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Addendum StartPage: 0

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

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

OFFICE OF PUBLIC UTILITY COUNSEL'S POST-HEARING INITIAL BRIEF (REDACTED)

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606

TABLE OF CONTENTS

SOAH DOCKET NO. 473-19-3864
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TO THE HONORABLE ADMINISTRATIVE LAW JUDGES:

The Office of Public Utility Counsel ("OPUC"), representing the interests of residential and small commercial consumers in Texas, respectfully submits this initial post-hearing brief and shows the following:[1]

I. INTRODUCTION/SUMMARY [Preliminary Order ("PO") Issues 1, 2, 3]

This case is the first comprehensive base-rate proceeding for CenterPoint Energy Houston Electric, LLC ("CenterPoint Houston" or the "Company") in nine years. The Company made this filing primarily to comply with the rate case review schedule established by the Public Utility Commission of Texas ("Commission") in 2018.[2] The Commission adopted the schedule to implement Senate Bill 735 that was passed by the Texas Legislature in 2017, which addressed the significant length of time between comprehensive rate cases for electric utilities operating in the Electric Reliability Council of Texas ("ERCOT") region.[3] Prior to the adoption of the schedule, electric utilities generally controlled the timing of their rate applications and could

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[1] OPUC's initial brief follows the approved briefing outline, but omits issues that OPUC does not address in its initial brief. OPUC reserves the right to address in its reply brief any issue raised by the parties in their initial briefs.

[2] CEHE Ex. 6 (Mercado Direct) at 12; 16 Tex. Admin. Code ("TAC") § 25.247(c)(2)(B). The Company's filing was also made as part of its commitment to file a rate case to address the effects of the Tax Cuts and Jobs Act of 2017 ("TCJA"). *Proceeding to Investigate and Address the Effects of the Tax Cuts and Jobs Act of 2017 on the Rates of Texas Investor-Owned Utility Companies*, Project No. 47945, CenterPoint Houston Letter to Commissioners (Feb. 13, 2018).

[3] *Rulemaking Proceeding to Establish Filing Schedules for Investor-Owned Electric Utilities Operating Solely Inside ERCOT*, Project No. 47545, Order Adopting New 25.247 (Apr. 16, 2018) (implementing Tex. S.B. 735, 85th Leg., R.S. (2017)).

choose to file an application only when it was advantageous for the utility. However, a regular, comprehensive review of an electric utility's rates is necessary to ensure that the utility's rates remain just and reasonable. This case is an opportunity for such a review.

Much has changed since the Company's last rate case. In this case, CenterPoint Houston seeks a prudence determination for more than $6 billion in capital investments made to its system since January 1, 2010.[4] During this time, CenterPoint Houston has benefited from a 10% return on equity ("ROE") despite a downward trend in authorized rates of return over the last several years. In addition, major federal tax reform occurred with the enactment of the TCJA in 2017, and the impacts of this legislation must be addressed in this proceeding. Further, the Company seeks to recover several regulatory assets and liabilities in this proceeding, including a regulatory asset to recover its Hurricane Harvey restoration costs. As a result, there are many important issues that must be addressed in the compressed timeframe of this rate proceeding. Ultimately, CenterPoint Houston bears the burden of proving that the rate change it has requested is just and reasonable,[5] and the Company should be held to that burden.

II. RATE BASE [PO Issues 4, 5, 10, 11, 12, 15, 16, 17, 18, 19]

A. Transmission and Distribution Capital Investment [PO Issues 4, 5, 10, 11, 12]

CenterPoint Houston seeks to increase its rate base to include all capital investments made to its system since the end of the 2019 test year used in the Company's last rate case. The capital investments span a period of nine years from January 1, 2010 to December 31, 2018. During that time, the Company added $3.036 billion of transmission plant[6] and $2.345 billion of distribution plant.[7] As discussed below, OPUC recommends three categories of disallowances to the Company's requested rate base additions: (1) projects for which the Company has failed to meet its burden of proof to show that the costs are reasonable, necessary, and prudent; (2) projects that the Company should have expensed rather than capitalized; and (3) certain equipment and other costs that the Company would over-recover due to its change in capitalization policy.

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[4] CEHE Ex. 6 (Mercado Direct) at 13.

[5] PURA § 36.006.

[6] CEHE Ex. 8 (Narendorf Direct) at 15.

[7] CEHE Ex. 7 (Pryor Direct) at 16.

1. Capital Project Prudence

Under the Commission's rules, plant investments must be used and useful in providing service to the public.[8] In addition, the expenses included in a utility's cost of service must be reasonable and necessary,[9] and thus, plant investments that yield expenses reflected in a utility's cost of service must also be reasonable and necessary. The Commission must also consider whether a utility's capital investments were "prudent." The Commission defines prudence as "the exercise of that judgment and the choosing of that select range of options which a reasonable utility manager would exercise or choose in the same or similar circumstances given the information or alternatives at the point in time such judgment is exercised or option is chosen."[10]

OPUC witness Mr. Karl Nalepa recommended the disallowance of capital project costs that CenterPoint Houston failed to show were reasonable, necessary, and prudent. These capital project costs relate to cost overruns due to construction errors at the Alexander Island and La Marque Substations and certain concrete foundation replacements.

a. Cost overruns due to construction errors.

The Company experienced significant cost overruns due to construction errors for the Alexander Island and La Marque Substations. The Alexander Island Substation project experienced a 104% cost overrun.[11] The Company described the reason for the cost overrun as follows: "Foundations were staked with the wrong line pull orientation which wasn't discovered until after the foundations were built. Foundations were removed and reconstructed. Structures had to be modified and some additional material had to be ordered."[12] The La Marque Substation project experienced a 92% cost overrun.[13] The Company's explanation for the cost

[8] 16 TAC § 25.231(c)(2).

[9] 16 TAC § 25.231(b).

[10] *Gulf States Utils. Co. v. Pub. Util. Comm'n*, 841 S.W.2d 459, 475-76 (Tex. App.—Austin 1992, writ denied).

[11] OPUC Ex. 5 (Nalepa Direct) at Att. KJN-3 at 36-37 (Response to PUC RFI No. 06-24).

[12] *Id.*

[13] *Id.*

overrun was that "Tower design and location changed during detailed engineering phase which led to some material errors. One angle structure had to be removed and replaced."[14]

For both substation projects, the costs exceeded the budgeted amounts because of errors in the original construction activities.[15] Construction errors are not prudent. A reasonable utility manager would not choose to commit a construction error. Accordingly, the costs related to the construction errors do not meet the Commission's prudence standard and should not be recovered from CenterPoint Houston's customers. In addition, the recovery of imprudent costs from customers would result in rates that are not reasonable and necessary.

In its rebuttal testimony, CenterPoint Houston acknowledged that construction errors resulted in increased costs.[16] However, the Company contended that the construction errors were not the sole reason for the difference in the initial project cost estimates and final project costs, and that the Company took steps to mitigate the cost of the construction errors.[17] Nevertheless, CenterPoint Houston bears the burden of proof to show that the entirety of its requested amount is prudent. It is not the intervenors' responsibility to parse out which portion, if any, of a particular capital investment was prudent. If the Company cannot isolate the portion of its capital investment that was prudent from the portion that was imprudent, then it has failed to meet its burden of proof on prudence. While the Company may have taken actions to mitigate the cost of the construction errors, it does not transform the character of the errors and make the costs associated with the errors prudent. It simply means that the cost of the imprudent action was less than it would have otherwise been. Accordingly, the Company has not demonstrated that the entirety of its costs for the Alexander Island and La Marque Substations were reasonable, necessary, and prudent.

Because the construction errors resulted in the cost overruns, OPUC recommends that the Company's plant in service be reduced by $1,701,421, which is the amount of the project costs that exceeded the budgeted amount for both substation projects.[18]

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[14] *Id.*

[15] OPUC Ex. 5 (Nalepa Direct) at 39.

[16] CEHE Ex. 32 (Narendorf Rebuttal) at 17-18.

[17] *Id.*

[18] OPUC Ex. 5 (Nalepa Direct) at 39.

b. Foundation replacements.

CenterPoint Houston is requesting to increase rate base by $8,879,219 for projects related to replacing certain concrete foundations. OPUC recommends that this amount be excluded from rate base because the Company has failed to demonstrate that the costs were reasonable, necessary, and prudent.

The specific projects at issue are identified as "HLP/00/0801" and described as "Foundation replacements due to Alkali-Silica Reaction (ASR) in the foundation causing large cracks in the piers/foundations. The reaction cannot be stabilized and is not reversible."[19] CenterPoint Houston witness Mr. Martin Narendorf indicated that ASR is a condition that exists due to the concrete materials, not the method of installation.[20] In particular, ASR is a reaction that may occur between the aggregate in concrete and the cement mix.[21] When these components are mixed there can be an adverse chemical reaction that causes a silica gel to form within the concrete that expands and contracts with wetting and drying cycles of the concrete, and can cause cracking forces to occur within the concrete.[22] The Company's capital project lists include three entries for ASR-related foundation replacements: $1,190,140 in 2015; $2,965,940 in 2016; and $4,723,139 in 2017.[23]

The Company has been aware of the ASR issue since at least 2005 to 2006.[24] Mr. Narendorf stated that once cracking issues associated with ASR were first identified, the Company developed a new concrete specification that included introducing additives to the concrete mix, such as fly ash.[25] The Company's capital project lists for 2010 to 2014 do not show costs for ASR foundation issues, but the lists for 2015 to 2017 show increasing amounts in each year. OPUC is not challenging the need for corrective action. Rather, the Company has failed to show that its selection of materials for the foundations was prudent, and thus, that the

[19] WP RMP-2, 2015 Capital Project List (p. 8 of 10); WP RMP-2, 2016 Capital Project List (p. 7 of 8); and WP RMP-2, 2017 Capital Project List (p. 8 of 8).

[20] CEHE Ex. 32 (Narendorf Rebuttal) at 15.

[21] Tr. at 1177-78 (Narendorf Cross).

[22] *Id.*

[23] WP RMP-2, 2015 Capital Project List (p. 8 of 10); WP RMP-2, 2016 Capital Project List (p. 7 of 8); and WP RMP-2, 2017 Capital Project List (p. 8 of 8); *see also* Tr. at 1175-77 (Narendorf Cross).

[24] Tr. at 1178-79 (Narendorf Cross).

[25] Tr. at 1179-80 (Narendorf Cross).

foundation replacements could not have been avoided. The Company has the burden of proof to demonstrate that its requested capital investments are reasonable, necessary, and prudent. It has failed to meet that burden for the ASR-related foundation replacements. Thus, OPUC recommends that the Company's plant in service be reduced by $8,879,219, which is the amount of the project costs for 2015 to 2017.

2. Capital Project Accounting/Capitalization Policy Changes

The distinction between capital costs and operating expenses has important implications for ratemaking. Capital costs are generally associated with major assets that will be used over time or extend the productive life of a previously purchased asset.[26] Conversely, operating expenses are costs incurred to run the day-to-day operations of a utility.[27] These costs are recurring in nature and are used to maintain a capital asset. A utility earns a return on its capital assets and recovers depreciation expense that represents the reduction in value of the asset due to wear and tear over its life. It would be inappropriate to allow a utility to recover in rates a return or depreciation expense on operating costs that should not be capitalized by the utility.

As discussed below, CenterPoint Houston has capitalized certain projects and equipment that should have been expensed, and thus, the cost of these items should be excluded from the Company's rate base. In addition, since its last rate case, the Company has made certain changes to its capitalization policy that would result in an over-recovery of costs for the items subject to the policy change. The Company's rate base should be adjusted to prevent this over-recovery.

a. <u>Costs that should have been expensed, not capitalized.</u>

CenterPoint Houston has capitalized the following items that should have been expensed: routine and corrective projects, and a corporate website redesign.[28] Because it is not proper to capitalize these items, these project costs should be removed from the Company's rate base.

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[26] OPUC Ex. 5 (Nalepa Direct) at 36.

[27] *Id.*

[28] OPUC witness Mr. Nalepa also initially recommended that certain substation tools be expensed, rather than capitalized, but based on additional information provided by the Company in its rebuttal testimony, OPUC is no longer recommending this change. *See* OPUC Ex. 5 (Nalepa Direct) at 37-38; CEHE Ex. 35 (Colvin Rebuttal) at 52-53.

i. Routine and Corrective Projects.

The Company characterizes the following projects as routine or corrective:[29]

AB1Z.[30] Proactive routine capital replacements to the overhead distribution system.

HLP/00/0011. Unscheduled substation corrective projects. Small, unscheduled corrective type projects and unforeseen equipment failures. These projects involve replacement of equipment and/or structures.

HLP/00/0012. Scheduled substation corrective projects. Small, scheduled corrective projects. These projects involve replacement of equipment and/or structures.

As shown in the following table, the Company has generally incurred costs for these projects every year since 2010, and therefore, these project costs are recurring expenses that should not be capitalized.

	AB1Z	HLP/00/0011	HLP/00/0012
2010	$ 6,341,735	$ 1,191,445	$ -
2011	$ 6,341,595	$ 1,298,293	$ -
2012	$ 7,904,953	$ 6,754,115	$ 2,940,965
2013	$ 11,167,517	$ 10,983,346	$ 1,097,412
2014	$ 11,278,636	$ 3,193,386	$ -
2015	$ 10,635,772	$ 3,547,907	$ 3,271,455
2016	$ 11,414,103	$ 3,454,006	$ 1,241,538
2017	$ 35,117,023	$ 3,582,621	$ 3,342,573
2018	$ 3,737,635	$ 2,566,221	$ 1,956,061
Total	$ 103,938,969	$ 36,571,340	$ 13,850,004

Given that these projects are routine or corrective in nature, and are intended to maintain a capital asset, these project costs more appropriately meet the criteria for expense items.[31]

The Company criticizes OPUC's use of the project descriptions to determine the nature of the work performed.[32] While OPUC agrees that a project description should not be the sole basis for determining whether work should be capitalized or expensed, it does provide some indication of the type of work performed. If the work is not routine or corrective, then those

[29] CEHE Ex. 7 (Pryor Direct) at WP RMP-2, 2010 – 2018 Capital Project Lists.

[30] This project is identified as AB1Z in the 2010 to 2017 Capital Project Lists, but as AB1X in the 2018 Capital Project List.

[31] OPUC Ex. 5 (Nalepa Direct) at 36.

[32] CEHE Ex. 31 (Pryor Rebuttal) at 13; CEHE Ex. 32 (Narendorf Rebuttal) at 15.

words should not be used to describe it. In addition, as shown in the table above, these expenses are regularly recurring, which further supports their routine nature.

In its rebuttal testimony, the Company noted that HLP/00/0011 and HLP/00/0012 each involve the replacement of equipment and/or structures.[33] However, this fact does not automatically result in the costs being properly capitalized. The Company's capitalization policy treats equipment and structures differently depending on whether they are classified as retirement units, substantial minor items, or less than substantial minor items of property.[34] The Company's policy requires that less than substantial minor items be classified as expenses, as well as the removal and replacement of substantial minor items.[35] The Company does not indicate the classification of each of the items included within these projects. Notably, however, HLP/00/0011 and HLP/00/0012 are identified as "small" corrective projects, which tends to indicate that they are generally minor items.

Ultimately, the Company bears the burden to prove that the project costs are recoverable from ratepayers. The vast majority of the costs were incurred outside of the Company's test year in this proceeding. Therefore, if the project costs should have been expensed rather than capitalized, they are not recoverable in this proceeding. The Company has not provided sufficient information on these projects to conclude that the full amount of costs for each project should be capitalized, rather than expensed.[36] Thus, OPUC recommends that the Company's plant in service be reduced by $154,360,313.

ii. Corporate Website Redesign.

The Company also seeks to capitalize the costs of a project titled "corporate website redesign."[37] As discussed below, the cost of the website redesign project is properly treated as

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[33] CEHE Ex. 32 (Narendorf Rebuttal) at 14-15.

[34] CEHE Ex. 12 (Colvin Direct) at KLC-11 at 4.

[35] *Id.*

[36] In his rebuttal testimony, CenterPoint Houston witness Mr. Randal Pryor contends that the Company offered to review work orders with the intervenors. CEHE Ex. 31 (Pryor Rebuttal) at 12, 14. However, based on a review of the discovery in this case, counsel for OPUC has been unable to locate such offer. With the exception of a sample work order provided as Exhibit R-RMP-3 of Mr. Pryor's rebuttal testimony, the Company's work orders do not appear to have been included in the record in this case.

[37] CEHE Ex. 7 (Pryor Direct) at WP RMP-2, 2014 Capital Project Lists, Project ENTD086 (Corporate website redesign).

an expense rather than a capital cost. This expense was incurred outside of the Company's test year in this proceeding, and thus, the project costs should not be recovered from CenterPoint Houston's customers.

The corporate website redesign project should be treated as an expense rather than a capital cost. OPUC witness Mr. Nalepa testified that while computers and computer software can be capitalized by a utility, the website redesign service is more properly recorded in an expense account, such as Federal Energy Regulatory Commission ("FERC") Account No. 923, Outside Services.[38] In rebuttal testimony, the Company provided FASB ASC 350-50,[39] which addresses generally accepted accounting principles ("GAAP") for "website development costs."[40] The Company noted that GAAP requires some costs to be expensed and other costs to be capitalized "dependent on the stage of the website development project."[41] However, the Company has failed to demonstrate that any costs for the website redesign project should be capitalized under the GAAP standards it provided in its testimony.

Citing to the GAAP standards, CenterPoint Houston witness Ms. Kristie Colvin stated that "[t]he Company appropriately capitalized costs that were incurred during the Application Development Stage."[42] However, there is no factual basis in the record to support this statement. The description of the project is simply "corporate website redesign."[43] The record does not contain any further description of the services actually provided. Even relying on the title of the project, it is not clear under the GAAP standards that this project would qualify as part of the application development stage.

Based on a review of FASB ASC 350-50, a website "redesign" appears to fall within the operating stage, rather than the development stage. According to the guidance, "[c]osts incurred during the operating stage include training, administration, maintenance, and other costs *to*

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[38] OPUC Ex. 5 (Nalepa Direct) at 37.

[39] "FASB ASC" stands for Federal Accounting Standards Board Accounting Standards Codification.

[40] CEHE Ex. 35 (Colvin Rebuttal) at 52 and Ex. R-KLC-08.

[41] *Id.* at 52.

[42] *Id.*

[43] CEHE Ex. Ex. 7 (Pryor Direct) at WP RMP-2, 2014 Capital Project Lists, Project ENTD086 (Corporate website redesign).

operate an existing website."[44] Operating stage activities include certain tasks that could be characterized as website redesign services, including "update site graphics," "create new links," and "add additional functionalities or features."[45] Under the guidance, costs incurred in the operating stage are generally expensed.[46] The guidance indicates that certain operating costs may be capitalized if they "add functionality," but it also states that "entities that cannot separate internal costs on a reasonably cost-effective basis between maintenance and relatively minor upgrades and enhancements shall expense such costs as incurred."[47] The Company has not provided any information on its website redesign project. As a result, it cannot be determined from the record whether any portion of the website redesign project is eligible to be capitalized. In such circumstances, the guidance provided by the Company defaults to treating the costs as expenses.

The Company bears the burden to prove that the costs it seeks to recover are reasonable and necessary. The Company has failed to demonstrate that it is proper to capitalize the costs of its website redesign project rather than expense the project costs, and thus, the Company has not shown that the costs should be included in rate base. Therefore, OPUC recommends that the Company's plant in service be reduced by $7,086,684 for the cost of the website redesign project.

b. Change in capitalization policy.

After its last rate case, CenterPoint Houston changed its capitalization policy for certain equipment and other costs to capitalize those items rather than expense them. In particular, the Company changed its capitalization policy for luminaires in 2014, microprocessor control devices in 2017, program assessment costs (underground cable life extension) in 2013, and certain construction overhead costs in 2014.[48] OPUC does not oppose setting rates in this case based on the changes in the Company's capitalization policy on a going-forward basis. However, as discussed below, if the Company is authorized to recover the costs that it

[44] CEHE Ex. 35 (Colvin Rebuttal) at R-KLC-08 (emphasis added).

[45] *Id.* at R-KLC-08 at 7, para. 55-9.

[46] *Id.* at R-KLC-08 at 4, para. 25-14.

[47] *Id.* at R-KLC-08 at 4, paras. 25-15 & 25-16.

