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

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC'S
<u>POST-HEARING REPLY BRIEF</u>

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I. Introduction/Summary [Preliminary Order (PO) Issues 1, 2, 3, 4]

In presenting its requested revenue requirement, CenterPoint Energy Houston Electric, LLC ("CEHE" or the "Company") has been transparent and candid regarding the financial pressure that has been created by two factors outside the Company's control—growth across the Company's service territory, from increasing density in the city center to brand new suburban communities and industrial complexes in outlying areas,[1] and the Tax Cuts and Jobs Act of 2017 ("TCJA"), which has significantly reduced the Company's cash flow. It is unfortunate that after producing thousands of pages of supporting documentation and participating in five days of hearing, the Intervenors and Public Utility Commission of Texas ("Commission") Staff remain steadfast in their refusal to seek a balanced result.

Through its testimony and supporting documentation, CEHE has shown that approval of its requested revenue requirement will allow the Company to preserve its financial integrity. This, in turn, will allow CEHE to support the continued population growth and commercial and industrial expansion expected in CEHE's service territory for years to come. In contrast, adoption of the proposals offered by Intervenors and Staff will weaken CEHE's financial integrity and jeopardize its ability to continue to provide what is arguably the most reliable electric service in the State of Texas. Make no mistake—despite their efforts to distract the Commission and the Administrative Law Judges ("ALJs") from volumes of evidence supporting the Company's cost of service and requested revenue requirement—the Intervenor and Staff proposals in this case are credit negative for CEHE. If adopted, these proposals threaten CEHE's future ability to respond to economic and customer growth, proactively maintain an existing system that faces annual hurricane risk, secure debt at reasonable rates, and meet the expectations of its customers and the Commission in terms of customer service, safety, and reliability.

[1] Tr. at 146-149 (Mercado Redirect) (Jun. 24, 2019).

Chiefly, the Intervenors and Staff argue that if CEHE actually needed a rate increase, it would have filed this case before it was required to do so under 16 Texas Administrative Code ("TAC") § 25.247.[2] This argument is not credible nor is it supported by the evidence in the record. It is also not credible that the Intervenors and Staff collectively seek to reduce CEHE's revenue requirement by hundreds of millions of dollars; the cumulative adjustments proposed by the City of Houston ("COH"), Texas Coast Utilities Coalition ("TCUC") and Gulf Coast Coalition of Cities ("GCCC") *alone* result in a current base rate decrease for CEHE of $130 million.[3] Intervenors and Staff espouse these huge disallowances despite the uncontroverted evidence that CEHE now serves nearly 400,000 customers more than were served by its electric transmission and distribution system at the time of its last base rate case and has invested more than $6 billion in its transmission and distribution system since 2010.[4] To arrive at their results, Intervenors and Staff:

- argue that the Company's capital structure should regress back to 60/40 for ratemaking purposes and that CEHE's return on equity should be drastically reduced—a result that would treat CEHE differently than every other transmission and distribution utility in the Electric Reliability Council of Texas ("ERCOT");[5]
- propose to disallow more than $115 million dollars in capital investment spent on programs that ensure the reliability of critical infrastructure serving not only residential customers, but downtown Houston, the Texas Medical Center, Bush Intercontinental Airport, and many other areas simply because CEHE's system is *too* reliable;[6]
- ignore actual test year costs in favor of outdated historical averages[7] and oppose the recovery of certain expense categories that the Legislature recently found should be presumed reasonable and necessary;[8]
- propose to preclude the recovery of regulatory assets previously approved by the Commission;[9] and,
- seek to overturn Commission-approved settlements intended to be forever final in nature—even when doing so would negatively impact the ability to secure or increase the costs to securitize storm related costs in the future.[10]

In other words, only through the taking of unreasonable positions, are the parties able to suggest that the Company's proposed rates should not be adopted.

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[2] Staff Initial Brief at 8; TIEC Initial Brief at 1; GCCC Initial Brief at 5.
[3] COH/HCC Initial Brief at 7.
[4] Direct Testimony of Kenny M. Mercado, CEHE Ex. 6 at 38-39 (Bates Pages).
[5] Staff Initial Brief at 33; TIEC Initial Brief at 34; TCUC Initial Brief at 2.
[6] COH/HCC Initial Brief at 9-13.
[7] *Id.* at 20-22 and 29; Staff Initial Brief at 49-51; OPUC Initial Brief at 63-65.
[8] Staff Initial Brief at 40-43; TIEC Initial Brief at 52-53; COH/HCC Initial Brief at 23-25.
[9] Staff Initial Brief at 20-21; OPUC Initial Brief at 25-29; GCCC Initial Brief at 12-17.
[10] TIEC Initial Brief at 5-7; GCCC Initial Brief at 33-39.

CEHE is confident that the ALJs and Commission will see past this ruse. There can be no dispute that the major components of the revenue increase sought by the Company relate primarily to capital investment that has been made in response to customer and load growth in and around the Houston area and necessary operations and maintenance ("O&M") expenses that have also been increasing consistent with that system growth.[11] There can also be no dispute that CEHE's current rates are not recovering over $900 million in distribution capital investment, in addition to unrecovered transmission and other capital that is providing service to customers today.[12] That is because these costs are not included in either the Distribution Cost Recovery Factor ("DCRF") or the Transmission Cost of Service ("TCOS") mechanisms. CEHE has calculated its proposed rates consistent with the Commission's required rate filing package ("RFP").[13] No party challenged the adequacy or completeness of the Company's application.[14] Thus, the evidence in this case compels the conclusion that CEHE's proposed rates are supported by law and policy, are absolutely essential for the fiscal health of the Company, and that the cuts suggested by Intervenors and Staff do not serve the public interest given the ultimate consequences of their recommendations. CEHE's requested rates, tariffs, and riders should be approved.[15]

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]

As shown through the evidence presented in CEHE's initial brief, all of the capital investment at issue in this case supports the continuing safe operation and reliability of the Company's transmission and distribution system. This investment has allowed CEHE to:

- respond to customer and load growth requiring the equivalent of installing a new electric system capable of serving a customer base roughly twice the size of Corpus Christi and its unincorporated areas or, for the past four years, building a distribution line from Austin to Houston and back each year;[16]

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[11] CEHE Ex. 6 at 55-56 (Mercado Direct).
[12] *See* Direct Testimony of Randal M. Pryor, CEHE Ex. 7 at 307 (Bates Pages) (total 2018 Distribution additions of $931,853,730 – none of which are being recovered in current rates); *See also* the Final Order in the Company's last DCRF filing, *Application of CenterPoint Energy Houston Electric, LLC to Amend its Distribution Cost Recovery Factor*, Docket No. 48226, Final Order at 2, Finding of Fact 6 (Aug. 30, 2018) (noting that proceeding reflected changes to invested capital between January 1, 2010 and December 31, 2017); This case presents capital investment through December 31, 2018.
[13] Direct Testimony of Kristie L. Colvin, CEHE Ex. 12 at 840-844 (Bates Pages).
[14] SOAH Order No. 4 at 2 (May 28, 2019).
[15] Attached as Appendix A to CEHE's reply brief is a Proposed Order with accompanying findings of fact and conclusions of law supporting the adoption of the Company's proposed rates, tariffs, and riders.
[16] In a Central Texas context, the magnitude of the Company's investment would equate to a system built to serve roughly half the size of the City of Austin or, alternatively, the cities of Round Rock, Pflugerville, Cedar Park and Georgetown, Texas combined.

- weather the impact of a generational storm event in 2017—Hurricane Harvey;[17] and
- install approximately 2.5 million Advanced Metering System ("AMS") meters, improving the intelligence and resiliency of its transmission and distribution system.[18]

Notably, the vast majority of CEHE's capital investment for which a prudence determination is sought has not been challenged. With regard to the capital projects that remain at issue, CEHE has shown that its capital expenditures were prudently incurred and that the investment is used and useful in providing electric service. Therefore, the Commission should approve the plant balances requested by CEHE in its RFP.

1. Capital Project Prudence

While CEHE acknowledges that the burden of proving that investment prudence lies with the utility, it disagrees with COH's suggestion in its initial brief that this burden must be fully met as part of the utility's direct case.[19] The law has long recognized that a utility's investments are presumed prudent until reasonably challenged.[20] Where the reasonableness of an expenditure is challenged, the "use of *hindsight is not permissible*."[21] The Commission has adopted a prudence standard that requires "the exercise of that judgment and the choosing of one 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 available at the point in time such judgment is exercised or option is chosen."[22] Further, the Commission has made clear that the utility's investment *choice need not have been the best*. Indeed,

> "it is not necessary that the decision be the one which the finder of fact would have considered optimal. Rather, there may be more than one prudent option within the

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[17] CEHE Ex. 6 at 46-47, 50 (Mercado Direct); CEHE Ex. 7 at 217-218 (Pryor Direct); Direct Testimony of Martin Narendorf Jr., CEHE Ex. 8 at 353-355 (Bates Pages).

[18] CEHE Ex. 1 at 13 (Application) (Bates Pages).

[19] Public Utility Regulatory Act, Tex. Util. Code Ann. §§ 11.001-66.016 (Supp) ("PURA") at § 36.006; COH/HCC Initial Brief at 5-6.

[20] *Application of Tex. Utils. Elec. Co. for Authority to Change Rates*, Docket No. 9300, 17 Tex. P.U.C. Bull. 2057, 2147 (Sept. 21, 1991).

[21] *Application of Texas-New Mexico Power Co. for Authority to Change* Rates, Docket No. 9491, Examiner's Report at Conclusion of Law No. 11 (Feb. 7, 1991) (emphasis added).

[22] *Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at Conclusion of Law 24 (Mar, 6, 2014); *Application of Texas-New Mexico Power Co. for Authority to Change Rates and Petition of Texas-New Mexico Power Co. for Deferred Accounting Treatment for TNMP One-Unit Two*, Docket Nos. 10200 and 10034, 19 Tex. P.U.C. Bull. 89 (Oct. 16, 1992); *Inquiry of the Public Utility Commission of Tex. into the Prudence and Efficiency of the Planning and Management of the Construction of the South Tex. Nuclear Project*, Docket No. 6668, 16 Tex. P.U.C. Bull. 183, 483 (Jun. 20, 1990); *Inquiry of the Pub. Util. Comm'n of Tex. into the Prudence and Efficiency of the Planning and Management of the River Bend Nuclear Generating Station*, Docket Nos. 7195 and 6755, 14 Tex. P.U.C. Bull. 1943, 2429 (May 16, 1988); *Application of Gulf States Utils. Co. for Authority to Change Rates*, Docket No. 6525, 12 Tex. P.U.C. Bull. 1043, 1097 (Oct. 15, 1986).

range of options available to the utility at any given time or under any given set of circumstances. Any decision or choice within the select range of options is prudent, and the Commission should not substitute its own judgment for that of the utility."[23]

Texas courts have consistently applied the prudence standard in the same way when reviewing Commission decisions.[24] The Austin Court of Appeals, citing the Commission's prudence standard stated, "an attempt to demonstrate prudent decision-making by retrospective analysis is inherently defensive and hence more suspect."[25] Moreover, the court recognized that there are two ways a utility can demonstrate the prudence of its decision-making—a showing its decision was prudent or that the same decision is in a select range of options that would have resulted had prudent decision-making been employed.[26] The court has further concluded that "the applicable standard does not require perfection."[27] These principles—no hindsight, no requirement of perfection, and a range of reasonable options—must necessarily guide the Commission's prudence determination in this case with regard to the capital projects discussed below.

a. Major Underground Rehabilitation Project and Underground Residential Distribution Cable Life Extension Program

COH argues that the $115 million CEHE invested in the Underground Residential Distribution ("URD") Cable Life Extension Program ("CLEP Program") and the Major Underground Rehabilitation Program should be disallowed.[28] COH contends that CEHE failed to demonstrate the need for these programs and that these programs provide no affirmative benefit to customers.[29] COH's position is contradicted by the substantial record evidence and should be rejected in its entirety.

While COH claims that CEHE provided only "cursory testimony" to support the recoverability of its transmission and distribution capital investment, the evidence proves otherwise.[30] CEHE's Application and RFP included the direct testimony of four witnesses, who each testified in support of CEHE's transmission and distribution system capital investment.

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[23] Docket No. 9491, Examiner's Report at Conclusion of Law 11.
[24] *See, e.g., Gulf States Util. Co. v. Pub. Util. Comm'n of Tex.*, 841 S.W.2d 459, 476 (Tex. App.—Austin 1992, writ denied); *Nucor Steel v. Pub. Util. Comm'n of Tex.*, 26 S.W.3d 742, 748 (Tex. App.—Austin 2000, pet. denied) (applying the Commission's prudence standard).
[25] *Gulf States*, 841 S.W.2d at 476.
[26] *Id.* at 475-76.
[27] *Nucor Steel,* 26 S.W.2d at 749.
[28] COH/HCC Initial Brief at 9-13.
[29] *Id.* at 9.
[30] *Id.* at 6, 10-11.

Specifically, CEHE witness Randal M. Pryor describes and supports the total capital investment that has been made in the Company's distribution system between January 1, 2010 and December 31, 2018.[31] As part of his direct testimony and workpapers, Mr. Pryor provides a detailed description of *every* distribution capital project since January 1, 2010,[32] as well as budget, capitalization, and other financial training specifics.[33] This information identifies the purpose of the capital project (i.e. load growth, restoration, system improvements, intelligent grid, etc.), the total project cost, including additions and net salvage, and the project category total.[34] Mr. Pryor also describes in detail CEHE's major distribution capital and O&M programs, including the CLEP Program.[35] CEHE witness Martin W. Narendorf Jr. similarly describes and supports the investment spent for transmission, substation and major underground work required to provide service to the distribution system.[36] CEHE witness Dale Bodden is responsible for the Engineering and Asset Optimization division and her testimony describes the engineering, planning, design and capital budgeting process for the distribution and transmission system.[37] Finally, CEHE witness Julienne P. Sugarek, who is responsible for the Power Delivery Solutions division, describes the customer interface, customer support and power quality solutions that directly impact CEHE's customers.[38]

Collectively, these testimonies comprise almost 600 pages of documentation supporting the reasonableness and need for CEHE's capital investment and direct O&M expenditures. Additionally, the Company made available files of thousands of projects supporting the level of requested investment and answered thousands of discovery requests that allow the investment to be verified and traced. In short, the abundance of evidence supporting the prudence of not only the CLEP Program and the Major Underground Rehabilitation Program, but *all* of CEHE's capital investment between January 1, 2010 and December 31, 2018, is staggering. Intervenor and Staff arguments to the contrary should be rejected.

COH's assertion that capital investment related to the CLEP Program and Major Underground Rehabilitation Program should be disallowed because customers receive no

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[31] CEHE Ex. 7 at 166-325 (Pryor Direct).
[32] *Id.* at Voluminous WP RMP-2 2010 through WP RMP-2 2018.
[33] *Id.* at 222-239 Exh. RMP-2 & Voluminous Exh. RMP-3.
[34] *Id.* at Voluminous WP RMP-2 2010 through WP RMP-2 2018.
[35] *Id.* at 203-205.
[36] CEHE Ex. 8 at 326-573 (Narendorf Direct).
[37] Direct Testimony of Dale Bodden, CEHE Ex. 9 at 574-657 (Bates Pages).
[38] Direct Testimony of Julienne P. Sugarek, CEHE Ex. 10 at 658-762 (Bates Pages).

discernable benefits from these programs also lacks merit.[39] There is no dispute that customers expect reliable electric service for their residences and businesses. CEHE has shown that the benefit of a reliable system is fewer interruptions of service and faster response times and reduced outage time for customers in the event of an outage.[40] COH, however, implies that CEHE's operations are *too* reliable and thus, the cost of capital programs designed to proactively maintain the reliability of the Company's transmission and distribution system should be disallowed.[41] Importantly, COH offers no specific challenge to any specific expenditure incurred for either the CLEP Program or Major Underground Rehabilitation Program. Rather, the entirety of COH's proposal to disallow capital investment is premised upon a flawed contention that customers have not "benefited" from these programs.[42] As detailed in CEHE's initial brief in Section II.A.1.a-b, the evidence soundly refutes this argument and COH's position should be rejected in its entirety.

With regard to the CLEP Program, the evidence shows:

- the CLEP Program proactively identifies potential failures in aged underground cable and other URD components that do not meet specification before they fail;[43]
- by identifying the risk of potential failures, CEHE better serves its customers by preventing future outages and maintaining system reliability;[44]
- the CLEP Program provides for the rehabilitation of the cable back to original manufacturer specifications, which improves the present condition of the cable and extends the expected life;[45]
- the CLEP Program has allowed CEHE to assess and extend the life of more than 10 times as many loops as it had been replacing annually; and
- CEHE's CLEP Program contractor, IMCORP, provides a 15-year life extension guarantee for the Company's cable system on all assessed loops.[46]

Likewise, as detailed in CEHE's initial brief at Section II.A.1.b, the evidence established that CEHE's investment in the Major Underground Rehabilitation Program was reasonable, necessary, and prudently incurred:

[39] COH/HCC Initial Brief at 9.
[40] CEHE Ex. 9 at 607 (Bodden Direct).
[41] COH/HCC Initial Brief at 9, 12-13.
[42] Direct Testimony of Scott Norwood, COH/HCC Ex. 1 at 15-18.
[43] CEHE Ex. 7 at 203 (Pryor Direct).
[44] *Id.* at 203.
[45] *Id.* at 204.
[46] *Id.*

- CEHE's Major Underground Rehabilitation Program has been in place for over 30 years and proactively identifies potential failures in aged underground cable and other components before those failures occur;[47]
- customers receive more reliable service because unscheduled equipment outages are often avoided and the proactive replacements are often completed without even a scheduled customer outage;[48]
- the proactive inspection and replacement of CEHE's Major Underground facilities is vital to the continuous supply of reliable power to customers served within downtown Houston, the Texas Medical Center, Bush Intercontinental Airport, and many other areas of critical importance;[49] and
- failure in the Major Underground infrastructure would significantly impact hundreds, if not thousands, of individuals living, working or receiving medical treatment in those key areas, and result in significant environmental, safety, and economic repercussions.[50]

The proactive work performed under both the CLEP Program and the Major Underground Rehabilitation Program resolves a problem before the problem occurs. Lengthy, unscheduled service interruptions are avoided and customers do not unnecessarily experience outages due to equipment that has been allowed to "run to failure."[51]

Finally, contrary to COH's assertion, CEHE does not rely on its Asset Investment Strategy ("AIS") tool to evaluate the prudence of undertaking a capital project.[52] Rather, CEHE uses AIS to assist in the optimization of the Company's annual capital portfolio.[53] All of the capital projects entered into the AIS tool are developed, analyzed, and justified apart from the AIS process.[54] The evidence demonstrating the customer benefit derived from the CLEP Program and Major Underground Rehabilitation Program is summarized above and in CEHE's initial brief. COH's proposed disallowance of the CLEP Program and the Major Underground Rehabilitation Program capital costs should be rejected.

b. Capital Project Oversight and Budget Estimation

CEHE's initial brief at Section II.A.1.c.2 explains why it is inappropriate to rely on initial project estimates as a sole basis on which to disallow capital investment. This issue is further discussed in the capital cost variance section below.

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[47] *Id.* at 203; Rebuttal Testimony of Martin W. Narendorf Jr., CEHE Ex. 32 at 9 (Bates Pages).
[48] CEHE Ex. 32 at 10-12 (Narendorf Rebuttal).
[49] *Id.* at 10.
[50] *Id.* at 10, 12.
[51] *Id.* at 10-12; COH/HCC Initial Brief at 10.
[52] CEHE Ex. 32 at 5 (Narendorf Rebuttal).
[53] *Id.* at 6.
[54] *Id.*

(1) Foundation Installation – Project HLP/00/0801

The Office of Public Utility Counsel ("OPUC") seeks to disallow approximately $8.8 million for projects related to concrete foundation replacement.[55] To evaluate the recovery of these costs, the Commission's prudence review must necessarily focus on the reasonableness of the decision that led to the expenditure. Broadly defined, "decision-making" is the process of choosing a course of action for addressing a problem or opportunity. In this respect, the question presented is whether it was reasonable for CEHE to repair the substation foundations upon discovery of the Alkali-Silica Reaction ("ASR") cracking issues. Here, there is no dispute that the foundations required repair. OPUC admits in its initial brief that it is not challenging the need for corrective action.[56] There is also no dispute that the corrective actions taken and the related costs incurred by CEHE were reasonable and necessary. Thus, the record evidence unequivocally supports a finding that the costs incurred by CEHE for these projects was prudent and should be recovered in rates.

In its initial brief, OPUC rejects the argument of its own witness, who opined that the foundation replacements were due to errors in the original installation,[57] in favor of a new argument. OPUC now argues that CEHE failed to show that its selection of materials for the foundations was prudent, and thus, that the foundation replacements could not have been avoided.[58] The evidence does not support OPUC's new claim and it should be rejected. As an initial matter, no party to this case challenged CEHE's decision to install concrete foundations for the substation projects at issue. The evidence further shows that there was no error on CEHE's part with regard to the selection of the concrete materials. Mr. Narendorf, the only witness in this case offering firsthand experience with ASR, provided compelling testimony regarding these facts:

- ASR is a condition that occurs in concrete materials unrelated to the method of installation;[59]
- ASR is a condition that occurs naturally in all concrete—not just concrete installed by CEHE;[60] and
- the risk of ASR cannot be eliminated, it can only be mitigated.[61]

[55] OPUC Initial Brief at 5.
[56] *Id.*
[57] Redacted Direct Testimony of Karl Nalepa, OPUC Ex. 5 at 38.
[58] OPUC Initial Brief at 5-6.
[59] CEHE Ex. 32 at 15 (Narendorf Rebuttal).
[60] Tr. at 1177 (Narendorf Cross) (Jun. 27, 2019).
[61] *Id.* at 1180.

OPUC's arguments regarding material selection are not credible. OPUC has admitted that the corrective actions taken by CEHE to mitigate the impacts of ASR on the Company's facilities was prudent.[62] Therefore, these capital costs should be recovered through rates.

