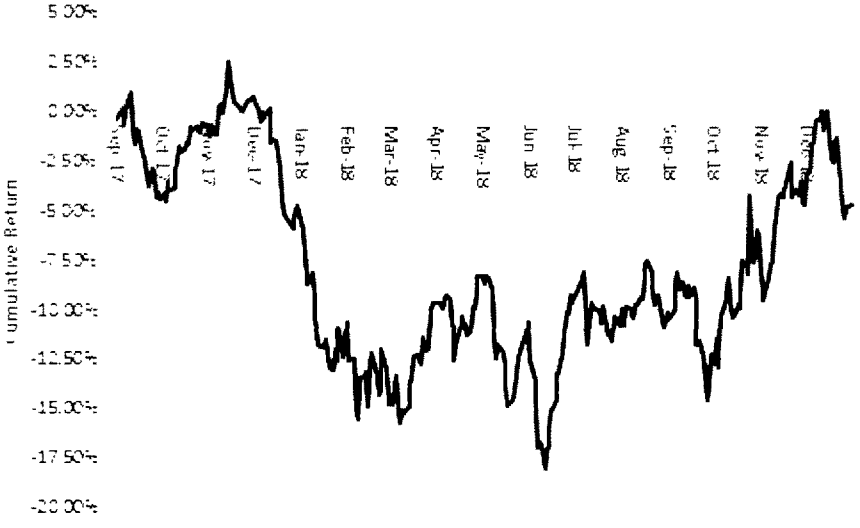
[1] For example, the low end of Ms. Winker's DCF range is 6.76 percent, which is 292 basis points below the 9.68 percent average ROE authorized for electric utilities since 2014 (excludes limited-issue riders and Illinois formula rate proceedings). *See,* Direct Testimony of Anjuli Winker, at 40.

Figure 6: Cumulative Abnormal Return[45]



I then extended the post-event window to December 31, 2018. Even in that case, with the effect of intervening events, the abnormal return remained well below zero (*see* Figure 7, below).

Figure 7: Cumulative Abnormal Return Extended[45]



[45] Source: S&P Global Market Intelligence. Based on a t-test, the cumulative abnormal returns are significant.

default service obligation, or how such differences would affect capital structure decisions.

If we consider credit ratings as measures of relative risk, the ratings for the distribution-only operating companies within Mr. Ordonez's proxy group are not substantially different than CenterPoint Houston's (*see* Figure 8). By way of example, Figure 8 also provides the ratings for AEP Texas Inc., and Baltimore Gas and Electric Company ~~(both of which are providers of last resort as is CenterPoint Houston)~~. Again, there is no meaningful difference between those two companies and CenterPoint Houston. In large measure, that may result from distribution companies' ability to recover default service costs in a "reasonably timely" fashion.[50] In any event, the Company's credit ratings are consistent with those of other distribution utilities.

Figure 8: Credit Ratings for CenterPoint Houston, AEP Texas Inc., Baltimore Gas and Electric Company, and Distribution-Only Proxy Companies[51]

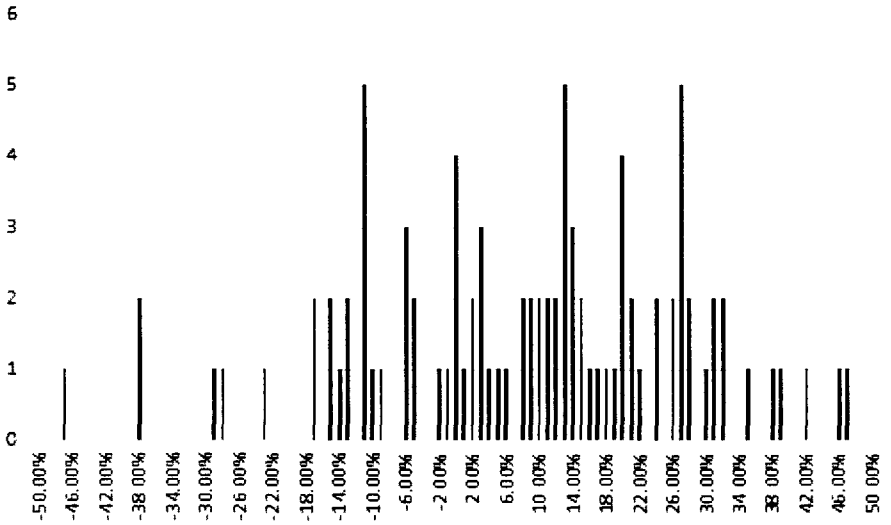
	Moody's LT Issuer	S&P LT Issuer	Moody's Corp.	S&P Corp.	Moody's Sr. Unsecured	S&P Sr. Unsecured
CenterPoint Houston	A3	BBB+	A3	BBB+	A3	N/A
Mr. Ordonez's Distribution-Only Proxy Companies	Baa1	A-	A3	A-	A3	A-
AEP Texas Inc.	Baa1	A-	Baa1	A-	Baa1	A-
Baltimore Gas and Electric Company	A3	A	A3	A	A3	A

As discussed earlier, it is the capital-intensive nature of utility operations, which requires continuing and efficient access to long-term capital to finance long-

[50] *See*, Moody's Investors Service, *Rating Methodology, Regulated Electric and Gas Utilities*, June 23, 2017, at 14.

[51] Source: S&P Global Market Intelligence

Figure 28: Frequency Distribution of Capital Appreciation Returns, 1926-2018[202]



Q. PLEASE NOW SUMMARIZE MR. GORMAN'S REVIEW OF THE DCF MODEL COMPONENTS.

A. Mr. Gorman argues utility dividend yields are reasonable by reference to utility bond yields, and growth rates are sensible relative to historical dividend growth, and expected GDP growth rates. He reasons that together, the Constant Growth DCF model components are economically logical,[203] and its results are reliable.[204] In particular, Mr. Gorman suggests because the current spread between A-rated utility bonds and utility dividend yields is comparable to the historical average, it ~~therefore~~ should be considered reasonable.[205] Mr. Gorman then compares dividend growth projections to the average dividend growth over the last thirteen years, and earnings

[202] Duff & Phelps, 2019 SBBI Yearbook, at A-3.
[203] Direct Testimony of Michael P. Gorman, at 77.
[204] *Ibid.*
[205] *Ibid.*, at 77-78.

position that the DCF model currently renders reliable estimates of the Company's Cost of Equity.

Regarding Mr. Gorman's comparison of expected and historical dividend growth rates, the relevant issue is whether investors rely on either in pricing utility stocks. As explained in my response to Ms. Winker~~Dr. Woolridge~~, dividend growth rates have not been statistically related to utility stock valuation levels. That finding is important because (as also discussed in my response to Ms. Winker), the DCF method is based on the fundamental present value formula, assuming the current market price is an accurate measure of long-term intrinsic value. If dividend growth rates have no meaningful ability to explain market valuations, I do not believe they should be relied on to conclude the DCF model currently provides economically logical and reliable results.

Q. PLEASE SUMMARIZE MR. GORMAN'S CONCERNS WITH YOUR CAPM ANALYSIS.

A. Mr. Gorman's concerns with my CAPM analysis lie primarily with my Market Risk Premium estimates.[209] In particular, Mr. Gorman argues my 13.75 percent and 17.14 percent projected returns on the market are "inflated."[210] Mr. Gorman further argues there is a "mismatch" between my calculation of the expected market return and the projected Treasury yields used in my CAPM analyses.[211]

[209] Direct Testimony of Michael P. Gorman, at 79.
[210] *Ibid.*, at 81.
[211] *Ibid.*, at 79.