[48] CEHE Ex. 12 (Colvin Direct) at 92-93.

capitalized since rates went into effect in its last rate case, it would result in an over-recovery of these costs and produce rates that are not just and reasonable.

The Company's change in capitalization policy was contested in each of its prior Distribution Cost Recovery Factor ("DCRF") filings since 2015, but each case settled and deferred consideration of the policy change to this base-rate proceeding.[49] The intervenors in the DCRF cases opposed the Company's change in capitalization policy because it would result in potential double counting of costs that were expensed in the Company's last rate case but then capitalized since that rate case.[50] In other words, the change in policy would result in ratepayers paying for the same expense twice: once as an expense item and once as a capital cost. For example, State Agencies witness Ms. Kit Pevoto testified that CenterPoint Houston's existing rates included operation and maintenance ("O&M") expenses of $939,000 for lighting luminaire replacement costs.[51] Therefore, the subsequent capitalization of any lighting luminaire replacement costs would allow the Company to recover costs that it already received through its existing rates.

When rates are set in a base-rate proceeding, they are based on a historical test year that is intended to be representative of the utility's costs going forward. The actual costs in future years may vary. However, this is not a case where OPUC is attempting to reconcile a historical expense amount with an actual expense amount. Instead, the issue is whether the Company should be able to recover both an expense amount in rates *and* a capitalized amount in rate base for the same items incurred during the same time period. At its core, PURA requires that a utility's rates be set at a level that is "just and reasonable."[52] Allowing a utility to recover the same cost twice produces rates that are not just and reasonable, and therefore is not consistent with PURA. While the Company should be able to change its capitalization policy when appropriate, those changes should only be effective for ratemaking purposes on a prospective basis.

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[49] OPUC Ex. 5 (Nalepa Direct) at 29-30.

[50] *Id.*

[51] *Id.* at 30 (citing *Application of CenterPoint Houston Electric, LLC for Approval of a Distribution Cost Recovery Factor Pursuant to PUC Subst. R. 25.243*, Docket No. 44572, Direct Testimony of Kit Pevoto at 10 (May 27, 2015)).

[52] PURA § 36.003(a).

Ms. Colvin's rebuttal testimony notes that the Company does not consider the timing of ratemaking proceedings when deciding whether to change its accounting practices.[53] OPUC does not contend that the Company strategically changed its capitalization policy so that it could over-recover these costs. What is important here is the effect of the Company's policy change on rates. The following table shows the amounts that have been capitalized since the Company's last rate case for the items that were previously expensed:[54]

Capitalized Expenses Due to Change in Policy ($)

	Accounts Payable	Property Accounting	Call Center	Micro processor	Luminaries	Program Assessment	Total
2009	-	-	-	-	-	-	-
2010	-	-	-	-	-	-	-
2011	-	-	-	-	-	-	-
2012	-	-	-	-	-	-	-
2013	-	-	-	-	-	2,662,605	2,662,605
2014	292,581	356,210	-	-	868,478	13,821,869	15,339,138
2015	267,939	367,141	210,013	-	683,172	12,184,931	13,713,196
2016	288,288	286,851	328,916	-	1,327,026	3,641,713	5,872,794
2017	295,303	383,424	388,523	143,964	-	6,000,571	7,211,785
2018	312,569	261,922	514,260	115,933	2,510,007	2,903,545	6,618,236
Total	1,456,680	1,655,548	1,441,712	259,897	5,388,683	41,215,234	51,417,754

To avoid an over-recovery of these costs, OPUC recommends that the entire amount of $51,417,754 be removed from the Company's rate base.

F. Other Prepayments

CenterPoint Houston is requesting to include $5,308,505 in its working capital allowance that represents a 13-month average balance for prepayments of other taxes—specifically, franchise taxes.[55] OPUC witness Ms. June Dively initially recommended reducing the amount included for prepayments of other taxes because they occurred on a quarterly basis and it appeared that the Company had erroneously included one-too-many quarterly payments in its calculation.[56] However, based on CenterPoint Houston's response to OPUC RFI No. 05-03,

[53] CEHE Ex. 35 (Colvin Rebuttal) at 60.

[54] OPUC Ex. 5 (Nalepa Direct) at 32.

[55] CEHE Ex. 1 at WP II-B-10; OPUC Ex. 9 at 1.

[56] OPUC Ex. 1 (Dively Direct) at 34.

which was received after Ms. Dively's testimony was filed,[57] it is clear that the prepayments are not made on a quarterly basis. However, CenterPoint Houston's response also showed that it is appropriate to reduce the Company's requested working capital allowance by the full $5,308,505 balance for prepayments of other taxes.

A utility may include a working capital allowance as a component of its rate base.[58] The working capital allowance can include "reasonable prepayments for operating expenses."[59] In general, working capital is the difference between current assets and current liabilities. The prepayments for taxes are considered working capital because a utility can use the money owed to the taxing authority until the taxes are actually paid. This is reflected in the Uniform System of Accounts ("USOA") adopted by the FERC, which groups Account No. 165, Prepayments under the category of "Current and Accrued Assets."[60]

As explained by CenterPoint Houston witness Ms. Colvin, the Company only prepays its franchise taxes when the first of the month falls on a Saturday, Sunday, or Monday that is a holiday.[61] Accordingly, CenterPoint Houston prepays its franchise taxes a maximum of two to four days in advance as follows:[62]

Date Payment Due	Date Payment Processed	Number of Days Paid in Advance
January 1, 2018	December 29, 2017	3
April 1, 2018	March 29, 2018	4
July 1, 2018	June 29, 2018	3
September 1, 2018	August 31, 2018	4
December 1, 2018	November 30, 2018	3
January 1, 2019	December 31, 2018	2

Based on the response to OPUC RFI No. 05-03, the amount of time between when these franchise taxes are processed and when the franchise taxes are due to the taxing authority, which represents weekend days and not business days, is not long enough for those payments to have cleared CenterPoint Houston's bank account. Consequently, the Company has no meaningful

[57] Tr. at 1307-08.

[58] 16 TAC § 25.231(c)(2)(B).

[59] 16 TAC § 25.231(c)(2)(B)(i)-(ii).

[60] 18 C.F.R. Part 101, Balance Sheet Chart of Accounts.

[61] OPUC Ex. 9 at 2.

[62] Tr. at 1309; OPUC Ex. 9 at 5-25.

opportunity to use these funds as working capital. Because these prepayments do not truly represent an available source of capital, it not appropriate to allow CenterPoint Houston to earn a return on the 13-month average of these franchise tax prepayments. Therefore, OPUC recommends that $5,308,505 for the full amount of the prepayments of other taxes be removed from the Company's working capital allowance.

G. Regulatory Assets and Liabilities [PO Issues 18, 19, 59]

In this proceeding, CenterPoint Houston is requesting to include regulatory assets totaling $134,488,639 in rate base to recover its costs related to Hurricane Harvey restoration, the Medicare Part D subsidy, Smart Meter Texas ("SMT"), the Texas gross margin tax ("TGMT"), and retail electric provider ("REP") bad debt.[63] For the reasons discussed below, OPUC recommends that: (1) CenterPoint Houston recover its costs related to Hurricane Harvey restoration, the Medicare Part D subsidy, and SMT through three separate riders instead of adding these regulatory assets to rate base; (2) CenterPoint Houston's request for a TGMT regulatory asset be denied altogether; and (3) CenterPoint Houston recover costs related to REP bad debt as an O&M expense. OPUC's specific recommendations are discussed below. However, OPUC first discusses certain common principles that should be considered for each of the Company's requested regulatory assets and liabilities, and then, provides general recommendations regarding the appropriate amortization period and method of recovery for these items.

Common principles applicable to regulatory assets and liabilities.

First, a regulatory asset or liability must be evaluated to ensure that the utility has received the proper regulatory authorization to book the asset or liability. FERC's USOA defines regulatory assets and liabilities as follows:

> Regulatory Assets and Liabilities are ***assets and liabilities that result from rate actions of regulatory agencies***. Regulatory assets and liabilities arise from specific revenues, expenses, gains, or losses that would have been included in net income determination in one period under the general requirements of the Uniform System of Accounts but for it being probable:

[63] CEHE Ex. 1, Schedule II-B-12.

> A. that such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services; or
> B. in the case of regulatory liabilities, that refunds to customers, not provided for in other accounts, will be required.[64]

Regulatory assets and liabilities, therefore, are tied to the "rate actions of regulatory agencies." A utility must seek Commission approval to book a regulatory asset or liability because the utility is requesting to recover or refund an expense, gain, or loss outside of the period in which it impacted the utility's net income.[65] For example, booking storm restoration expenses as a regulatory asset allows the utility to record those expenses until they can be recovered from customers through a change in rates.[66] Thus, when a transmission and distribution utility ("TDU") seeks to recover a regulatory asset or liability, it is required to specifically identify in its rate-filing package ("RFP") the Commission order or other authority that serves as the basis for recording the regulatory asset or liability.[67]

Another important consideration when assessing a regulatory asset is the amortization period over which it will be recovered from customers. The period chosen should strike a balance between moderating the impact on customer rates and achieving intergenerational equity.[68] Intergenerational equity addresses how closely the costs being recovered by the utility are matched with the customer population that existed at the time the costs were incurred by the utility.[69] Moderating the impact on rates focuses on the amount of the regulatory asset. A larger regulatory asset will have a larger impact on rates and, thus, it may be appropriate to spread the recovery over a longer period of time. Once the amortization period is determined, the full amount of the regulatory asset is divided by the length of time chosen to establish the amortization expense related to the asset. For example, CenterPoint Houston's current rates are

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[64] 18 C.F.R. Part 101, Paragraph 31 (emphasis added).

[65] OPUC Ex. 1 (Dively Direct) at 9; *see also West Tex. Util. Co. v. Office of Pub. Util. Counsel*, 896 S.W.2d 261, 265 (Tex. App.—Austin 1995, writ dism'd) ("The Commission follows a two-step process for deferred charges [for new power plants]. First, it gives the utility permission to record the charges. After the utility has recorded the charges, the Commission gives the utility permission to recover the charges. The deferred costs recorded by the utility are subject to review at the subsequent rate hearing…").

[66] OPUC Ex. 1 (Dively Direct) at 9.

[67] Transmission & Distribution Investor-Owned Utilities Rate Filing Package for Cost-of-Service Determination at 19 (Nov. 19, 2015).

[68] OPUC Ex. 1 (Dively Direct) at 12.

[69] *Id.*

set to recover a $453,000 regulatory asset for expedited switching that was amortized over three years, which results in an amortization expense of $151,000 per year.[70]

Finally, the method of recovery must be evaluated. Two of the most common ways for a utility to recover a regulatory asset are to include the asset in rate base or to establish a rider to recover the asset. When a regulatory asset is added to a utility's rate base, the utility recovers the annual amortization expense for the asset, as well as a return on the full amount of the asset at the utility's weighted average cost of capital ("WACC").[71] The utility continues to recover these amounts until its next base rate case. If a regulatory asset is recovered through a rider, the asset is tracked separately from the Company's base rates, and recovery ends once the full amount is collected from customers. Thus, a rider reduces the likelihood of the utility over-recovering the asset.

Using the previous example of the $453,000 regulatory asset for expedited switching amortized over three years, CenterPoint Houston's recovery of that asset has progressed as follows since its last rate case:

	Amortization Expense	**Balance of the Asset at Beginning of the Year**	**Annual Return (.0821 * 453,000)[72]**
Year 1	$151,000	$453,000	$37,191
Year 2	$151,000	$302,000	$37,191
Year 3	$151,000	$151,000	$37,191
Year 4	$151,000	$0	$37,191
Year 5	$151,000	$0	$37,191
Year 6	$151,000	$0	$37,191
Year 7	$151,000	$0	$37,191
Year 8	$151,000	$0	$37,191

By the end of the third year the rates in Docket No. 38339 were in effect, this regulatory asset was fully amortized.[73] However, CenterPoint Houston has continued to earn a return on the entire $453,000 each year, along with a $151,000 depreciation expense.[74] Over Years 4

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[70] *Application of CenterPoint Electric Delivery Company, LLC, for Authority to Change Rates*, Docket No. 38339, Order on Rehearing at FOF Nos. 65-66.

[71] OPUC Ex. 1 (Dively Direct) at 11.

[72] The Company's currently approved overall rate of return is 8.21%. Docket No. 38339, Order on Rehearing at FOF No. 75A.

[73] Tr. at 1305.

[74] Tr. at 1305-06.

through 8,[75] CenterPoint Houston will recover a total return of $185,955 and a total amortization expense of $755,000 on a fully amortized regulatory asset.[76] Accordingly, the Company will have benefitted from a $940,955 over-recovery of its expedited switching regulatory asset, which is more than twice the original $453,000 value of the asset.[77] The expedited switching regulatory asset provides a stark example of the risk of over-recovery that is imposed on customers when a regulatory asset with a short amortization period is included in rate base.

CenterPoint Houston's regulatory assets should be recovered through separate riders with a five-year amortization period.

Applying the principles described above, OPUC recommends that, to the extent the assets are recoverable, CenterPoint Houston's regulatory assets be recovered through separate riders with a five-year amortization period. OPUC's proposal prevents the Company from over-recovering the assets and appropriately balances the customer rate impact with intergenerational equity.

The Company proposes to amortize its regulatory assets over three years. However, using a three-year amortization period increases the risk of over-recovery of the asset because a TDU is only required to file a full base rate case every four years.[78] If the utility waits the full four years, it is guaranteed at least one year of over-recovery on any regulatory asset with a three-year amortization period. A TDU that comes in earlier than the four-year maximum does not face the same risk because it can simply renew its request to include the regulatory asset in rate base for any remaining unamortized amount.

This issue is illustrated by looking at the impact of the Company's request in this proceeding. Using the Company's requested three-year amortization period and its requested WACC of 7.39%,[79] the Company would recover a total of $54 million per year for amortization expense and return as shown in the table below:

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[75] The rates set in Docket No. 38339 took effective in September 2011 and the rates set in this case will be effective in October 2019 at the earliest. Tr. at 1304-05.

[76] Tr. at 1305-06.

[77] Tr. at 1306-07.

[78] 16 TAC § 25.247(b)(1).

[79] CEHE Ex. 27 (McRae Direct) at 41.

(in millions)	(a) Amount of Asset	(b) Amortization Expense (a) / 3	(c) Return (a) * .0739
Hurricane Harvey	$73,148,639	$24,382,880	$5,405,684
Medicare Part D	$33,204,000	$11,068,000	$2,453,776
SMT	$6,939,000	$2,313,000	$512,792
Texas Gross Margin Tax	$19,627,000	$6,542,333	$1,450,435
REP Bad Debt	$1,570,000	$523,333	$116,023
Total	$134,488,639	$44,829,546	$9,938,710

The earliest the Commission will issue a final order in this proceeding is October of this year, which means that CenterPoint Houston could wait until October of 2023 to file its next base rate case.[80] If that case is fully litigated, new rates would not be effective until April or May of 2024 at the earliest, and CenterPoint Houston's customers would overpay for these five regulatory assets by more than $80 million. OPUC's proposal to use a five-year amortization period would reduce the risk of over-recovery.

CenterPoint Houston asserts that a three-year amortization period is consistent with the amortization period approved in its last rate case in Docket No. 38339.[81] However, the preceding discussion of the expedited switching regulatory asset highlights why a longer amortization period is necessary to protect customers. Citing to OPUC witness Ms. Dively's testimony, the Company argues that the three-year amortization period will achieve intergenerational equity.[82] While Ms. Dively did recognize the importance of achieving intergenerational equity, she also specifically stated that this goal should be balanced with moderating the impact on customers' rates—a point that CenterPoint Houston does not address.[83] Instead, the Company focuses on its need to be "made whole." A five-year amortization period would make the Company whole and reduce the risk of over-recovery.

OPUC also recommends recovery of the regulatory assets through a rider rather than base rates. When a regulatory asset is recovered through a rider, the possibility that a utility will over-

[80] This assumes that no motion for rehearing is filed or granted.

[81] CEHE Ex. 35 (Colvin Rebuttal) at 42.

[82] *Id.*

[83] OPUC Ex. 1 (Dively Direct) at 12.

recover the asset is eliminated because a rider can be designed to automatically expire after a certain amount of time has passed or a set amount of revenue has been recovered by the utility. Further, revenues from a rider are collected separately from base rates—a feature that makes a rider an especially appropriate method of recovery for regulatory assets that represent non-recurring costs.[84] Base rates are set using the cost of service from a historical test year, so the expenses included in the cost of service should be representative of the amounts and types of expenses a utility incurs year after year.[85] Typically, the types of expenses that are booked as regulatory assets, like storm restoration costs, are not annually recurring costs. Therefore, the nature of the cost that gives rise to the regulatory asset is important when determining the best method for recovering the costs.

The Company disagreed that the regulatory assets should be recovered through riders, but stated that if they are, then regulatory assets and liabilities should be treated equally and amortized over the same period.[86] With the exception of the refund provided for unprotected excess deferred income taxes ("Rider UEDIT"), OPUC is not opposed to this proposal so long as the amortization period is five years.

The Company also proposed the use of a single rider to recover all regulatory assets and liabilities (except TGMT and Rider UEDIT) amortized over three years.[87] From a customer perspective, combining multiple regulatory assets and liabilities into a single charge does not provide transparency on the individual costs that customers are paying for. Additionally, the Company has not quantified the effect of its proposed catch-all rider on customers. The rider is presented in Ms. Colvin's rebuttal testimony, but she does not calculate the amount that would be recovered through the catch-all rider, nor compare it to the amount that would be recovered under the application as filed. CenterPoint Houston also does not address how this change in recovery would affect the allocation of these costs among its rate classes. Because the record

[84] *Id.* at 11; *see also Application of Southwestern Public Service Company for Authority to Change Rates*, Docket No. 43695, Order on Rehearing at FOF No. 210 (Feb. 23, 2016) ("The $211,911 is a one-time expense. To avoid possible over-recovery, it should be recovered not through base rates but rather through a rider set to recover that specific amount.").

[85] OPUC Ex. 1 (Dively Direct) at 11.

[86] CEHE Ex. 35 (Colvin Rebuttal) at 43.

[87] *Id.* at 43-44.

does not contain sufficient evidence to justify CenterPoint Houston's request for a single catch-all rider, OPUC recommends that this proposal be rejected.

CenterPoint Houston also asserts that the amount recovered through the single catch-all rider should include a return on the regulatory assets and liabilities.[88] However, as explained above, booking a regulatory asset allows a utility to defer certain costs until they can be included in rates and recovered from customers. Once booked, the regulatory asset provides an immediate benefit to the utility because the expenses that are deferred do not impact the utility's net income, and therefore, do not impact earnings per share. In addition, the regulatory assets that CenterPoint Houston requests represent expenses, not capital assets, and utilities are not permitted to earn a return on expenses.[89]

In the following subsections, OPUC applies its recommendations to the specific regulatory assets requested by the Company.

2. Hurricane Harvey

CenterPoint Houston is requesting to include a $73,148,639 regulatory asset for Hurricane Harvey restoration costs amortized over three years in its rate base. The asset is comprised of $64,406,143 for deferred restoration expenses and $8,742,496 for carrying charges.[90] As discussed in Section IV.F. below, the amount of the Hurricane Harvey asset should be reduced by $9.525 million to remove certain Hurricane Harvey-related expenses that the Company failed to validate, as well as an adjustment that the Company agreed to make regarding employee awards and gifts, and expensed capital costs. In addition, as discussed in Subsection b. below, the carrying charges should be reduced by $1.275 million. As adjusted, OPUC recommends that the Hurricane Harvey regulatory asset be removed from rate base and recovered via a hurricane cost recovery factor ("HCRF") rider with a five-year amortization period ("Rider HCRF").[91]

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[88] *Id.* at 44.

[89] *See* 16 TAC § 25.231(c) (allowing a utility a reasonable opportunity to earn a reasonable rate of return on its *invested capital*).

[90] CEHE Ex. 1, WP/II-E-4.1.1; CEHE Ex. 2, Schedule II-B-12.

[91] OPUC Ex. 1 (Dively Direct) at 15-16.

a. Deferred Storm Restoration Costs.