(2) Capital Cost Variances

(a) Alexander and La Marque Substations

Although OPUC acknowledges the prudence standard in its initial brief, it ignores the application of that standard in recommending a disallowance of project costs associated with two substation projects—Alexander Island ("Alexander) and La Marque.[63] Staff similarly challenged costs related to these two substations and the costs associated with five other projects.[64] In support of its position, OPUC contends that "construction errors are not prudent."[65] Contrary to OPUC's assertion, the Commission's prudence standard does not require perfection.[66] Yet, that is exactly what OPUC demands.

Staff's assertion that the design and location changes to the La Marque substation were foreseeable also lacks support.[67] With regard to La Marque, the evidence is clear that the original estimate provided for a total of four structures.[68] The evidence further shows that several changes to the La Marque substation were required after detailed engineering was prepared and construction initiated:

- Seven structures, not four structures, were ultimately required.[69]
- One structure was moved and rotated during construction to avoid underground utilities.[70]
- One structure, staked in close proximity to the next, resulted in a foundation rebuild.[71]

These facts illustrate the flaw associated with Staff's overly simplistic proposal to impose a 10% contingency cap on capital cost recovery based on the difference between the initial cost estimate plus a 10% variance and the final actual costs.[72] As explained in CEHE's initial brief at Section II.A.1.c.2, such benchmarking is unreasonable because initial estimates are often made at least a

[62] OPUC Initial Brief at 5.
[63] *Id.* at 3-4.
[64] Staff Initial Brief at 10-14.
[65] OPUC Initial Brief at 4.
[66] *Nucor Steel,* 26 S.W.2d at 749.
[67] Staff Initial Brief at 11.
[68] CEHE Ex. 32 at 17 (Narendorf Rebuttal).
[69] *Id.*
[70] *Id.* at 17-18.
[71] *Id.* at 18.
[72] Staff Initial Brief at 10; Direct Testimony of Tom Sweatman, Staff Ex. 8 at 21, Attachment TS-4.

year and a half in advance of construction and before a work order is even prepared.[73] In addition, these initial estimates function more as an early guideline than anything else because they are premised upon one or more of the following:

- Preliminary understanding of project scope;[74]
- Preliminary design;[75]
- Limited construction inputs;[76]
- Rule of thumb guidelines;[77]
- Assumptions;[78]
- Preliminary understanding of actual conditions;[79]
- Preliminary understanding of environmental conditions;[80]
- Projected costs;[81]
- Preliminary or no geotechnical data;[82]
- Preliminary or no subsurface engineering data;[83] and
- Preliminary or no right of way research.[84]

Thus, use of an initial estimate to evaluate final project costs is misguided and should be rejected. It is also inconsistent with the well-accepted prudence standard; a "fixed" cost cap disallowance fails to undertake the requisite evaluation of the facts, circumstances, and options that caused the costs to be incurred.[85] Here, the evidence demonstrates that CEHE presented well-substantiated justification for the final cost of each challenged capital project and thus, demonstrated the prudence of its capital expenditures.

(b) Dow Substation

Staff continues to request a disallowance of costs that CEHE did not include in its rate base request in this case.[86] CEHE has, however, affirmatively stated that it has not included costs associated with this project in its rate base.[87] Staff's proposed adjustment totaling $19,663.00[88] would reduce rate base by an amount that was simply never included in rate base. Disallowance

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[73] CEHE Ex. 32 at 21 (Narendorf Rebuttal).
[74] *Id.*
[75] *Id.* at 20-21.
[76] *Id.* at 19.
[77] *Id.* at 20.
[78] *Id.* at 19.
[79] *Id.* at 21.
[80] *Id.*
[81] *Id.*
[82] *Id.*
[83] *Id.*
[84] *Id.* at 19.
[85] *Gulf States*, 841 S.W.2d at 475-476; Docket No. 9491, Examiner's Report at Conclusion of Law 11.
[86] Staff Initial Brief at 11.
[87] CEHE Ex. 32 at 71, Exh. R-MWN-1, PUC RFI No. 6-24 (Narendorf Rebuttal).
[88] Staff Initial Brief at 11; Staff Ex. 8 at 21, Attachment TS-4 (Sweatman Direct).

of a cost not included in rate base violates PURA § 36.051 as it would operate as an arbitrary adjustment to the Company's invested capital.[89] Staff's proposed disallowance of capital investment not included in this filing should be rejected.

(c) W.A. Parish Substation

A comparison of the final actual cost to the final estimate demonstrates that this project actually came in 5.7% under budget.[90] Changes between the initial estimate and the final estimate were due to a variety of small cost differences to labor and materials.[91]

(d) Jones Creek

The evidence supporting the need for the Jones Creek Project is compelling and undisputed. Ms. Bodden testified that the Jones Creek substation was built in 2017 to support load growth and resolve reliability concerns on the system.[92] No party questioned the additional load identified that required the Jones Creek Project. There is also no dispute that the Jones Creek substation was submitted to the ERCOT RPG for review as part of the Jones Creek Project and was approved by the ERCOT Board of Directors on February 10, 2015.[93] Contemporaneous documentation of the project is found in the 21-page ERCOT RPG Jones Creek Project Report detailing the project and the required substation, as well as the project update provided to CEHE's Executive Committee.[94] Despite this evidence, Staff argues that CEHE failed to explain cost overruns for the entire project and the need for a distribution substation and thus, proposes an adjustment to rate base totaling $10,232,609.00.[95] Staff's argument lacks merit.

The cost variance for this project was thoroughly explained and detailed. Regarding the need to construct a distribution substation, the Executive Committee presentation attached to Mr. Narendorf's rebuttal testimony describes how permitting issues precluded distribution circuits from crossing the Brazos River, so a new distribution substation had to be constructed at the site and elevate it 8' above sea level.[96] Additional permitting issues also eliminated the original plan to utilize low water crossings, so the Company was required to construct two bridges across tidal influence canals.[97] The evidence further establishes that several necessary scope changes were

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[89] PURA § 36.051.
[90] CEHE Ex. 32 at 37-57, Exh. R-MWN-1, PUC RFI No. 1-38 (Narendorf Rebuttal).
[91] *Id.* at 71, Exh. R-MWN-1, PUC RFI No. 06-24.
[92] CEHE Ex. 9 at 606 (Bodden Direct).
[93] CEHE Ex. 8, WP MWN-3 (Narendorf Direct).
[94] CEHE Ex. 32, Exh. R-MWN-3 (Narendorf Rebuttal).
[95] Staff Initial Brief at 12.
[96] CEHE Ex. 32 at 91, Exh. R-MWN-3 (Narendorf Rebuttal).
[97] *Id.* at 78, Exh. R-MWN-1, PUC RFI No. 11-02.

made through the duration of this project that led to additional infrastructure needs and thus, cost increases. In particular, area load steadily increased throughout the development of the Jones Creek Project and required design modifications.[98] CEHE further explained that geo-tech and subsurface engineering data, which was not available prior to project approval, subsequently revealed a need for substantially larger foundations than originally estimated.[99] Importantly, CEHE also provided contemporaneous documentation of management's cost oversight processes. In particular, detailed documentation was presented to CEHE's Executive Committee regarding the project's cost variance as well as the need for the additional distribution substation.[100]

These facts establish that CEHE reasonably exercised its judgment in making cost decisions involving the Jones Creek project throughout the entirety of the project. The decisions made by CEHE were based on the facts and circumstances at the time and fall within a select range of options which a reasonable utility manager would exercise or choose in the same or similar circumstances given the information or alternatives available at the point in time such judgment is exercised or option is chosen.[101] Thus, CEHE has established the final costs associated with the Jones Creek project were prudent and should be recovered in rates.

(e) Springwoods

Staff incorrectly states that there was a 15.8% cost overrun for the transmission construction portion of Springwoods substation.[102] The evidence shows that the transmission-only portion of this project had a -10% difference, or a 10% underspend on transmission work.[103] With regard to the substation-only portion of Springwoods, the estimate was $10.6 million and the actual cost was approximately $11.8 million. Cost variance for the construction of Springwoods substation inside the fence was shown to be primarily driven by increased site improvement costs for vegetation clearing and additional dirt backfill quantities and a wire-wall security fence.[104]

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[98] *Id.*
[99] *Id.*
[100] *Id.* at 91, Exh. R-MWN-3.
[101] Docket No. 40443, Order on Rehearing at Conclusion of Law 24; Docket Nos. 10200 and 10034, 19 Tex. P.U.C. Bull. 89; Docket No. 6668, 16 Tex. P.U.C. Bull.at 483; Docket Nos. 7195 and 6755, 14 Tex. P.U.C. Bull. at 2429; Docket No. 6525, 12 Tex. P.U.C. Bull. at 1097.
[102] Staff Initial Brief at 13.
[103] CEHE Ex. 32 at 71-72, Exh. R-MWN-1, PUC RFI No. 6-24 (Narendorf Rebuttal).
[104] *Id.* at 66-68, Exh. R-MWN-1, PUC RFI No. 5-8.

(f) Tanner

Staff is incorrect in stating that the Company indicated a 16.3% cost overrun for the transmission construction portion of Tanner substation.[105] The transmission-only portion of this project was shown to be a -10.5% difference, or a 10.5% underspend on transmission work.[106] Further, with respect to the substation-only portion of Tanner, the evidence demonstrates a -12.6% difference, or a 12.6% underspend.[107]

In sum, Staff's proposed application of an arbitrary 10% contingency cap on capital cost recovery despite acknowledging that full recovery of capital costs is appropriate if the utility presents well-substantiated justification for the final project costs is not just and reasonable.[108] During the discovery phase of this proceeding, the Company responded to numerous detailed questions regarding transmission and substation projects. The Company provided project lists, estimated costs, actual costs, and explanations of any variances. This documentation provides ample justification to explain the reasonableness and necessity of any cost overrun of 10% or higher under even Staff's proposed standard.[109] Moreover, the evidence demonstrates that the budget variances identified by OPUC and Staff represent approximately 0.12% and 0.68%, respectively, of the approximately $3.0 billion High Voltage Operations capital for which the Company seeks recovery.[110]

Further, the Company demonstrated an average cost variance of approximately *negative* 8.5% for all transmission lines reported on its monthly construction progress reports filed between January 1, 2010 and December 31, 2018 that were not paid for by an individual customer.[111] This means that taken as a whole the actual cost of the Company's ratepayer funded transmission line projects was *lower* than estimated. These statistics prove that CEHE manages its projects professionally and prudently, and as a result has a very near perfect track record in managing its capital projects. By focusing on isolated examples in which CEHE went over a specific budget estimate, Staff impermissibly imposes a standard of perfection upon CEHE. Staff's position is also inconsistent with the governing standard for cost recovery, which provides that a utility "may meet its burden *without proving the reasonableness and necessity of every individual dollar paid*

[105] Staff Initial Brief at 13.
[106] CEHE Ex. 32 at 71-72, Exh. R-MWN-1, PUC RFI No. 6-24 (Narendorf Rebuttal).
[107] *Id.* at 66-68, Exh. R-MWN-1, PUC RFI No. 5-8.
[108] Staff Ex. 8 at 6 (Sweatman Direct).
[109] CEHE Ex. 32 at 35-80, Exh. R-MWN-1 (Narendorf Rebuttal).
[110] *Id.* at 28.
[111] *Id.* at 18 & 81-82, Exh. R-MWN-2.

on a granular level, but may present evidence that is comprehensive [in nature]."[112] The Company has established that the challenged expenditures are reasonable and necessary and that the expenses were prudently incurred.

2. Capital Project Accounting/Capitalization Policy Changes

CEHE's initial brief thoroughly addressed all arguments raised regarding the Company's capitalization policy and capital project accounting.[113] With regard to the capital project accounting questioned by OPUC,[114] CEHE demonstrated that the Company must, under the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts ("USOA"), record these items as capital investment. Simply stated, CEHE does not capitalize O&M costs.[115] The evidence proves that:

- CEHE follows the applicable accounting rules established by generally accepted accounting principles ("GAAP") and the FERC USOA for public utilities;[116]
- As required under Commission Rule 25.72, CEHE maintains its books and records in compliance with the FERC USOA;[117]
- Under the FERC USOA, a project is either capital, or O&M, not both;[118]
- CEHE's processes, controls, and training related to work orders ensure the proper classification of distribution and transmission capital investment;[119]
- CEHE's capitalization policy provides for the cost of a repair and/or replacement to be capitalized only when the project encompasses the repair and/or replacement of the retirement unit in its entirety;[120] and
- To ensure compliance, the Company routinely monitors and reviews its accounting policies and practices for compliance with GAAP and FERC standards.[121]

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[112] *Entergy Tex., Inc. v. Pub. Util. Comm'n of Tex.*, 490 S.W.3d 224, 240 (Tex. App.—Austin 2014, pet. denied) (emphasis added); *see also Entergy Gulf States, Inc. v. Pub. Util. Comm'n*, 112 S.W.3d 208, 214-15 (Tex. App.—Austin 2003, pet. denied).
[113] *See* CEHE Initial Brief at Section II.A.2.
[114] OPUC Initial Brief at 6-10.
[115] Rebuttal Testimony of Randal M. Pryor, CEHE Ex. 31 at 14 (Bates Pages).
[116] Rebuttal Testimony of Kristie L. Colvin, CEHE Ex. 35 at 59 (Bates Pages).
[117] *Id.*
[118] FERC USOA Part 101, Electric Plant Instructions.
[119] CEHE Ex. 7 at 190-193 (Pryor Direct); CEHE Ex. 12 at 926-930 (Colvin Direct); CEHE Ex. 35 at 51-52 (Colvin Rebuttal).
[120] CEHE Ex. 12 at 926-930 (Colvin Direct); CEHE Ex. 35 at 51-52 (Colvin Rebuttal).
[121] CEHE Ex. 35 at 59 (Colvin Rebuttal).

a. Proactive Routine Capital Replacements to the Overhead Distribution System (AB1Z) and Substation Projects (HLP/00/0011 and HLP/00/0012)

CEHE's initial brief in Section II.A.2.a thoroughly discusses the evidence demonstrating that CEHE has properly capitalized these project costs as required by the FERC USOA. Importantly, OPUC does not dispute this evidence. OPUC relies on project descriptions to argue that work in these projects should be expensed, rather than capitalized.[122] Project descriptions provide a general description of the work performed—no more, no less.[123] It is the actual work performed in these projects that dictates whether the costs are capitalized or expensed under the FERC USOA.[124] OPUC fails to mention those portions of the project descriptions in the 27 voluminous workpaper files to Mr. Pryor's direct testimony (WP-RMP-2) that clearly describe the work performed as including "replacement of equipment and or structures," all of which are capital-related activities.[125] Thus, as discussed in CEHE's initial brief, the Company is required by the FERC USOA to account for these projects as capital investment.[126]

OPUC's contention that the costs in these projects are recurring in nature is also irrelevant.[127] CEHE maintains and operates a distribution system that safely and reliably serves over 2.5 million end-use retail electric customers across an approximately 5,000 square mile service territory.[128] As a practical matter, corrective projects involving the replacement of equipment and/or structures occur as part of the Company's day-to-day activities. OPUC disingenuously states that CEHE did not provide sufficient information on these projects to allow OPUC to conclude that the project costs should be capitalized.[129] The information provided in the Company's filing and supporting workpapers identifies every single capital project reflected on the Company's books and records during the time period at issue.[130] Based on this information, the Company, unlike OPUC, analyzed each capital project to determine its eligibility for inclusion in plant in service.[131] Those project costs are summarized in the Company's schedules and workpapers and the individual costs are included in individual work orders and invoices related to

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[122] OPUC Initial Brief at 7-8.
[123] CEHE Ex. 31 at 13 (Pryor Rebuttal).
[124] *Id.*
[125] *Id.* at 12 & Voluminous WP RMP-2.
[126] CEHE Ex. 35 at 51-52 (Colvin Rebuttal).
[127] OPUC Initial Brief at 7-8.
[128] *Id.*
[129] *Id.* at 8.
[130] CEHE Ex. 31 at 14 (Pryor Rebuttal).
[131] *Id.*

each capital project.[132] The information produced to support the capitalization of these project costs clearly satisfies CEHE's burden of proof.

b. Capital Projects ENTD086–Corporate Website Redesign and S/101318/CG/Tools

Based solely on a general project description, OPUC recommends that costs CEHE spent on a website redesign project are not capital costs and should be expensed.[133] Schedule V-K-5.2 contains descriptions of significant capital projects. At Line No. 17, CEHE identifies the "Corporate Website Rebuild" project and includes the following description: "replatform corporate website, mobile enable corporate sites and enhance customer service experience for power alert notifications and online customer self-service as well as electric customer registration."[134] As a project in which the website was *rebuilt*, it involved more than relatively minor upgrades and enhancements that would qualify only for treatment as expenses under FASB Accounting Standards Codification ("ASC") ASC 350-50. For example, the re-platforming involved acquiring new hardware that was needed for website infrastructure development.[135] Adding major new functions was also necessary to enable the corporate website to be accessed on mobile devices, set up new customer service platforms, modify the Power Alert Service, and add new options for online customer self-service.[136] CEHE witness Shachella D. James explained the ways in which technology investment since the last rate case has enabled CEHE to be better positioned to respond during catastrophic weather events.[137] Specifically, the Power Alert Service kept customers informed during Hurricane Harvey and improvements in mobile device technology provided for approximately 350,000 outage notifications being delivered through the Power Alert Service and over 22,000 new Power Alert Service enrollments.[138]

In addition, the Website Rebuild activities fall within the guidance addressed in ASC 350-50-25-15, which states that:

> costs incurred in the operation stage that involve providing additional functions or features to the website shall be accounted for as, in effect, new software. That is, costs of upgrades and enhancements that add functionality shall be expensed or capitalized based on the general model of paragraph 350-40-25-7 (which requires

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[132] *Id.*
[133] OPUC Initial Brief at 8-10.
[134] CEHE Ex. 2 at 991, Schedule V-K-5.2.
[135] *See id.*
[136] *Id.*
[137] Direct Testimony of Shachella D. James, CEHE Ex. 17 at 1590 (Bates Pages).
[138] *Id.* at 1591.

> certain costs related to upgrades and enhancements to be capitalized if it is probable that they will result in added functionality . . . .).[139]

This language rebuts OPUC's contentions that the activities necessary for the Corporate Website Rebuild are not proper capital costs. The work performed added new functionality and required new software. In addition, because these costs were properly capitalized, the fact that they were incurred in 2014 should not exclude them from rate recovery despite OPUC's position to the contrary.

c. Changes in Capitalization Policy

OPUC also expresses concerns about whether costs are potentially "double-counted" due to changes in CEHE's capitalization policy.[140] The issue here is quite simple. All parties agree the Company must follow the FERC USOA and comply with accounting rules established by GAAP.[141] This means CEHE has an obligation to maintain its financial records, which reflect the results of the capitalization policy, in accordance with GAAP and FERC standards under Commission Rule 25.72.[142] In order to ensure compliance, CEHE routinely monitors and reviews its accounting policies and practices for compliance with GAAP and FERC standards.[143] Changes are made, when necessary, to ensure that costs continue to be categorized and accounted for consistent with the work being performed. For example, CEHE must determine accounting treatment for any new items—such as underground cable assessment—or changes in technology such as luminaires or microprocessor control devices that emerge between rate cases.[144] Moreover, CEHE exercised due diligence in determining that a portion of its Property Accounting, Accounts Payable and Call Center costs should be capitalized to reflect the fact that those activities support construction projects.[145] This decision was made in conformance with FERC accounting guidelines. Thus, the capital amounts reflected in this case are a result of proper changes to the Company's capitalization policy that are consistent with GAAP and FERC USOA requirements.

3. Land Costs

CEHE's initial brief in Section II.A.3 thoroughly refutes Staff's argument that land costs for three distribution substation facilities that are not yet energized should be excluded from the

[139] CEHE Ex. 35 at 134, Exh. R-KLC-08 (Colvin Rebuttal).
[140] OPUC Initial Brief at 11.
[141] CEHE Ex. 35 at 55-56 (Colvin Rebuttal).
[142] *Id.* at 59.
[143] *Id.*
[144] *Id.* at 60.
[145] *Id.* at 58.

Company's rate base.[146] In its initial brief, Staff again offers no FERC accounting support for its position.[147] And, while Staff attempts to find support in 16 TAC § 25.231(c)(2), it provides no explanation of how its interpretation of the "used and useful" rule can, in this instance, be reconciled with the Commission requirement in 16 TAC § 25.72, which requires CEHE to keep its books and records in compliance with the FERC USOA for public utilities.

CEHE established that under either FERC Account 3600 or FERC Account 1050, the land is appropriately classified as a rate base item functionalized to distribution because the original cost of land and land rights are held for future use under a defined plan.[148] The evidence is uncontroverted that substation projects are currently under construction on the three tracts of land.[149] Thus, the land costs are properly classified as rate base under the FERC USOA.

Finally, Staff misrepresents CEHE witness Kristie L. Colvin's rebuttal testimony when it alleges that CEHE did not properly classify the costs as plant held for future use.[150] That is not Ms. Colvin's testimony. Ms. Colvin testified that "[i]f the land were not already included in FERC Account 3600 Land and Land Rights, it would still be classified as Plant Held for Future Use in FERC Account 1050,"[151] which would also be classified as rate base under the FERC USOA.[152] Staff's proposed disallowance should be denied.