Recovering the Hurricane Harvey regulatory asset via Rider HCRF is consistent with how Hurricane Harvey costs were treated in the settlement of Texas New-Mexico Power Company's ("TNMP") most recent base-rate proceeding in Docket No. 48401.[92] While settlements are not precedential, a comparison to this docket illustrates why OPUC's recommendation is the most appropriate way for CenterPoint Houston to recover its storm restoration costs for Hurricane Harvey. The settlement agreement in Docket No. 48401 included an HCRF rider amortized over five years to recover $6,639,732 in restoration costs for Hurricane Harvey, plus carrying charges accrued through the day before the effective date of the base rates approved in that docket.[93] Before adding the $8.7 million in carrying charges, the $64.4 million Hurricane Harvey regulatory asset requested by CenterPoint Houston is just under ten times the amount of TNMP's regulatory asset, but the Company is requesting a shorter three-year amortization period. If a three-year amortization period is approved for the Company's Hurricane Harvey regulatory asset, the amortization expense alone will cost customers $23.0 million per year,[94] which is more than three times the entire amount of TNMP's Hurricane Harvey regulatory asset.

Additionally, CenterPoint Houston's storm restoration costs are one-time expenses as shown by the testimony of CenterPoint Houston witness Mr. Gregory Wilson. Mr. Wilson calculated the annual expense needed to fund the Company's self-insurance reserve for property losses.[95] However, Mr. Wilson's analysis excluded losses from Hurricane Ike because they were securitized.[96] Mr. Wilson also excluded losses from Hurricanes Rita and Harvey, which were below the $100 million threshold required for securitization, but larger than what CenterPoint Houston can reasonably recover through its self-insurance reserve.[97] The Company's decision to exclude storm restoration costs from the historical data used to determine the annual expense of

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[92] *Application of Texas-New Mexico Power Company for Authority to Change Rates*, Docket No. 48401, Order (Dec. 20, 2018).

[93] Docket 48401, Order at FOF No. 62.

[94] OPUC Ex. 1 (Dively Direct) at 13-14. The amortization expense is $19.4 million per year if OPUC's $10,799,000 adjustment is adopted.

[95] CEHE Ex. 28 (Wilson Direct) at 5.

[96] *Id.* at 9.

[97] *Id.* at 9-10.

funding the Company's self-insurance reserve confirms that storm restoration costs should not be treated as recurring costs for ratemaking purposes.

Both the large size of the Hurricane Harvey regulatory asset and the non-recurring nature of storm restoration costs support OPUC's recommended treatment of this asset. Moving the regulatory asset to a rider will prevent over-recovery of a non-recurring cost, while a five-year amortization period is necessary to moderate the impact on customers due to the large amount of the asset.

b. Carrying Costs.

If OPUC's recommendation regarding Rider HCRF is adopted, then all issues associated with the Hurricane Harvey regulatory asset, including carrying costs, should be addressed in a separate compliance docket.[98] This process is consistent with Docket No. 48401,[99] and will provide for a deliberate and thorough review of: (1) whether CenterPoint Houston should be permitted to recover carrying charges,[100] and (2) whether CenterPoint Houston's requested $8.7 million amount and carrying charge rate applied are reasonable.[101] The additional review time is particularly important here due to the atypical manner in which the request for carrying charges occurred in this case.

CenterPoint Houston did not initially request carrying charges on the Hurricane Harvey costs in its application filed on April 5, 2019. The Company added the carrying charges to its request on May 20, 2019 in its Errata 1 filing after receiving a discovery request asking whether the Hurricane Harvey regulatory asset included carrying charges.[102] The calculations supporting the carrying charges were filed two days later with the Company's response to PUC RFI No. 08-14.[103] OPUC agrees with GCCC witness Mr. Lane Kollen that the Commission should reject CenterPoint Houston's request to recover carrying charges in this case because, despite the fact

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[98] OPUC Ex. 1 (Dively Direct) at 14-15.

[99] Docket No. 48401, Order at FOF No. 64.

[100] *See* GCCC Ex. 1 (Kollen Direct) at 11-12 (challenging whether the Company has established a statutory basis permitting recovery of carrying charges related to deferred storm restoration costs for Hurricane Harvey).

[101] *See* OPUC Ex. 5 (Nalepa Direct) at 5 (adjusting the amount of carrying charges requested).

[102] GCCC Ex. 1 (Kollen Direct) at 8-12; CEHE Ex. 35 (Colvin Rebuttal) at 7.

[103] GCCC Ex. 1 (Kollen Direct) at Att. B.

that it was presented in an "errata," the request was not made to correct an error in the Company's RFP.[104]

However, if CenterPoint Houston's request for carrying charges is granted in this proceeding, the Company's calculation of the carrying charges should be corrected. Under PURA § 36.402(b), system restoration costs include carrying costs at the utility's WACC. While this statute applies to securitized system restoration costs rather than base-rate proceedings, it provides guidance on calculating carrying costs for system restoration costs and is relied on by the Company as authority to recover carrying costs.[105] CenterPoint Houston calculated the carrying costs using the WACC for the periods in which it incurred the Hurricane Harvey costs, but incorrectly applied a monthly "compound interest" formula to determine the charges.[106] PURA § 36.402(b) ties the amount of carry costs to a utility's WACC. When calculating the return component of a utility's cost of service, the utility's WACC is applied to its rate base on an annual basis. The rate of return is not compounded on a monthly basis. If it were, the Company would over-recover its return. Similarly, if the Company compounds its carrying costs on a monthly basis, it will over-recover them. Thus, if CenterPoint Houston is permitted to recover carrying costs on the Hurricane Harvey costs, an annual "simple interest" formula should be used to calculate them.[107] The resulting amount of carrying charges is $8.616 million, which is $0.126 million less than the Company's request of $8.742 million.[108] In addition, if OPUC's recommendation in Section IV.F. below is adopted to reduce the Hurricane Harvey regulatory asset by $9.525 million, then the carrying charges associated with this amount should also be removed, which results in a further reduction to carrying charges of $1.148 million.[109] Therefore, the total financial impact of OPUC's carrying charge recommendations is a reduction of $1.275 million.

[104] *Id.* at 11.

[105] CEHE Ex. 35 (Colvin Rebuttal) at 36-37.

[106] OPUC Ex. 5 (Nalepa Direct) at 21.

[107] *Id.*

[108] *Id.*

[109] *Id.* at 22.

3. Medicare Part D

CenterPoint Houston is requesting to include a $33.2 million Medicare Part D regulatory asset amortized over three years in its rate base.[110] The Company is also requesting an $8.7 million increase to its federal income tax expense, which is equal to one third of the Medicare Part D regulatory asset before gross-up ($26.2 million).[111] OPUC recommends removing this regulatory asset from rate base and recovering it via a rider ("Rider MEDD") with a five-year amortization period.

CenterPoint Houston's Medicare Part D regulatory asset is the result of a change in tax law that effectively eliminated the non-taxable status of the 28% subsidy the Company receives for the cost of providing prescription drug benefits to its employees.[112] The law enacting the change was passed in 2010, but the subsidy did not actually become taxable until January 1, 2013.[113] In anticipation of the impact on its revenues, CenterPoint Houston requested an increase in its income tax expense and a $9.3 million regulatory asset in Docket No. 38339.[114] The Commission denied the increase to income tax expense, but authorized the Company to book "the difference between what its rates assume the Medicare Part D subsidy tax expense will be and what CenterPoint Houston is required to pay" as a regulatory asset.[115] However, the Commission's order in that case was silent as to how the Company should recover the Medicare Part D regulatory asset.

For the reasons discussed in the beginning of this section, it is reasonable to recover the Medicare Part D regulatory asset via Rider MEDD due to the size and the nature of the asset. An expense of over $30 million is too large to justify the three-year amortization period requested by CenterPoint Houston. Accordingly, OPUC recommends a five-year amortization period to moderate the impact on customers. Because this is a non-recurring expense, OPUC also recommends recovering the asset outside of base rates through a rider to protect customers

[110] CEHE Ex. 2, Schedule II-B-12; CEHE Ex. 13 (Pringle Direct) at 44-45.

[111] CEHE Ex. 13 (Pringle Direct) at 44-45.

[112] *Application of CenterPoint Energy Houston Electric, LLC*, Docket No. 38339, Order on Rehearing at 8 (Jun. 23, 2011).

[113] Docket No. 38339, Order on Rehearing at 8.

[114] *Id.* at 9.

[115] *Id.* at FOF Nos. 157A and 159A.

against over-recovery of this cost. Using OPUC's recommended five-year amortization period and recovery method, the net impact on customers is a reduction of $6,530,000, comprised of a reduction to the cost of service of $13,171,000 and an increase in charges through Rider MEDD of $6,641,000.[116]

4. Texas Margin Tax

CenterPoint Houston is requesting to include a $19,627,000 TGMT regulatory asset amortized over three years in rate base.[117] According to CenterPoint Houston, the TGMT regulatory asset is needed because the Company's current rates recover the amount of TGMT that it paid during the test year, which is based on the taxable revenues for the calendar year that immediately precedes the test year.[118] As a result of this one-year lag, CenterPoint Houston created a regulatory asset to defer the current year's accrued TGMT costs until they are recovered the following year in rates.[119] CenterPoint Houston asserts that it received Commission approval to book the TGMT regulatory asset in Docket No. 29526 and that recovery of the asset in rate base is warranted due to Commission Staff's request in Docket No. 45757 that the Company change its accounting treatment.[120]

As discussed below, CenterPoint Houston's request to recover the TGMT regulatory asset should be denied for four reasons. First, the Commission did not approve this regulatory asset in Docket No. 29526.[121] Second, the Company's decision to change the accrual method of accounting will not result in any unrecovered expense because the accounting treatment used to record the TGMT has no bearing on the ratemaking treatment of the TGMT expense.[122] Third, CenterPoint Houston has misconstrued Commission Staff's position in Docket No. 45747 as a request to change the accounting treatment applied to the TGMT, and therefore, the Company has not justified why it needs to make the change at this time.[123] Finally, even if the TGMT

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116 OPUC Ex. 1 (Dively Direct) at 19.

117 CEHE Ex. 2, Schedule II-B-12.

118 CEHE Ex. 12 (Colvin Direct) at 39.

119 *Id.* at 39-40.

120 *Id.*

121 OPUC Ex. 1 (Dively Direct) at 23-24.

122 *Id.* at 22-23.

123 *Id.* at 20-21.

regulatory asset had been calculated correctly, the recovery of the asset would be prohibited by the rule against retroactive ratemaking.[124]

a. Docket No. 29526 did not approve the TGMT regulatory asset.

Contrary to CenterPoint Houston's assertion, the Commission's decision in Docket No. 29526 did not approve the Company's current practice of booking a TGMT regulatory asset. Docket No. 29526 specifically dealt with stranded costs and other true-up balances under PURA § 39.262 related to the transition to competition.[125] Under regulation, electric utilities were required to invest in generation assets that would not hold their value in a deregulated competitive market.[126] To address the now uneconomic portion of these generation assets, the Legislature authorized the recovery of these stranded costs if the utilities met certain conditions.[127] In Docket No. 29526, CenterPoint Houston was allowed to record a regulatory asset to recover $14,187,517 in deferred debits arising from the proportionate share of its Texas franchise taxes (what is now the TGMT) related to uneconomic generation assets.[128] The deferred debits were the result of discontinuing the application of Statement of Financial Accounting Standards ("SFAS") No. 71.[129]

CenterPoint Houston's reliance on the Commission's Order on Rehearing in Docket No. 29526 is misplaced because the findings in the order are limited to the recovery of stranded costs. Finding of Fact ("FOF") No. 229 specifically stated that "[d]eferred debits related to a utility's discontinuance of the application of SFAS No. 71 for generation-related assets are a component of stranded costs under the definition of 'stranded cost' set forth in PURA § 39.251(7)."[130] The fact that those deferred debits arose from CenterPoint Houston's Texas franchise tax expense (which later became the TGMT) was not the basis for allowing the Company to recover those costs.

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[124] *Id.* at 26.

[125] *Application of CenterPoint Energy Houston Electric, LLC, Reliant Energy Retail Services, LLC and Texas Genco, LP to Determine Stranded Costs and Other True-up Balances Pursuant to PURA § 39.262*, Docket No. 29526, Order on Rehearing at 1 (Dec. 17, 2004).

[126] *Id.* at 10.

[127] *Id.* at 10-11.

[128] *Id.* at FOF Nos. 230-232.

[129] *Id.* at FOF Nos. 227-229.

[130] *Id.* at FOF No. 229.

Moreover, FOF No. 232 in the Order on Rehearing only addressed the portion of the Company's TGMT corresponding to generation-related deferred debits.[131] If the Commission intended to approve the two-year recovery cycle for the TGMT, then the full amount should have been treated as a stranded cost. Further, the lone finding of fact that specifically acknowledged that CenterPoint Houston recovered TGMT on a two-year cycle *prior* to deregulation did not speak to the Commission's approval of this method post-deregulation.[132] Finally, the transition to competition, which led to the need to address the portion of CenterPoint Houston's Texas franchise taxes related to uneconomic generation assets, is not applicable to this proceeding where no similar change in regulation has occurred. Thus, CenterPoint Houston's TGMT regulatory asset is not supported by the Commission order in Docket No. 29526 or other authority as required by the Commission's TDU RFP.[133]

b. <u>The Company's change of accounting method does not require creation of a TGMT regulatory asset.</u>

In an effort to justify the requested recovery of the TGMT regulatory asset, CenterPoint Houston is improperly conflating the regulatory treatment of the TGMT with the accounting treatment used to record this expense on the Company's books. The Company did not request recovery of a TGMT regulatory asset in Docket No. 38339[134] because "under the payment method, the regulatory asset recorded each year is recovered in the following year."[135] However, the fact that the Company uses the payment method of accounting has no impact on how the TGMT expense is recovered in rates.

The rates set in Docket No. 38339 recover $16,388,000 for TGMT expense every year.[136] This amount is recovered regardless of whether the TGMT expense was booked using the payment method or the accrual method of accounting and regardless of whether the amount of the expense was based on the payment made in the test year (which is based on the taxable revenues for the year preceding the test year). CenterPoint Houston has not claimed that its

[131] *Id.* at FOF No. 232.

[132] *Id.* at FOF No. 235.

[133] OPUC Ex. 1 (Dively Direct) at 24.

[134] *Id.* at Att. JMD-2.

[135] CEHE Ex. 35 (Colvin Rebuttal) at 27.

[136] OPUC Ex. 1 (Dively Direct) at Att. JMD-3.

current rates do not recover a reasonable and necessary amount for its TGMT expense, nor does it dispute that it has recovered this expense every year since its current rates were set in 2011. Instead, the Company is seeking to recover what it describes as a "one-time, one-year, regulatory asset that contains the balance of unrecovered TMT expense" due to the two-year accounting cycle.[137] This amount only exists because of the difference between the accounting treatment the Company used to book the TGMT expense and the regulatory treatment used to recover that expense.[138] If the Company were entitled to dollar-for-dollar recovery of its TGMT expense, then the two-year recovery cycle becomes relevant, but that is not how ratemaking based on a historic test year works under PURA and the Commission's rules.[139] It is not reasonable for CenterPoint Houston to recover a TGMT regulatory asset simply because it elected to change how it recorded this expense after its last rate case.

c. The change in accounting treatment is not required.

CenterPoint Houston has also failed to explain why it needs to change the accounting treatment used to record its TGMT expense. Contrary to the Company's assertion, Commission Staff's position in Docket No. 45747 did not constitute a request to discontinue its use of the payment method of accounting. In Docket No. 45747, CenterPoint Houston requested a DCRF to recover costs associated with distribution-related investment placed in service between January 1, 2015 and December 31, 2015.[140] CenterPoint Houston and Commission Staff disagreed over the correct way to calculate the amount of the TGMT expense to be recovered as "Current Other Taxes as Related to Current Net Distribution Capital" under 16 TAC § 25.243(d). CenterPoint Houston included an amount for the TGMT expense based on the 2014 revenues and used a 0.95% tax rate to calculate the TGMT payment that the Company made during the 2015 calendar year.[141] In contrast, Commission Staff recommended using the 2015 revenues and the

[137] CEHE Ex. 35 (Colvin Rebuttal) at 30.

[138] OPUC Ex. 1 (Dively Direct) at 26.

[139] *See id.* at 22-23.

[140] *Application of CenterPoint Houston Energy Electric, LLC to Amend its Distribution Cost Recovery Factor and to Reconcile Docket No. 44572 Revenues*, Docket No. 45747 (Jul. 20, 2016).

[141] OPUC Ex. 2 (Dively Direct Workpapers) at 4.

current tax rate of 0.75% because this amount was more closely related to the Current Net Distribution Capital placed in service during calendar year 2015.[142]

Under 16 TAC § 25.243(d), Current Other Taxes as Related to Current Net Distribution Capital are calculated using "current tax rates and the methodology from the last comprehensive base-rate proceeding."[143] To justify its use of the higher 0.95% tax rate, CenterPoint Houston argued that the "methodology from the last comprehensive base rate proceeding," Docket No. 38339, was the two-year recovery cycle.[144] As discussed above, this is merely an accounting treatment—a fact that was illustrated by Commission Staff's argument that the methodology for calculating the TGMT expense that was approved in Docket No. 38339 was the cost of goods sold method.[145] Therefore, while Commission Staff criticized the accounting treatment that CenterPoint Houston seeks to change in this proceeding, Commission Staff did not request that the Company make this change. Instead, Commission Staff argued that it did not matter what tax rate the Company actually applied to determine the TGMT expense that it paid in 2015 because the correct interpretation of 16 TAC § 25.243(d) required using the current tax rate (i.e., the tax rate that would be applied to the revenues collected under the DCRF approved Docket No. 45747).[146] Thus, CenterPoint Houston's proposed transition to the accrual method of accounting was not required by the Commission.

d. <u>Recovery of the TGMT regulatory asset would constitute retroactive ratemaking.</u>

Even if the Commission is inclined to approve CenterPoint Houston's TGMT regulatory asset, recovery of the asset is not permitted because it would constitute retroactive ratemaking. CenterPoint Houston's current rates already recover a TGMT expense each year. Thus, if the Company transitioned to the accrual method of accounting, the only unrecovered amount resulting from transition would be the difference between: (1) the cumulative, historical accrual-based amounts incurred by the Company, and (2) the historical amounts actually recovered by

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[142] *Id.* at 12, 14.

[143] 16 TAC § 25.243(d).

[144] OPUC Ex. 2 (Dively Direct Workpapers) at 10-11.

[145] *Id.* A company may choose to reduce the revenues on which its TGMT payment is based by the greater of the cost of goods sold, certain employee compensation or 30% of total revenues.

[146] *Id.* at 11-12.

the Company in rates for the same period.[147] Allowing CenterPoint Houston to recover this difference would require setting the rates approved in this case at an amount that recoups the Company's historical losses.[148] Such an approach would constitute retroactive ratemaking, which is strictly prohibited.[149]

Thus, for these reasons, the Company's request to recover a TGMT regulatory asset should be denied in its entirety.

5. Smart Meter Texas ("SMT")

CenterPoint Houston is requesting to include a $6,939,000 SMT regulatory asset in rate base amortized over three years.[150] OPUC recommends removing this regulatory asset from rate base and recovering the asset through a rider ("Rider SMTCR") with a five-year amortization period.

The SMT regulatory asset is intended to recover the Company's O&M costs incurred after February 2017 for participating in the SMT web portal.[151] The Commission approved CenterPoint Houston's SMT regulatory asset as part of the settlement in Docket No. 47364, which addressed the Company's final reconciliation of costs for deploying advanced meters.[152] FOF No. 13(e) from the Commission's Order states that:

> It is reasonable for CenterPoint to establish a regulatory asset in which to record SMT costs incurred after the end of the final reconciliation period and prior to the implementation date of new base rates (the rate implementation date) resulting from its next comprehensive base rate proceeding. CenterPoint will not seek recovery of such costs until such rate proceeding, at which time the reasonableness of the individual SMT costs accumulated in such regulatory asset through the end of the applicable test year (the test year end) will be subject to review. All SMT

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147 OPUC Ex. 1 (Dively Direct) at 26.

148 *Id.*

149 *See State v. Pub. Util. Comm'n of Tex.*, 883 S.W.2d 190, 199 (Tex. 1994) ("The rule [against retroactive ratemaking] prohibits a public utility commission from setting future rates to allow a utility to recoup past losses or to refund to consumers excess utility profits.").

150 CEHE Ex. 2, Schedule II-B-12.

151 Separately, CenterPoint Houston is seeking to recover its ongoing SMT expenses in base rates. OPUC addresses its recommendations regarding the ongoing SMT expenses in Section IV.I. below.

152 *Application of CenterPoint Energy Houston Electric, LLC for the Final Reconciliation of Advanced Metering Costs*, Docket No. 47364, Order at FOF No. 13(e) (Dec. 14, 2017).