B. Indirect Corporate Costs

Section II.A.2.b of CEHE's initial brief summarizes the evidence refuting COH's claim that the Company included indirect corporate costs in its prior DCRF filings.[153] For brevity, CEHE will not repeat that evidence here. However, COH's misrepresentation of the Company's discovery response must be addressed. COH's statement in its initial brief that CEHE identified indirect corporate costs included in its DCRF filing as part of discovery is patently incorrect.[154] In response to discovery, CEHE identified corporate costs associated with Accounts Payable,

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[146] Staff Initial Brief at 15.
[147] *Id.*
[148] CEHE Ex. 35 at 54 (Colvin Rebuttal).
[149] *Id.*
[150] Staff Initial Brief at 15.
[151] CEHE Ex. 35 at 54 (Colvin Rebuttal).
[152] *Id.*
[153] COH/HCC Initial Brief at 8.
[154] *Id.*

Property Accounting and Call Center.[155] These costs are *directly* assigned to capital work by those departments and are *not* indirect corporate costs as COH represents.[156]

The Commission has explained that indirect corporate costs are those costs not directly necessary to provide distribution service and include items *such as corporate aircraft and artwork.*[157] Indirect corporate costs are costs that cannot be directly assigned.[158] For this reason, the Company does not assign indirect corporate costs to capital projects.[159] Rather, the Company only capitalizes corporate costs directly associated with capital projects.[160] The Company established that the work performed by Property Accounting, Accounts Payable and Call Center is all work performed based on capital activity and is, unlike indirect corporate costs, directly necessary to provide distribution service.[161] As such, these corporate costs are appropriately included and recovered through the Company's DCRF charges.[162] Because there are no indirect corporate costs assigned to capital projects either in this case or in the Company's prior DCRF filings, there is no need to make adjustments to exclude such costs and COH's proposal should be rejected.

C. Distribution Line Clearance Project

CEHE's initial brief in Section II.B summarizes the evidence demonstrating that the Company properly capitalized costs related to its Distribution Line Clearance Project (Project Number HLP/00/1055). CEHE capital work charged to Project 1055 is performed to identify and remediate transmission line clearance issues.[163] Staff does not dispute the replacement work charged to this project, it instead seeks to redefine that work as maintenance.[164] In doing so, Staff appears to base its position on the fact that replacement activity is occurring in connection with existing transmission and distribution lines.[165] This is a distinction without a difference.

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155 Rebuttal Testimony of Michelle M. Townsend, CEHE Ex. 37 at 7 (Bates Pages).
156 *Id.*; *See* COH/HCC Initial Brief at Attachment 3.
157 *Rulemaking Related to Periodic Rate Adjustments*, Project No. 39465, Order at 33 (Sept. 22, 2011) (emphasis added); CEHE Ex. 37 at 5-7 (Townsend Rebuttal).
158 CEHE Ex. 37 at 7 (Townsend Rebuttal).
159 *Id.*
160 *Id.*
161 *Id.* at 6.
162 *Id.* at 5-6.
163 CEHE Ex. 35 at 54 (Colvin Rebuttal); CEHE Ex. 32 at 13-14 & 69-70, Exh. R-MWN-1, PUC RFI No. 06-22 (Narendorf Rebuttal).
164 Staff Initial Brief at 14-15.
165 *Id.*

The evidence shows that the remediation activities recorded in this project include the replacement of poles, conductors, and other capital assets that are classified as retirement units.[166] Thus, it does not matter whether the replacement of the pole or conductor is performed in connection with an existing transmission or distribution line or it is being installed as part of new construction. Per the FERC USOA,[167] all property is considered to be either a discrete retirement unit or a minor item of property.[168] Replacements of retirement units are required to be capitalized.[169] Moreover, each utility is required to maintain a written retirement unit listing to use when accounting for additions, replacements, and retirements of plant.[170] When a defined retirement unit is added to or retired from electric plant, the cost of that activity shall be applied to the appropriate capital account.[171]

Staff's reliance in its initial brief on an excerpt from *Accounting for Public Utilities* further supports CEHE's position. In particular, the excerpt cited by Staff and provided as an attachment to its initial brief expressly states that a "... pole is a unit of property, including the pole itself, the crossarm, down guys, anchor, and other minor hardware. When a work order is closed, *the total cost is unitized*, creating assets that represent the various units of property that were installed on the work order."[172] Thus, while Project 1055 involves work that is required to maintain compliance with National Electrical Safety Code clearance standards, the entirety of the work is appropriately classified as capital when it involves facility replacement. This is required by FERC USOA and confirmed in the treatise cited by Staff. Staff's argument should be rejected.

D. Prepaid Pension Asset and Accrued Postretirement Cost

1. Prepaid Pension Asset

CEHE has largely responded to the arguments in GCCC's initial brief, which opposes the Company's request to include the Prepaid Pension Asset in rate base, including discussion of why unrecognized (or unrealized) losses for pension expense do not affect prepayments to the Pension Plan.[173] CEHE also noted agreement with GCCC that, if the Commission approves inclusion of

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[166] CEHE Ex. 35 at 55 (Colvin Rebuttal).
[167] *See id.* at 55, Exh. R-KLC-07.
[168] *Id.* at 51.
[169] *Id.*
[170] *Id.*
[171] *Id.* at 51-52.
[172] *See* Staff Initial Brief at attachment (Robert L. Hahne & Gregory E. Aliff, Accounting for Public Utilities, § 16.7 Continuing Property Records System (pp. 512-513), Release 33 (2016)).
[173] CEHE Initial Brief at pages 23-25, including agreeing with GCCC that if the Commission approves inclusion of the Prepaid Pension Asset in Rate Base, the capitalized portion identified as CWIP should be removed. If this occurs, CEHE must also be authorized to apply and recover an amount for AFUDC on the CWIP portion.

the Prepaid Pension Asset in Rate Base, the capitalized portion identified as CWIP should be removed. The Net CWIP component is $72.9 million.[174] If this occurs, CEHE must also be authorized to apply and recover an amount for AFUDC on the CWIP portion. Notably, however, GCCC fails to respond to the Commission's prior approval of inclusion of prepaid pension assets in rate base.[175]

GCCC also makes several assertions in briefing that require a response. As a threshold matter, GCCC focuses on whether CEHE will be "harmed" by not including the Prepaid Pension Asset in rate base.[176] The issue is not one of "harm." Instead, it is about traditional ratemaking principles and basic fairness. In many ways, the Prepaid Pension Asset is just like any other prepayment that is traditionally included in rate base, except for the fact that the prepayments to the pension plan are *mandatory* under the Employee Retirement Income Security Act ("ERISA").[177]

As to GCCC's position that the calculation of pension expense based on the twelve-month test year (adjusted for a known and measurable change) should match the calculation of the Prepaid Pension Asset, CEHE has already explained that its use of a 13-month average to calculate the Prepaid Pension Asset balance is consistent with and required by the Commission's RFP instructions.[178] In addition, GCCC's argument is based on an incorrect premise—there is no requirement that the method used to calculate an expense item must match the method used to calculate a rate base item. Specifically, no party challenged CEHE's use of 2019 actuarial reports to determine its requested pension expense. That approach, however, does not and should not dictate how the Prepaid Pension Asset is determined, particularly when a utility is required to use a 13-month average for prepayments. For these reasons, the Commission should reject Mr. Kollen's position that the test year balance for the Prepaid Pension Asset be used.

Furthermore, GCCC erroneously claims the Prepaid Pension Asset the Company seeks to

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[174] The 13-month average Prepaid Pension Asset balance of $176,267,694 (Schedule II-B-10) multiplied by the 2018 capitalization percentage of 52.32% (WP II-D-3f) equals $92,223,258. ADFIT at the 21% rate must be removed. 21% of $92.2 million is $19,366,884. The Net CWIP component equals $92,223,258 minus $19,366,884, for a total of $72,856,374.

[175] *See 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 Finding of Fact 28 (Nov. 2, 2012); *Application of AEP Texas Central Company for Authority to Change Rates,* Docket No. 33309, Order on Rehearing at Finding of Fact 25 (Mar. 4, 2008).

[176] GCCC Initial Brief at 10, 11.

[177] Rebuttal Testimony of George C. Sanger, CEHE Ex. 46 at 8-9 (Bates Pages).

[178] CEHE Ex. 35 at 50 (Colvin Rebuttal).

include in rate base included the $370.442 million of unrealized loss in the pension plan at December 31, 2018.[179] The Prepaid Pension Asset the Company seeks to include in rate base is actuarially calculated and shown in the actuarial study and does not include the unrealized loss. In fact, Company rebuttal witness Mr. Sanger, who is the enrolled actuary for the plan itself, defined the Prepaid Pension Asset as the accumulation of past plan contributions minus the accumulation of pension expense recorded over the same period.[180] The Prepaid Pension Asset thus, does not include unrealized losses.

Finally, GCCC claims the Company has not met its burden of proof to recover the Prepaid Pension Asset in rate base because it has not previously requested this treatment or shown why facts and circumstances have changed to now support the request.[181] This purported standard is not justified or reasonable. Instead, the facts and evidence in this case support adoption of CEHE's request to include the existing Prepaid Pension Asset amount in rate base—that is true regardless of what did or did not happen in the past. Moreover, the Company is not asking to include return on the Prepaid Pension Asset prior to December 31, 2018.[182] GCCC's arguments on the burden of proof issue are unfounded. As Mr. Sanger noted, GCCC unnecessarily complicates this issue.[183] Just as other prepayments are included in rate base, so too should the Company's Prepaid Pension Asset. Contributions have been made to the pension plan in excess of pension expense recovered through rates. When that occurs, it is reasonable for the utility to earn a return on non-ratepayer supplied funds that are used to fund cost of service items, and the Company's proposal should be adopted.

2. Accrued Postretirement Cost[184]

Unlike the Prepaid Pension Asset, Accrued Postretirement Cost is not the result of prepayments—neither CEHE nor customers have made prepayments to fund Postretirement Medical Plan ("PRM") expenses, and CEHE has not recovered the costs of the items in PRM through rates.[185] The Accrued Postretirement Cost balance as of the end of the test year was $146.7 million and is the result of PRM expenses exceeding PRM contributions.[186] Nevertheless,

[179] GCCC Initial Brief at 9.
[180] CEHE Ex. 46 at 5 (Sanger Rebuttal).
[181] GCCC Initial Brief at 10.
[182] CEHE Ex. 46 at 10-11 (Sanger Rebuttal).
[183] *Id.* at 7.
[184] In this section, CEHE responds to arguments in GCCC's initial brief at Section II.G.7, BRP Pension and Postretirement.
[185] CEHE Ex. 46 at 11-12 (Sanger Rebuttal).
[186] *Id.* at 11, 14.

GCCC argues that if the Prepaid Pension Asset is included in rate base, comparable treatment supports subtraction of a "post-retirement benefit regulatory liability" of $68.5 million.[187] CEHE already explained in its initial brief that the $146.7 million balance related to PRM *includes* the $68.5 million amount Mr. Kollen identifies.[188] For the sake of brevity, CEHE will not repeat those detailed arguments and related calculations here. The evidence shows the entirety of the $146.7 million should not be used to adjust rate base because it is not the result of prepayments by either customers or the Company.[189]

Nevertheless, GCCC focuses on the way the $68.5 million is identified on the Company's books, but this focus is misplaced and is based on a misunderstanding of the RFI response on which Mr. Kollen relies. In the original RFP schedules, the Company included an adjustment for the item on Schedule II-B-11 labeled "Reg Liability Pension BRP and Postretirement" in the amount of $68.5 million to remove the item from rate base for Total Company. In fact, the only Benefit Restoration Plan liability CEHE requests to include in rate base is $6.9 million added as an adjustment in the original Schedule II-B-11, which Ms. Colvin addressed in direct testimony.[190] As shown on Mr. Kollen's Attachment E, COH sent CEHE an RFI asking for "each regulatory asset and liability, provide an explanation of the item, the reason *for including it in rate base* . . . ." Thus, in the discovery response, CEHE clearly states:

> 2. Regulatory Liability Pension BRP and Postretirement - This item *is not a regulatory liability* and was inadvertently included on II-B-11. It should have been on II-B-7 Rate Base Accounts - Accum. Provisions and will be corrected in an errata filing (emphasis added).[191]

Consistent with this discovery response that only addressed regulatory asset or liability items CEHE was *requesting in rate base*, in the errata provided to parties, the Company removed the entirety of the $68.5 million amount labeled as "Reg Liability Pension BRP and Postretirement" on line 18 of Schedule II-B-11 as was shown in the original filing.[192] Relatedly, the adjustment to include the $6.9 million Benefit Restoration Plan liability was moved to errata Schedule II-B-7 and is shown with other Accumulated Provisions.[193] In the discovery response that Mr. Kollen attached to his own testimony, the Company very clearly states that the "Regulatory Liability

[187] GCCC Initial Brief at 19-20.
[188] CEHE Initial Brief at 26.
[189] CEHE Ex. 46 at 14 (Sanger Rebuttal).
[190] CEHE Ex. 12 at 906 (Colvin Direct).
[191] Redacted Direct Testimony of Lane Kollen, GCCC Ex. 1 at 110, Att. E, COH RFI No. 03-40.
[192] CEHE Ex. 2 at 58, Schedule II-B-11, Line 18.
[193] *Id.* at 40, Schedule II-B-7, Line 8.

Pension BRP and Postretirement" item is not a regulatory liability being requested in rate base. This is also clearly shown in the errata filing.[194]

In fact, GCCC's argument is premised on the notion that where the Prepaid Pension Asset, which is a regulatory *asset*, is included in rate base, so too should the purportedly corresponding regulatory *liability* for PRM be included in rate base. That premise, however, is wrong—the Company does not consider the Prepaid Pension Asset a *regulatory asset* (it is in fact a prepayment) and the $68.5 million is not a regulatory liability for ratemaking purposes.[195] This amount has not been funded by customers and should not be subtracted from rate base. In addition, GCCC argues the $68.5 million Benefit Restoration Plan ("BRP") Pension and Postretirement Regulatory Liability "appeared to be calculated in a manner consistent with" the Prepaid Pension Asset.[196] That amount—the $68.5 million—is not comparable to the Prepaid Pension Asset. Instead, it is the balance related to Accumulated Other Comprehensive Income ("AOCI").[197] AOCI is a balance sheet item that is equal to the plan's accumulated unrecognized loss plus the accumulated unrecognized prior service cost.[198] To clarify, accounting rules dictate that unrealized gains and losses related to regulated entities, such as CEHE, should be recorded as a regulatory asset or liability.[199] That is why the amount was labeled on the Company's book as "RegLiab-AOCI Offset." However, there is no accounting guidance or requirement for how these amounts should be treated within rate base. CEHE *does not* include these unrealized gains or losses in any rate filing and the $68.5 million should not be used to adjust rate base in this case.

GCCC goes on to argue that there is no "meaningful distinction" between that amount and the Prepaid Pension Asset because "*all* cash collected in rates for the Company's pension costs is placed in an irrevocable trust fund."[200] GCCC is incorrect. There *is* a "meaningful distinction"

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[194] CEHE Ex. 2 at 58, Schedule II-B-11, Line 18.
[195] The $68.522 million represents the negative $69.297 million unrecognized gain associated with the PRM, netted with the positive $0.744 million unrecognized loss associated with the Deferred Compensation Plan as of December 31, 2018. The BRP is not part of this calculation. Furthermore, the $0.744 million is not a component of the PRM. Therefore, the focus should be on the $69.297 million unrecognized gain for the PRM. CEHE Ex. 46 at 14 (Sanger Rebuttal).
[196] GCCC Initial Brief at 21.
[197] CEHE Ex. 46 at 13 (Sanger Rebuttal).
[198] *Id.* at 15.
[199] CEHE Ex. 35 at 84, Exh. R-KLC-01 (Colvin Rebuttal), which states, Under Accounting Standards Codification (ASC) 715-30-35 (GCCC03-04b Attachment 1 ASC 715-30-35.pdf), the unrecognized gains or losses from the plan's re-measurement are required to be recorded on a company's books as other comprehensive income (loss), or, for regulated entities pursuant to ASC 980-340-25 (which was attached to the response), as a regulatory asset or liability, respectively.
[200] GCCC Initial Brief at 21.

because unrecognized gains and losses have not been expensed.[201] And, the $68.5 million balance is the result of a negative $69.297 million unrecognized gain related to the PRM combined with the positive $0.744 million unrecognized loss associated with the Deferred Compensation Plan.[202] Therefore, there is no "cash collected" for the $68.5 million balance. So, any argument about parallel treatment should be dismissed, particularly because the $68.5 million balance is subsumed within the accrued postretirement cost balance as shown in the excerpt from the Postretirement Medical Actuarial Report included in the RFP and Mr. Sanger's rebuttal testimony.[203]

Finally, CEHE addressed in its Initial Brief why both unrealized gains and unrealized losses should be kept out of rate base.[204] Yet, GCCC addresses the issue of a $370.442 million balance in unrealized losses in the pension plan at the end of the test year and argues it should be used to adjust the Prepaid Pension Asset. Once again, GCCC is incorrect with respect to the proper treatment of the unrealized loss. Similar to the calculation of the unrealized gain of $69.297 million related to PRM, there is a $370.442 million unrealized loss in the pension plan. Neither the unrealized gain or loss amount is immediately recognized in pension/PRM expense. Instead, it is deferred and amortized into future expenses over several years.[205] An amortization of unrealized gains will be reflected as a reduction to total expense for future periods and the opposite is true for the treatment of unrealized loss.[206] In contradiction with traditional ratemaking principles and basic fairness, GCCC unfairly seeks to reduce rate base regardless of the nature of these amounts. This one-side position should be rejected. The Company, on the other hand, *does not* include the negative $69.297 million unrealized gain or positive $370.442 million unrealized loss in any rate filing, because doing so would be double counting. Thus, GCCC's position should not be adopted.

E. Deferred Federal Income Tax [PO Issue 17, 19]

1. Accumulated Deferred Federal Income Tax ("ADFIT")

No party contests CEHE's adjusted test year ADFIT balance of $(969.0) million (other than as may result from adjustments to other issues) or its credit against rate base.[207] Both should be approved as reasonable and necessary.

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[201] CEHE Ex. 46 at 7 (Sanger Rebuttal)
[202] *Id.*
[203] CEHE Initial Brief at 26, CEHE Ex. 2 at Aon 2018 Retirement Plan Actuarial Valuation Report (CNP Retirement Plan AV 2018.pdf (Confidential)).
[204] CEHE Initial Brief at 26, citing to CEHE Ex. 12 at 965 (Exh. KLC-09) (Colvin Direct) and CEHE Ex. 46 at 14-15 (Sanger Rebuttal).
[205] CEHE Ex. 46 at 7 (Sanger Rebuttal).
[206] *Id.* at 16-17.
[207] CEHE Initial Brief at 27; CEHE Ex. 12 at 898 (Colvin Direct) & CEHE Ex. 2 at 40-41, Schedule II-B-7.

2. Excess Deferred Income Taxes ("EDIT")

Other than as may result from adjustments to other issues, no party contests the following EDIT balances as of December 31, 2018:

- total TCJA-related EDIT balance of $646.1 million and the associated regulatory liability of $(823.9) million;[208]
- the TCJA-related protected EDIT balance of $562.5 and the associated regulatory liability balance of $(718.5) million;[209] and
- the total pre-TCJA protected EDIT regulatory liability balance of $(1.99) million.[210]

CEHE has established that, as of December 31, 2018, the total TCJA-related unprotected EDIT balance is $83.6 million, and the associated unprotected EDIT regulatory liability balance is $(105.4) million.[211] With the exception of GCCC and Texas Industrial Energy Consumers ("TIEC") as to EDIT relating to Transition Bonds and System Restoration Bonds (addressed below in Section IX.A), no party contests the amount of unprotected EDIT to be returned to customers.

F. Cash Working Capital [PO Issue 15]

As noted in CEHE's initial brief, the Company's requested cash working capital allowance is uncontested.

G. Other Prepayments

The only contested item in Other Prepayments relates to franchise fee payments. OPUC is the only party that challenges the issue and it moved away from the argument it put forth in testimony because a discovery response CEHE filed clarified why OPUC's position was incorrect.[212] Nevertheless, OPUC for the first time in briefing puts forward a new argument that CEHE's working capital allowance should be reduced by the $5.3 million in franchise fee payments because those prepayments do not represent an available source of capital for CEHE.[213] OPUC, however, cites to no supporting testimony or other evidence for that conclusion, so there is no evidentiary basis for its ultimate position.

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[208] CEHE Initial Brief at 28; Direct Testimony of Charles W. Pringle, CEHE Ex. 13 at 1006-1007 (Bates Pages).
[209] CEHE Initial Brief at 28; CEHE Ex. 13 at 1007 (Pringle Direct).
[210] CEHE Ex. 2 at 59-60, Schedule II-B-12, Lines 28-29.
[211] CEHE Ex. 13 at 1007 (Pringle Direct).
[212] OPUC Initial Brief at 12-13.
[213] *Id.* at 14.

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

While several parties address individual regulatory assets the Company seeks to recover as part of base rates, OPUC is the most vocal party to address the way in which those costs should be recovered. CEHE and OPUC agree that the FERC USOA authorizes a utility to recover regulatory assets and regulatory liabilities and that such recovery results from regulatory approval.[214] In fact, the Rate Base section of the Commission's RFP contains Schedule II-B-12, *Regulatory Assets*, which confirms that the Commission itself understands that recovery of regulatory assets, including through rate base, is a typical ratemaking practice.[215] And, because these are amounts included in Rate Base, a utility properly earns a return on regulatory assets.

OPUC disputes, however, the Company's request to amortize and recover its regulatory asset balances over a three-year period despite the fact that the Commission approved a three-year recovery period in the Company's last rate case.[216] CEHE already noted in its initial brief that using a five-year period conflicts with the position of OPUC's own witness, Ms. Dively, who acknowledges the need for intergenerational equity.[217] Using the three-year period would more closely align recovery or return of the costs with the customers who existed at the time the costs were incurred.[218] To attempt to illustrate its objections to the three-year recovery period, OPUC shows calculations of rate recovery over a period longer than three years to show that additional costs will continue to be recovered through rates if the amortization period is not lengthened to match the expected period between rate cases.[219] This concern is overstated, however.