> costs found reasonable will be recovered using an appropriate amortization period to be determined in that proceeding.[153]

Notably, the Commission's Order did not address whether CenterPoint Houston could include the SMT regulatory asset in rate base and earn a return on it.

To prevent an over-recovery of the SMT costs, CenterPoint Houston should recover these costs through Rider SMTCR amortized over five years. The Order in Docket No. 47364 states that the costs comprising the asset are one-time expenses that the Company will incur over a finite period. Therefore, it is appropriate for CenterPoint Houston to recover these costs outside of base rates through a rider. Furthermore, these costs are O&M expenses, rather than capital assets, so the Company should not earn a return on these costs. Additionally, the five-year amortization period is consistent with the time period in the settlement approved in Docket No. 48401. Under the settlement, the parties agreed to amortize TNMP's under-collection of costs related to its advanced metering system over five years.[154] While the settlement is not precedential, it shows that a five-year amortization period for this type of cost can be reasonable and is achievable. Using OPUC's recommended amortization period and recovery method, the net impact on customers is a reduction of $1,361,000, comprised of a reduction to the cost of service of $2,749,000 and an increase in charges through Rider SMTCR of $1,388,000.[155]

6. REP Bad Debt

CenterPoint Houston is requesting to include a $1,570,000 REP bad debt regulatory asset in rate base that is amortized over three years. As discussed below, approximately two-thirds of the requested amount is derived from a credit approved in Docket No. 38339 and does not qualify for recovery under 16 TAC § 25.107(f)(3)(B), which addresses creation of a regulatory asset for REP bad debt expenses. The remaining $511,290 should be recovered as a recurring expense, rather than a capital asset. Thus, OPUC recommends removing this regulatory asset from rate base, reducing the amount by $1,058,255, and recovering the remaining balance of $511,290 as an expense amortized over five years and recorded in FERC Account No. 904.

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[153] *Id.*

[154] Docket No. 48401, Order at FOF No. 69.

[155] OPUC Ex. 1 (Dively Direct) at 30.

First, CenterPoint Houston should not recover the full $1,570,000 requested for its REP bad debt regulatory asset because $1,058,255 of this total amount is derived from a credit for REP bad debt that was included in the Company's cost of service in Docket No. 38339.[156] Workpaper II-D-2.2.1 from Docket No. 38339 shows a $144,308 credit for REP bad debt,[157] and CenterPoint Houston's response to COH RFI No. 03-41 specifically identifies this number as a credit.[158] The Company divided the $144,308 credit by 12 to determine a monthly amount of $12,026 related to this credit, and then multiplied $12,026 by 88 months to reflect the amount of time that has elapsed between September 2011 (the effective date of the rates approved in Docket No. 38339) and December 2018 (the end of the test year for this proceeding).[159]

The portion of CenterPoint Houston's REP bad debt regulatory asset that is derived from the credit approved in Docket No. 38339 does not qualify for recovery as a regulatory asset. Under 16 TAC § 25.107(f)(3)(B), an electric utility may establish a regulatory asset for "bad debt expenses, net of collateral...and bad debt already included in its rates, resulting from a REP's default on its obligation to pay delivery charges to the TDU."[160] Typically, a credit represents an amount that is recovered by a utility and not an expense that the utility has incurred.[161] In this case, the $144,308 credit represents a $142,156 write-off from March 2009 and a $2,152 write-off from October 2009 that were not offset by an accrual for REP bad debt booked during the test year used in Docket No. 38339.[162] CenterPoint Houston has not disputed that the $144,308 credit actually represents a recovery of bad debt, and the fact that there was no offsetting accrual in 2009 suggests that it was a recovery for bad debt incurred outside of the test year.[163] Thus it is reasonable to conclude that the bad debt included in the Company's current rates is not a bad debt *expense*.

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[156] *Id.* at 31.

[157] *Id.* at Att. JMD-4.

[158] *Id.* at Att. JMD-4 at 3 n.1.

[159] *Id.* at 31 and Att. JMD-4 at 3.

[160] 16 TAC § 25.107(f)(3)(B).

[161] OPUC Ex. 1 (Dively Direct) at 31.

[162] *Id.* at Att. JMD-5.

[163] OPUC Ex. 1 (Dively Direct) at 31.

Nevertheless, the Company seeks to reverse 88 months' worth of the credit included in its current rates and recover it as a regulatory asset. In other words, CenterPoint Houston is using the Commission's rule to make itself whole by reversing a credit, not an expense. CenterPoint Houston witness Ms. Colvin asserts that a regulatory asset recorded pursuant to 16 TAC § 25.107(f)(3)(B) must include the amount for bad debt expense in rate base regardless of whether the rates are recovering a debit or a credit.[164] However, Ms. Colvin does not point to any Commission decision supporting this interpretation of the rule and ignores the rule's plain language, which only permits the creation of a regulatory asset for bad debt *expenses* in excess of the bad debt included in rates. Credits are not bad debt.

In addition to misconstruing 16 TAC § 25.107(f)(3)(B), the Company has failed to show that it is appropriate to recover the requested REP bad debt regulatory asset in rate base. The rule simply allows for the creation of the regulatory asset and the recovery of a reasonable level of amortization. It does not address whether the regulatory asset can be included in rate base or whether the utility can earn a return on the asset.[165] The only support Ms. Colvin provides for the requested method of recovery is FOF No. 48 from the Final Order in Docket No. 46957 and Schedule II-B-12.[166] FOF No. 48 states:

> Oncor's total regulatory asset balances as of December 31, 2016, as presented in Oncor's RFP, which includes the net unamortized amount of what was approved in previous proceedings and the additional balances since Docket No. 38929 for self-insurance or "storm" reserve, pension benefits/other post-employment benefits (OPEBs), and AMS under-recovered costs are approved.[167]

On its own, this Commission finding does not make it clear whether the total regulatory asset balances approved by the Commission included a balance for REP bad debt. Presumably, Schedule II-B-12 would have provided additional information; however, Schedule II-B-12 was not attached to the Final Order and counsel for OPUC was not able to locate it in Ms. Colvin's

[164] CEHE Ex. 35 (Colvin Rebuttal) at 40.

[165] 16 TAC § 25.107(f)(3)(B).

[166] CEHE Ex. 35 (Colvin Rebuttal) at 39 nn.77 & 78.

[167] *Application of Oncor Electric Delivery Company, LLC for Authority to Change Rates*, Docket No. 46957, Order at FOF No. 48 (Oct. 13, 2017).

rebuttal testimony or the accompanying workpapers. Consequently, the Company has failed to present evidence sufficient to support including the REP bad debt regulatory asset in rate base.

To protect customers from over-recovery, OPUC recommends that CenterPoint Houston recover $102,258 per year as REP bad debt expense to be recorded in FERC Account No. 904, Uncollectible Accounts.[168] This total amount represents the aggregate REP bad debt expense of $511,290 that the Company incurred between 2011 and the end of the test year amortized over five years.[169] Although the Company does not incur a bad debt expense every year, it is an expense that recurs frequently enough to qualify as a reasonable and necessary cost of providing utility service.[170] Therefore, to set the bad debt expense at a level that is representative of the expense that CenterPoint would incur in a single year, it is reasonable to normalize the expense over a period of years. Taking the aggregate amount of REP bad debt expense incurred since the Company's current rates took effect and smoothing out the expense over a five-year amortization period accomplishes this goal.

III. RATE OF RETURN [PO Issues 4, 5, 7, 8, 9]

OPUC recommends an overall rate of return of 6.55% based on a 9.15% ROE, 4.38% cost of debt, and capital structure of 54.5% long-term debt and 45.5% equity.[171]

A. Return on Equity [PO Issue 8]

OPUC's recommended ROE of 9.15% is within a narrow range of recommendations provided by the other intervenors and Commission Staff, with Texas Coast Utilities Coalition's ("TCUC") recommendation of 9.0% at the low end and Commission Staff's recommendation of 9.45% on the high end.[172] The intervenor and Commission Staff witnesses all conclude that the 10.4% ROE requested by CenterPoint Houston exceeds investor requirements under current and projected capital market conditions and does not reflect the lower risk of a TDU.

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[168] OPUC Ex. 1 (Dively Direct) at 32. Under the FERC USOA, Account No. 904 "shall be charged with amounts sufficient to provide for losses from uncollectible utility revenues." 18 C.F.R. Part 101, Operation and Maintenance Expense Accounts at Account No. 904.

[169] *Id.* at 32 and Att. JMD-4 at 3. This amount excludes the $1,058,255 credit discussed earlier in this section.

[170] OPUC Ex. 1 (Dively Direct) at 32.

[171] OPUC Ex. 3 (Winker Direct) at 4.

[172] TCUC Ex. 1 (Woolridge Direct) at 4; Staff Ex. 3A (Ordonez Direct) at 7.

OPUC witness Ms. Anjuli Winker recommended an ROE of 9.15% that is derived from three models commonly used to estimate a utility's cost of equity: (1) the constant-growth Discounted Cash Flow ("DCF") model, (2) the Bond Yield Plus Risk Premium model, and (3) the Capital Asset Pricing Model ("CAPM").[173] Ms. Winker relied on the first two models to reach her recommended ROE range.[174] Ms. Winker's CAPM analysis results were not directly incorporated into her final ROE recommendation. However, her analysis served as a qualitative check on the results of the other two models and showed that a reduced ROE for CenterPoint Houston is appropriate given the continued low interest rate environment.[175]

OPUC's recommended 9.15% ROE also includes Ms. Winker's consideration of the effects of the TCJA and CenterPoint Houston's low business risk as a TDU operating in Texas.[176] The results of her analyses are summarized in the following table:[177]

Methodology	Range
Discounted Cash Flow	6.76% to 9.92%
Bond Yield Plus Risk Premium	8.98% to 9.04%
Capital Asset Pricing Model	N/A
Recommended ROE	**9.15%**

OPUC's recommended 9.15% ROE should be adopted because it is reasonably sufficient to support the Company's financial health, maintain and support its credit, and enable it to continue to attract invested capital. In support of OPUC's recommendation, below is a discussion of the current market environment's impact on Ms. Winker's ROE analysis, the proxy group that Ms. Winker used in her models, and the results of each of the models she used.

1. Current Market Environment

OPUC's recommended ROE takes into consideration the current low-interest market environment in which CenterPoint Houston operates. As discussed in Ms. Winker's testimony,

[173] OPUC Ex. 3 (Winker Direct) at 5.

[174] *Id.* at 40.

[175] *Id.*

[176] *Id.*

[177] *Id.*

while the federal funds rate was increased in 2017 and 2018, the Federal Open Market Committee ("FOMC") issued a statement on May 1, 2019 announcing its decision to maintain the target range for the federal funds rate at 2-1/4 to 2-1/2%.[178] Moreover, the projections of the federal funds rate included in an FOMC press release issued on June 19, 2019, show that interest rates will remain at 2.4% for the rest of 2019, decrease to 2.1% in 2020, and finally increase back to 2.4% in 2021.[179] Thus, it appears that interest rates will continue to remain at low levels for the foreseeable future, and CenterPoint Houston's authorized cost of equity should reflect this market expectation.

CenterPoint Houston witness Mr. Robert Hevert contends that because the credit rating agencies have assessed the consequences of the TCJA, it is reasonable to assume that investors have recognized the same consequences.[180] Mr. Hevert provides no support for this assertion, and specifically states that he does not recommend a higher ROE to account for the TCJA.[181] However, he does conclude that investors have begun to see utilities as less attractive relative to other industry sectors because "non-regulated companies may benefit from the TCJA in ways utilities cannot."[182]

OPUC disagrees that investors currently see the utility sector as relatively risky. As Ms. Winker testified, "[m]ost electric utility stocks have performed well in 2019."[183] The U.S. financial market viewed the TCJA as an overall near-term negative, but a longer-term positive for regulated utilities, and has continued to view the assets of regulated utilities as critical infrastructure assets that are generally less risky than other types of corporate assets.[184] In fact, the utility sector has exhibited robust utility stock valuations over the last several years, which is a strong indicator that utilities have access to capital under reasonable terms and conditions, and at relatively low costs.[185] Texas Industrial Energy Consumers ("TIEC") witness Mr. Michael

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[178] *Id.*

[179] TIEC Ex. 21.

[180] CEHE Ex. 26 (Hevert Direct) at 16.

[181] *Id.* at 19.

[182] *Id.* at 18.

[183] OPUC Ex. 3 (Winker Direct) at 5.

[184] *Id.* at 17.

[185] *Id.*

Gorman concurs that regulated utilities have received robust stock valuations over the last several years, which is evidence that utilities have access to equity capital.[186] Utility stock valuations over the last several years demonstrate that the market continues to embrace the regulated utility industry as a safe-haven investment and views utility equity and debt investments as low-risk securities.[187]

Further, CenterPoint Houston's current corporate credit ratings are considered investment grade by Standard & Poor's ("S&P"), Fitch Ratings ("Fitch"), and Moody's Investors Service ("Moody's").[188] Both Fitch and Moody's have acknowledged that [redacted].[189] In addition, Moody's stated that the Company [redacted].[190]

2. Proxy Group

OPUC used a "proxy group" of comparable companies to conduct the DCF and CAPM analyses described below. OPUC's proxy group included 20 utility companies comparable to CenterPoint Houston that were selected using screening criteria similar, but not identical, to the criteria used by CenterPoint Houston witness Mr. Hevert.[191] Each of the comparable companies in Ms. Winker's proxy group consistently pay quarterly cash dividends, are reported on by at least two utility industry equity analysts, and have investment grade senior unsecured bond and/or corporate credit ratings from S&P.[192] The comparable companies also have regulated electric operating income that is at least 60.00 percent of the total regulated operating income.[193] However, Ms. Winker chose "companies whose regulated operating income over the most

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[186] TIEC Ex. 5 (Gorman Direct) at 13.

[187] OPUC Ex. 3 (Winker Direct) at 16.

[188] *Id.* at 14-15.

[189] *Id.* at 15-16.

[190] *Id.* at 15.

[191] *Id.* at 21.

[192] *Id.* at 20.

[193] *Id.*

recently reported fiscal years comprised less than 60.00 percent of the *total income for the company*" rather than "60.00 percent of the *total consolidated enterprise*" because Mr. Hevert's criterion suggests that a company is comparable only if it was formed as the result of the consolidation of multiple companies through a merger or acquisition.[194] She also chose "companies that are currently known to be party to a merger, significant asset sale or acquisition, bankruptcy, or other significant transaction" rather than "companies that are currently known to be a party to transformative transaction" because Mr. Hevert's criterion does not clearly state the types of transactions that are transformative.[195] With these modifications, Ms. Winker's proxy group differs from Mr. Hevert's in that it excludes ALLETE, Inc., American Electric Power Company, Inc., NextEra Energy, Inc., and Southern Company, all four of which are parties to an ongoing or recently completed significant transaction.[196]

3. Discounted Cash Flow Analysis

The DCF model is based on the premise that the current price of a share of stock is equal to the present value of all future cash flows (i.e., future dividends). The rate at which investors discount the future dividends represents the riskiness of the future cash flows (i.e., the required return).[197] The DCF analysis looks at three factors: a current stock price, an expected dividend, and an expected growth rate in dividends.[198]

Ms. Winker used a constant-growth DCF model, which assumes that dividends grow at a constant rate.[199] Her model incorporates two estimated dividend yields for the proxy group. Ms. Winker's first estimate of 3.45% used the average high and average low stock prices reported in the issues of *Value Line* published on March 15, April 26, and May 17, 2019.[200] Ms. Winker's second estimate of 3.33% averaged *Value Line's* 2019 high and low stock prices with the May 3, 2019, closing stock prices reported by Yahoo Finance.[201] Ms. Winker's dividend yield

[194] *Id.* at 21.

[195] *Id.*

[196] *Id.*

[197] *Id.* at 23-24.

[198] *Id.* at 25.

[199] *Id.* 24.

[200] *Id.* at 26.

[201] *Id.*

calculation is consistent with the industry average yields of 3.4% and 3.3% reported by Value Line on March 15, 2019 and May 17, 2019, respectively.[202]

In addition to estimated dividend yields for the proxy group, the DCF model also requires an estimate of the dividend growth rate expected by investors. The development of the expected dividend growth rate is the most controversial component of the DCF model, and experts can reasonably disagree about the importance of various growth rate measures. OPUC recommends considering the sustainable retained earnings growth rate (i.e., BR growth rate) when estimating a long-term dividend growth rate.[203] Earnings retention rates are the primary source of book value growth, and book value growth, in turn, is the primary source of sustainable dividend growth. This is due to the fact that earnings that are not paid out as dividends are reinvested by the utility.[204] As additional plant is funded by retained earnings, the utility is allowed to earn its authorized rate of return on the additional plant in rate base, which leads to future growth in earnings and dividends.[205] The BR growth rate helps gauge whether investors' current long-term dividend growth rates can be sustained in future periods.[206] In addition to the BR growth rate, Ms. Winker also considered *Value Line's* historical 5-year and 10-year growth in earnings, dividends and book value for the proxy group as well as *Value Line's* 5-year projected growth in earnings, dividends and book value.[207]

In contrast, Mr. Hevert relied entirely on analyst estimates of projected earnings growth in developing the dividend growth component of his DCF model.[208] As discussed in TCUC witness Mr. Randall Woolridge's direct testimony, a recent study by Lacina, Lee, and Xu "has shown that analysts' long-term earnings growth rate forecasts are not more accurate at forecasting future earnings than naive random walk forecasts of future earnings."[209] Mr.

[202] OPUC Ex. 3B (Workpapers to Winker Direct) at 17-19.

[203] OPUC Ex. 3 (Winker Direct) at 27.

[204] *Id.* at 28.

[205] *Id.*

[206] *Id.*

[207] *Id.* at 30.

[208] CEHE Ex. 26 (Hevert Direct) at 61.

[209] TCUC Ex. 1 (Woolridge Direct) at 58.

Woolridge also opines that using analyst long-term earnings per share forecasts results in an overstated cost of equity.[210]

Contrary to Mr. Hevert's approach, when estimating expected dividend growth rates for the proxy group, it is appropriate to consider historical growth rates, as past performance is an indication of future performance, especially in a regulated industry like the electric utility industry.[211] The regulatory process results in fewer fluctuations and more stable revenues and earnings for electric utilities, and as a result, investors attach more significance to the past financial results of these utilities than for other sectors of the economy.[212] Investors do not rely exclusively on a single factor in making their investment decisions due to the abundance of information available to assist with the evaluation of stocks. Earnings forecasts are only one of the many statistics they use for making investment decisions.[213] It is neither realistic nor logical to maintain that investors only consider projected (estimated) data to the exclusion of historic (actual) data because data on historical growth rates is readily available to investors.[214]

Ms. Winker's review of the proxy group's historical and projected growth rates resulted in a reasonable growth rate expectation of 3.43% to 6.47%.[215] This range incorporates:

- A 2020 BR growth rate calculated by Ms. Winker;
- A 5-year projected BR growth rate;
- *Value Line's* 5-year and 10-year historical dividend, earnings, and book value growth; and
- *Value Line's* 5-year projected dividend, earnings, and book value growth.[216]

OPUC's DCF model analysis results in an overall recommended DCF range of 6.76% to 9.92%.[217]

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[210] *Id.*

[211] OPUC Ex. 3 (Winker Direct) at 29.

[212] *Id.*

[213] *Id.*

[214] TCUC Ex. 1 (Woolridge Direct) at 32.

[215] OPUC Ex. 3 (Winker Direct) at 30.

[216] *Id.* at 30-31 and Atts. AW-1 and AW-2.

[217] *Id.* at 31.

4. Risk Premium Analysis

The second analysis performed by Ms. Winker estimated CenterPoint Houston's cost of equity using a bond yield plus risk premium model.[218] This model is based on the premise that it is riskier to invest in a company's equity (stocks) than to invest in its debt (bonds).[219] As such, this model calculates a risk premium, which is the additional amount an investor requires as compensation for assuming the risk of investing in stocks rather than bonds.[220] Thus, as the cost of a company's debt increases so does the risk premium.[221]

Ms. Winker began with the data that Mr. Hevert gathered from SNL Financial to calculate an annual average authorized ROE for regulated electric utility companies.[222] However, instead of using the average 30-year Treasury yields (including a 200-day lag period) and projected near-term and long-term 30-year Treasury yields, Ms. Winker used Moody's Average Public Utility Bond Yields as reported in Mergent Bond Records.[223] Public utility bonds are issued in the industry in which CenterPoint Houston operates; therefore, they provide a more comparable and reasonable estimate of investor risk premium expectations than 30-year historical and projected Treasury yields.[224]

Next, Ms. Winker calculated the difference between the SNL Financial annual average authorized ROEs from January 2000 to December 2018 and Moody's Average Public Utility Bond Yields for the same period.[225] Using this shorter and more current 18-year time period effectively captures the trend in authorized ROEs while remaining long enough to encompass the last two recessions and the last two periods of economic growth.[226] The average risk premium during this 18-year period was 4.64%.[227]

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[218] *Id.* at 33.