When OPUC asked Ms. Colvin about this issue at the hearing, Ms. Colvin noted that, "items are set, and it's a reasonable level of cost. And then items change."[220] By these statements, Ms. Colvin is simply acknowledging the reality of how rates are set—test year costs, with certain adjustments, are used to determine cost levels that are likely to prevail at the time new rates are implemented. This includes costs recovered through regulatory assets even though the assets address specific types of costs. In fact, the evidence shows that for the following regulatory assets or liabilities, CEHE will continue to incur and thereby defer the same types of costs for recovery

[214] *Id.* at 14-15; CEHE Ex. 12 at 868-869 (Colvin Direct).
[215] *See* CEHE Ex. 2 at 59-60, Schedule II-B-12.
[216] OPUC Initial Brief at 17-18.
[217] *See* Direct Testimony of June Dively, OPUC Ex. 1 at 14-15.
[218] CEHE Ex. 35 at 42 (Colvin Rebuttal).
[219] OPUC Initial Brief at 16-17.
[220] Tr. at 1305 (Colvin Cross) (Jun. 28, 2019).

in a future rate case: REP Bad Debt, Expedited Switching Costs, SMT, Medicare Part D and PURA § 36.065 Pension and OPEB balance.[221]

OPUC urges the Commission to require CEHE to recover costs in regulatory assets through separate riders. In addition to the concern Staff identifies in its initial brief about limiting the number of separate riders at any given time,[222] OPUC completely ignores comparable treatment for CEHE's regulatory liabilities. For the reasons CEHE explained in its initial brief, this one-sided approach should not be adopted.[223] If regulatory assets are moved to riders but regulatory liabilities are not, the Company would over-refund amounts to customers. OPUC does not address or acknowledge this reality. Using OPUC's illustrative example for a regulatory asset, the results of including the Company's $60.6 million PURA Pension and OPEB regulatory liability in rate base with a return as requested in this case are as follows:

	Amortization Expense	**Balance of the *Liability* at Beginning of the Year**	**Annual Return (.0877*-60,642,000)**
Year 1	$ (20,214,000)	$ (60,642,000)	$ (5,318,303)
Year 2	$ (20,214,000)	$ (40,428,000)	$ (5,318,303)
Year 3	$ (20,214,000)	$ (20,214,000)	$ (5,318,303)
Year 4	$ (20,214,000)	$ 0	$ (5,318,303)
Year 5	$ (20,214,000)	$ 0	$ (5,318,303)
Year 6	$ (20,214,000)	$ 0	$ (5,318,303)
Year 7	$ (20,214,000)	$ 0	$ (5,318,303)
Year 8	$ (20,214,000)	$ 0	$ (5,318,303)

Under CEHE's proposal to include this regulatory liability in rate base, it will be fully returned to customers after three years. But, with the amount included in base rates, an additional $20.2 million per year is returned to customers, in addition to an annual amount of return of $5.3 million, until new rates are set. Given the need for comparable and equitable treatment for customers and the Company, either all regulatory assets and liabilities (other than with respect to unprotected EDIT returned through Rider UEDIT) must be included in rate base, as CEHE

[221] CEHE Ex. 12 at 848, 873, 877-878 (Colvin Direct); CEHE Ex. 13 at 1033 (Pringle Direct); PURA § 36.065.
[222] Staff Initial Brief at 18, 21-22 in which Staff states that it "does not oppose—from an accounting perspective—OPUC's recommendation to remove regulatory assets and liabilities from rate base and establish recovery of those regulatory assets and liabilities through separate riders. From a cost recovery perspective, however, Staff notes that it may be desirable to limit the number of separate riders at any given time." Notably, OPUC does *not* recommend recovery of regulatory liabilities through riders.
[223] CEHE Initial Brief at 30-31.

proposed, or all regulatory assets and liabilities (other than with respect to Rider UEDIT) must be recovered through a rider.

CEHE continues to request recovery of regulatory assets and regulatory liabilities (other than with respect to Rider UEDIT) through base rates and to do so over a three-year period.[224] If, however, the Commission were to consider the rider approach, CEHE proposes the use of a single rider (except TMT if the change in recovery method is not approved and Rider UEDIT) amortized over three years.[225] OPUC's position on this alternative is conflicting in that OPUC states that it does not oppose CEHE's alternative position to recover regulatory assets and liabilities through a rider as long as a five-year period is used, yet OPUC also contends that the record is insufficient to support the adoption of a single rider.[226] CEHE already noted above why a five-year period should not be used. OPUC's "transparency" concerns should not stand in the way of adoption of a rider for all regulatory assets and liabilities (other than with respect to Rider UEDIT)—the rider itself would identify the balance of each regulatory asset or liability and would provide customers with just as much transparency as they have for any other tariffed rate that CEHE charges. In addition, quantifying the effects of the rider is not complicated because all of the relevant information is in CEHE's RFP.

In summary, the combination of all regulatory assets and liabilities (other than with respect to Rider UEDIT) is as follows:

Regulatory Asset / Liability	**Source[227]**	**Amounts**	**Annual Amortization Expense (3-Year Period)**	**Annual Return (.0877)**
Hurricane Harvey	WP II-B-12	$73,148,639	$24,382,880	$6,415,136
Medicare Part D	WP II-B-12	$33,203,913	$11,067,971	$2,911,983
Smart Meter Texas	WP II-B-12	$6,939,132	$2,313,044	$608,562
Texas Margin Tax	WP II-B-12	$19,627,578	$6,542,526	$1,721,339
REP Bad Debt	WP II-B-12	$1,569,545	$523,182	$137,649
PURA Pension/ OPEB Deferral	WP II-B-11	$(60,642,000)	$(20,214,000)	$(5,318,303)
Totals		$73,846,807	$24,615,603	$6,476,366

That cumulative balance of $73.85 million would be amortized over three years, with $24.6 million collected annually from customers through the rider. Finally, allocation of these costs among rate

[224] CEHE Ex. 35 at 42 (Colvin Rebuttal).
[225] *Id.* at 43.
[226] OPUC Initial Brief at 19-20.
[227] CEHE Ex. 1 and CEHE Ex. 2 (Errata 1) contains the Company's Schedule WPs.

classes would also be addressed in the rider itself, with the Company allocating costs based on what the Commission orders in this case, if the rider approach is adopted. Thus, contrary to OPUC's assertion, the record evidence supports CEHE's alternative request to recover regulatory assets and liabilities through a single rider.[228]

Finally, OPUC challenges CEHE's request to earn a return on regulatory asset and liability amounts if they are all included in a rider. To support its position, OPUC claims the regulatory assets CEHE requests "represent expenses, not capital assets."[229] Yet, there is no requirement and OPUC does not point to any support for the idea that regulatory assets must contain capital assets or capital investment for a utility to earn a return on the balances. In fact, the Commission's own approval of regulatory assets confirms that regulatory assets may contain *expense* amounts. Examples include SMT expenses or REP Bad Debt expenses, and PURA § 36.065 specifically contemplates creation of a regulatory asset or liability for pension and OPEB *expense*. Because the Commission's own RFP includes the Regulatory Assets schedule in the Rate Base schedules, earning a return on them is appropriate. In addition, subsection (d)(3) of PURA § 36.065, *Pension and Other Postemployment Benefits*, provides for the addition of the reserve account balance to rate base, which means it will earn a return. There is no support for OPUC's punitive position that regulatory asset and liability amounts should not include a return.

1. Protected Excess Deferred Income Tax[230]

No party challenges CEHE's proposal to return its protected EDIT balance to customers under ARAM or the Company's rate base treatment of protected EDIT, and both should be approved.[231] Similarly, no party disputes that the Company's TCJA-related protected EDIT balance should be adjusted when calculating ADFIT in future DCRF filings.[232]

2. Hurricane Harvey Regulatory Asset

In its brief, OPUC recommends the removal of $9.505 million from CEHE's Hurricane Harvey regulatory asset on the ground that CEHE allegedly "failed to validate those expenses."[233] With the exception of $77,983 of restoration costs, OPUC's recommendation continues to

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[228] CEHE Ex. 35 at 43 (Colvin Rebuttal).
[229] OPUC Initial Brief at 20.
[230] CEHE believes the parties' agreed briefing outline designated this section as "Unprotected Excess Deferred Income Tax" in error and is addressing Protected Excess Deferred Income Tax here. CEHE addresses Unprotected Excess Deferred Income Tax in Section IX.A.
[231] CEHE Initial Brief at 31-32; CEHE Ex. 13 at 1020 (Pringle Direct).
[232] CEHE Initial Brief at 32; CEHE Ex. 12 at 937 (Colvin Direct).
[233] OPUC Initial Brief at 58-59.

mischaracterize the findings in CEHE's Hurricane Harvey EOP Expense Validation Review (the "Audit") and should be rejected as contrary to both the record and the law.

a. The O&M Costs included in Hurricane Harvey Regulatory Asset are Valid and Reasonable

As an initial matter, GCCC has specifically stated that "it does not take issue with CenterPoint's recovery of its requested Hurricane Harvey restoration costs and *does not challenge any component of that cost* or the underlying restoration effort."[234] OPUC, thus, stands alone on this issue. Notably, while OPUC bears the burden to present evidence that "reasonably challenges" CEHE's expenditures, it fails to do so.[235] Instead, OPUC contends that because the entire pool of invoices was not audited, the Company has not met its burden to demonstrate that the unaudited expenses were reasonable.[236] OPUC's argument is inconsistent with the governing standard for cost recovery, which provides that a utility "may meet its burden *without proving the reasonableness and necessity of every individual dollar paid on a granular level*, but may present evidence that is comprehensive [in nature]."[237] CEHE has done just that.

As explained in the rebuttal testimony of CEHE witness Kelly C. Gauger (Vice President, Audit Services for CenterPoint Energy Service Company, LLC ("Service Company")), the Company validated Hurricane Harvey restoration expenses through a multi-layered approach: first, through its robust system of pre-existing internal controls; second, through the efforts of the Hurricane Harvey expense validation team; and third, through the Audit itself.[238] This multi-layered approach is both effective and appropriate within the context of a crisis situation like Hurricane Harvey, where the primary focus is on restoring power to customers as quickly and safely as possible and where decisions must sometimes be made quickly.[239] The "overall conclusion of the Audit was that the EOP expense validation effort provided reasonable justification for Hurricane Harvey-related expenses."[240] Moreover, Ms. Gauger's rebuttal testimony and CEHE's initial brief spelled out *in detail* the specific information supporting that

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[234] GCCC Initial Brief at 26 (emphasis added).
[235] *See Entergy Tex.*, 490 S.W.3d at 240 ("utility has burden to establish prima facie case of prudence of expenses; if utility makes such case, burden shifts to intervenor to present evidence that reasonably challenges expenditure." (citing *Entergy Gulf States,* 112 S.W.3d at 214-15) (overruling OPUC's challenge to Entergy ice storm restoration costs where substantial evidence supported Commission's determination in Entergy's favor).
[236] OPUC Initial Brief at 60.
[237] *Entergy Tex.*, 490 S.W.3d at 240 (emphasis added); *see also Entergy Gulf States,* 112 S.W.3d at 214-15.
[238] Rebuttal Testimony of Kelly C. Gauger, CEHE Ex. 38 at 3 (Bates Pages).
[239] *Id.* at 9.
[240] CEHE Initial Brief at 33.

overall conclusion as to the challenged hotel, catering and logistics, and EOP OnePay expenses.[241] This is more than adequate evidence to satisfy CEHE's burden that Hurricane Harvey expenses were—on a comprehensive as opposed to granular level—prudently incurred. OPUC fails to "reasonably challenge" these costs. Its complaints about the lack of full and perfect documentation as to some restoration expenses is tantamount to a claim that CEHE must prove the reasonableness and necessity of every individual dollar paid on a granular level, when the Austin Court of Appeals has repeatedly rejected that position.[242]

Similarly flawed is OPUC's attempt to justify Karl Nalepa's "gross up" (or extrapolation) of Audit exceptions on the ground that the Company's judgmental sampling methodology left some expenses unaudited.[243] First, this argument ignores record evidence about the other mechanisms the Company employed to ensure prudence of Hurricane Harvey restoration costs—namely, its robust pre-existing system of internal controls and the efforts of the validation team more generally, which *no party* (including OPUC) has challenged. Second, such a standard purports to require CEHE to prove the prudence of every dollar paid on an individual, granular level, which again is contrary to law.[244] Third, it ignores Ms. Gauger's rebuttal testimony that "grossing up" audit exceptions is only appropriate when statistical sampling methods are used and that it was not possible to conduct a statistical audit of Hurricane Harvey restoration costs due to the non-uniform nature of the expenses incurred.[245]

b. Recovery of Hurricane Harvey Costs Through Base Rates is Reasonable

There is no dispute CEHE recorded a regulatory asset to defer Hurricane Harvey O&M expenses and that it did so based on prior treatment the Commission approved for CEHE's Hurricane Ike costs. In addition, this regulatory asset is properly included on Schedule II-B-12, in the Rate Base section of the RFP. And, where CEHE has incurred system restoration costs to promptly restore service after a hurricane, it has incurred significant costs prior to recovering those expenses in rates. Despite this evidence, GCCC and OPUC strenuously argue that these system restoration costs should be recovered through a rider rather than base rates. For support, GCCC points to the Company's use of a rider to return unprotected EDIT to customers. That is

[241] CEHE Ex. 38 at 4-7 (Gauger Rebuttal); CEHE Initial Brief at 33-34.
[242] *Entergy Tex.*, 490 S.W.3d at 240; *Entergy Gulf States,* 112 S.W.3d at 214-15.
[243] OPUC Initial Brief at 60.
[244] *Entergy Tex.*, 490 S.W.3d at 240; *Entergy Gulf States,* 112 S.W.3d at 214-15.
[245] CEHE Ex. 38 at 8-9 (Gauger Rebuttal).

distinguishable from the Hurricane Harvey O&M balance to be recovered, which is not going to change. The undisputed evidence shows CEHE expects the unprotected EDIT balance to change, possibly significantly, over time.[246] For example, a change in law—or specific guidance from the Treasury or IRS—could affect what amounts are properly characterized as protected EDIT or unprotected EDIT.[247] For this reason, Rider UEDIT is an appropriate way to segregate these costs from the rest of the cost of service to allow CEHE to track and record any over- or under-recovery of amounts collected under Rider UEDIT compared to the actual net liability amount.[248] That is not necessary for the costs in the Hurricane Harvey regulatory asset. GCCC does not acknowledge that PURA § 36.065 directs utilities to create a reserve account to track pension and OPEB expense against amounts collected through rates and to apply any surcharge or deficit to rate base in the utility's next case. That is an example of a regulatory asset (or liability) that is specifically authorized by PURA even though it creates a situation in which a utility may recover more costs from customers (or return more costs to customers for a liability) than the balance in the reserve account.

In addition, OPUC relies heavily on comparisons between the size of CEHE's Hurricane Harvey asset and the smaller storm cost balance Texas-New Mexico Power Company ("TNMP") had in Docket No. 48401 to support its position for recovery through a rider.[249] Simple comparisons of the sizes of the balances and TNMP's agreement to recover costs through a storm cost rider are not persuasive—particularly when TNMP's case was resolved by a settlement agreement in which numerous issues influenced the final settlement outcome.

OPUC also characterizes the Hurricane Harvey system restoration costs as one-time expenses to urge recovery through a rider, noting that the Hurricane Harvey balance was not used by CEHE witness Gregory S. Wilson to determine the self-insurance reserve balance and accruals.[250] There is no dispute that CEHE's self-insurance reserve has not been adequate to protect the Company against storm-related costs. Recovering Hurricane Harvey O&M charges outside of the self-insurance reserve is a practical necessity given the low reserve balance and doing so through base rates, with the balance amortized over a three-year period, is appropriate.

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[246] CEHE Ex. 12 at 909-910 (Colvin Direct).
[247] CEHE Ex. 13 at 1007 (Pringle Direct).
[248] CEHE Ex. 12 at 910 (Colvin Direct).
[249] OPUC Initial Brief at 21.
[250] *Id.* at 21-22.

c. Including Carrying Charges in the Hurricane Harvey Regulatory Asset is Appropriate

CEHE agrees with the sound approach Staff takes in support of CEHE's request to recover $8.7 million carrying costs for Hurricane Harvey system restoration costs. Staff witness Jorge Ordonez explained that, "it is important to assure utilities that the Commission will allow them to recover prudently incurred costs, *including carrying costs*, associated with hurricane restoration."[251] CEHE identified the need to request carrying charges in the course of responding to a discovery response from Staff.[252] Accordingly, it filed an errata. Rather than accept CEHE's errata for what it is—correction of an oversight—GCCC insists on characterizing CEHE's request in inflammatory and untrue rhetoric.[253] Inflammatory rhetoric of that sort is not productive and is intended to distract from the substance of the issues in this case. OPUC also disputes the errata filing CEHE made to include carrying charges, claiming "the request was not made to correct an error in the Company's RFP."[254] This is not accurate—CEHE made an "error" by not including carrying charges in its original request, which it corrected in the errata filing.

GCCC also tries to justify its opposition to CEHE's proper request to recover carrying charges by arguing that PURA contains a distinction for system restoration costs in excess of $100 million. While the statute supports only *securitization* of system restoration costs in excess of $100 million, it supports recovery of carrying charges regardless of the amount of system restoration costs at issue. PURA § 36.402(b) includes carrying costs in the definition of "system restoration costs." In addition, PURA § 36.405(a) and (b) both support recovery of system restoration costs in a base rate proceeding such as this case. Specifically, subsection (a) states that an electric utility is entitled to recover system restoration costs *in its next base rate proceeding* or through any other proceeding authorized by Subchapter C or D.[255] Similarly, subsection (b) explains that system restoration costs can be recovered through the issuance of "transition bonds," which relate only to securitization, or *until system restoration costs are otherwise recovered pursuant to the provisions of this subchapter*.[256] This statutory support shows why GCCC's

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[251] Direct Testimony of Jorge Ordonez, Staff Ex. 3A at 39.

[252] CEHE Ex. 2 at 1150, WP/II-B-12 Errata 1; GCCC Ex. 1 at Att. B, Bates Page 99, Staff RFI No. 08-14 (Kollen Direct).

[253] GCCC Initial Brief at 28-29, stating "[t]his so-called errata is nothing more than an attempt to increase its claimed revenue deficiency on the basis of an irrelevant statute that the Company itself did not believe applied until it filed its so-called errata."

[254] OPUC Initial Brief at 23.

[255] Emphasis added.

[256] Emphasis added.

arguments against CEHE's recovery of carrying charges should be rejected, and CEHE's and Staff's positions should be adopted.

OPUC is the only party that challenges the Company's actual calculation of the carrying costs, including the monthly compound interest method CEHE used.[257] Staff, on the other hand, affirmatively supports the Company's calculation of the carrying costs, as does prior Commission practice of using a compound interest method.[258] In addition, the monthly compounding method reflects the Company's actual carrying costs because CEHE incurs additional carrying costs each month until it collects the balance of the Hurricane Harvey regulatory asset.[259] Thus, OPUC's position to apply a simple interest formula should be rejected.

The record evidence also shows the Commission has all the evidence it needs to conduct a "deliberate and thorough review"—to use OPUC's words—of CEHE's request to recover Hurricane Harvey costs in the amount of $64.3 million plus $8.7 million in carrying charges. Nevertheless, OPUC suggests a separate compliance docket should be opened to address the issue, including whether CEHE should be permitted to recover carrying charges. For support, OPUC points to TNMP's agreement to create a separate compliance docket for its recovery of Hurricane Harvey costs.[260] That compliance docket, however, was not limited to Hurricane Harvey cost recovery because it also addressed issues related to the TCJA.[261] And, given that TNMP agreed to create a compliance docket as part of an overall settlement, we simply cannot know from the evidence *in this case* what motivated TNMP to make that agreement and whether it was related to other issues in the settlement. For these reasons, OPUC's reliance on that settlement—even with the acknowledgement that it is not precedential[262]—is not persuasive here.

3. Medicare Part D Regulatory Asset

a. Recovery of the Medicare Part D Regulatory Asset

GCCC alone argues that the Commission in this proceeding should ignore its express order in Docket No. 38339 permitting CEHE to recover the regulatory asset relating to the Medicare Part D Subsidy.[263] In doing so, GCCC not only asks the Commission to set aside all of its detailed

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[257] OPUC Initial Brief at 23.
[258] Staff Ex. 3A at 39 (Ordonez Direct); *Application of Texas-New Mexico Power Company to Change Rates*, Docket No. 48401, Testimony is Support of Stipulation at Exhibit SRW-S-2, page 2 of 12 (Nov. 12, 2018).
[259] CEHE Ex. 35 at 38 (Colvin Rebuttal).
[260] OPUC Initial Brief at 22.
[261] OPUC Ex. 8.
[262] OPUC Initial Brief at 21.
[263] GCCC Initial Brief at 13, 15.

findings and authorizations on this issue in Docket No. 38339 but also seeks a draconian result whereby CEHE *forever* bears the burden of tax on the Medicare Part D Subsidy—a result the Commission never intended.

Specifically, GCCC now wants the Commission to ignore that, in Docket No. 38339, the Commission:

- recognized that CEHE had "proposed to amortize a $9.3 million (grossed up) ADFIT and income-tax-related regulatory asset over a three-year period to account for a Medicare Part D subsidy receivable as of December 31, 2009;"[264]
- did not disagree with CEHE's computation of that regulatory asset and incorporated CEHE's computations of the relevant permanent differences, Medicare Part D Subsidy amounts, and accruals in the Findings of Fact;[265]
- expressly authorized CEHE to *continue* to accrue and monitor this regulatory asset, thereby appropriately ensuring that the timing issue created by the 2010 Health Care Legislation would be addressed in CEHE's next rate case.

The Commission found:

> As with CenterPoint's proposal to increase its income tax expense to account for this future change, the health care legislation underlying CenterPoint's proposal to amortize *this regulatory asset* will not be effective until January 1, 2013, a change too far into the future to be included in the rates set in this proceeding. However, the Commission *authorizes* CenterPoint to *continue* to *monitor* and *accrue* the difference between what their rates assume the Medicare Part B [sic] subsidy tax expense would be and the reality of what CenterPoint is required to pay as a regulatory asset to be addressed in CenterPoint's next rate case.[266]

The Commission in Docket No. 38339 thus fully acknowledged that not taking the 2010 Health Care Legislation into account in Docket No. 38339 would create a timing issue for CEHE. But it is clear from the above that the Commission never intended that CEHE *forever* bear the tax expense of the Medicare Part D Subsidy, as GCCC now proposes. The precise opposite is the

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[264] Docket No. 38339, Order on Rehearing at 9.

[265] *See id.* at 9-10; Finding of Fact 150 ("The Medicare Part D subsidy created a permanent difference of $28.6 million from 2004 through 2009, as calculated pursuant to FASB Statement No. 109."); 151 ("Only $5.4 million of the $28.6 million Medicare Part D subsidy was actually received from 2004 through 2009 while the $23.2 million of the permanent difference related to amounts that were anticipated to be received in 2010 and afterwards but nevertheless was required to be accrued under FASB Statement No. 106."); *see also* CEHE Ex. 13 at 1029 (Pringle Direct) ("Only $5.4 million of the $28.6 million permanent difference related to subsidies that were actually received by the Company from 2004 through 2009. The remaining permanent difference related to amounts that were anticipated to be received in 2010 and afterward but that were required to be accrued under SFAS 106.").

[266] Docket No. 38339, Order on Rehearing at 9-10 (emphases added). *See also* Finding of Fact 159A ("It is appropriate for CenterPoint to monitor and accrue the difference between what its rates assume the Medicare Part B subsidy tax expense will be and what CenterPoint is required to pay as a regulatory asset to be addressed in CenterPoint's next rate case.").

case: the Commission authorized CEHE to *continue* to monitor and accrue the difference between what its rates had assumed the Medicare Part D Subsidy expense would be and what CEHE was required to pay as a regulatory asset to be addressed in its next rate case—this rate case.[267]

b. Computation of the Medicare Part D Regulatory Asset

As with its proposal that no recovery should be permitted for the Medicare Part D Subsidy regulatory asset, GCCC is again alone in disputing CEHE's computation of the asset.[268] OPUC—the only other intervenor to address the Medicare Part D Subsidy issue—raises no objection to CEHE's computations with respect to the Medicare Part D Subsidy.[269] Staff likewise does not recommend any adjustments to the Medicare Part D Subsidy regulatory asset.[270]

As an initial matter, GCCC asserts that the CEHE's calculation "relies on the same *methodology* that the Commission *rejected* in Docket No. 38339 and fails to comply with the methodology specified by the Commission for prospective deferral of a regulatory asset in that prior docket."[271] Yet nowhere in the Commission's order in Docket No. 38339 does the Commission "reject," criticize, or adjust CEHE's computation of the regulatory asset CEHE sought in that case, as discussed above. In this proceeding, CEHE again properly computed the Medicare Part D Subsidy regulatory asset, as discussed in detail in its initial brief and in the direct and rebuttal testimonies of CEHE witness Charles W. Pringle,[272] and each of GCCC's objections to the computations are erroneous.

GCCC argues that the regulatory asset should be computed only beginning in 2013 and that computing the regulatory asset by reference to amounts accrued beginning in 2004 constitutes a "retroactive deferral."[273] This is patently erroneous for the reasons discussed above.

Further, if the Commission in Docket No. 38339 intended CEHE to establish and compute the Medicare Part D Subsidy regulatory asset beginning only in 2013 (or somehow viewed measuring the regulatory asset by reference to accruals beginning in 2004 as constituting retroactive deferrals), the Commission's direction in Docket No. 38339 to CEHE to "continue" to monitor and accrue would be nonsensical: there would be no amount or regulatory asset to

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[267] CEHE Initial Brief at 37; CEHE Ex. 13 at 1031 (Pringle Direct).
[268] GCCC Initial Brief at 13-17.
[269] *See* OPUC Initial Brief at 27.
[270] Staff Initial Brief at 18.
[271] GCCC Initial Brief at 13-14 (emphasis added).
[272] CEHE Initial Brief at 40-42; CEHE Ex. 13 at 1030-1033, 1038-1047 (Pringle Direct); Rebuttal Testimony of Charles W. Pringle, CEHE Ex. 36 at 9-12 (Bates Pages).
[273] GCCC Initial Brief at 14.

"continue" to "monitor" or "accrue" before 2013. Instead, the Commission in Docket No. 38339 necessarily recognized:

- that the appropriate regulatory asset to continue to accrue, monitor, and recover is the difference between the income tax expense benefit passed through to ratepayers that assumed a 0% tax rate and the actual income tax expense owed with respect to the Medicare Part D Subsidy;[274] and
- that, because of the requirements of accrual accounting (which took into account subsidies to be received well into this century), rates since 2004 have reflected this difference and must be appropriately included in the calculation of the regulatory asset.[275]

GCCC next errs in asserting that CEHE failed to offset temporary differences reflected in the income tax expense allowed in rates in Docket No. 38339 by the changes in the temporary differences from 2013 through 2018.[276] This assertion is a straw man - there are no relevant temporary differences. Therefore, there is no error in CEHE's calculation, as detailed in its initial brief and in the testimony of Mr. Pringle.[277]

GCCC then faults CEHE for supposedly failing to update its Medicare Part D Subsidy regulatory asset based on actuarial reports for 2013 through 2018.[278] Yet actuarial reports were neither necessary for the computation nor were they required by the Commission in Docket No. 38339.

When calculating its regulatory asset, CEHE knew both:

- that any accrued cash received on or after January 1, 2013, has been, and would be, subject to a federal income tax rate of either 35% or 21% (instead of the 0% reflected in customer's rates);[279] and
- the amount of subsidy reflected in CEHE's rates since 2004.[280]

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[274] CEHE Initial Brief at 40-42; CEHE Ex. 36 at 15-16 (Pringle Rebuttal).
[275] CEHE Initial Brief at 38-40.
[276] GCCC Initial Brief at 14.
[277] CEHE Initial Brief at 40-42. More specifically, all required FAS 106 temporary differences were recorded in the first quarter of 2010 and properly reflected in the ADFIT in CEHE's books and records. CEHE Ex. 36 at 10 (Pringle Rebuttal); CEHE Ex. 13 at 1029 (Pringle Direct). The FAS 106 temporary differences have no impact on the computation of the regulatory asset in subsequent periods: the subsidies are subject to tax, and the deferred amounts are reflected as required under ASC 740. CEHE Ex. 36 at 10–11 (Pringle Rebuttal). For the Medicare Part D Subsidy balance, a temporary difference was established only for the difference in the accrued permanent benefit as of the first quarter of 2010 and the anticipated cash receipts for 2010, 2011 and 2012 since those receipts would remain nontaxable. *Id.* But *after 2012*, the temporary difference ceases to exist because the Medicare Part D Subsidy becomes taxable. *Id.* GCCC appears to assume in error that a temporary difference exists related to cash receipts received after 2012. *Id.* But no temporary difference can exist after January 1, 2013, for those amounts. *Id.*
[278] GCCC Initial Brief at 14. GCCC's brief refers to "actual reports," but CEHE believes that the intended reference is to "actuarial" reports.
[279] CEHE Ex. 36 at 11–12 (Pringle Rebuttal).
[280] *Id.*

Thus, CEHE readily and correctly made the with and without subsidy calculation ordered by the Commission in Docket No. 38339 without having to obtain any unnecessary actuarial reports that GCCC would seek now for purely hypothetical purposes.[281]

GCCC also asserts that CEHE failed to offset the Medicare Part D Subsidies from 2013 through 2018 as it did in from 2004 through 2012.[282] This assertion seems to be based on a fundamental misunderstanding by GCCC of this issue. GCCC states that the "calculation requires an annual quantification of the *subsidy* due less the *subsidy* actually received from the federal government each year from 2013 through 2018, compared to the same two amounts reflected in the 2009 test year used in Docket No. 38339."[283] GCCC also incorrectly states elsewhere in its initial brief that the Commission rejected recovery of the regulatory asset in Docket No. 38339 because "the expiration *of the subsidy* had not yet occurred and would not occur until two years into the future."[284]

These assertions make no sense because there is no reason to compare *subsidy* amounts for any periods—the *subsidies* are not affected by the change in taxability of the Medicare Part D Subsidy. Nor did the subsidy expire on January 1, 2013—it only became taxable at that time. The Medicare Part D Subsidy regulatory asset instead represents the recovery of a *tax expense* that equals the difference between (i) accrued benefits to customers provided in rates (as a reduction to tax expense) since 2004 and (ii) the amount of *tax expense* benefit actually realized by CEHE for the cash received while those amounts were *not* subject to tax: 2004 through 2012.[285] Cash receipts of the Medicare Part D Subsidy starting in 2013 were taxable and therefore do not change the computation for the regulatory asset.[286]

GCCC's last criticism of the computation is likewise groundless. GCCC asserts that CEHE failed to remove the portion capitalized to construction work in progress ("CWIP").[287] While *pension expense* is capitalized to CWIP, CEHE does not capitalize *income tax expense* to CWIP.[288] Because the Medicare Part D Subsidy regulatory asset is related to *income tax expense* and because

[281] *Id.*
[282] GCCC Initial Brief at 15.
[283] *Id.* at 16 (emphasis added).
[284] *Id.* at 13 (emphasis added).
[285] CEHE Ex. 36 at 11–12 (Pringle Rebuttal).
[286] *Id.*
[287] GCCC Initial Brief at 15.
[288] CEHE Ex. 36 at 12–13 (Pringle Rebuttal).

CEHE seeks to recover a reduction in *income tax expense* that was provided to customers but that was ultimately not realized as a result of the change in tax law,[289] GCCC's argument is in error.

In total, GCCC's disagreements with CEHE's calculation establish that it misunderstands the Commission's order in Docket No. 38339, the premise behind the Medicare Part D Subsidy regulatory asset, and CEHE's calculation of the regulatory asset. They should accordingly be rejected.

c. Recovery of the Medicare Part D Subsidy Regulatory Asset

OPUC proposes that the Medicare Part D Subsidy regulatory asset through the end of the test year be removed from rate base for recovery over a five-year period through a proposed Rider MEDD.[290] As explained in CEHE's initial brief at Section II.G.3, OPUC's proposed amortization period should be rejected because:

- the three-year period proposed by CEHE is consistent with treatment approved in Docket No. 38339;
- amortizing regulatory assets and liabilities over the same period provides equitable treatment for both customers and the Company;
- the three-year amortization period ensures that the costs to be recovered from or returned to customers are more closely aligned with the customers that existed at the time the costs were incurred; and
- OPUC's one-sided approach of recovering regulatory assets over five years while returning regulatory liabilities over three years is inequitable.[291]

OPUC also proposes to deny a return with respect to the Medicare Part D Subsidy regulatory asset.[292] This proposal ignores the fact that CEHE has pre-funded the asset over numerous years, resulting in a significant amount of funds CEHE has yet to recover.[293] Including a return on this regulatory asset is appropriate and reasonable and should be allowed by the Commission.

Finally, CEHE's initial brief addresses in full why, if OPUC's Rider MEDD were adopted, it must be adjusted to reflect an increase for the Texas Margin Tax ("TMT").[294]

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[289] *Id.*
[290] OPUC Initial Brief at 27.
[291] CEHE Initial Brief at 30. OPUC appears to now agree that regulatory assets and liabilities should be treated equally and amortized over the same period, albeit over five years. OPUC Initial Brief at 19.
[292] OPUC Initial Brief at 24-25.
[293] CEHE Ex. 36 at 16 (Pringle Rebuttal).
[294] CEHE Initial Brief at 43.

4. Texas Margin Tax Regulatory Asset

The Company is requesting to change the way it recovers its TMT expense as an accommodation to Staff.[295] To properly do so, CEHE must also recover a "stranded," one-time regulatory asset resulting from this change in rate recovery method.[296] This recovery is neither duplicative nor harmful to customers.[297] On the other hand, denying the recovery—as GCCC, OPUC, and Staff propose—would forever deny CEHE from recovering a full year of TMT expense.

Despite Intervenors' and Staff's descriptions otherwise, the issue is straightforward. The Commission has previously allowed CEHE rate recovery for its TMT expense based on the Company's cash *payment* of taxes during the test year even though such payment is based on the taxable year prior to the test year.[298] The actual TMT expense is thus deferred each year until it is recovered in rates the next year, resulting in a regulatory asset to reflect the one-year lag between the taxable year and the payment year.[299] In this proceeding, the Company is requesting

- the *actual* \$20,027,048 TMT expense for the 2018 test year (rather than what is *paid* in the test year) and

- recovery of the 2017 TMT expense *paid* in the test year (but not yet recovered) as a regulatory asset to be recovered over three years consistent with the equitable recovery period sought by CEHE for other regulatory assets and liabilities.[300]

The TMT thus becomes a current year expense and the new rate recovery method eliminates the need to record a regulatory asset related to TMT each year.[301] If the Company's regulatory asset proposal were denied, CEHE would *never* recover the \$19.6 million of 2017 TMT expense that it *paid* in the test year.[302]

a. Intervenors and Staff Misunderstand CEHE's TMT Regulatory Asset Request

GCCC's, Staff's, and OPUC's challenges to CEHE's request appear to be based on a host of misunderstandings. These errors result in their unnecessarily complicating and mischaracterizing the Company's TMT regulatory asset request and in seeking a one-sided result

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[295] *Id.* at 44.
[296] *Id.*
[297] *Id.* at 43-45; CEHE Ex. 35 at 29 (Colvin Rebuttal).
[298] CEHE Initial Brief at 44; CEHE Ex. 13 at 1025 (Pringle Direct).
[299] CEHE Initial Brief at 44; CEHE Ex. 12 at 874-875 (Colvin Direct).
[300] CEHE Initial Brief at 44-45; CEHE Ex. 12 at 874-875 (Colvin Direct); CEHE Ex. 13 at 1025 (Pringle Direct).
[301] CEHE Initial Brief at 44-45.
[302] *Id.*; CEHE Ex. 35 at 29 (Colvin Rebuttal).

where the Company forever bears a full year of TMT expense that it can never recover.

GCCC wrongly believes that the Company will be overcompensated for its TMT expense and that customers will be harmed by the proposed amortization of the regulatory asset.[303] This is not the case. The Company's proposal merely allows it to recover the 2017 TMT expense *that CEHE has already paid* and that is *not otherwise reflected in rates* as a regulatory asset over three years.[304] The evidence demonstrates that there is no possible duplicative recovery in CEHE's proposal and that CEHE would be harmed if the Commission were to disallow recovery of the regulatory asset because it would forever be denied recovery of that 2017 TMT expense.[305] Relatedly, GCCC claims the Company "concedes" that the one-time TMT regulatory asset in the amount of $19.6 million should not be included in rate base.[306] This is not accurate. CEHE is willing to accept exclusion of the one-time TMT regulatory asset from rate base *only if* its related request to change the TMT expense recovery method is not approved.[307] Stated differently, if CEHE is not permitted to recover the one-time TMT regulatory asset, the change in the expense recovery method should not be adopted because then the costs in the regulatory asset would never be recovered and the Company would not be kept whole. The TMT issue is an all-or-nothing request: either both the expense and regulatory asset recovery are approved or the regulatory asset is denied and the Company's TMT expense request becomes the $19.6 million.[308]

GCCC also argues that there is no compelling reason to use the expense accrued in the same year as the liability is accrued because the expense remains relatively constant.[309] GCCC misses the point. CEHE's request simplifies the Company's TMT expense recovery by eliminating the need to record a TMT regulatory asset altogether and to recover TMT expense on a one-year lag.[310] The Company's proposal allows the TMT expense to simply be the amount assessed on the revenue in the period the revenue was earned.[311]

Staff states that CEHE is not authorized to record a regulatory asset for TMT and thus

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[303] GCCC Initial Brief at 17-18.
[304] CEHE Initial Brief at 44-45; CEHE Ex. 13 at 1024-1025 (Pringle Direct).
[305] CEHE Initial Brief at 44-45; CEHE Ex. 35 at 29 (Colvin Rebuttal).
[306] OPUC Initial Brief at 18.
[307] CEHE Ex. 35 at 29 (Colvin Rebuttal).
[308] *Id.*
[309] GCCC Initial Brief at 18-19.
[310] GCCC also incorrectly compares this change to a 1992 change in accounting method for unbilled revenue. GCCC Initial Brief at 19. Unlike TMT expense (which is a cash item that must be collected from customers and submitted to taxing authorities), unbilled revenue is a non-cash accrual item that will reverse and never be collected from customers. CEHE Initial Brief at 45; CEHE Ex. 35 at 29 (Colvin Rebuttal).
[311] *Id.* at 27.

should not be allowed recovery of the TMT regulatory asset.[312] Staff is mistaken both as to the underlying facts and as to this conclusion. The Commission authorized CEHE to record a regulatory asset in the Order on Rehearing in Docket No. 29526 when the Commission recognized a deferred debit for state franchise taxes and that state franchise taxes were recovered on a two-year cycle.[313] Staff counters that Docket No. 29526 is not applicable to the Company's TMT expense because the order in Docket No. 29526 spoke only to the state franchise tax.[314] Yet Staff ignores the fundamental point that such tax was the predecessor to the TMT and that the regulatory asset treatment was approved, despite the tax's label.[315]

Staff further argues that CEHE's treatment of the TMT expense is unique and that the Company should correct its accounting treatment without recovery of the TMT regulatory asset because such asset was never authorized by the Commission.[316] Not only is Staff incorrect regarding the authorization of the TMT regulatory asset, as discussed above, but denying recovery of the regulatory asset would mean that the Company would *never* recover the 2017 TMT expense. The equities weigh fully against Staff because CEHE is requesting this change to its TMT expense to be consistent with that of other utilities and so should not be forever harmed by doing so.[317]

Staff's argument that GAAP accounting does not necessarily control regulatory treatment is likewise without merit.[318] CEHE relied on FERC and GAAP requirements and prior Company dockets when recording the regulatory asset.[319] If the Company is not allowed to recover the regulatory asset, that amount will forever be lost.

Staff also argues that TMT amounts have been recovered to the same extent as any other line item in the Company's revenue requirement in Docket No. 38339 and so amounts for TMT expense have been fully recovered.[320] This argument demonstrates a fundamental mistake. CEHE's requested TMT regulatory asset is a one-time TMT expense amount (namely, the 2017 TMT expense that was paid by CEHE in the test year) that will *never be recovered* by the Company if the Company's TMT regulatory asset proposal is rejected. The Company is not proposing a

[312] Staff Initial Brief at 19.
[313] *Application of CenterPoint Energy Houston Electric for a True-Up Filing*, Docket No. 29526, Docket No. 29526, Order on Rehearing at 46-47 (Dec. 17, 2004).
[314] Staff Initial Brief at 20.
[315] CEHE Initial Brief at 46; CEHE Ex. 35 at 31-32 (Colvin Rebuttal).
[316] Staff Initial Brief at 19.
[317] CEHE Initial Brief at 44; CEHE Ex. 35 at 24 (Colvin Rebuttal).
[318] *See* Staff Initial Brief at 20.
[319] CEHE Ex. 35 at 32 (Colvin Rebuttal).
[320] Staff Initial Brief at 20.

shift from a two-year recovery cycle to a current-year expense method for other line items in its revenue requirement.

Though numerous, OPUC's arguments are all in error and should be rejected. OPUC argues that the Company is not entitled to the TMT regulatory asset because the Commission did not approve the asset.[321] Yet, as explained above, the order in Docket No. 29526 expressly acknowledged that the predecessor to the TMT was recovered on a two-year cycle with an amount recorded as a deferred debit in one year and the regulatory asset recovered in the next year.[322]

- OPUC argues that the order in Docket No. 29526 does not apply to this proceeding because such docket related only to stranded costs.[323] This argument clouds the issue: the order in Docket No. 29526 confirms that a regulatory asset is appropriate when the expense at issue is recovered on a one-year lag.[324]
- OPUC erroneously states the Company is using the payment method of accounting when in fact the Company uses the accrual method of accounting, which results in the need to record the regulatory asset for the recovery of the cash payment in base rates.[325]
- OPUC argues that the transition to accrual accounting, a statement that is incorrect as noted in the bullet above, does not require creation of a TMT regulatory asset.[326] The Company is not proposing the "creation" of a regulatory asset. Rather, the Company is merely proposing recovery over three years of the TMT regulatory asset that it method as an accommodation to Staff.[327]
- OPUC argues that the Company's accounting treatment is the only reason that the regulatory asset exists and that the Company is not entitled to fully recover its TMT expense.[328] OPUC provides no support for such assertion. In fact, as noted above, it is the regulatory recovery that results in the regulatory asset exists due to the change in recovery.
- OPUC argues that this change is not required and thus the TMT regulatory asset should not be approved.[329] The Company is requesting this change in response to Staff requests to be consistent with that of other utilities.[330] OPUC would then seek to harm CEHE and deny recovery of the TMT regulatory asset for an amount of TMT expense that CEHE has already paid and that it would otherwise never recover.

[321] OPUC Initial Brief at 29.
[322] CEHE Initial Brief at 46; Docket No. 29526, Order on Rehearing at 46-47.
[323] OPUC Initial Brief at 26.
[324] CEHE Initial Brief at 46; CEHE Ex. 35 at 25 (Colvin Rebuttal).
[325] OPUC Initial Brief at 27.
[326] *Id.*
[327] CEHE Initial Brief at 44-45; CEHE Ex. 35 at 32 (Colvin Rebuttal).
[328] OPUC Initial Brief at 31.
[329] *Id.* at 31-32.
[330] CEHE Initial Brief at 44-45; CEHE Ex. 35 at 24 (Colvin Rebuttal).

- OPUC argues that the TMT regulatory asset request is prohibited retroactive ratemaking,[331] which prevents utilities from recouping historical losses via their current rates.[332] Yet the TMT regulatory asset is not a loss: it was established based on normal on-going expenses—expenses generated from the one-year lag between the taxable year for the TMT expense and the payment year for such expense.[333] Consistent with Texas law, such a regulatory asset is not retroactive ratemaking and such amounts have been afforded rate recovery in the past.[334]

b. Reversion to Prior Method

As CEHE stated in its initial brief,[335] if both of CEHE's TMT proposals—recovering 2018 TMT expense and recovering the one-time, stranded 2017 TMT expense as a regulatory asset—are not approved, CEHE would revert to its former methodology. Ms. Colvin explained the steps that would be necessary to reflect its former methodology in the rate filing in Exhibit R-KLC-05.[336] This would result in the 2017 payment being reflected in the cost of service and 2018 expense being recorded as a regulatory asset.[337]

5. Smart Meter Texas ("SMT") Regulatory Asset

As it does with other regulatory asset balances, OPUC recommends the SMT balance be recovered through a separate rider over a five-year period and not earn a return.[338] CEHE opposes OPUC's positions for the reasons addressed in Section II.H above.