[219] *Id.*

[220] *Id.*

[221] *Id.*

[222] *Id.* at 34.

[223] *Id.* at 34-35.

[224] *Id.* at 35.

[225] *Id.* at 35 and Att. AW-3.

[226] *Id.* at 34.

[227] *Id.* at 35.

Finally, Ms. Winker added her risk premium of 4.64% to the average 2018 Moody's utility bond yields of 4.34% to reach an ROE of 8.98%.[228] She also added her risk premium to the 4.40% Moody's BBB utility bond yield reported on May 17, 2019 to reach an ROE of 9.04%. Using the resulting ROEs as the upper and lower bounds, Ms. Winker's bond yield plus risk premium model results in a recommended ROE range of 8.98% to 9.04%.[229]

CenterPoint Houston witness Mr. Hevert also utilized a bond yield plus risk premium model. However, Mr. Hevert's analysis has several conceptual problems that result in an inflated risk premium.[230] Mr. Hevert based his analysis on electric utility rate proceedings conducted between January 1, 1980 and February 15, 2019, which had an average risk premium of 4.66%.[231] This amount is comparable to the risk premium of 4.64% calculated by Ms. Winker. However, because Mr. Hevert believed that his calculated risk premium would understate the cost of equity, he made an upward adjustment of 1.46% to 2.24%, which he states accounts for the inverse relationship between interest rates and risk premiums.[232] The adjustment results in Mr. Hevert's recommended ROE range moving upward from an unadjusted 7.69% - 8.71% to 9.93% - 10.17%.[233] However, Mr. Hevert's adjustment to account for the inverse relationship between interest rates and risk premiums was redundant and inflates his results. The 39 years of historical data that Mr. Hevert used to calculate his risk premium reaches back to 1980 and incorporates various periods of very high, medium and very low interest rates. Mr. Hevert's 39-year time period makes it unnecessary to upwardly adjust his risk premium because it already incorporates the tendency of an inverse relationship between interest rates and risk premiums.[234]

Further, Mr. Hevert's upward adjustment to his 4.66% basic risk premium also does not recognize that investor-expected risk premiums do not remain constant over time. As noted by TIEC witness Mr. Gorman, academic studies have shown that the relationship between interest

[228] *Id.*

[229] *Id.*

[230] *Id.* at 36-37.

[231] CEHE Ex. 26 (Hevert Direct) at 70, 72.

[232] OPUC Ex. 3 (Winker Direct) at 36; CEHE Ex. 26 (Hevert Direct) at 72.

[233] OPUC Ex. 3 (Winker Direct) at 35; CEHE Ex. 26 (Hevert Direct) at Exh. RBH-5.

[234] OPUC Ex. 3 (Winker Direct) at 36.

rates and risk premiums is influenced by changes in *perception of the risk* of bond investments *relative to* equity investments, and not simply to changes in interest rates.[235] For these reasons, OPUC recommends that Mr. Hevert's bond yield plus risk premium analysis be rejected and that OPUC and the other intervenors' risk premium analyses be relied on for estimating the cost of equity.

5. Capital Asset Pricing Model

OPUC's third method of estimating the cost of equity for CenterPoint Houston uses the capital asset pricing model ("CAPM"), which is a model that describes the relationship between risk and expected return that is used when pricing a security.[236] This model is used by Ms. Winker as a qualitative check and confirms that a reduced ROE for CenterPoint Houston is appropriate given the continued low interest rate environment.[237] Under the CAPM, the cost of equity is estimated as the sum of the interest rate on a risk-free security plus a market risk premium.[238] The yield on long-term U.S. Treasury bonds is typically used as the risk-free rate, and the market risk premium represents the investor-expected incentive for holding the stock instead of a risk-free security. Ms. Winker's CAPM produced an ROE of 8.20%.[239]

Mr. Hevert's CAPM analysis resulted in an ROE range of 8.37% to 11.66%[240] but his CAPM analysis is flawed and should not be given any weight. Mr. Hevert's analysis uses two market risk premiums that were derived by conducting a DCF analysis for the S&P 500. However, Mr. Hevert's DCF model for the S&P 500 uses sustainable market growth rates that are far too high to be a rational outlook for sustainable long-term market growth, especially when compared to historic returns of the market.[241] Specifically, Mr. Hevert uses sustainable market growth rates of approximately 11.63% and 14.82%.[242] For comparison, Duff & Phelps estimates the actual capital appreciation for the S&P 500 over the period 1926 through 2018 to have been

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[235] TIEC Ex. 5 (Gorman Direct) at 83-84.

[236] OPUC Ex. 3 (Winker Direct) at 37.

[237] *Id.* at 39-40.

[238] *Id.* at 37.

[239] *Id.* at 39.

[240] CEHE Ex. 26 (Hevert Direct) at 69.

[241] TIEC Ex. 5 (Gorman Direct) at 80.

[242] *Id.* at 80-81.

5.8% to 7.7%.[243] Mr. Hevert's growth rates are also more than two times the U.S. GDP long-term growth outlook of 4.00%.[244] Current projected U.S. GDP growth is closer to the 4.0% to 4.5% range.[245] Because Mr. Hevert relies on unreasonably high market growth rates when calculating his estimated market DCF returns for his CAPM analysis, it produces inflated and unreliable results. Therefore, Mr. Hevert's CAPM results should not be considered by the Commission in establishing CenterPoint Houston's cost of equity.

B. Cost of Debt [PO Issue 8]

OPUC witness Ms. Winker did not recommend adjusting CenterPoint Houston's requested long-term cost of debt of 4.38%.[246]

C. Capital Structure [PO Issue 7]

OPUC recommends a capital structure of 54.5% debt and 45.5% equity.[247] This capital structure differs only slightly from the Company's current capital structure, which was approved by the Commission in Docket No. 38339, and reflects the current book values found in Schedule II-C-2.1 of the Company's RFP.[248] CenterPoint Houston's current capital structure has supported the issuance of long-term debt totaling approximately $2.4 billion since 2012.[249] Even after the TCJA took effect, the Company was able to issue $400 million in long-term debt at a 3.95% interest rate.[250] Therefore, a 54.5%-45.5% capital structure will allow CenterPoint Houston to continue to attract capital without unnecessarily inflating its rates.

D. Overall Rate of Return [PO Issue 8]

OPUC recommends an overall rate of return of 6.55%. This recommendation is calculated by incorporating Ms. Winker's recommended ROE of 9.15%, long-term cost of debt

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243 *Id.*

244 *Id.*

245 *Id.*

246 OPUC Ex. 3 (Winker Direct) at 44.

247 *Id.* at 43.

248 *Id.*

249 *Id.* at 42.

250 *Id.*

of 4.38%, and capital structure of 54.5% debt and 45.5% equity, as shown in the following table:[251]

	% of Capitalization	**Cost**	**Weighted Cost**
Long-Term Debt	54.5%	4.38%	2.3%
Common Equity	45.5%	9.15%	4.16%
TOTAL	**100%**		**6.55%**

OPUC's recommendation is an appropriate and reasonable overall rate of return for CenterPoint Houston that allows the Company a reasonable opportunity to earn a reasonable return on its invested capital used and useful in providing service to the public in excess of its reasonable and necessary operating expenses.[252] For these reasons, the Commission should adopt an overall rate of return for CenterPoint Houston of 6.55%.

IV. OPERATING AND MAINTENANCE EXPENSES [PO Issues 4, 5, 21, 22, 25, 26, 28, 29, 33, 35, 36, 38, 39, 54, 55]

Only expenses that are reasonable and necessary to provide service to the public are eligible to be included in allowable expenses.[253] An allowable expense is one that an electric utility "incurred in furnishing normal electric utility service and in maintaining electric utility plant used by and useful to the electric utility in providing such service to the public."[254] With these standards in mind, OPUC recommends adjustments to the Company's requested expenses in the following categories: incentive compensation, affiliate expenses, Hurricane Harvey restoration costs, self-insurance reserve, vegetation management, SMT expense, and loss on the sale of land.

[251] OPUC Ex. 3 (Winker Direct) at 44.

[252] *See* PURA § 36.051.

[253] 16 TAC § 25.231(b).

[254] 16 TAC § 25.231(b)(1)(A).

B. Labor Expenses

1. Incentive Compensation

OPUC recommends adjusting CenterPoint Houston's requested expenses for its short-term and long-term incentive compensation plans ("STI Plan" and "LTI Plan," respectively) to remove all costs associated with financially-based performance goals. Applying OPUC's recommendation results in total reductions of $12,579,000 for the STI Plan and $12,116,000 for the LTI Plan as follows:

	STI Plan[255]	**LTI Plan**[256]
Plan Expenses	($11,656,000)	($11,250,000)
Payroll Tax	($834,000)	($780,000)
Texas Gross Margin Tax	($90,000)	($86,000)

The Commission's precedent is well-established that incentive compensation based on financial performance measures should be excluded from rates. CenterPoint Houston has not provided evidence sufficient to support a finding that this precedent does not apply to its incentive compensation plans. Therefore, 82.68% of the Company's STI Plan costs and 100% of its LTI Plan costs should be excluded from the cost of service.

Since at least 2005, the Commission has repeatedly held that incentives to achieve financial measures are not necessary and reasonable to provide service to the public because they are of more immediate benefit to a company's shareholders, rather than ratepayers.[257] In Southwestern Public Service Company's ("SPS") most recent fully litigated base rate case, Docket No. 43695, the Commission once again confirmed that a utility may not include the costs

[255] OPUC Ex. 1 (Dively Direct) at 44; OPUC Ex. 2A (Dively Confidential Workpapers) at WP JMD-9.

[256] *Id.* at 46; OPUC Ex. 2A (Dively Confidential Workpapers) at WP JMD-8.

[257] *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 40443, Order on Rehearing at FOF Nos. 214-220 (Mar. 6, 2014); *Application of Entergy Texas, Inc. for Rate Case Expenses Pertaining to PUC Docket No. 39896*, Docket No. 40295, Order at 2 (May 21, 2013); *Application of Entergy Texas, Inc. for Authority to Change Rates*, Docket No. 39896, Order on Rehearing at FOF Nos. 127-133 (Nov. 2, 2012); Docket No. 38339, Order on Rehearing at FOF Nos. 81-83; *Application of Oncor Electric Delivery Company, LLC for Authority to Change Rates*, Docket No. 35717, Order on Rehearing at FOF Nos. 92-93 (Nov. 30, 2009); *Application of AEP Texas Central Company for Authority to Change Rates*, Docket No. 33309, Order on Rehearing at FOF No. 82 (Mar. 4, 2008); *Application of AEP Texas Central Company for Authority to Change Rates*, Docket No. 28840, Order at FOF Nos. 169-70 (Aug. 15, 2005).

of incentives that are tied to financial performance measures in rates.[258] In its Order on Rehearing in that case, the Commission adopted a $2,604,995 adjustment to SPS's annual incentive compensation plan because SPS had removed some, but not all, of the costs associated with the plan's financially-based components.[259] The Commission based its decision on the fact that the incentive compensation plan included both financially-based and performance-based goals, and that payouts under the plan were not made to employees unless an earnings per share trigger was met by the company.[260] The combination of these elements led the Commission to disallow the annual incentive compensation costs that were directly tied to the financial metrics (which SPS had already removed) as well as 50% of the remaining incentive compensation costs (in recognition of the financial trigger).[261]

The Commission reached a similar conclusion in Southwestern Electric Power Company's ("SWEPCO") most recent base rate case, Docket No. 46449, to make a $2,277,726 adjustment to SWEPCO's annual incentive compensation plan.[262] The Commission's Order on Rehearing stated that "[a] certain amount of incentives to achieve operational measures is reasonable and necessary to the provision of electric service. However, SWEPCO failed to prove that its proposal removed all of the costs associated with the financially-based components of the annual incentive plan."[263] Similar to SPS, SWEPCO's incentive compensation plan included both financially-based and performance-based goals, as well as an earnings per share trigger.[264] However, the adjustment that was recommended by the State Office of Administrative Hearings ("SOAH") Administrative Law Judges ("ALJs") in the proposal for decision ("PFD") and adopted by the Commission recognized that SWEPCO's trigger was

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[258] *Application of Southwestern Public Service Company for Authority to Change Rates*, Docket No. 43695, Order on Rehearing at 5 (Feb. 23, 2016).

[259] *Id.* at FOF Nos. 84A and 85A.

[260] *Id.* at FOF Nos. 83A and 83B.

[261] *Id.* at 6; *see also* Docket No. 43695, PFD at 90-91 (describing the methodology underlying the adjustment adopted by the Commission).

[262] *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449, Order on Rehearing at FOF No. 198 (Mar. 19, 2019).

[263] *Id.* at FOF No. 197.

[264] *Id.* at FOF No. 195-96.

weighted at 75% rather than 100% and adjusted the blanket 50% reduction to the cost of the annual incentive plan accordingly.[265]

In Docket No. 46449, SWEPCO also voluntarily removed all of its long-term incentive compensation plan costs that were financially-based.[266] However, the Commission agreed with the conclusion in the SOAH ALJs' PFD that it was proper to include the $359,705 related to restricted stock units ("RSUs") in rates.[267] To reach this conclusion, the SOAH ALJs' PFD relied on the Commission's decision in SWEPCO's prior rate case in Docket No. 40443, which allowed SWEPCO to recover the cost of the RSUs.[268]

a. Short-Term Incentive Compensation

OPUC recommends disallowing $11,656,000 of the $29,462,931 that CenterPoint Houston requested for its STI Plan.[269] The STI Plan includes a financial trigger based on CenterPoint Houston's core operating income, and the plan is not funded unless a defined level of operating income is met or exceeded by the Company.[270] Payouts made to employees under the STI Plan are based on a mix of financial and operational performance goals weighted as follows:

Performance Goal	**Weight[271]**
Overall Company Core Operating Income	38.44%
Overall CNP Consolidated Earnings Per Share	30.51%
Overall O&M Expenditures	13.73%
Customer Satisfaction	7.09%
Overall Company Safety Performance	10.22%

265 *Id.* at FOF No. 198; *see also* Docket No. 43695, PFD at 240-41, 243.

266 Docket No. 46449, Order on Rehearing at FOF No. 199.

267 Docket No. 46449, PFD at 245.

268 *Id.*

269 OPUC Ex. 1 (Dively Direct) at 46; OPUC Ex. 2A (Dively Confidential Workpapers) at WP JMD-9; CEHE Ex. 1, WP II-D-3 Adj. 2.1; CEHE Ex. 1a, Confidential WP II-D-3.6.1a.

270 Tr. at 1340-41.

271 OPUC Ex. 2A (Dively Confidential Workpapers) at WP JMD-9; Staff Ex. 4A (Filarowicz Direct) at Att. MF-11.

CenterPoint Houston characterizes the core operating income and earnings per share metrics as financial goals and the three remaining metrics as operational goals.[272]

Despite admitting in discovery that its STI Plan includes both financial and operational goals, CenterPoint Houston is seeking to recover the full cost of the plan. This position is contrary to well-established Commission precedent, including the Commission's decision in SPS's rate case in Docket No. 43695 discussed above, which stated:

> It is well-established that a utility may not include in its rates the costs of incentives that are tied to financial performance measures...when a utility elects to adopt a compensation plan that involves both financially-based and performance-based metrics, the utility still must show it has removed all aspects of the financially-based goals from its requested expense.[273]

Therefore, CenterPoint Houston should not recover the STI Plan costs tied to the core operating income and earnings per share metrics because those costs should not have been requested by the Company.

In addition, CenterPoint Houston should not recover the STI Plan costs tied to overall O&M expenditures because this metric was mischaracterized as an operational goal. This performance measure is similar to the O&M growth management performance measure that SPS voluntarily removed from the costs of its annual incentive plan in Docket No. 43695, and CenterPoint Houston has failed to explain how its overall O&M expenditures metric is different from SPS's metric.[274] As described by CenterPoint Houston witness Ms. Lynne Harkel-Rumford, "the goals associated with STI motivate employees to effectively manage operations expenses, which contribute to a financially healthy company, allowing investors to earn a reasonable return on their investment."[275] While it is true that customers benefit from company goals that promote cost savings, the prudent management of O&M expenditures is already encouraged by the ratemaking process through the requirement that an electric utility may only recover its reasonable and necessary operating expenses.[276]

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272 Staff Ex. 4A (Filarowicz Direct), Att. MF-11.

273 Docket No. 43695, Order on Rehearing at 5.

274 Docket No. 43695, PFD at 88.

275 CEHE Ex. 22 (Harkel-Rumford Direct) at 27.

276 PURA § 36.051.

Further, the achievement levels for this metric are based on how far overall O&M expenditures fall below a target amount,[277] and the amount CenterPoint Houston saves on O&M expenditures directly affects the Company's bottom line. Ms. Harkel-Rumford has not explained what CenterPoint Houston does with the cost savings that are generated from meeting this performance goal, so there is no way to know if the cost savings are used for a purpose that benefits the Company's customers.[278] Consequently, it is Center Point Houston's shareholders that reap the immediate benefits of this performance goal, while customers do not see any of the benefits until the Company files a base rate case.[279]

Based on the foregoing considerations, OPUC recommends that the 82.68% of CenterPoint Houston's STI plan costs that are associated with operating income, earnings per share, and overall O&M expenditures be excluded from rates because the metrics are financially-based performance measures that immediately benefit the Company's shareholders. OPUC also supports Commission Staff and the City of Houston's recommendations to disallow an additional 50% of the STI Plan expense that is not directly tied to the Company's financial performance measures.[280] This disallowance recognizes the financial trigger included in CenterPoint Houston's STI Plan and is consistent with the methodology applied by the Commission in Docket Nos. 43695 and 46449.[281]

Finally, OPUC addresses the assertion by CenterPoint Houston witness Ms. Colvin that the intervenor witnesses incorrectly based their recommended reductions to the Company's STI Plan on per book amounts provided in discovery or workpapers supporting the schedules in the Company's RFP.[282] Ms. Colvin contends that these intervenor witnesses should have based their adjustments on a total STI expense of $16,881,000.[283] As stated above, OPUC witness Ms. Dively recommended disallowing 82.68% of CenterPoint Houston's requested STI expenses, and

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[277] CEHE Ex. 39 (Harkel-Rumford Rebuttal) at 15; *see also* CEHE Ex. 22 (Harkel-Rumford Direct) at Confidential Exh. LHR-5 at 2.

[278] Staff Ex. 4A (Filarowicz Direct) at 17.

[279] OPUC Ex. 1 (Dively Direct) at 42-43; COH Ex. 2 (Garrett Direct) at 25.

[280] Staff Ex. 4A (Filarowicz Direct) at 37; COH Ex. 2 (Garrett Direct) at 30.

[281] *See* Docket No. 46449, Order on Rehearing at FOF Nos. 194-98; Docket No. 43695, Order on Rehearing at 5-6 & FOF Nos. 83A-85A.

[282] CEHE Ex. 35 (Colvin Rebuttal) at 17.

[283] *Id.* at 17, Figure 3.