6. REP Bad Debt Regulatory Asset

As a threshold matter, OPUC's stance that REP Bad Debt expense should be treated as an expense item rather than a regulatory asset has no merit.[339] OPUC's position is directly contrary to the plain language of Commission Rule 25.107(f)(3)(B), which clearly provides for the creation of a regulatory asset:

> A TDU *shall create a regulatory asset for bad debt expenses*, net of collateral posted pursuant to subparagraph (A) of this paragraph and bad debt already included in its rates, resulting from a REP's default on its obligation to pay delivery

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[331] OPUC Initial Brief at 29.

[332] *See State v. Pub. Util. Comm'n of Tex.*, 883 S.W.2d 190, 199 (Tex. 1994) ("Restated, the rule [against retroactive ratemaking] prohibits a utility commission from making a retrospective inquiry to determine whether a prior rate was reasonable and imposing a surcharge when rates were too low or a refund when rates were too high.").

[333] *See id.* ("The State and OPUC argue that because the old rate is effective through the regulatory lag period, allowing expenses incurred during this period to be deferred and included in the rate base is tantamount to retroactive ratemaking. While we recognize that regulatory lag is ordinarily an element of the risk associated with investment in a utility . . . *reducing the impact of regulatory lag does not equate to retroactive ratemaking.*") (emphasis added).

[334] CEHE Initial Brief at 46; CEHE Ex. 35 at 30 (Colvin Rebuttal).

[335] CEHE Initial Brief at 47.

[336] CEHE Ex. 35 at 119, Exh. R-KLC-5, PUC RFI No. 08-01 (Colvin Rebuttal).

[337] CEHE Initial Brief at 47.

[338] OPUC Initial Brief at 30-31.

[339] *Id.* at 34.

> charges to the TDU. Upon a review of reasonableness and necessity, a reasonable level of amortization of *such regulatory asset* shall be included as a recoverable cost in the TDU's rates in its next rate case or such other rate recovery proceeding as deemed necessary (emphasis added).

OPUC and Texas Energy Association for Marketers ("TEAM") also make much of the fact that the existing amount of REP Bad Debt expense being recovered through rates approved in Docket No. 38339 is a credit.[340] Contrary to the plain language of the rule, they urge the Commission to remove the credit amount from the REP Bad Debt regulatory asset calculation. This would be incorrect. Again, CEHE is simply following the language in the rule to create a regulatory asset that consists of the bad debt balance in test year *minus* collateral *minus* "bad debt already included in rates."[341] For CEHE, the "bad debt already include in rates" is a negative number because it is a credit. When that negative number is subtracted in the simple formula required by the rule, it becomes a positive number and results in an overall REP Bad Debt regulatory asset balance of $1.569 million.[342] As Ms. Colvin explained, the rule does not state that the "bad debt already included in rates" has to be a debit amount.[343] In short, CEHE does not have the discretion to ignore the rule requirements; nor can it unilaterally discontinue the credit in its existing rates.

OPUC also disputes CEHE's request to include the REP Bad Debt regulatory asset in rate base, despite the fact that it is a proper regulatory asset included in one of the Rate Base RFP schedules, Schedule II-B-12. To support CEHE's request on this issue, Ms. Colvin noted that the Commission approved Oncor's request to recover a regulatory asset for bad debt.[344] Yet, OPUC concludes that because its counsel cannot locate the RFP schedule Ms. Colvin cites from the Oncor docket, CEHE "has failed to present sufficient evidence" to support its request to include this regulatory asset in rate base. Just as the Final Order from Docket No. 46957 is publicly available on the PUC Interchange, so too is Schedule II-B-12, which shows the regulatory asset balances presented in Oncor's RFP that were approved in the case.[345] Because those materials are publicly

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[340] *Id.* at 31-33. TEAM Initial Brief at 3.
[341] 16 TAC § 25.107(f)(3)(B).
[342] This calculation is shown at CEHE Ex. 2 at 1334, WP/II-D-2.2a.1. *See* also CEHE Ex. 35 at 39-40 (Colvin Rebuttal).
[343] CEHE Ex. 35 at 40 (Colvin Rebuttal).
[344] *Id.* at 39 (Colvin Rebuttal), citing *Application of Oncor Electric Delivery Company, LLC for Authority to Change Rates*, Docket No. 46957, Final Order at Finding of Fact 48 and Schedule II-B-12 (Oct. 13, 2017).
[345] Docket No. 46957, Oncor Rate Filing Package at RFP, Vol. 7, Section II, 2163-2168 (Item 1 on the PUC Interchange in Docket No. 46957).

and readily available, particularly to parties that regularly appear before this Commission, CEHE was not required to include them in Ms. Colvin's testimony workpapers.

Finally, TEAM makes the curious allegation that CEHE "knowingly" filed an inaccurate allocation of the REP Bad Debt amount.[346] In its response to the RFI cited by TEAM, CEHE explained that it "tracks bad debt expense by rate class and in preparing the response to this RFI realized that the Company had incorrectly allocated them," and included a table showing the correct allocation.[347] CEHE witness Matthew A. Troxle also addressed this issue in his rebuttal testimony and provided the same, corrected allocation amounts that were provided in response to TEAM's RFI.[348] The Company acknowledged and corrected its mistake, and no further action on this issue is needed in this case.

7. BRP Pension and Postretirement Issues

CEHE addressed this issue in Section II.D (Rate Base - Prepaid Pension Asset and Accrued Postretirement Cost). For the reasons stated in Section II.D, there should be no adjustment to rate base for these costs.

8. Other Regulatory Assets and Liabilities

a. PURA § 36.065 Pension and OPEB Regulatory Liability

b. Hurricane Ike Regulatory Liability

c. Expedited Switching Costs Regulatory Asset

d. Deferred Accounting Treatment for Interest Rate Hedging

No party challenges CEHE's requests regarding each of these Other Regulatory Assets and Liabilities, nor does any party address these issues in their initial brief. Because CEHE's positions are unchallenged, they should be approved for each of these items, as addressed in CEHE's initial brief.

I. Capitalized Incentive Compensation

Staff challenges the capitalized portions of incentive compensation by offering the argument: if certain financially based incentive compensation expenses are disallowed, then the capitalized portions of financially based incentive compensation should be disallowed as well.[349] COH agrees,[350] and the total adjustment proposed is a reduction to CEHE's rate base in the amount

[346] TEAM Initial Brief at 3.
[347] TEAM Ex. 1 at 6-7.
[348] Direct Testimony of Mathew A. Troxle, CEHE Ex. 30 at 3010 (Bates Pages).
[349] Staff Initial Brief at 22-23.
[350] COH/HCC Initial Brief at 15.

of $2,365,000.[351] However, as addressed below in Section IV.B.1, Staff's proposed adjustments, at a minimum, would: (1) remove the capitalized portions of incentive compensation pay tied to collective bargaining agreements (in violation of PURA § 14.006); (2) improperly designate an operational measure (control of O&M expenditures) as a financial measure; and (3) additionally disallow 50% of all operationally based STI (solely because it cannot be paid unless the Company reaches a financial "trigger"). The capitalized incentive compensation amounts tied to Staff's improper designations alone are: (1) $243,368 tied to capitalized direct union salaries and $461 tied to affiliate union salaries; (2) $1,093,540 tied to direct non-union CEHE salaries and $211,642 tied to affiliate non-union salaries where Staff has labeled O&M control measures improperly as a financial measure; and (3) $689,538 tied to direct non-union CEHE salaries and $134,401 tied to affiliate non-union salaries where Staff inappropriately reduces safety and customer service related STI by 50%.[352] The total of this over-reaching is $2,372,950 and would eliminate Staff's proposed adjustment to rate base. As discussed in Section IV.B.1, these adjustments are inappropriate—separate and apart from any argument related to whether financially based incentive compensation should be recovered. The Company's initial brief details why all of the Company's incentive compensation costs should be recovered. However, at a minimum, Staff's proposed adjustment should be revised to reflect the removal of incentive compensation for union employees and blanket adjustments that inappropriately include operational measure amounts.

J. Capitalized Non-Qualified Pension Expense

Staff challenges the capitalized portions of non-qualified pension expense by essentially offering a flow-through argument: if non-qualified pension expense is disallowed, so too should the capitalized portions of those costs be removed from rates.[353] Staff's position on capitalized pension expense should be rejected based on the evidence detailed in Section IV.B.5 of CEHE's initial brief and Section IV.B.4 of its reply brief, and a flow-through adjustment to remove the capitalized portions of reasonable and necessary non-qualified pension expense should not be made.

[351] Staff Initial Brief at 22.
[352] *See* Staff Ex. 15A (the Company's response to Staff RFI No. PUC 16-1).
[353] Staff Initial Brief at 23.

III. Rate of Return [PO Issues 4, 5, 7, 8, 9]

A. Return on Equity [PO Issue 8]

As explained in CEHE's initial brief, the Commission-approved return on equity ("ROE") should be reasonably sufficient to assure confidence in the financial soundness of the utility, to maintain and support the utility's credit, and to attract the capital necessary for the proper discharge of the utility's public duties.[354] The evidence in this case has established that the award of an ROE materially lower than 10% will not be sufficient to sustain CEHE's credit metrics.[355]

A common theme among the Intervenor briefs is an attempt to paint CEHE as the outlier insofar as ROE recommendations are concerned;[356] however, the return required by equity investors cannot be decided according to a headcount of witnesses. The ROE must be established at a level that will preserve CEHE's financial integrity and allow it to maintain access to capital on reasonable terms, regardless of how many parties line up in favor of an extremely low ROE. For the following reasons, the Staff and Intervenor arguments on ROE are flawed and should be rejected. CEHE requests that the Commission approve the 10.4% ROE recommended by CEHE witness Robert B. Hevert.[357]

1. Response to OPUC's Arguments on ROE

OPUC contends that its recommended ROE is appropriate because it considers the "current low-interest market environment" in which CEHE operates.[358] However, as discussed in CEHE's initial brief, OPUC witness Anjuli Winker does not accurately consider the current capital market conditions and their effect on the cost of equity.[359] Mr. Hevert's testimony demonstrates that market volatility is expected to increase from its current levels.[360] As Mr. Hevert explains, the recent reductions in interest rates have been associated more with anomalous events than they have been with changes in fundamental economic conditions,[361] and those anomalous events are not expected to persist. Despite OPUC's assertion that investors do not see the utility sector as relatively risky,[362] Mr. Hevert's analysis of the historical relationship between the Moody's

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[354] CEHE Initial Brief at 52.
[355] Rebuttal Testimony of Robert B. McRae, CEHE Ex. 43, Confidential Exh. R-RBM-3 at 1 (Bates Pages).
[356] *See* TIEC Initial Brief at 9; Walmart Initial Brief at 3; OPUC Initial Brief at 34; TCUC Initial Brief at 8.
[357] Direct Testimony of Robert B. Hevert, CEHE Ex. 26 at 2664 (Bates Pages).
[358] OPUC Initial Brief at 35.
[359] CEHE Initial Brief at 56; *see* Rebuttal Testimony of Robert B. Hevert, CEHE Ex. 42 at 31-45.
[360] CEHE Ex. 42 at 34 (Hevert Rebuttal).
[361] *Id.* at 32, 39-40.
[362] OPUC Initial Brief at 36.

Investors Service ("Moody's) Utility and Corporate Baa debt yields proves otherwise.[363] OPUC also points to Moody's and Fitch Ratings ("Fitch") opinions from early to mid-2018 to support its assertion that CEHE particularly is low-risk.[364] However, the most dispositive source of Moody's opinion on the ROE necessary to adequately reflect CEHE's level of risk is Moody's June 17, 2019 credit outlook, which states that Staff and Intervenor's recommendations, if adopted, would be considered credit-negative for CEHE.[365]

Ms. Winker's proxy group differs from Mr. Hevert's in that it excludes four companies[366] that Ms. Winker contends are parties to an ongoing or recently completed "significant transaction."[367] However, Ms. Winker does not explain what transactions rendered those companies ineligible to be included in her proxy group.[368] Mr. Hevert's rebuttal testimony demonstrates that the recent transactions undergone by Ms. Winker's excluded companies were not significant or transformative to those companies in terms of relative market capitalization.[369] Accordingly, these four companies were suitable proxies and should not have been excluded.[370]

OPUC takes issue with Mr. Hevert's reliance on estimates of projected earnings growth in developing the dividend growth component of his Discounted Cash Flow ("DCF") model.[371] OPUC argues that it is appropriate to consider historical growth rates because past performance is an indication of future performance, and because investors attach more significance to the past financial results of utilities due to their regulated nature.[372] However, OPUC's assertion is based solely on Ms. Winker's unsupported opinion.[373] In contrast, Mr. Hevert presented a regression analysis of growth rates and utility Price/Earnings ratios, which shows earnings growth to be the only growth rate with statistically strong and theoretically sound ability to explain changes in utility valuations.[374] As explained in CEHE's initial brief, projected earnings growth should be

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363 CEHE Ex. 42 at 44-45 (Hevert Rebuttal).
364 OPUC Initial Brief at 37.
365 *See* CEHE Ex. 43, Confidential Exh. R-RBM-3 at 1 (McRae Rebuttal).
366 ALLETE, Inc. ("ALLETE"), American Electric Power Company, Inc. ("AEP"), NextEra Energy, Inc. ("NextEra"), and Southern Company ("Southern").
367 OPUC Initial Brief at 38.
368 CEHE Ex. 42 at 46 (Hevert Rebuttal).
369 *Id.* at 46-47. Mr. Hevert explains that NextEra's purchase of Gulf Power Company and Florida City Gas from Southern represented about 5% of NextEra's and less than 10% of Southern's market capitalization. ALLETE's sale of its U.S. Water Services subsidiary represented about 6% of ALLETE's market value. AEP's acquisition of Sempra Energy Renewables represented about 2% of AEP's market capitalization.
370 *Id.* at 48.
371 OPUC Initial Brief at 39.
372 *Id.* at 40.
373 *See* CEHE Ex. 42 at 54 (Hevert Rebuttal).
374 *Id.* at 54.

the only variable used in the DCF analysis.[375] Furthermore, regardless of any fundamental differences in analyses, Ms. Winker's use of Sustainable Growth rates estimates produces average DCF estimates in the range of 6.77%-6.98%, which are too low to have much, if any, meaning in determining CEHE's cost of equity.[376]

CEHE's initial brief explains the deficiencies in Ms. Winker's Bond Yield Plus Risk Premium analysis, which will not be repeated here.[377] In its brief, OPUC asserts that Mr. Hevert's Bond Yield Plus Risk Premium analysis is flawed because he "adjusted" his calculated risk premium upward from 1.46% to 2.24% to account for the relationship between risk premia and 30-Year Treasury bond yields.[378] However, as Mr. Hevert's testimony explains, Ms. Winker's assertion is incorrect and appears to misunderstand his analysis.[379] Although the average equity risk premium is provided as an attachment to Mr. Hevert's testimony, it is never used as the basis for his ROE recommendation.[380] Rather, his equity risk premium estimate is based on a regression analysis, which continues to show a statistically significant inverse relationship between the equity risk premium and Treasury bond yields.[381] While Ms. Winker asserts that the relationship between interest rates and risk premiums is not as direct as Mr. Hevert assumes in his regression analysis,[382] recreating Ms. Winker's Bond Yield Plus Risk Premium analysis clearly captures this observable, inverse relationship.[383]

Finally, OPUC restates TCUC's argument that Mr. Hevert's Capital Asset Pricing Model ("CAPM") analysis is flawed because he established his market risk premium by conducting a DCF analysis of all of the companies in the Standard & Poor's ("S&P") 500 Index. CEHE addressed this argument in its initial brief.[384]

2. Response to TCUC's Arguments on ROE

TCUC argues that TCUC witness Dr. J. Randall Woolridge's testimony established two key points in determining a ROE for CEHE: (1) that the trend in nationwide authorized ROEs is downward; and (2) that despite the Federal Reserve's moves to increase the federal funds rate,

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[375] CEHE Initial Brief at 56.
[376] CEHE Ex. 42 at 56 (Hevert Rebuttal).
[377] CEHE Initial Brief at 57.
[378] OPUC Initial Brief at 42.
[379] CEHE Ex. 42 at 57 (Hevert Rebuttal).
[380] *Id.*
[381] *Id.*
[382] Direct Testimony of Anjuli Winker, OPUC Ex. 3 at 36.
[383] CEHE Ex. 42 at 59-60 (Hevert Rebuttal).
[384] CEHE Initial Brief at 53.

interest rates and capital costs have remained at historically low levels and are likely to remain low for some time.[385] However, TCUC is incorrect on both accounts. First, as Mr. Hevert testified, if we consider individual cases over a relevant timeframe (rather than annual averages over long periods) there is no downward trend in authorized ROEs.[386] While Dr. Woolridge does not consider it a "trend," he does admit that ROEs in the first quarter of 2019 were rising.[387] Second, as explained in CEHE's initial brief, interest rates have been rising since 2016 and are expected to continue to rise.[388] In fact, Dr. Woolridge acknowledges that the Federal Funds rate has increased eight times since 2015.[389] While TCUC argues that in spite of this increase, long-term interest rates and capital costs have not increased in any meaningful way,[390] current Treasury yields are relatively low, but increasing. Consensus near-term forecasts of the 30-year Treasury yield reported by Blue Chip Financial Forecast indicate the market expects long-term rates to reach 3.5% by the second quarter of 2020.[391] Despite TCUC's attempts to discount it, the potential for rising rates represents risk for utility investors.[392] Because the cost of equity is forward-looking, it is crucial to consider whether investors see the likelihood of increasing costs of capital during the period in which the rates set in this proceeding will be in effect.[393]

TCUC takes issue with Mr. Hevert's recommended ROE of 10.4%, asserting that it is supported only by his CAPM results and a single set of data points from Value Line.[394] This argument has no merit. Mr. Hevert's recommended 10.4% ROE fits squarely within not only his CAPM results, but also the range of results produced by his DCF method (5.55%-15.78%), and his Expected Earnings approach (6.50%-14.05%).[395]

With respect to Mr. Hevert's CAPM analysis, TCUC asserts that Mr. Hevert employs an "excessively high" projected long-term risk-free interest rate, and that his market risk premiums are "exaggerated" and do not reflect current market fundamentals.[396] However, TCUC's arguments regarding Mr. Hevert's market risk premiums are internally inconsistent—

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385 TCUC Initial Brief at 9-11; *see also* H-E-B Initial Brief at 25.
386 CEHE Ex. 42 at 7, 73-74 (Hevert Rebuttal).
387 *See* Tr. at 525-526 (Woolridge Cross) (Jun. 26, 2019).
388 CEHE Initial Brief at 53.
389 Tr. at 531 (Woolridge Cross) (Jun. 26, 2019).
390 TCUC Initial Brief at 12.
391 CEHE Ex. 26 at 2673 (Hevert Direct).
392 *Id.*
393 *Id.* at 2671.
394 TCUC Initial Brief at 24.
395 CEHE Ex. 42 at 118 (Hevert Rebuttal).
396 TCUC Initial Brief at 24; *see also* H-E-B Initial Brief at 25.

Dr. Woolridge utilizes two economists' surveys in support of his own market risk premium and in defense of his critique of Mr. Hevert's, while at the same time arguing in his direct testimony that a Bloomberg Survey was not credible because "100% of the economists were wrong."[397] With respect to Mr. Hevert's Earnings Per Share growth rates, Mr. Hevert's analysis of the S&P 500 earnings retention shows that it has trended upward over time and is currently well above its historical average.[398] Consequently, the Sustainable Growth model included in Dr. Woolridge's DCF analysis suggests that the future growth of the S&P 500 could outpace its historical growth.[399] Moreover, CEHE demonstrated on cross that FERC has expressly rejected Dr. Woolridge's argument that it is improper to the use of DCF results of the S&P 500 as the CAPM growth rate.[400]

TCUC also argues that it is erroneous to use adjusted betas, because it is Dr. Woolridge's conclusion that utility betas do not regress to 1.0 over three- to five-year periods.[401] However, Mr. Hevert testified that the period over which one might expect utility beta coefficients to drift toward the market mean should not dictate the method by which the market risk premium is selected.[402]

TCUC next asserts that Mr. Hevert's Bond Yield Risk Premium analysis produces an inflated measure of the risk premium because his approach uses historical authorized ROEs and Treasury yields.[403] However, this criticism is misplaced, because (1) Mr. Hevert applied both historical and projected interest rates to the regression coefficients developed in the Risk Premium analysis (not to an average historical risk premium); and (2) the estimated risk premium does not increase in lock step with interest rates; thus, the resulting ROE estimate does not overstate the cost of equity.[404] TCUC further argues that Mr. Hevert's Bond Yield Risk Premium analysis is a gauge of utility commission behavior, rather than investor behavior.[405] However, utility commission decisions reflect the same type of market-based analyses at issue in this proceeding.[406] Furthermore, because authorized returns are publicly available, it is reasonable to conclude that

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397 CEHE Ex. 42 at 131 (Hevert Rebuttal).
398 *Id.* at 135.
399 *Id.*
400 Tr. at 546-547 (Woolridge Cross) (Jun. 26, 2019).
401 TCUC Initial Brief at 26-27.
402 CEHE Ex. 42 at 142 (Hevert Rebuttal).
403 TCUC Initial Brief at 27-28.
404 CEHE Ex. 42 at 152-153 (Hevert Rebuttal).
405 TCUC Initial Brief at 27.
406 CEHE Ex. 42 at 151 (Hevert Rebuttal).

authorized ROE data is reflected, at least to some degree, in investors' return expectations and requirements.[407]

TCUC further argues that Mr. Hevert's Expected Earnings approach should be ignored because it is accounting based and does not measure the market cost of equity capital.[408] These factors do not invalidate the Expected Earnings approach; rather, its simplicity is a benefit, not a detriment.[409] TCUC also argues that the Expected Earnings approach is inappropriate because book equity does not change with investor return requirements, as market prices do.[410] Utility rates, however, are set based on the book value of equity.[411] Therefore, the Expected Earnings approach provides a direct measure of the book-based return comparable-risk utilities are expected to earn, consistent with the *Hope* and *Bluefield* "comparable return" standard.[412] In that sense, it is a direct measure of the expected opportunity cost of equity capital, a principle Dr. Woolridge acknowledges.[413]

3. Response to COH's and GCCC's Arguments on ROE

COH and GCCC offered no evidence on this issue, but each state in their initial briefs that they support TCUC witness Dr. Woolridge's ROE recommendations.[414] CEHE has addressed these recommendations in response to TCUC's arguments.

4. Response to TIEC's Arguments on ROE

TIEC's story on ROE and capital structure is one-sided and severely undercut by the evidence in this case. For example, TIEC opines that if only CEHE were ring-fenced, "CEHE's credit would improve *three notches*, putting it in the top 3% of utilities in the country."[415] What TIEC doesn't want the Commission to focus on is that its argument applies only to the S&P metrics, not to the metrics of Moody's or Fitch.[416] With regard to Moody's and Fitch, TIEC's recommendations in this case would undoubtedly drop CEHE's credit metrics below the levels established by Moody's and Fitch for CEHE's current credit ratings.[417] TIEC's solution to that problem is to pretend that Moody's and Fitch do not exist. Indeed, TIEC witness Michael Gorman

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407 *Id.* at 152.
408 TCUC Initial Brief at 28-29.
409 CEHE Ex. 42 at 154 (Hevert Rebuttal).
410 TCUC Initial Brief at 29.
411 CEHE Ex. 42 at 154 (Hevert Rebuttal).
412 *Id.* at 154-155.
413 *See id.* at 154; Direct Testimony of J. Randall Woolridge, TCUC Ex. 1 at 22.
414 COH/HCC Initial Brief at 19; GCCC Initial Brief at 21.
415 TIEC Initial Brief at 3 (emphasis in the original).
416 CEHE Ex. 43 at 23 (McRae Rebuttal).
417 *Id.* at 24.

was asked repeatedly on cross to address the Moody's criteria, but he evaded the question at every turn.[418] TIEC cannot make Moody's and Fitch go away by pretending they do not exist.

What is even more remarkable about TIEC's brief is its refusal to acknowledge that its story does not hold up even under the S&P criteria. Mr. Gorman's initial calculation of S&P credit metrics under his ROE recommendation actually assumed a 10.0% ROE, not the 9.25% ROE recommended by Mr. Gorman.[419] CEHE pointed out Mr. Gorman's error and explained that remedying it would result in credit metrics below the level needed to maintain the standalone credit rating assigned by S&P for CEHE.[420] Incredibly, Mr. Gorman admitted that he had made the error and that it would reduce the CFO/Debt ratio below 13.0%,[421] the level needed to maintain CEHE's standalone credit rating, but he did not change his recommendation or his testimony alleging that his recommendation would support CEHE's credit rating. At that point, it became clear that TIEC would not let mere facts stand in the way of its argument.

Indeed, Mr. Gorman's analysis of the effects of his ROE and capital structure recommendations on CEHE's credit metrics is so careless that it merits no weight in this case. For example, Mr. Gorman admitted that his calculation of CEHE's credit metrics ignored TIEC's recommendation that the Commission require CEHE to refund an additional $29 million of additional excess deferred income during the first year the rates set in this case are in effect.[422] Nor did his calculations reflect the $43 million of additional excess deferred taxes that TIEC is demanding CEHE refund in the second year the rates are in effect.[423] TIEC cannot have it both ways. If it wants to make refund recommendations, it must account for those recommendations in its credit metrics analysis. Conversely, if it wants to assume no refunds in its credit metrics analysis, it must not advocate for such refunds.

The ROE section of TIEC's initial brief is also notable for what it does not address—the Moody's June 16, 2019 comment noting that an authorized ROE materially below 10.0% would be a credit negative for CEHE. In particular, Moody's noted that CEHE's cash flow metrics will be under strain going forward because of the effects of the TCJA and CEHE's capital expenditure forecast.[424] Rather than address the issues raised by that very recent comment in an honest,

[418] Tr. at 608-609 (Gorman Cross) (Jun. 26, 2019).
[419] CEHE Ex. 43 at 22 (McRae Rebuttal).
[420] CEHE Ex. 43 at 22-23 (McRae Rebuttal).
[421] Tr. at 574 (Gorman Cross) (Jun. 26, 2019).
[422] *Id.* at 570-571.
[423] *Id.* at 570-574.
[424] CEHE Ex. 43, Confidential Exh. R-RBM-3 at 1 (McRae Rebuttal).

straightforward way, TIEC relies on a more dated, March 2018 CenterPoint Energy, Inc. ("CNP") presentation that describes the TCJA as a "manageable event."[425] What TIEC ignores, however, is that the same March 2018 document forecasts a drop in CEHE's ratio of Funds from Operations to Debt ("FFO/Debt") of more than 650 basis points from 2017 to 2019 as a result of the TCJA. TIEC also ignores the fact that it is proposing a reduction in CEHE's equity ratio by 500 basis points in this case, a factor that could not have been considered in the March 2018 report. Moreover, TIEC ignores that the March 2018 report assumes a "constructive regulatory environment" in Texas, which would not exist if the Commission were to accept TIEC's ROE and capital structure recommendations.

Most troubling of all, TIEC flatly misrepresents the testimony of CEHE witness Robert McRae. Contrary to TIEC's assertion, Mr. McRae did not testify that "adopting TIEC witness Mr. Gorman's recommendations, including his 40% equity ratio and a 9.25% ROE with ring-fencing measures, would improve CEHE's S&P credit rating relative to CEHE's actual credit rating."[426] What Mr. McRae actually stated in his testimony was that if CEHE were considered on a standalone basis, as TIEC is proposing, S&P's targeted FFO/Debt ratio for CEHE would be 18-20%, and that Mr. Gorman's proposal would result in an FFO/Debt ratio of 12.7%.[427] TIEC statements are a misstatement of the evidence and should be given no weight.

TIEC also portrays a misleading picture of the authorized ROEs in other jurisdictions. For example, TIEC asserts that the average ROE for wires-only utilities was 9.18% in the first half of 2018,[428] while ignoring that the average ROE for delivery-only utilities for all of 2018 was 9.38% and the average so far in 2019 is 9.42%.[429] And even that statistic is misleading, because it includes extremely low formula rates from Illinois that are based on a premium over bond rates, not on actual investor requirements.[430]

Moreover, TIEC's argument that utility credit ratings have improved from 2011 through 2017, with credit upgrades significantly outpacing downgrades[431] is a similarly misleading argument with respect to determining CEHE's required ROE. As explained in detail in CEHE's initial brief, the enactment of the TCJA in 2017 has significantly changed utilities' key cash flow

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[425] TIEC Initial Brief at 38.
[426] *Id.* at 3.
[427] CEHE Ex. 43 at 22-24 (McRae Rebuttal).
[428] TIEC Initial Brief at 11.
[429] Tr. at 526 (Woolridge Cross) (Jun. 26, 2019).
[430] *Id.* at 527.
[431] TIEC Initial Brief at 11.

metrics, and pre-TCJA comparisons are of limited value. Indeed, Mr. McRae's Exhibit R-RBM-2 shows that there have been twice as many downgrades as upgrades in 2019 because of the effects of the TCJA.

TIEC's brief also sets forth Mr. Gorman's various ROE analyses.[432] CEHE's initial brief explained the multiple flaws in those analyses,[433] and it is unnecessary to repeat them here. However, TIEC errs by representing that Mr. Gorman's proxy group is reasonable in part because Mr. Hevert did not criticize Mr. Gorman's removal of one company from the proxy group.[434] In fact, Mr. Hevert's rebuttal testimony establishes that he disagrees with Mr. Gorman's exclusion, and that Avangrid is a comparable proxy because although its ultimate parent company owns approximately 83% of the company, Avangrid's stock price reflects the risk associated with its operations (not its parent's), a vast majority of which are regulated utility operations.[435]

TIEC attempts to discredit Mr. Hevert's ROE recommendation and paint a pattern of his recommendations as "unreasonably high" and "inflated" by arguing that Mr. Hevert's exact ROE recommendations have not been adopted by regulators.[436] As Mr. Hevert testified, however, it is not at all unusual for regulators to reject the specific recommendations of all of the ROE witnesses and to select some number within the range of the specific recommendations.[437] Indeed, it is likely that a survey of cases in which Mr. Gorman has testified would find that his extremely low ROE recommendations are seldom adopted by regulators. Moreover, in certain cases, the ROE adopted by the regulator was within Mr. Hevert's recommended range, or within 20 or fewer basis points of his particular recommended ROE.[438]

TIEC identifies three main points of criticism with Mr. Hevert's ROE analyses: (1) his constant growth DCF model is based on "unsustainably high growth rates;" (2) his CAPM is based on inflated market risk premiums; and (3) his Bond Yield Plus Risk Premium studies are based on inflated utility equity risk premiums.[439]

With respect to his DCF analysis, Mr. Hevert's growth rates are not "unsustainably high"—in fact, they represent approximately the 42nd percentile of the actual capital appreciation rates

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[432] *Id.* at 16-24.
[433] CEHE Initial Brief at 57-58.
[434] *See* TIEC Initial Brief at 16.
[435] CEHE Ex. 42 at 91-92 (Hevert Rebuttal).
[436] *See* TIEC Initial Brief at 24-25; *see also* H-E-B Initial Brief at 25-26.
[437] Tr. at 723 (Hevert Cross) (Jun. 26, 2019).
[438] *Id.* at 723-724.
[439] TIEC Initial Brief at 9-10.

observed from 1926 to 2018.[440] TIEC also erroneously implies that Mr. Hevert seeks to "discredit the results of the DCF model entirely" simply because it did not produce Mr. Hevert's desired results.[441] First, this is a simplistic assertion that ignores that since 2014 the model has produced results consistently and meaningfully below authorized returns,[442] which suggests that state regulatory commissions have recognized that the model's results are not necessarily reliable estimates and are giving other methods more meaningful weight.[443] Even FERC has recently addressed its longstanding focus on the DCF method and expressed concern that relying on that methodology alone will not produce just and reasonable results.[444] Second, Mr. Hevert did not in fact attempt to "discredit" his DCF results. Rather, he testified that in the current capital market environment Constant Growth DCF-based models should be viewed with caution, because they do not adequately reflect changing capital market conditions and high levels of instability, whereas Risk Premium-based methods do.[445] Accordingly, he gave somewhat more weight to the Risk Premium-based methods in arriving at his recommendation,[446] but he did not entirely discard his DCF results.

In addressing his CAPM analysis, Mr. Hevert's rebuttal testimony demonstrates that the market return estimates which Mr. Gorman asserts are "inflated"[447] represent approximately 50th and 56th percentile of actual returns observed from 1926 to 2019.[448] Moreover, because market returns historically have been volatile, Mr. Hevert's market return estimates are statistically indistinguishable from the long-term arithmetic average market data on which Mr. Gorman relies.[449] Mr. Hevert's rebuttal further demonstrates based on historical data, the market risk premia estimated from his projected market returns are likewise not inflated.[450] TIEC also alleges that Mr. Hevert fails to appropriately set his market risk premium in relationship to the projected risk-free rate.[451] While TIEC seems to argue that the risk-free rate used to calculate the market

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[440] CEHE Ex. 42 at 92 (Hevert Rebuttal).
[441] TIEC Initial Brief at 28.
[442] CEHE Ex. 26 at 2666-2667 (Hevert Direct).
[443] *Id.*
[444] *Id.* at 2691.
[445] *Id.* at 2715.
[446] *Id.* at 2723-2724.
[447] Direct Testimony of Michael P. Gorman, TIEC Ex. 5 at 81.
[448] CEHE Ex. 42 at 98 (Hevert Rebuttal).
[449] *Id.*
[450] *Id.* at 98-99.
[451] TIEC Initial Brief at 30.

risk premium should be the same as the risk-free rate term in the CAPM,[452] this argument is not credible, as Mr. Gorman's analysis relies on an approach analogous to Mr. Hevert's.[453] Had Mr. Gorman eliminated the "mismatch" in his calculation and used the risk-free rate that underlies the average market return he utilized, his CAPM estimate would have been 270 basis points higher.[454]

CEHE has addressed TIEC's arguments regarding Mr. Hevert's Bond Yield Plus Risk Premium analysis in its initial brief and will not repeat those points here.[455] TIEC next argues that Mr. Hevert's Expected Earnings analysis should be rejected because it does not measure the market required return.[456] For the same reasons set forth in response to TCUC's argument, the Expected Earnings approach provides a direct measure of the expected opportunity cost of capital and should not be disregarded.[457]

Finally, TIEC argues that Mr. Hevert's flotation cost adjustment should be disregarded because it is not based on CEHE's known and measurable costs of issuing equity.[458] TIEC also points out that the Commission has previously rejected a flotation cost adjustment.[459] However, as other Intervenors in this case have noted,[460] the Commission is not strictly bound by its precedent and may reconsider previously decided issues.[461] CEHE requests that the Commission do so here. Flotation costs are not current expenses and are not reflected on the income statement; rather, they are part of the invested costs of the utility and are reflected on the balance sheet under "paid in capital."[462] Whether they are paid directly or through an underwriting discount, these costs result in net proceeds that are less than the gross proceeds.[463] Because flotation costs permanently reduce the equity portion of the balance sheet, the Commission should adopt an adjustment to CEHE's ROE to ensure that the authorized return enables investors to realize their required return.[464]

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[452] *See id.* at 31.
[453] CEHE Ex. 42 at 100 (Hevert Rebuttal).
[454] *Id.*
[455] CEHE Initial Brief at 53-54, 58.
[456] TIEC Initial Brief at 32-33.
[457] CEHE's Ex. 42 at 106 (Hevert Rebuttal).
[458] TIEC Initial Brief at 33-34.
[459] *Id.*
[460] *E.g.*, TCUC Initial Brief at 37-38.
[461] *See Oncor Elec. Delivery Co., LLC v. PUCT*, 406 S.W.3d 253, 267 (Tex. App. –Austin 2013, no pet).
[462] CEHE Ex. 42 at 107 (Hevert Rebuttal).
[463] *Id.*
[464] *Id.*

5. Response to Staff's Arguments on ROE

CEHE's initial brief explained the several deficiencies in Staff witness Jorge Ordonez's ROE analyses,[465] and those points will not be repeated here for the sake of brevity.

6. Response to H-E-B's Arguments on ROE

H-E-B argues that CEHE's authorized ROE should be reduced in this case because of its purported issues with CEHE's service quality.[466] These arguments were addressed in CEHE's initial brief at Section XI.A.2 and are addressed in this reply brief under that same section. H-E-B also piggybacks onto other Intervenors' criticisms of Mr. Hevert's ROE analyses,[467] which have been addressed in other sections.

7. Response to Walmart's Arguments on ROE

Walmart Inc.'s ("Walmart") comments on ROE, which do not include any quantitative analysis or specific ROE recommendation, were addressed in CEHE's initial brief.[468]

B. Cost of Debt [PO Issue 8]

No party raised any issue regarding CEHE's cost of long-term debt in initial briefs. TCUC asserts that based on Dr. Woolridge's alternative recommendation to include short-term debt in CEHE's capital structure, the cost of short-term debt to be used in calculating CEHE's overall rate of return is 2.27%.[469] His calculation of a short-term debt rate, however, is irrelevant because short-term debt should not be included in capital structure for the reasons set forth in the next subsection of this reply brief.

C. Capital Structure [PO Issue 7]

CEHE has requested Commission approval of a capital structure composed of 50% debt and 50% equity.[470] As explained in CEHE's initial brief, CEHE provided quantitative analyses showing that an equity ratio lower than 50% will not satisfy the credit metrics needed to maintain CEHE's current credit rating.[471]

No party seriously disputes that the TCJA will reduce CEHE's cash flow, but all parties nevertheless resist the need for a higher equity ratio in CEHE's capital structure. They instead

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465 CEHE Initial Brief at 55-56.
466 *See* H-E-B Initial Brief at 10-26.
467 *See id.* at 25-26.
468 CEHE Initial Brief at 59.
469 TCUC Initial Brief at 30.
470 CEHE Initial Brief at 60.
471 *Id.* at 61.

seem to hope that the situation will somehow resolve itself,[472] or attempt to shift the responsibility back to CEHE, asserting that if it simply manages its finances well enough, it can withstand the impacts of the TCJA.[473] The credit rating agencies, however, do not engage in the same kind of wishful thinking. Instead, they look at quantitative analyses such as the ratio of Cash From Operations to debt[474] and qualitative analyses such as the supportiveness of the regulatory environment.[475] Under Staff's and Intervenors' capital structure recommendations, the rating agencies would find no quantitative or qualitative reason to refrain from downgrading CEHE's current credit ratings. In fact, as the record in this proceeding establishes, Moody's has already made it clear that that it considers a rate case outcome for CEHE that includes an equity ratio of lower than 45% to be credit-negative.[476] If Staff or Intervenor's capital structure recommendations are adopted and CEHE is downgraded, its ratings will not rise again any time soon.[477]

The Staff and Intervenor initial briefs also continue to insist that the Commission should adopt their recommended capital structure of 60% debt and 40% equity because it is the "standard" or "prevailing structure" of ERCOT TDUs.[478] To support this assertion, they point to the five example utilities listed in Mr. Ordonez's testimony.[479] However, this reliance is misplaced, as it was clearly established during the hearing that of these five utilities, only *one* of the utilities listed in Mr. Ordonez's testimony is a TDU operating in ERCOT, and that utility has a currently pending rate case in which it is requesting an increase to that equity ratio.[480]

Another common theme in the Staff and Intervenor briefs is their attempt to discount CEHE's business and regulatory risk, particularly by pointing to the regulatory cost-recovery mechanisms available to CEHE.[481] CEHE's initial brief addressed CEHE's business and regulatory risks that support its requested capital structure, and those arguments will not be reproduced in full here.[482] However, it bears repeating that the regulatory cost-recovery

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[472] *See* TIEC Initial Brief at 38-39; Staff Initial Brief at 31; OPUC Ex. 3 at 43 (Winker Direct).
[473] *See* H-E-B Initial Brief at 28-29.
[474] Direct Testimony of Robert B. McRae, CEHE Ex. 27 at 2829-2830 (Bates Pages).
[475] CEHE Ex. 27 at 2830 (McRae Direct).
[476] CEHE Initial Brief at 62.
[477] *See* CEHE Ex. 43 at 30 (McRae Rebuttal).
[478] TIEC Initial Brief at 35; H-E-B Initial Brief at 27, 29; *see also* Staff Initial Brief at 29 (relying on Docket No. 22344).
[479] TIEC Initial Brief at 35 n.222; H-E-B Initial Brief at 31 n.102;
[480] CEHE Initial Brief at 66. Note: H-E-B does concede that certain of the five utilities are transmission-only but continues to argue that they are similarly situated to CEHE. H-E-B Initial Brief at 31.
[481] *See* H-E-B Initial Brief at 29-30; TIEC Initial Brief at 40-41; OPUC Initial Brief at 37; Staff Initial Brief at 30.
[482] CEHE Initial Brief at 67-70.

mechanisms that Staff and Intervenors give so much weight to were in place when the Commission awarded CEHE a higher equity ratio in its last base rate case,[483] and such mechanisms are fully considered by the credit rating agencies in their evaluation of CEHE.[484] Moreover, as Mr. Hevert testified, recovery mechanisms are common among the proxy companies.[485] To the extent the proxy companies have mechanisms in place to address revenue shortfalls or cost recovery, CEHE's use of TCOS and DCRF mechanisms make it more comparable to its peers[486]—who have equity ratios more in line with CEHE's request than what Staff and Intervenors recommend.[487] Moreover, it is important not to lose sight of the fact that while Staff and Intervenors argue that CEHE does not face any additional business risks that justify increasing its equity ratio,[488] they are not recommending that CEHE's capital structure remain at its current level, but rather that it be *decreased* by 500 basis points.

Finally, the Staff and Intervenor briefs argue that their capital structure recommendations will lead to lower rates for customers than CEHE's requested capital structure.[489] In the short-term, that is likely true, but viewed over the lives of the bonds CEHE will be issuing over the next several years, the customer savings touted by parties become much more speculative. As Mr. McRae explains, the ultimately beneficiaries of lower bond coupon rates are customers, not CEHE, because the costs of debt are passed through in rates on a dollar-for-dollar basis.[490] Moreover, if CEHE experiences a downgrade, its cost of equity will rise as well, which will also affect customers.[491] The trade-off must be measured over decades because even though customers may pay less upfront under Staff and Intervenor's recommended capital structures, they will suffer from the overall higher financing costs for the entire life of the asset being financed if the debt is priced based on a lower credit rating.

In the following subsections, CEHE will address the specific Staff and Intervenor arguments regarding capital structure to the extent those arguments were not addressed in CEHE's initial brief.

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[483] *Id.* at 69.
[484] *Id.* at 69-70.
[485] CEHE Ex. 26 at 2710 (Hevert Direct).
[486] *Id.*
[487] *Id.* at 2714.
[488] *E.g.,* TIEC Initial Brief at 36-37 (significant load growth is nothing new for CEHE and it has experienced consistent customer growth over the last 30 years), 40 (CEHE is facing no new natural disaster risk).
[489] *Id.* at 49; *See* H-E-B Initial Brief at 31-32.
[490] CEHE Ex. 43 at 40-41 (McRae Rebuttal).
[491] *Id.* at 41.