82.68% of $16,881,000 is $13,957,211.[284] Notably, the combination of Ms. Dively's recommended disallowance and Ms. Colvin's total STI expense results in a reduction to the Company's STI expense that is larger than the $11,656,000 reduction recommended by OPUC. Thus, Ms. Colvin's recommendation would increase OPUC's recommended disallowance by $2,301,211.

b. Long-Term Incentive Compensation

OPUC recommends disallowing the full $11,250,034 that CenterPoint Houston requested for its LTI Plan.[285] The LTI Plan awards certain CenterPoint Houston employees, mainly executives and other key employees, with two types of CenterPoint Energy ("CNP") stock—performance shares and restricted stock.[286] The performance goals for the LTI Plan are measured using the three-year periods that overlap with the test year, 2016 through 2018, 2017 through 2019, and 2018 through 2020, and are based on total shareholder return and operating income for 2016 and 2017 and total shareholder return and net utility income for 2018.[287] The test year costs for the LTI Plan are based on the performance shares and RSUs for these three periods.[288] As with its STI Plan, CenterPoint Houston has not removed the LTI Plan costs directly related to financially based metrics from the amount requested.[289]

The Commission denied CenterPoint Houston's request to recover its LTI Plan costs in Docket No. 38339 because it found that the plan was based on financially-based performance metrics.[290] The basis for this decision has not changed in the eight years since the Commission issued its Order on Rehearing in Docket No. 38339. Tying the award of LTI to shareholder return and operating income shifts the plan participants' focus to achieving goals that primarily benefit the Company's shareholders.[291] As noted by City of Houston witness Mr. Mark Garrett, the Company has acknowledged this aspect of the LTI Plan in its description of the plan's

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[284] *See* Tr. at 1275.

[285] OPUC Ex. 1 (Dively Direct) at 44; OPUC Ex. 2A (Dively Confidential Workpapers) at WP JMD-8.

[286] CEHE Ex. 22 (Harkel-Rumford Direct) at 30.

[287] *Id.*

[288] *Id.*

[289] *See id.* at 20-21 ("The Company is requesting recovery of...test year LTI expenses.")

[290] Docket No. 38339, Order on Rehearing at FOF No. 82; *see also* Docket No. 38339, PFD at 66-67.

[291] OPUC Ex. 1 (Dively Direct) at 44.

objectives, which state in relevant part that "[s]uch awards will...give Participants in the Plan an interest in the Company parallel to that of the shareholders..."[292] Thus, OPUC joins Commission Staff, the City of Houston, and TIEC in recommending that 100% of the costs of CenterPoint Houston's LTI Plan be excluded from rates.

On rebuttal, CenterPoint Houston argues that the portion of the LTI Plan that is paid out in the form of RSUs is time based, rather than financially based.[293] However, evidence introduced by TIEC suggests otherwise. Ms. Harkel-Rumford admitted during cross-examination that the LTI Plan is "designed to reward participants for sustained improvements in CenterPoint's financial performance and increases in the value of CenterPoint's common stock and dividends" and that RSUs are "intended to reward employees for long term stock appreciation."[294] The Proxy Statement that accompanied CNP's notice of its annual shareholder meeting scheduled for April 25, 2019, states that one of the goals of the executive compensation plan is to "align interests of executives with shareholders."[295] Moreover, the Proxy Statement shows that CNP executives generally have outstanding grants in any given year covering three concurrent periods.[296] Consequently, once an executive meets the initial three-year vesting period, there is a much stronger incentive to perform in a manner that keeps stock prices high over the long term, which directly benefits shareholders.[297]

In light of these facts, it is reasonable to conclude that some portion of the RSUs are awarded based on financial goals, yet the only evidence provided by the Company is an assertion that RSU awards are wholly time-based. As stated previously, CenterPoint Houston bears the burden of showing that it has removed *all* financially based incentives from its requested LTI expense because its LTI Plan includes both performance-based and financially based goals.[298] The Company has not met its burden. Consequently, the entire amount of CenterPoint Houston's LTI expense that is based on the RSUs should be removed from the cost of service.

[292] COH Ex. 2 (Garrett Direct) at 35 (quoting the LTI Plan provided in response to PUC RFI No. 03-03).

[293] CEHE Ex. 39 (Harkel-Rumford Rebuttal).

[294] Tr. at 1343-44.

[295] TIEC Ex. 15 at 22; *see also* Tr. at 96-98.

[296] TIEC Ex. 15 at 34.

[297] *See id.* at 36 ("The restricted stock units are intended to retain executive officers *and reward them for absolute long-term stock appreciation...*") (emphasis added).

[298] Docket No. 43695, Order on Rehearing at 5.

D. Affiliate Expenses [PO Issue 35, 36]

1. Vectren Issues

OPUC recommends a full disallowance of the $1.6 million adjustment made to the affiliate expenses billed to CenterPoint Houston by CenterPoint Energy Service Company, LLC ("Service Company") to account for "integration planning." Both the Service Company and CenterPoint Houston are wholly owned subsidiaries of CenterPoint Energy ("CNP"). On February 1, 2019, CNP completed a merger with Vectren Corporation ("Vectren").[299] During the latter part of the test year, certain Service Company employees spent time performing activities related to the merger, which CenterPoint Houston witness Ms. Michelle Townsend describes as integration planning activities.[300] According to Ms. Townsend, the $1.6 million increase to affiliate expenses billed to the Company represents an estimate of the expenses that the Service Company would have charged to CenterPoint Houston but for the need to perform integration planning.[301]

The Company's adjustment to account for integration planning should be denied because it is not a known and measurable change. Under 16 TAC § 25.231(b), an electric utility may recover its "historical test year expenses as adjusted for known and measurable changes."[302] To determine the amount of the adjustment, CenterPoint Houston tracked all labor and time that Service Company employees billed to planning integration activities and then "calculated an *estimate* of the portion that would have [*sic*] billed to CenterPoint Houston using 2018 planned billings."[303] While it is true that the Company knows with certainty the amount of time that Service Company employees spent on integration planning, Ms. Townsend has admitted that the additional $1.6 million allocated to CenterPoint Houston is an "estimate" based on an "assumption" that these employees would have spent time providing support services to the Company absent the need to work on the merger.[304] In addition, CenterPoint Houston used the

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[299] OPUC Ex. 1 (Dively Direct), Att. JMD-10 at 1.

[300] CEHE Ex. 15 (Townsend Direct) at 46.

[301] *Id.*

[302] 16 TAC § 25.231(b).

[303] CEHE Ex. 15 (Townsend Direct) at 46 (emphasis added).

[304] CEHE Ex. 37 (Townsend Rebuttal) at 17.

Service Company's 2018 planned billings, which are also estimated, to determine the portion of the amount billed to integration planning activities that would have been billed to CenterPoint Houston for support services under normal circumstances.[305] However, there is no real way to know if all $1.6 million of the Service Company employee time billed to CenterPoint Houston would have actually been spent providing services to the Company.[306]

CenterPoint Houston has also failed to provide sufficient evidence to show that the level of Service Company billings diverted to integration planning is temporary. The Texas Supreme Court has held that the Commission may take into account changes in costs occurring after the test year in order to make test year costs as representative as possible of the recurring costs that are "apt to prevail in the future."[307] While the integration planning phase is over, CNP's merger with Vectren has already resulted in a reduction of 32 full-time equivalents,[308] and CenterPoint Houston's response to OPUC RFI No. 01-12 states that when the Vectren companies are added to CNP's allocation schedule, the costs allocated to other CNP companies (including CenterPoint Houston) decrease.[309] Further, the Company's response to GCCC RFI No. 01-14 includes a projection of the cost savings that will result from the synergies achieved through the merger,[310] and CenterPoint Houston witness Mr. Jeffrey Myerson testified that the cost savings to CNP resulting from the merger with Vectren are estimated at more than $50 million in 2019 and more than $75 million in 2020.[311]

Taken together, these facts outweigh Ms. Townsend's unsupported assertion that it is necessary to adjust the affiliate costs allocated to CenterPoint Houston to capture "normal Service Company billings"[312] because the Company has not shown that this level of billings will

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[305] *Id.*

[306] OPUC Ex. 1 (Dively Direct) at 48.

[307] *Suburban Util. Corp. v. Pub. Util. Comm'n of Tex.*, 652 S.W.2d 358, 366 (Tex. 1983).

[308] OPUC Ex. 1 (Dively Direct) at Att. JMD-12.

[309] *Id.*

[310] *Id.* at HSPM Att. JMD-11.

[311] CEHE Ex. 47 (Myerson Rebuttal) at 13.

[312] CEHE Ex. 37 (Townsend Rebuttal) at 17.

continue to be normal post-merger. Thus, OPUC recommends reducing CenterPoint Houston's requested cost of service by $1,523,202.[313]

2. Compensation for Use of Capital

OPUC recommends a $7,842,463 reduction to CenterPoint Houston's cost of service to remove affiliate expenses for "compensation for use of capital" because the Company has not shown that these expenses meet the affiliate standard in PURA § 36.058. The disallowance is comprised of a $7,786,463 reduction to O&M expenses and a corresponding $56,000 reduction to the TGMT expense.[314] As shown in the Company's response to PUC RFI No. 02-37, the $7,786,463 billed to CenterPoint Houston by its affiliate, the Service Company, represents a return on assets that are held by the Service Company and used to provide bundled services to its affiliates (including CenterPoint Houston).[315]

Expenses paid to an affiliate are held to a higher standard than expenses paid to a third party.[316] In order for a utility to recover expenses paid to an affiliate, the Commission must find that: (1) the expense is reasonable and necessary; and (2) the price charged to the utility is not higher than the price charged by the supplying affiliate to its other affiliates or to a nonaffiliated person under the same market conditions.[317] This analysis is necessary because affiliate transactions are not arms-length, which raises the possibility of self-dealing.[318]

The compensation for use of capital expense does not meet the first prong of the affiliate standard because CenterPoint Houston has not shown why the amount of the return paid to the Service Company is reasonable and necessary. CenterPoint Houston has admitted that this expense was not separately identified in Schedule V-K-7 of the Company's RFP and was instead buried in the costs allocated to the Finance, Technology Operations, and Business Operations Support service classes included in the schedule.[319] Consequently, it was only through discovery

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313 OPUC Ex. 1 (Dively Direct) at 50.

314 *Id.* at 40.

315 *Id.* at Att. JMD-6.

316 PURA § 36.058.

317 PURA § 36.058 (b)-(c).

318 *R.R. Comm'n of Tex. v. Rio Grande Valley Gas Co.*, 683 S.W.2d 783, 786 (Tex. App.—Austin 1984, no writ).

319 CEHE Ex. 37 (Townsend Rebuttal) at 15.

that the Company revealed the specific assets on which the return was paid, the amount of return paid to the Service Company, and how the return was calculated.[320]

Further, OPUC witness Ms. Dively raised issues regarding how the return on the shared assets was calculated, which CenterPoint Houston has failed to address. First, Ms. Dively opined that CenterPoint Houston's response to GCCC RFI No. 01-09 indicated that the value of the Service Company assets was determined using the "Estimated Net Book Value as of 12/31/2017," which is "calculated during the planning process using the June 30, 2017 Net Book Value and adjusted for the remaining 2017 depreciation and adjustments."[321] However, CenterPoint Houston did not provide the data underlying the calculations thereby precluding a review of the original cost, depreciation, and adjustments used to reach the net book value.[322] Second, Ms. Dively noted that CenterPoint Houston did not explain why it applied the overall rate of return to the estimated net book value for 2017, rather than the actual net book value as of December 31, 2018, which is the value that coincides with the Company's test year for this case.[323]

Third, Ms. Dively concluded that it was unreasonable for CenterPoint Houston to pay a return on shared assets that was computed using an overall rate of return of 11.37%.[324] This return is significantly higher than both the Company's currently-authorized return of 8.21%[325] and the Company's requested return of 7.39%. Specifically, the overall rate of return incorporated a cost of debt of 6.92%, a return on equity of 11.25%, and a capital structure of 60% debt and 40% equity.[326] In comparison, the Company has requested a cost of debt of 4.38%, a return on equity of 10.4%, and a capital structure of 50% debt and 50% equity.[327]

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320 OPUC Ex. 1 (Dively Direct) Atts. JMD-6 through JMD-8.

321 OPUC Ex. 1 (Dively Direct) at 38.

322 *Id.*

323 *Id.* at 38-39.

324 *Id.* at 39 and Att. JMD-8.

325 Docket No. 38339, Order on Rehearing at FOF No. 75A.

326 OPUC Ex. 1 (Dively Direct) at 39.

327 CEHE Ex. 27 (McRae Direct) at 4.

Finally, Ms. Dively noted that the tax gross-up factor of 1.6044 appears to be based on a 35% federal tax rate (rather than the current 21%) plus about 4.29% in undisclosed other taxes.[328]

Rather than addressing Ms. Dively's concerns, the rebuttal testimony of CenterPoint Houston witness Ms. Townsend simply states that 11 of the Company's witnesses testified to the reasonableness and necessity of the services provided to CenterPoint Houston by the Service Company.[329] Of those 11 witnesses, the three potentially relevant Company witnesses are Ms. Colvin, Ms. Shachella James, and Mr. John Slanina because their testimonies relate to the three service classes on Schedule V-K-7 (Finance, Technology Operations, and Business Operations Support) that the compensation for use of capital expense is embedded in.[330] None of these witnesses expressly address the reasonableness of the costs allocated to CenterPoint Houston for compensation for use of capital, nor do they tie their explanations of the various services provided by these three groups to any particular type of shared asset on which CenterPoint Houston pays a return.

Ms. Townsend's rebuttal testimony also incorrectly cites to PURA § 36.051 as support for her contention that it is reasonable for the Service Company to earn a return on its shared assets.[331] This provision of PURA only allows "the utility" to earn a reasonable return on assets, and PURA §§ 11.004 and 31.002 define public utility and utility as "a person or river authority that owns or operates for compensation in this state equipment or facilities to produce, generate, transmit, distribute, sell, or furnish electricity in this state."[332] The Service Company does not fall within this definition. In addition, PURA § 11.003 includes a separate definition for affiliate that includes references to a public utility, which suggests that an affiliate is its own distinct entity.[333] Accordingly, Ms. Townsend's rebuttal testimony does not show why it is reasonable

[328] OPUC Ex. 1 (Dively Direct) at 39.

[329] CEHE Ex. 37 (Townsend Rebuttal) at 15.

[330] CEHE Ex. 15 (Townsend Direct) at Figure 2. OPUC notes that Charles Pringle, Robert McRae, and Michelle Townsend also provide testimony in support of specific service classes that are within the Finance organization.

[331] CEHE Ex. 37 (Townsend Rebuttal) at 13.

[332] *See* PURA § 11.004(1) (stating that utility means "an electric utility, as that term is defined by Section 31.002").

[333] PURA § 11.003(2).

for the Service Company to earn a return on its shared assets or why the amount of return requested is reasonable.

F. Hurricane Harvey Restoration Costs [PO Issues 54, 55]

1. Disallowance for failure to validate expenses.

OPUC recommends the removal of certain expenses from the Hurricane Harvey regulatory asset because the Company failed to validate the expenses. OPUC's recommended disallowance is based on the results of an internal audit that the Company conducted for its Hurricane Harvey-related costs. The primary objectives of the internal audit review were to:

1. Assess process and procedures to capture, identify, and accurately record storm-related costs;
2. Evaluate the process to ensure that only Hurricane Harvey-related expenses were charged as storm costs;
3. Determine if there were adequate internal controls in place to validate that appropriate storm-related expenses were charged as storm costs, and to ensure that payments were properly charged to the correct accounts; and
4. Verify whether consistent and adequate documentation was retained to support storm-related expenses.[334]

The internal audit's overall conclusion was that the Company's Emergency Operations Plan ("EOP") expense validation effort provided reasonable justification for Hurricane Harvey-related expenses.[335] However, the internal audit identified a number of instances where costs were incorrect or not adequately documented by the Company.[336]

The identified costs were primarily centered on three areas: EOP Hotel Expenses, EOP Catering and Logistics, and EOP OnePay Expenses.[337] For each of these three categories, OPUC witness Mr. Nalepa's conclusions and recommended disallowance amounts are as follows:

> EOP Hotel Expenses: The review sampled 18 invoices representing 81% of the total audit population.[338] It found two samples totaling \$3,496 that had unresolved invoice discrepancies and five samples totaling \$218,796 that did not have complete or consistent documentation. Grossing up for the percentage

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[334] OPUC Ex. 5 (Nalepa Direct) at Att. KJN-3 at 42 (Audit p. 3) (Confidential).

[335] *Id.* at Att. KJN-3 at 43 (Audit p. 4) (Confidential).

[336] OPUC Ex. 5 (Nalepa Direct) at 16.

[337] OnePay is an expense approval and reimbursement system.

[338] OPUC Ex. 5 (Nalepa Direct) at Att. KJN-3 at 45 (Audit p. 6) (Confidential).

sampled suggests that $274,435 in hotel expenses had inadequate documentation.[339]

EOP Catering and Logistics Expenses: The review sampled four invoices representing 89% of the total audit population.[340] One invoice of $2 million had services that were procured and paid for by the same manager in violation of Company policy and had incomplete documentation. A second invoice of $3.41 million had no supporting documentation. A third invoice of $957,344 had inconsistently applied contract rates and lacked documentation on a portion of the expenses. Finally, a fourth invoice included vendor agreements of $1.52 million that were not signed when the services were rendered by the vendor. Grossing up for the percentage sampled suggests that $8.858 million in catering and logistics expenses were incorrect or had inadequate documentation.[341]

EOP OnePay Expenses: The review sampled 50 expenses representing 36% of the total audit population.[342] The review found six samples totaling $5,937 of hotel occupancy taxes that had been suspended by the Governor during hurricane relief efforts. The review also found five samples totaling $128,283 that lacked complete documentation. Grossing up for the percentage sampled suggests that $373,833 in OnePay expenses were incorrect or had inadequate documentation.[343]

The total recommended disallowance for these three categories is $9.505 million. In rebuttal, the Company agreed with the removal of $77,983 of these costs.[344]

While the internal audit concluded that the EOP expense validation effort provided reasonable justification for Hurricane Harvey-related expenses, it is clear that the audit found specific instances when contemporaneous documentation of expenses was incorrect or inadequate as described above.[345] In rebuttal testimony, CenterPoint Houston witness Ms. Kelly Gauger contended that while certain items lacked "full" documentation, there was sufficient documentation to conclude that the expenses were incurred for the Hurricane Harvey storm

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[339] *Id.* at 17.

[340] *Id.* at Att. KJN-3 at 47-48 (Audit p. 8-9) (Confidential).

[341] *Id.* at 17.

[342] *Id.* at Att. KJN-3 at 52 (Audit p. 13) (Confidential).

[343] OPUC Ex. 5 (Nalepa Direct) at 17.

[344] CEHE Ex. 20 (Gauger Rebuttal) at 9-10; *see also* CEHE Ex. 35 (Colvin Rebuttal) at 35. The agreed amount is comprised of $3,496 for hotel invoices with unresolved discrepancies, $5,937 for hotel occupancy taxes that were paid but had been suspended by the Governor, and $68,550 for catering expenses with inconsistent contract rate documentation.

[345] OPUC Ex. 5 (Nalepa Direct) at 16.

restoration efforts.[346] For example, for the $218,796 in hotel invoices that the audit found "did not have complete or consistent documentation," Ms. Gauger states that "the documentation was sufficient to determine that the expenses were valid and appropriate."[347] However, this statement is not is not based on the audit results, and Ms. Gauger did not provide any supporting documentation for her statement. Ms. Gauger makes similar claims regarding the $3.4 million catering expense and the EOP OnePay expenses, but again does not provide supporting documentation.[348] In contrast, each of OPUC's recommended disallowances is based on the specific findings of the internal audit.

Ultimately, the internal audit identified deficiencies in the Company's documentation for certain Hurricane Harvey restoration costs. The Company has the burden of proving its expenses are reasonable and necessary, and if the Company cannot for lack of documentation, then the expenses must be removed from the Company's cost of service. Therefore, OPUC recommends that the Hurricane Harvey regulatory asset be reduced by $9.505 million for the expenses identified above and that the associated carrying charges also be removed.

The Company criticized Mr. Nalepa's calculation of the disallowance amount because he "grossed up" the sample results.[349] However, because the entire pool of invoices was not audited, the Company has not demonstrated that the unaudited expenses were reasonable. While the Company states that it used judgmental sampling rather than statistical sampling,[350] the choice of sampling technique does not prove that the unsampled invoice amounts are reasonable. Some method must be used to account for the lack of information for the unsampled invoices. OPUC's proposal to gross up the results of the audit findings is a reasonable method of estimating the portion of the expenses that did not have adequate documentation. Nevertheless, if the amounts are not grossed-up, the total amount of $8,243,856 for the specific invoices identified in the audit that lacked documentation should be removed from the Company's Hurricane Harvey regulatory asset.

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[346] CEHE Ex. 20 (Gauger Rebuttal) at 6.

[347] *Id.*

[348] *Id.* at 7-8.

[349] *Id.* at 10-11.

[350] *Id.*

2. Disallowance for employee awards and gifts, and expensed capital costs.

OPUC witness Mr. Nalepa recommended an adjustment to the Company's Hurricane Harvey expenses to remove $18,713 for employee awards and gifts and expensed capital costs.[351] In rebuttal, the Company stated that it agreed with this adjustment.[352] Accordingly, $18,713 should be removed from the Company's proposed Hurricane Harvey regulatory asset.

G. Self-Insurance Reserve [PO Issues 16, 33]

CenterPoint Houston self-insures against storm-related property losses impacting its transmission and distribution assets, rather than obtaining property insurance from a third-party. Under the Commission's rules, a utility's self-insurance plan provides for accruals to be credited to reserve accounts.[353] The reserve accounts are to be charged with certain property and liability losses that occur and that are not paid or reimbursed by commercial insurance.[354]

In this proceeding, CenterPoint Houston is requesting an annual accrual of $7.685 million and a new target property insurance reserve of $6.55 million. The accrual consists of two elements: (1) $3.575 million to provide for average annual O&M expense losses from storm events where the O&M expense loss is greater than $100,000 and the total event loss does not exceed $100 million; and (2) $4.110 million accrued annually for three years to achieve the target reserve of $6.55 million from the current reserve deficit level of ($5.791 million).[355]

OPUC recommends an adjustment to the accrual amount for the target reserve. Under the Company's proposal, it would reach its target amount over a period of three years. However, consistent with OPUC witness Ms. Dively's recommendation to use a five-year amortization period for the Company's regulatory assets, OPUC recommends a five-year period for accruing the target reserve. As discussed in Section II.G above, the longer period more appropriately strikes the balance between moderating the impact on customer rates and achieving intergenerational equity.[356] In addition, City of Houston witness Mr. Mark Garrett testified that

[351] OPUC Ex. 5 (Nalepa Direct) at 18-19.

[352] CEHE Ex. 35 (Colvin Rebuttal) at 35.

[353] 16 TAC § 25.231(b)(1)(G).

[354] CEHE Ex. 12 (Colvin Direct) at 27.

[355] CEHE Ex. 28 (Wilson Direct) at 5.

[356] OPUC Ex. 1 (Dively Direct) at 12.

the reserve deficiency occurred over an eight-year period and that it would be reasonable to reestablish the reserve over eight years.[357] The length of time over which the deficiency occurred also weighs in favor of a longer period than the three years proposed by the Company. OPUC believes that a five-year period strikes the right balance.

Using a three-year time period as the Company proposes is unnecessary and would fail to account for the significant impact on customer rates. Notably, in its last rate case, the Company requested to build its reserve over a ten-year period.[358] In this case, CenterPoint Houston contends that using a five- or eight-year period to build up the target reserve may subject the Company to additional storm losses that could further deplete the reserve.[359] However, the risk of storm losses exists regardless of the time period used to rebuild the reserve. If the reserve is not sufficient to cover storm losses, there are other options available to the Company to recover its costs. For instance, if the Company experiences significant losses, it can seek to securitize the storm restoration costs,[360] which it has done for other storms like Hurricane Ike. In addition, under the Commission's rate review schedule, CenterPoint Houston must file a comprehensive base-rate proceeding every four years.[361] If the Company experiences storm losses prior to its next rate case, it can seek to recover its storm restoration costs in its next rate case similar to how it seeks to recover its Hurricane Harvey costs in this proceeding. The time period for restoring the target reserve must balance both the interests of customers and the utility. For the reasons discussed above, using a five-year period to rebuild the target reserve is reasonable in this case.

The impact of using the five-year period is that the target reserve amount is \$1.642 million less than the Company's calculated target reserve.[362] The adjustment should be made to Schedule II-D-2 of CenterPoint Houston's application, which reflects a known and measurable change for the property loss accrual. Using OPUC's revised accrual amount, the adjustment in column 3 of Schedule II-D-2 would be \$1.893 million.[363]

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[357] COH/HCC Ex. 2 (Garrett Direct) at 53-54.

[358] Docket No. 38339, PFD at 72

[359] CEHE Ex. 35 (Colvin Rebuttal) at 23.

[360] PURA §§ 36.401-.403.

[361] 16 TAC § 25.247.

[362] OPUC Ex. 5 (Nalepa Direct) at 24.

[363] *Id.*

H. Vegetation Management

CenterPoint Houston's vegetation management expenses in the test year were abnormally high compared to recent years and should be normalized to better represent the expenses the Company will incur in the future. During the test year, CenterPoint Houston incurred $35.022 million in vegetation management expenses.[364] In contrast, between 2011 and 2017, the Company's annual vegetation management expenses averaged $26.78 million.[365] The 2018 expense of $35.02 million was $8.24 million, or 31%, higher than the prior seven-year average. The table below is a summary of the Company's expenditures in prior years compared to the test year:[366]

CenterPoint Houston Annual Tree Trimming Expense

Program Description	2011	2012	2013	2014	2015	2016	2017	2018
Proactive Tree Trimming	20.39	20.31	19.89	18.98	22.15	24.18	21.73	28.02
Hazard Tree Removal	3.26	6.02	2.93	1.20	0.93	0.76	0.61	0.62
Reactive Tree Trimming	2.51	2.15	2.70	2.76	3.95	4.51	5.56	6.38
Total	26.16	28.48	25.52	22.94	27.03	29.45	27.90	35.02

As shown in the table, the Company's vegetation management expenses for the 2018 test year represent a significant increase from the prior years.

CenterPoint Houston has not demonstrated that the higher level of expenses in 2018 is likely to continue in the future. The Company stated that its contractor bid prices on a per mile basis have increased since 2014 and its overhead pole miles are increasing each year.[367] However, as shown in Table 1 above, the Company's vegetation management expenses do not show a steady year-over-year increase as would be expected with a year-over-year increase in contractor bid prices and overhead pole miles. Instead, the table shows that, from 2011 to 2017, the Company's expenses fluctuated up and down from a high of $29.45 million in 2016 to a low of $22.94 million in 2014. Notably, in 2017, the Company's proactive trimming, reactive trimming, and hazard tree removal were halted for a significant period of time due to Hurricane

[364] CEHE Ex. 7 (Pryor Direct) at WP RMP-1; OPUC Ex. 5 (Nalepa Direct) at KJN-3 at 8-9 (CEHE Response to COH RFI No. 1-27).

[365] CEHE Ex. 7 (Pryor Direct) at WP RMP-1; OPUC Ex. 5 (Nalepa Direct) at KJN-3 at 8-9 (CEHE Response to COH RFI No. 1-27).

[366] OPUC Ex. 5 (Nalepa Direct) at 8.

[367] CEHE Ex. 7 (Pryor Direct) at 42-44.

Harvey.[368] It is not clear whether the reduced vegetation management activity in 2017 impacted the need for additional vegetation management in 2018. Even so, any "catch-up" work does not justify a permanent increase in the Company's annual vegetation management expenses.

Even with the lower levels of vegetation management expenses in prior years, the Company has been able to adequately conduct its tree trimming activities with no adverse effect on reliability. With the average annual expenditures of $26.78 million for 2011 to 2017, the Company has been able to trim on average more than 4,900 miles of overhead lines each year since 2011[369] (excluding 2017 because tree trimming activities were interrupted by Hurricane Harvey).[370] The number of miles trimmed during that period ranged from a high of 5,606 in 2011 to a low of 3,922 in 2017.[371]

To normalize the vegetation management expenses, OPUC witness Mr. Nalepa recommended that vegetation management expenses be set at $28.126 million, which is $6.896 million less than the Company's request. This recommendation is based on the average vegetation management expenses incurred by the Company during the three-year period of 2015-2017. The average expenditures consist of expenses made in the years immediately before the 2018 test year and reflect the most recent tree trimming activity. The use of average expenditures addresses the year-to-year variation in expenses. The three-year period reflects the next highest annual expenditures (excluding 2012, a year in which the Company had unusually high hazard tree removal costs).

The Company has the burden of proof to demonstrate that its requested expenses are reasonable and necessary. In this case, the Company has not shown that its test-year level of vegetation management expenses is representative of its expected annual expenses. Therefore, the amount that the Company has requested is not reasonable and necessary. For the reasons stated above, OPUC requests that the Commission adopt Mr. Nalepa's adjustment to normalize the vegetation management expenses. Mr. Nalepa recommends that vegetation management expenses be set at $28.126 million, which is a reduction of $6.896 million from the Company's

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368 OPUC Ex. 5 (Nalepa Direct) at KJN-3 at 35 (CEHE Response to PUC RFI No. 05-01).

369 *Id.* at KJN-3 at 10 (CEHE Response to COH RFI 08-04).

370 *Id.* at KJN-3 at 35 (CEHE Response to PUC RFI No. 05-01).

371 *Id.*

request. OPUC notes that City of Houston witness Mr. Scott Norwood makes a similar adjustment to normalize CenterPoint Houston's vegetation management expenses as part of his broader recommendation to normalize several of the Company's O&M expenses.[372] OPUC believes that Mr. Norwood's recommended adjustment would also be a reasonable method for normalizing the Company's vegetation management expenses.

I. Smart Meter Texas Expense

In this proceeding, CenterPoint Houston is requesting $3.6 million in "anticipated" SMT expenses, which reflects an adjustment to its test-year amount of SMT expenses.[373] However, the Company's proposed adjustment includes changes that are not known and measurable, and therefore, should be rejected. Instead, OPUC recommends starting with the test-year level of SMT expenses and making one adjustment to reflect a known and measurable change established by contract.

CenterPoint Houston's SMT expenses relate to the Company's participation in the SMT portal, which is an ERCOT-wide website that provides access to smart meter data to end-use retail customers, competitive retailers, and other customer-authorized third parties.[374] SMT is jointly owned and operated by CenterPoint Houston, Oncor Electric Delivery Company, AEP Texas Inc., and TNMP under a Joint Development and Operations Agreement ("JDOA"). The parties to the JDOA contract with IBM for the design, development, and ongoing operation of the SMT website.[375] Under the JDOA, CenterPoint Houston is responsible for a share of the annual SMT costs.

CenterPoint Houston's share of the annual SMT costs is expected to change in 2019 and beyond. In 2018, the Commission updated the business requirements for SMT, commonly referred to as "SMT 2.0," in Docket No. 47472.[376] CenterPoint Houston witness John Hudson stated that after the Commission's order in Docket No. 47472, the contract between the JDOA

[372] COH/HCC Ex. 1 (Norwood Direct) at 6-13; COH/HCC Ex. 2 (Garrett Direct) at 51-52 (noting that Mr. Norwood's O&M adjustment includes an adjustment to normalize vegetation management expenses).

[373] CEHE Ex. 11 (Hudson Direct) at 28.

[374] *Id.* at 27.

[375] *Id.*

[376] *See Commission Staff's Petition to Determine Requirements for Smart Meter Texas*, Docket No. 47472, Order (July 12, 2018).

parties and IBM was amended to cover the changes necessary to comply with the SMT 2.0 requirements and to extend the term of the contract through 2024.[377]

Rather than using 2018 test-year SMT expenses, the Company prepared an estimate of the costs "expected" to be incurred under the SMT program for the period 2020 through 2024.[378] The Company's direct testimony did not provide any description or explanation of the proposed changes. However, based on a workpaper to Schedule II-D-I of the Company's application, the Company's requested amount includes an estimate of employee travel and meal expenses, professional and legal expenses, contracted IT, and maintenance costs, plus an added 10% contingency factor for "Misc Unexpected Expenses."[379]

With one exception discussed below, the Company has failed to demonstrate that its "expected" SMT expenses reflect known and measurable changes to its test-year level expenses. The Company's expected SMT expenses include increases from the test-year level that are not explained or supported by the Company. For instance, the requested amounts are higher for employee travel expenses ($1,500 vs. $1,132.15) and business meals and entertainment ($240 vs. $28.98),[380] but no explanation is provided as to why those amounts would be higher or represent a known and measurable change. The Company is also including an estimate for professional services related to the JDOA project manager, but Mr. Hudson acknowledged that the contract is for services on an hourly basis and that the actual amount incurred could be higher or lower than the estimate for the services. Thus, the amount for these services is not known and measurable.

In addition, CenterPoint Houston has applied a 10% contingency factor to all of its requested SMT expenses.[381] The Company contends that this amount is necessary to cover potential change requests that are authorized under the amended SMT contracts.[382] However, on cross-examination, Mr. Hudson acknowledged that the amounts for the potential change requests in future years are unknown.[383] In addition, he stated that CenterPoint Houston has experienced

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[377] CEHE Ex. 11 (Hudson Direct) at 28.

[378] *Id.* at 27-28.

[379] CEHE Ex. 2 at WP/II-D-1 Adj 10.

[380] Tr. at 249-50 (Hudson Cross).

[381] CEHE Ex. 2 at WP/II-D-1 Adj 10; Tr. at 253-54 (Hudson Cross).

[382] CEHE Ex. 34 (Hudson Rebuttal) at 5; Tr. at 257-58 (Hudson Cross).

[383] Tr. at 258-59 (Hudson Cross).

change requests prior to 2019,[384] so the Company has not demonstrated that a representative amount of change requests is not already included in the test year. Moreover, the contingency factor is designed to provide a buffer for unexpected costs that may occur but cannot be quantified. Therefore, the contingency factor is an unknown and unmeasurable cost and should not be recovered from customers.

While CenterPoint Houston's "expected" SMT costs are generally not known and measurable, the record does support one change to the test-year amounts. It is undisputed that the Company's SMT contracts were amended to address SMT 2.0. Because the SMT costs for 2020 and after are based on actual contract costs, these amounts should be used to calculate the ongoing SMT expenses, instead of the 2018 test year amounts. In the test year, CenterPoint Houston's costs under the contracts were for "IT services" in the amount of $3,450,044 and software maintenance in the amount of $214,673, for a total of $3,664,717.[385] Going forward, these contracts are replaced by the "hosting contract" ($2,356,368), "maintenance contract" ($478,404) and "Maintenance – Oracle" ($125,000), for a total of $2,959,772.[386] The difference between the contract totals is $704,945. The Company's test-year SMT expenses were $3.925 million, but in this proceeding, it is requesting $3.565 million in base rates for ongoing SMT expenses.[387] After replacing the 2018 contract amounts with the current contract amounts, the Company's ongoing SMT expense amount would be reduced by $0.345 million to $3.220 million.[388] This amount should be used rather than the Company's estimates, because it appropriately reflects the Company's historical test-year expenses, adjusted for known and measurable changes.

J. Loss on Sale of Land

During the test year, CenterPoint Houston incurred a loss of $1.464 million on the sale of 14 tracts of land associated with the Brazos Valley Connection transmission project. The

[384] Tr. at 258 (Hudson Cross).

[385] CEHE Ex. 2 at WP/II-B-12d SMT; Tr. at 252 (Hudson Cross).

[386] CEHE Ex. 2 at WP/II-D-1 Adj 10; Tr. at 252 (Hudson Cross).

[387] CEHE Ex. 12 (Colvin Direct) at 32; CEHE Ex. 2 at WP/II-D-1 Adj 10.

[388] $3,924,608 - $3,664,717 + $2,959,772 = $3,219,663. This amount differs slightly from the calculation in OPUC witness Mr. Nalepa's testimony based on information provided by Mr. Hudson at the hearing clarifying which 2018 contract amounts were comparable to the Company's current contract amounts.

Company is seeking to share that loss on a 50/50 basis between its shareholders and customers.[389] The Company's request to share the loss with customers should be denied. CenterPoint Houston has not demonstrated that the loss was reasonable nor that customers should be responsible for paying a share of the loss.

The record contains limited information on the reasonableness of the loss. The total book value of the tracts was $2.294 million, but the tracts were sold for a total of $0.830 million, resulting in a total loss of $1.464 million.[390] The Company's direct testimony did not provide any description of the sales transactions or explain why there was a loss on the sale of the tracts. In rebuttal, CenterPoint Houston witness Mr. Narendorf described the reason for the loss as follows:

> When land was purchased, entire lots had to be purchased instead of just acreage for the proposed right-of-way easement. Many of the tracts included improvements, such as homes or other structures at the time of purchase. In order to make the land useful for the project, the land was cleared and this required the demolition of these improvements. Upon completion of the project, the Company sold off the excess areas of fee-purchased land that was no longer suitable for the utility to own. With the improvements no longer existing, the property can only be assessed for the value of the land, resulting in a reduction from the original purchase price.[391]

While the Company has now provided some description of the loss, it is not sufficient to determine whether the full amount of the loss was reasonable and necessary. For instance, the information provided does not explain why full tracts of land were purchased rather than smaller tracts or easements. The information also does not discuss what steps the Company took, if any, to preserve the value of the properties, such as limiting the amount of demolition performed. No information was provided regarding the market price of similar tracts at the time of purchase or sale of the tracts. As a result, it is not possible to determine whether the Company overpaid for the tracts or sold below market price. The Company bears the burden of proving that its costs are reasonable and necessary. Given the lack of information provided on the loss on the sale of

[389] CEHE Ex. 12 (Colvin Direct) at 50; CEHE Ex. 1 (Application) at WP/II-E-5.1.

[390] OPUC Ex. 5 (Nalepa Direct) at 24-25.

[391] CEHE Ex. 32 (Narendorf Rebuttal) at 32.

the land, the Company has failed to meet its burden, and the loss should not be recovered from customers.

The Company has also failed to demonstrate that sharing a *loss* on the sale of land is appropriate. The Company contends that in its last rate case the Commission found that customers should share in any gain or loss resulting from the sale of land during the test year.[392] However, the Company's interpretation of the Commission's decision is overbroad. The Company cites FOF No. 137 from the Order on Rehearing, which stated that: "Land is not a depreciable asset, and customers have not paid any depreciation expense associated with the land. This does not mean ratepayers have no claim on any gain or loss resulting from the sale of land."[393] While this FOF references a gain or loss, the case itself dealt only with a gain on a sale.[394] The Commission also noted that ratepayers pay a return on the investment and expenses associated with land, such as taxes, and that customers should benefit through a 50% share of the gain on any land sold during the test year.[395] Thus, the Commission was acknowledging that customers should benefit from their contributions that made the gain possible. In this case, CenterPoint Houston would have the customers provide not only a return on the land and payment of associated expenses, but also shield the Company from a portion of its loss on the land.

There are important policy considerations that warrant the different treatment for a loss on the sale of land versus a gain on the sale of land. If a utility is allowed to share losses on the sale of land, it may reduce the utility's incentive to obtain the best purchase and sales prices because the utility would not fully bear the consequences of its decisions.[396] The utility also controls if and when a parcel of land is sold, not the customer.[397] If there is a loss on the sale of the land, the utility should be expected to document its actions to show that the original purchase price was reasonable and the subsequent sales price was reasonable. This documentation is particularly important for significant losses, such as the one in this case where the Company

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392 CEHE Ex. 12 (Colvin Direct) at 50.

393 Docket No. 38339, Order on Rehearing at FOF No. 137.

394 *Id.* at FOF No. 139B.

395 *Id.* at 5.

396 OPUC Ex. 5 (Nalepa Direct) at 26.

397 *Id.*

incurred a 64% reduction in the value of the land. The Company purchased the land for almost $22,000 per acre, but sold it for less than $8,000 per acre.[398] As discussed above, the Company provided a brief description of how the loss occurred, but did not provide sufficient information to demonstrate the reasonableness of the sales price and loss.

For the reasons discussed above, the Company's loss on the sale of the land should not be passed on to customers. OPUC, therefore, recommends reducing the Company's requested increase by $732,057, which is 50% of the total loss on the sale of the land.

VI. BILLING DETERMINANTS [PO Issue 4, 5, 45]

A. Weather Normalization

Weather normalization is the process is which utilities make weather adjustments to normalize energy usage patterns in the test year.[399] By looking at weather data from recent years, a test year weather pattern can be constructed that is representative of normal conditions. This approach ensures that rates are not based upon the specific and possibly uncharacteristic weather pattern that occurred in one particular year.

One of the factors in the normalization process is the determination of a reasonable historic period to provide a baseline for normal weather. In this case, CenterPoint Houston proposes to use a 20-year time period to compute the weather adjustment.[400] However, a 20-year weather normalization period is not consistent with Commission precedent. In recent years, the Commission has consistently used a 10-year weather normalization period to ensure that trends in weather data are appropriately captured. Accordingly, both OPUC and Commission Staff recommend the use of a 10-year weather normalization period in this case.[401]

When CenterPoint Houston's last base rate proceeding was decided in 2011, it was common for the Commission to use a 30-year weather normalization period.[402] However, since that time, the Commission has consistently used a 10-year weather normalization period in litigated base-rate proceedings. In SWEPCO's rate case in Docket No. 40443 that was decided

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[398] *Id.*

[399] OPUC Ex. 5 (Nalepa Direct) at 40.

[400] CEHE Ex. 29 (McMenamin Direct) at 36-37.

[401] OPUC Ex. 5 (Nalepa Direct) at 5; Staff Ex. 5A (Maloy Direct) at 19-21.

[402] *See, e.g.*, Docket No. 38339, Order on Rehearing at FOF 181.

in 2014, the Commission rejected the utility's proposal to use a 30-year weather normalization period and instead adopted a 10-year weather normalization period.[403] In that case, the Commission based its decision on the existence of weather trends, stating in FOF Nos. 256 to 258 that:

> 256. Weather data is not randomly distributed by year. There can be weather trends.
>
> 257. The use of a 30-year period for normalizing weather is not a reasonable means of capturing such trends.
>
> 258. The use of 10 years of data is a reasonable means of capturing such weather trends.[404]

Consistent with this precedent, the Commission adopted a 10-year weather normalization period in 2016 in SPS's rate case in Docket No. 43695.[405] The issue was litigated again in SWEPCO's most recent rate case in Docket No. 46449, which was decided in 2018. In that case, the Commission similarly found in FOF Nos. 271 to 275 that:

> 271. Weather data are not randomly distributed by year. There can be weather trends, including both warming and cooling trends.
>
> 272. The use of a 30-year period for normalizing weather is not a reasonable means of capturing such trends.
>
> 273. The use of 10 years of data is a reasonable means of capturing such weather trends.
>
> 274. The use of 10 years of data is more sensitive to weather patterns during the test year.
>
> 275. The weather-normalization adjustment should be applied to adjust billing units and allocation factors for a 10-year weather-normalization period, based on the class billing determinants and external allocation factors used to calculate rates using a 10-year weather-normalization period.[406]

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[403] Docket No. 40443, Order on Rehearing at FOFs 256-58.

[404] *Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at FOF Nos. 256-58 (Mar. 6, 2014).

[405] Docket No. 43695, Order on Rehearing at FOF No. 238.

[406] Docket No. 46449, Order on Rehearing at FOF Nos. 271-75.

Thus, the Company's proposal to use a 20-year weather normalization period is not consistent with the Commission's use of a 10-year weather normalization period in other recent rate cases.

Further, in addition to rate cases, the Commission uses a 10-year weather normalization period in other types of utility proceedings. In particular, the Commission uses a 10-year weather normalization period for: (1) DCRF proceedings;[407] (2) calculating a utility's annual energy efficiency goals;[408] and (3) utility earnings monitoring reports ("EMRs").[409] Notably, when the Commission adopted Section 25.247 of its rules, it concluded that it was "appropriate to specify in the rule the use of a 10-year period for weather normalization. This clarification eliminates potential controversy and ensures consistency with other commission rules and form instructions."[410] The Company's proposal to use a 20-year weather normalization period has introduced the type of controversy that the Commission sought to avoid, and if approved, it would create a mismatch between the weather normalization period used in this case and the weather normalization period used in the Company's subsequent DCRF proceedings, annual energy efficiency goals, and EMRs. Therefore, the Company's proposal should be rejected.

CenterPoint Houston witness Dr. J. Stuart McMenamin based his recommendation for a 20-year time period on two factors: (1) recent surveys conducted by his employer Itron Inc. ("Itron"), and (2) his contention that using shorter periods provides "a less stable measure."[411] With respect to the surveys, there is not sufficient evidence in the record to use the surveys as a basis for overturning the Commission's current precedent for a 10-year weather normalization period. Dr. McMenamin did not provide any of the underlying data on which the surveys were based, nor did he provide any details regarding the facts that other jurisdictions relied on to support their selected time period.[412] As Dr. McMenamin noted, Itron did not ask about the

[407] 16 TAC § 25.243(b)(5) (defining "weather-normalized" as "[a]djusted for normal weather using weather data for the most recent ten calendar years").

[408] 16 TAC § 25.181(e)(3)(A).

[409] OPUC Ex. 5 (Nalepa Direct) at 44; *see also* 16 TAC § 25.247(2)(B); Staff Ex. 10 (CenterPoint Houston 2018 EMR Excerpt) at 29.

[410] *Rulemaking Proceeding to Establish Filing Schedules for Investor-Owned Electric Utilities Operating Solely Inside ERCOT*, Project No. 47545, Order Adopting New 25.247 at 21 (Apr. 16, 2018).

[411] CEHE Ex. 44 (McMenamin Rebuttal) at 27-28.

[412] Tr. at 367 (McMenamin Cross).

reasons for moving away from the 10-year weather normalization period.[413] Further, the survey results show that many electric utilities are still using a 10-year (or shorter) weather normalization period.[414] In fact, as recently as 2018, the Commission maintained its support for a 10-year weather normalization period.[415] Thus, the survey results do not indicate that a 10-year weather normalization period is unreasonable.

Dr. McMenamin noted that based on "group conversations on the topic," the main reason reported for moving from a 10-year period is to provide a wider window and, thus, a more stable forecast process.[416] As an initial matter, it is not clear who participated in the group conversations that Dr. McMenamin is referring to or what the basis was for those individual participants' opinions. Nevertheless, the Commission has also raised specific concerns with using shorter time periods for weather normalization. In adopting the DCRF rule, the Commission stated:

> The use of larger sample sizes in the development of inferential statistics is generally more representative than smaller sizes, but only when statistical data points are randomly distributed. As Oncor Cities point out, weather data are not randomly distributed by year. There can be weather trends, and the commission concludes that the use of ten years of data is a reasonable means of capturing such trends.[417]

Thus, the use of the 10-year period was intentional because longer periods may not adequately capture weather trends.

Notably, Dr. McMenamin agreed that the use of a 10-year weather normalization period would be valid.[418] He also does not refute the basis for the Commission's prior decisions that a 10-year period is appropriate, namely that weather data are not randomly distributed by year and that there can be weather trends.

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[413] CEHE Ex. 44 (McMenamin Rebuttal) at 29.

[414] *Id.* at 28.

[415] Docket No. 46449, Order on Rehearing at FOF Nos. 271-75.

[416] CEHE Ex. 44 (McMenamin Rebuttal) at 29.

[417] *Rulemaking Related to Periodic Rate Adjustments*, Project No. 39465, Order Adopting New §25.243 at 38 (Sept. 22, 2011).

[418] CEHE Ex. 44 (McMenamin Rebuttal) at 22.

If there are weather trends as the Commission has previously recognized, then using a longer time period is more likely to produce results that are biased toward understating temperatures, which would result in per kWh charges that are too high due to lower billing determinants. A reduction in billing determinants has the same effect as increasing the Company's revenue requirement,[419] which would result in higher rates for customers.

Based on these considerations, the Commission should adopt a 10-year weather normalization period in this proceeding. Using calculations performed by the Company, OPUC witness Mr. Nalepa recommended increasing test year revenues by $11.902 million to account for using a 10-year weather normalization period.[420] However, Commission Staff witness Ms. Alicia Maloy recommended certain adjustments to the weather normalization regression models used for the calculations.[421] If Commission Staff's recommendations are adopted, the calculation of the amount of the 10-year weather adjustment should be updated accordingly.

B. Energy Efficiency Plan Adjustment

CenterPoint Houston is seeking to adjust test-year billing determinants to account for energy efficiency measures that were installed throughout the test year.[422] The Company refers to this change as the Energy Efficiency Plan ("EEP") adjustment. The Company contends that the energy reductions associated with its energy efficiency programs were not fully captured in the test year data and that its proposed change to the billing determinants is a known and measurable adjustment. As discussed below, the Commission should not adopt the Company's proposed EEP adjustment because the change is not known and measurable, and is a type of lost revenue adjustment mechanism ("LRAM"), which the Commission has previously rejected.

A utility's cost of service is set based on its cost of rendering service to the public during a historical test year, *adjusted for known and measurable changes.*[423] To depart from the test-year data, a utility's proposed change must be both known and measurable. To satisfy this

[419] Staff Ex. 7 (Abbott Direct) at 6-8.

[420] OPUC Ex. 5 (Nalepa Direct) at 45-46.

[421] Staff Ex. 5A (Maloy Direct) at 21-25.

[422] CEHE Ex. 30 (Troxle Direct) at 10.

[423] 16 TAC § 25.231(a) (emphasis added).

standard, the expenses that are accounted for in the utility's cost of service are "limited to amounts actually realized or which can be anticipated with reasonable certainty."[424]

In calculating its proposed EEP adjustment, the Company is not using measurements of actual cost savings from its energy efficiency programs. Instead, the Company's calculations are based on "deemed savings" obtained from the Commission's Technical Reference Manual ("TRM") for energy efficiency programs.[425] The Commission's TRM defines deemed savings as "an approach for estimating average or typical savings for efficiency measures installed in relatively homogenous markets with well-known building characteristics and usage schedules."[426] The Commission's TRM, therefore, indicates that the savings amounts listed are estimates that are based on averages and that the savings amounts are intended to apply to certain markets. The estimates are based on engineering algorithms and common practice, rather than actual measured energy and demand savings.[427] In addition, the estimates are not tailored to CenterPoint Houston's specific service area, so there may be factors specific to that service area that may impact the actual savings calculations for the Company. Thus, to the extent that there were actual energy reductions as a result of CenterPoint Houston's energy efficiency programs in the test year, these energy reductions are not reflected in the Company's EEP adjustment.

Further, the implementation of energy efficiency measures does not automatically lead to energy usage reductions. As the Commission indicated in its report to the 85th Legislature regarding alternative ratemaking mechanisms, "[q]uantifying the sales lost due to conservation is problematic and controversial.... [M]ethods rely upon a combination of sampling, statistical analysis, and estimation of customer loads, and sometimes upon engineering estimates of the energy savings associated with particular energy efficiency investments."[428] The Commission's report cited several studies indicating that "[e]ngineering estimates have dubious reliability" in the context of energy efficiency. One study found that for a sample of 30,000 households participating in a residential energy efficiency program, the "model-projected savings [were]

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[424] *Oncor Elec. Delivery Co. LLC v. Pub. Util. Comm'n of Texas*, 406 S.W.3d 253, 263 (Tex. App.—Austin 2013, no pet.) (citing *Suburban Util. Corp. v. Public Util. Comm'n*, 652 S.W.2d 358, 362 (Tex.1983)).

[425] CEHE Ex. 30 (Troxle Direct) at 12.

[426] Staff Ex. 7 (Abbott Direct) at 10.

[427] OPUC Ex. 5 (Nalepa Direct) at 47.

[428] Staff Ex. 7 (Abbott Direct) at 11-12 (citing *Report to the 85th Legislature – Alternative Ratemaking Mechanisms*, Project No. 46046, Christensen Report at 24 (Jan. 12, 2017)).

roughly 2.5 times the actual savings."[429] Another study found that consumers with improved insulation and more efficient heating equipment conserved 8-13% less energy than would be predicted from engineering models.[430] Lastly, another study found that upgrading the efficiency of air conditioners actually *increased* energy consumption, rather than decreasing energy consumption.[431] Thus, the Commission's report and the referenced studies show the risk of simply assuming that deemed savings will materialize or be in the amount that is projected. Deemed savings simply do not equate to known and measurable savings.

As discussed by Commission Staff witness Mr. William Abbott, energy efficiency should not be conflated with energy conservation.[432] There is a well-documented "rebound" or "upsizing" effect from certain energy efficiency measures, in which "more energy efficient appliances can actually induce more energy usage, or at least offset a large portion of what would otherwise be energy reductions."[433] This phenomenon is demonstrated in the studies mentioned above. Because the Company is not using actual savings information, the extent of the rebound effect for the particular energy efficiency measures that the Company implemented cannot be known or measurable.

Additionally, CenterPoint Houston's proposed EEP adjustment should be rejected because it is an impermissible LRAM. An LRAM is a rate adjustment mechanism that would permit a utility to recover revenues that are specifically reduced as a result of the utility's energy efficiency programs.[434] The Company has twice before proposed LRAMs that the Commission has rejected. In the Company's EECRF proceeding in Docket No. 38213, the Company requested an LRAM to collect lost revenues based on "verified and reported 2009 energy savings."[435] In that docket, the Commission found that: "P.U.C. SUBST. R. 25.181 and PURA §§ 36.204 and 39.905 do not permit a utility to recover the amount of decrease in revenues that

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[429] *Id.*

[430] *Id.*

[431] *Id.*

[432] *Id.* at 21-22.

[433] *Id.* at 22.

[434] OPUC Ex. 5 (Nalepa Direct) at 48.

[435] *Id.*

result from energy-efficiency programs through an EECRF."[436] In addition, when the Commission amended its energy efficiency rule in Project No. 37623, CenterPoint Houston filed comments supporting the adoption of an LRAM, contending that energy efficiency programs harm the ability of utilities to recover Commission-authorized costs. Consistent with its prior decision in Docket No. 38213, the Commission declined to adopt an LRAM mechanism in the energy efficiency rule.

While there are some minor differences between the Company's prior proposals and its proposed EEP adjustment in this proceeding, each proposal fundamentally involves an increase to rates based on estimated reductions in energy sales due to energy efficiency measures.[437] While the Company's current proposal would reduce billing determinants, this proposed adjustment would have the same effect as increasing the revenue requirement.[438] Further, as noted in the Commission report discussed above, LRAMs "require controversial estimates of sales lost due to conservation," and there "is a significant risk of over-estimating efficiency gains, thus over-compensating utilities and over-charging customers."[439] This same risk is present with the Company's proposed EEP adjustment.

For the reasons discussed above, CenterPoint Houston's proposed EEP adjustment is not known and measurable and should be rejected by the Commission. Furthermore, this case is the Company's "third bite at the apple" at requesting an LRAM, and the Commission should deny the Company's request based on prior precedent. Removing the Company's requested EEP adjustment would increase test year revenues by $1.205 million, and correspondingly, reduce the Company's requested increase by the same amount.[440]

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[436] *Application of CenterPoint Energy Houston Electric, LLC to Defer Energy Efficiency Cost Recovery and for Approval of an Energy Efficiency Cost Recovery Factor*, Docket No. 38213, Supplemental Preliminary Order at 6 (June 23, 2010).

[437] Staff Ex. 7 (Abbott Direct) at 17.

[438] *Id.*

[439] *Id.* at 12.

[440] OPUC Ex. 5 (Nalepa Direct) at 49.

VII. FUNCTIONALIZATION AND COST ALLOCATION [PO Issues 4, 5, 43, 44, 46]

B. Class Allocation

3. Transmission and Key Accounts

CenterPoint Houston proposes to allocate the costs for its Transmission and Key Accounts Department to all customer classes.[441] However, consistent with cost-causation principles, OPUC recommends that the department's costs for the "Transmission Accounts and Support" group be directly assigned to the transmission function.

The Transmission and Key Accounts Department is comprised of three groups: Transmission Accounts and Support, Key Accounts, and Street Lighting Design.[442] Of these three groups, OPUC witness Mr. Nalepa recommended that the costs for the Transmission Accounts and Support group be directly assigned to the transmission function because the group is 100% dedicated to serving transmission customers.[443] According to the Company, the Transmission Accounts and Support group "is responsible for the interconnection of large industrial customers and generators to the transmission system, approval and payment of Transmission Cost of Service payments to other Transmission Service Providers, and coordination of regulatory filings for CenterPoint Houston's transmission projects, including the monthly construction reports, final cost reports, and Certificate of Convenience and Necessity ("CCN") applications."[444] Each of these functions directly relates to transmission service.

The Commission prefers to directly assign costs to functions to the maximum extent reasonably possible consistent with cost causation.[445] The Commission has addressed a similar issue in recent rate cases for vertically integrated utilities regarding the treatment of "major account representatives."[446] These representatives are utility employees who provide services

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[441] CEHE Ex. 2 at Schedule II-I-TDCS. The costs for the department are customer service-related expenses that are functionalized to "T&D Customer Service." These costs are found on lines 605-623 of the spreadsheet titled "Schedule H-I-J and CA ERRATA - 1" at tab "II-I-TDCS."

[442] CEHE Ex. 10 (Sugarek Direct) at 7-8.

[443] OPUC Ex. 5 (Nalepa Direct) at 50-52.

[444] *Id.*

[445] Staff Ex. 2A (Murphy Direct) at 17-18 (citing the Commission's TDU rate-filing package and *Texas Utilities Electric Company Filing in Compliance with Subst. R. 23.67*, Docket No. 15638, Order at 2 (Oct. 20, 1997).

[446] *See, e.g.*, Docket No. 46449, Order on Rehearing at FOF No. 294-99.

either to large customers or national chains.[447] The Commission concluded in SWEPCO's recent rate case that it was reasonable to allocate the cost of such representatives *solely* to the large commercial and industrial customers who benefitted from their services and, further, that such allocation was consistent with cost-causation principles.[448] The Commission has also made similar findings for major account representatives for Entergy Texas, Inc. ("ETI")[449] and SPS.[450] The same principles that apply to major account representatives apply here and support the direct assignment of costs to transmission customers.

To determine the amount to directly assign to transmission, OPUC witness Mr. Nalepa initially recommended taking one third of the annual expense for the Transmission and Key Accounts Department because the Transmission Accounts and Support group is one of three groups in the department. At the hearing, however, CenterPoint Houston witness Ms. Julienne Sugarek indicated that the annual cost of the Transmission Accounts and Support group is $1.3 million.[451] Accordingly, OPUC recommends that $1.3 million be directly assigned to transmission. The Company has allocated $267,000 to the transmission voltage class,[452] and this amount should be increased by $1,033,000.[453] In addition, the costs allocated to other classes should be correspondingly reduced by first directly assigning the customer service-related transmission costs, and then allocating the remaining costs using CenterPoint Houston's allocation factors.

4. Allocation of Hurricane Harvey Restoration Costs [PO Issue 56]

In its application, CenterPoint Houston was inconsistent in explaining its proposed functionalization of the Hurricane Harvey regulatory asset.[454] As discussed in OPUC witness Mr. Nalepa's testimony, the Hurricane Harvey regulatory asset contains both distribution- and

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[447] *Id.* at FOF No. 294.

[448] *Id.* at FOF Nos. 297-99.

[449] *Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment*, Docket No. 39896, Order on Rehearing at 8 (Nov. 1, 2012).

[450] Docket No. 43695, Order on Rehearing at FOF Nos. 312-14.

[451] Tr. at 235 (Sugarek Cross).

[452] OPUC Ex. 5 (Nalepa Direct) at 52 (citing Schedule II-I-TDCS).

[453] $1,300,000 - $267,000 = $1,033,000.

[454] OPUC Ex. 5 (Nalepa Direct) at 49.

transmission-related costs.[455] Therefore, Mr. Nalepa recommended that the recovery of the regulatory asset be functionalized to both distribution and transmission customers based on the relative amount of each type of cost in the asset. In rebuttal, the Company agreed with Mr. Nalepa's recommendation,[456] and thus, the appropriate functionalization of the asset no longer appears to be in dispute. The Company provided the correct functionalization in its updated Schedule II-E-4.1 filed on June 14, 2019. The amounts in the updated schedule differ from the amounts in Mr. Nalepa's direct testimony because the Company's errata added carrying charges to the Hurricane Harvey regulatory asset. OPUC has proposed certain disallowances to the requested amount for the Hurricane Harvey regulatory asset and a correction to the calculation of associated carrying charges. The amount of the regulatory asset that is ultimately approved for recovery in this case should be functionalized to both transmission and distribution.

IX. RIDERS [PO Issues 4, 5, 43, 51, 52]

C. Other Riders

As discussed in Section II.G. above, OPUC recommends that the Commission establish separate riders for the Company's regulatory assets for Hurricane Harvey restoration costs, the Medicare Part D subsidy, SMT expense, TGMT expense, and REP bad debt. OPUC's support for the recommended riders is discussed above.

XII. CONCLUSION

For the reasons stated herein and discussed in the testimonies of its witnesses, OPUC respectfully requests that the SOAH ALJs adopt and incorporate OPUC's recommendations into the PFD in this proceeding. OPUC further asks to be granted any other relief to which it may be entitled.

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[455] *Id.* at 50.

[456] CEHE Ex. 35 (Colvin Rebuttal) at 38-39.

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing document was served on all parties of record in this proceeding on this 9th day of July 2019 by facsimile, electronic mail, and/or first class, U.S. Mail.

Cassandra Quinn