1. Response to TCUC's Arguments on Capital Structure

TCUC's primary argument in support of its primary recommended capital structure of 60% debt and 40% equity is that under Dr. Woolridge's calculations, CEHE's common equity ratio was in the 38%-45% range for the period from 2016-2018 and CEHE has been able to raise capital and maintain its credit ratings under that equity ratio.[492] CEHE addressed this argument in its initial brief.[493] Moreover, to the extent that Dr. Woolridge is suggesting that CEHE should be maintaining a 50% equity ratio if it wants the Commission to approve a 50% equity ratio, CEHE's shareholders would earn a debt return on part of their equity investment.[494] And if equity investors believe that they will receive a debt return on part of their equity investment, they will require a much higher equity return on the remaining investment to compensate them for that debt return.[495]

In addition to its primary recommended capital structure, TCUC offers an alternative recommendation of 0.90% short-term debt, 55.48% long-term debt, and 43.62% equity.[496] Interestingly, TCUC spends less than two pages of its initial brief supporting its primary recommendation, and nearly six pages bolstering its alternative recommendation. As explained in CEHE's initial brief, TCUC's inclusion of short-term debt in CEHE's capital structure is inappropriate,[497] and TCUC's arguments to the contrary are unpersuasive.

First, TCUC's assertion that CEHE finances its operations and investments with short-term debt[498] is misleading. CEHE initially funds its capital investments with a combination of internally-generated funds, short-term debt, long-term debt, and common equity investments from CNP.[499] But the short-term debt initially used to fund operations and capital investments is converted to long-term debt, similar to when a utility asset is removed from CWIP and placed in service. Thus, according to Mr. McRae, CEHE's long-term investments that are placed in service are financed with long-term debt and equity.[500] Because CEHE earns a return on the investment only after it has been placed in service, only the long-term debt used to finance that investment should be included in the capital structure.

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[492] TCUC Initial Brief at 31, 37.
[493] CEHE Initial Brief at 62-63.
[494] CEHE Ex. 43 at 15 (McRae Rebuttal).
[495] *Id.*
[496] TCUC Initial Brief at 32.
[497] CEHE Initial Brief at 62-63.
[498] TCUC Initial Brief at 32-33.
[499] *See* CEHE Ex. 27 at 2836 (McRae Direct); CEHE Ex. 43 at 16 (McRae Rebuttal); TCUC Initial Brief at 33.
[500] CEHE Ex. 43 at 14, 16 (McRae Rebuttal).

TCUC also argues that the credit-rating agencies include the entirety of CEHE's debt obligations in their ratings.[501] However, while rating agencies consider all forms of debt obligations, not all of the expenditures financed with those various forms of debt are included in rate base or considered in ratemaking.

Second, TCUC argues that the Commission is not bound by its past precedent on this issue.[502] While it is true that the Commission is not bound to follow its prior decisions in the same way that courts are,[503] TCUC has presented no compelling reasons for the Commission to depart from its 2016 holding in Docket No. 43695 that "it is unreasonable and inconsistent with Commission precedent" to include short-term debt in a utility's capital structure.[504] In fact, the arguments that TCUC presents in support of its argument here are largely the same arguments raised by the U.S. Department of Energy in Docket No. 43695, which were expressly rejected by the ALJ[505] and subsequently the Commission.[506] For all these reasons, the Commission should reject TCUC's alternative recommendation to include short-term debt in CEHE's capital structure.

2. Response to COH's and GCCC's Arguments on Capital Structure

COH/HCC and GCCC offered no evidence on this issue, but each state in their initial briefs that they support TCUC witness Dr. Woolridge's capital structure recommendation.[507] CEHE has addressed these recommendations in response to TCUC's arguments.

3. Response to TIEC's Arguments on Capital Structure

TIEC's flawed arguments that CEHE has not shown it faces business risks that will require it to maintain a higher equity percentage[508] have been largely addressed above and in CEHE's initial brief,[509] and it is unnecessary to repeat them here. CEHE will respond in this section only to arguments not previously addressed.

TIEC alleges that CEHE is asking the Commission to increase the equity ratio as a way to boost earnings.[510] That argument has no merit. As noted in CEHE's initial brief, an increased equity ratio is one of the mechanisms identified by the rating agencies to combat reduced cash

[501] TCUC Initial Brief at 33.
[502] *Id.* at 37-38.
[503] *Oncor,* 406 S.W.3d at 267.
[504] CEHE Ex. 69 at Tab 6 (CEHE's Cross Book of Mr. Woolridge).
[505] *See Application of Southwestern Public Service Co. for Authority to Change Rates*, Docket No. 43695, Proposal for Decision (PFD) at 78-81 (Oct. 12, 2015).
[506] CEHE Ex. 69 at Tab 6 (CEHE's Cross Book of Mr. Woolridge).
[507] COH/HCC Initial Brief at 19; GCC Initial Brief at 21.
[508] TIEC Initial Brief at 36-41.
[509] CEHE Initial Brief at 67-70.
[510] *See* TIEC Initial Brief at 35-36.

flow under the TCJA and was chosen by CEHE because it is the mechanism that is the least costly to customers.[511]

TIEC's arguments that the TCJA does not justify increasing CEHE's equity percentage are based on TIEC's erroneous assumption that certain concepts are mutually exclusive (*i.e.*, the TCJA cannot be both a positive benefit to stakeholders and customers *and* weaken CEHE's credit quality) and should be disregarded. TIEC argues that based on statements by CEHE's parent company to S&P that the TCJA would be a "manageable event" for its cash flow metrics, that the TCJA does not pose a challenge that would support CEHE's capital structure request.[512] Simply because CNP has characterized the TCJA's impact on its cash flow metrics as "manageable" does not disqualify or demerit CEHE's request in this case—rather, CEHE's efforts to employ a tool endorsed by the rating agencies to mitigate the effects of the TCJA on its cash flow is in fact "managing" this event. TIEC further cites CNP's messaging that the TCJA is a win for customers and other stakeholders, and a positive driver for 2019 as minimizing the impacts of the TJCA.[513] As explained by Mr. McRae, the impacts of the TCJA do benefit CEHE's customers by reducing CEHE's revenue requirement; however, it is also true that they weaken CEHE's credit quality in the absence of any mitigation measures.[514]

TIEC also argues that Mr. McRae has admitted Mr. Gorman's proposed ROE and capital structure would allow CEHE to continue to enjoy "investment grade credit ratings" and thus "CEHE's own witness has confirmed" that Mr. Gorman's recommendations would allow CEHE to maintain its financial integrity.[515] However, as explained in CEHE's initial brief, TIEC is conflating two different things—"investment grade" credit ratings do not equate to financial integrity.[516] Maintaining "investment grade" credit ratings is an incredibly low standard—it simply provides that CEHE's credit metrics will not fall below those of every other utility.[517] TIEC is also incorrect that Mr. Gorman's recommendations would result in a "one-notch upgrade" for CEHE under S&P's ratings.[518] CEHE's standalone S&P rating is a+, and Mr. Gorman's recommendations would represent a two-notch downgrade for CEHE to a-.[519] As was

[511] CEHE Initial Brief at 68.
[512] TIEC Initial Brief at 38.
[513] *Id.*
[514] CEHE Ex. 27 at 2837 (McRae Direct).
[515] TIEC Initial Brief at 50.
[516] CEHE Initial Brief at 64.
[517] *Id.*
[518] TIEC Initial Brief at 48.
[519] CEHE Ex. 43 at 23 (McRae Rebuttal).

demonstrated by Mr. Gorman's cross, Mr. Gorman's evaluation of CEHE's credit metrics is based entirely on S&P's rating system, and he did no analysis with respect to Moody's or Fitch.[520] Mr. McRae's rebuttal testimony demonstrates that CEHE's metrics would experience a downgrade under both Moody's and Fitch's criteria if Mr. Gorman's recommendation was adopted,[521] which Mr. Gorman does not directly dispute.[522]

Finally, TIEC asserts that even if Mr. Gorman's proposed ROE and capital structure recommendations resulted in a downgrade for CEHE and a substantial increase in debt costs, CEHE's cost of debt would still be lower than its cost of equity.[523] But this is an extremely narrow and short-sighted view. When a utility's credit rating is downgraded, that rating typically does not rebound quickly, even in the face of improved financial metrics.[524] If CEHE's credit ratings fall and the cost of debt rises, customers will pay the higher coupon rates on those bonds for the entire lives of the bonds that are issued while the costs are higher,[525] whereas a higher equity ratio can be reversed in CEHE's next rate case if the conditions warrant. As Staff and Intervenors have pointed out,[526] under the requirements of PURA § 36.157 and 16 TAC § 25.247(c)(2)(B), CEHE is now on a regular rate review schedule that would require the Company to file another rate case as soon as 48 months after the final order in this proceeding. Reversing a higher equity ratio in four years is far better than risking having customers pay higher coupon rates for two or three decades.[527] Moreover, TIEC overlooks that if CEHE's cost of debt rises significantly, its cost of equity will likely increase significantly as well because equity investors demand an equity risk premium over the cost of debt, whatever its level may be.[528] Contrary to TIEC's apparent assumption, the cost of debt does not exist in a vacuum.

4. Response to OPUC's Arguments on Capital Structure

CEHE's initial brief fully addressed all of OPUC's arguments regarding capital structure,[529] and for the sake of brevity those points will not be repeated here.

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[520] Tr. at 580, 608-610 (Gorman Cross) (Jun. 26, 2019).
[521] CEHE Ex. 43 at 24-25 (McRae Rebuttal).
[522] Tr. at 581 (Gorman Cross) (Jun. 26, 2019).
[523] TIEC Initial Brief at 51.
[524] CEHE Ex. 43 at 30 (McRae Rebuttal).
[525] *Id.*
[526] TIEC Initial Brief at 1; Staff Initial Brief at 8.
[527] *See* CEHE Ex. 43 at 30 (McRae Rebuttal).
[528] *See id.* at 15.
[529] *See* CEHE Initial Brief at 64.

5. Response to Staff's Arguments on Capital Structure

In its initial brief, CEHE explained the many deficiencies in Staff witness Mr. Ordonez's capital structure analysis,[530] and it is unnecessary to repeat them here. CEHE will respond in this reply brief only to the new arguments asserted by Staff.

As previously discussed, Staff argues that CEHE's risk associated with timely recovery of transmission and capital expenditures is mitigated by the existence of the interim transmission cost of service mechanism ("Interim TCOS"), and the DCRF mechanism.[531] As CEHE established at the hearing,[532] these mechanisms were available at the time that the Commission issued its decision in Docket No. 38339, and accordingly would have been considered by the Commission in setting an equity ratio of higher than 40% for CEHE. Staff attempts to discount this fact with a nonsensical argument that "it was not apparent at the time how well these mechanisms would be utilized," but that nine years later it has been established that these mechanisms "work well."[533] In essence, Staff appears to be stating that because CEHE has effectively utilized these regulatory cost-recovery mechanisms, this is a result that the Commission can consider in reducing CEHE's equity ratio to a level below the one established in Docket No. 38339. This argument seems to speculate that the Commission did not account for the future effectiveness of these cost-recovery mechanisms in setting CEHE's equity ratio, which is too tenuous a premise to be given any weight. As an initial matter it disregards that the Commission approved a 45% equity ratio for TNMP with full knowledge of how both DCRF and TCOS were working.[534] Moreover, Staff's argument willfully ignores that the credit rating agencies are fully aware of the availability and utilization of these regulatory cost-recovery mechanisms by utilities over the past 9 years, and Moody's has still stated that absent a credit positive rate case outcome (i.e., an equity ratio of at least 45%), CEHE's credit metrics will weaken.[535] Mr. Ordonez does not dispute these facts—he simply chooses to disregard them.[536]

Staff acknowledges that an increase in ROE or authorized depreciation rates are tools to mitigate the effects of the TCJA, but notably excludes that rating agencies have identified a third

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[530] *Id.* at 65.
[531] Staff Initial Brief at 30.
[532] Tr. at 663-665 (Ordonez Cross) (Jun. 26, 2019); Tr. at 625-627 (Gorman Cross) (Jun. 26, 2019).
[533] Staff Initial Brief at 30.
[534] Docket No. 48401, Order at Finding of Fact 48 (issued Dec. 20, 2018).
[535] CEHE Ex. 43, Confidential Exh. R-RBM-3 at 1 (McRae Rebuttal).
[536] Tr. at 662 (Ordonez Cross) (Jun. 26, 2019).

option: an increase in the authorized equity ratio.[537] Staff appears to assert that because it has recommended relief through its two acknowledged mitigation options by supporting CEHE's proposed depreciation rates, as well as allegedly accounting for the effects of the TCJA through Mr. Ordonez's proxy group, that an increase in CEHE's authorized equity ratio is unnecessary.[538] This argument is flawed and should be disregarded. First, CEHE has not proposed increased depreciation rates as a mitigation measure in this case. As explained by Mr. McRae, CEHE chose to propose an increase in its authorized equity ratio in order to mitigate the TCJA's effects on cash flow at the lowest cost to customers.[539] Thus, Staff's support of CEHE's proposed depreciation rates is a red herring that does nothing to mitigate the impact of the TCJA. Second, as discussed in CEHE's initial brief, Mr. Ordonez admits that the TCJA had no effect on his selection of proxy group companies.[540] Accordingly, Staff's ROE recommendation does not in fact reflect any actual consideration of the effect of the TCJA on CEHE's required ROE.

Staff next joins on to the argument of other Intervenors that because CEHE was subject to the TCJA for the entire test year, any risks posed are already reflected in its current credit ratings.[541] As explained in CEHE's initial brief, simply because CEHE has not yet been downgraded is not indicative of future actions.[542] Credit rating agencies are watching the outcomes of individual regulatory decisions in order to determine credit metrics for specific utilities.[543] Moreover, as set forth in CEHE's initial brief, the combined impacts of the TCJA and CEHE's capital expansion program will not allow CEHE to maintain its current credit rating, absent support from the Commission in this rate case.[544]

Next, Staff asserts that Mr. Ordonez does "not agree with the Company's assertion that the Commission should provide extraordinary relief in helping CEHE maintain an A- issuer rating."[545] However, as Mr. Ordonez admitted on cross, "extraordinary relief" is his own characterization of CEHE's request.[546] In a somewhat perplexing explanation, he states that utility companies are subject to "countless" risks which the Commission should take into consideration in granting a

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[537] Staff Initial Brief at 30.
[538] *See id.* at 30-31.
[539] CEHE Ex. 27 at 2841 (McRae Direct); CEHE Ex. 43 at 7 (McRae Rebuttal).
[540] CEHE Initial Brief at 55-56.
[541] Staff Initial Brief at 31.
[542] CEHE Initial Brief at 64.
[543] *See id.* at 68.
[544] *See id.* at 52.
[545] Staff Initial Brief at 32.
[546] Tr. at 674 (Ordonez Cross) (Jun. 26, 2019).

ROE or capital structure, and "if the Company reasonably requests that the Commission should address or take into consideration six or seven risks, that's why I characterize [it as] extraordinary."[547] On some level, Mr. Ordonez's testimony appears to agree that CEHE faces certain risks that should be taken into account in determining its appropriate ROE and capital structure. Furthermore, it is inaccurate to say that CEHE's requested capital structure is extraordinary—as listed in CEHE's initial brief, several other regulatory commission decisions have approved higher equity ratios for utilities to mitigate the effects of the TCJA.[548]

6. Response to H-E-B's Arguments on Capital Structure

Like other Intervenors, H-E-B mistakenly characterizes a capital structure composed of 60% debt and 40% equity as the "Commission's standard"[549] or "preferred"[550] capital structure. However, this simplistic conclusion ignores that the Commission specifically found in CEHE's last base rate case that CEHE's business and regulatory risk merited a capital structure of 55% debt and 45% equity,[551] not 60% debt and 40% equity. CEHE is not attempting to stray from some established standard in this case; rather, it is seeking Commission-review of its current individual circumstances and risk, which exceed the risks presented in the last case that merited a 45% equity ratio, due to the enactment of the TCJA.

H-E-B also argues that CEHE is requesting a higher amount of equity in its capital structure based on part on its "hope to return to, and maintain, a higher credit rating than its current credit rating" given its February 2019 downgrade.[552] This is inaccurate. As the portion of Mr. McRae's testimony cited by H-E-B indicates, CEHE's requested equity ratio will help CEHE *maintain*,[553] not increase, its current credit rating in light of the impacts of the TCJA. H-E-B states that CEHE's ratepayers "should not bear the burden" of CEHE's February 2019 downgrade.[554] Ironically, H-E-B recommends a capital structure that has been expressly identified by Moody's as "credit-negative" and that will likely subject CEHE to further downgrades in the future. H-E-B asserts that CEHE has not demonstrated that a change in its credit rating would improve service to, or benefit, customers.[555] In fact, CEHE has established that a downgrade in its credit metrics, which

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[547] *Id.* at 673-674.
[548] CEHE Initial Brief at 61.
[549] H-E-B Initial Brief at 27.
[550] *Id.* at 29.
[551] CEHE Initial Brief at 65, 69.
[552] H-E-B Initial Brief at 27.
[553] CEHE Ex. 27 at 2834 (McRae Direct).
[554] H-E-B Initial Brief at 27.
[555] *Id.* at 28.

it would be subject to under H-E-B's recommended capital structure, would be detrimental to CEHE's customers.[556]

H-E-B also states that CEHE's current credit rating is sufficient, and CEHE is currently able to raise capital under its existing capital structure.[557] As CEHE explained in its initial brief in response to other Intervenors, this is a hollow argument that should be disregarded.[558]

D. Overall Rate of Return [PO Issue 8]

The application of the 50/50 capital structure, the 10.4% ROE, and the 4.38% cost of debt results in an overall weighted average cost of capital of 7.39%. For the reasons discussed above and in its initial brief, CEHE requests that the Commission approve an overall rate of return of 7.39%.[559]

E. Financial Integrity [PO Issue 9]

The overwhelming evidence in this case demonstrates that CEHE can provide safe and reliable service at a reasonable cost to customers without the Commission's imposition of the ring-fencing measures proposed by Staff and TIEC. CEHE demonstrated that the financial protections that it has in place are robust and provide the needed separation from its parent and affiliates,[560] and that the ring-fencing measures TIEC and Staff propose would have no beneficial impact on its credit ratings or provide any other benefits to CEHE customers.[561] Further, no party provided any compelling legal basis for the Commission to impose such ring-fencing measures in the context of a rate proceeding under Chapter 36. Therefore, Staff and TIEC's proposed financial ring-fencing measures should be rejected.[562]

Contrary to Staff's contention, CEHE established that CEHE is not operationally or financially intermingled with CNP or its affiliates because CNP has carefully managed its relationship with its subsidiaries to avoid an intermingling or interdependence among CEHE and its affiliates or parent.[563] Staff places excessive focus on the recent transaction in which CNP acquired Vectren to support its claim for additional ring-fencing.[564] But the facts of the transaction

[556] CEHE Ex. 43 at 40-41 (McRae Rebuttal).
[557] H-E-B Initial Brief at 28.
[558] CEHE Initial Brief at 62.
[559] *See id.* at 70.
[560] Rebuttal Testimony of Ellen Lapson, CEHE Ex. 48 at 25-26 (Bates Pages).
[561] *Id.* at 40-41 & Confidential Exh. R-EL-5.
[562] In its initial post-hearing brief, H-E-B also argues in support of the measures proposed by Staff and TIEC but provides no unique analysis beyond that addressed by Staff and TIEC. Therefore, CEHE's has focused its response on Staff and TIEC.
[563] *Id.* at 11-12.
[564] *See also id.* at 12; Staff Brief at 34.

do not support Staff's position. CNP's acquisition was not a leveraged buyout similar to that in the EFH/Oncor transaction.[565] In fact, the leverage of the transaction was roughly consistent with CNP's overall capital structure,[566] and Vectren is primarily composed of utility businesses, including low-risk gas utilities.[567] Staff points to the downgrade to CNP's credit rating by the ratings agencies as evidence of the associated risks.[568] While CNP did receive a downgrade from Moody's and S&P as a result of the transaction, it was a single notch and CNP is still at a BBB+ or the equivalent of BBB; and Moody's did not change its ratings of CEHE because Moody's evaluates companies individually (not as a family).[569] These facts do not support a claim of unreasonable risk to CEHE from CNP.

For whatever limited risk may exist for CEHE based on its relationship to CNP, CEHE established that its current structure and policies provides adequate protection for those risks. CEHE witness Ellen Lapson conducted a two-track analysis and determined that CEHE's practices provide an adequate separation from its affiliates, and would "prevent CenterPoint Houston from being subject to an involuntary bankruptcy, and CenterPoint Houston could maintain access to funding and liquidity despite financial distress of CNP or any of the Company's affiliates."[570] Ms. Lapson's conclusions are supported by the credit ratings issued by Moody's and Fitch to CEHE, which are two notches above that of CNP.[571]

Staff provided no such rigorous analysis to support its conclusion, only the bald assertion that the Vectren transaction was risky (which the facts do not support); and that CNP's business is otherwise generally risky (also unsupported by the facts).[572] Staff cites to Ms. Lapson's rebuttal for the general proposition that ring-fencing is appropriate in the utility context[573] without acknowledging the facts and analysis she presents that establish CEHE's current structure and practices provide a robust ring-fence and the necessary separation.[574] Additionally, Staff also ignores the fact that S&P currently rates CEHE on the low volatility table, indicating the lowest

[565] CEHE Ex. 48 at 13 (Lapson Rebuttal).
[566] *Id.*
[567] *Id.*
[568] Staff Initial Brief at 35.
[569] CEHE Ex. 48 at 14 (Lapson Rebuttal).
[570] *Id.* at 26.
[571] *Id.* at 17.
[572] Staff Initial Brief at 35.
[573] *Id.* at 34 nn.144-45.
[574] CEHE Ex. 48 at 22-26 (Lapson Rebuttal).

level of business risk, and therefore the proposed ring-fencing measures would not further improve the S&P risk profile of CEHE.[575]

CEHE's current practices are the same or similar to many of the measures proposed by Staff witness Tietjen and therefore no Commission action is needed to address them. The following are CEHE's practices consistent with Staff's proposed measures: 1. CEHE normally dividends only up to 60% of net income to CNP, 3. CEHE trues up its capital structure to the structure approved by the Commission at least once a year, [576] 5. CEHE maintains a separate credit rating from CNP, 7. CEHE does not commingle assets with affiliates, 8. CEHE does not pledge assets with respect to any debt obligation of its affiliates, 9. CEHE transactions with affiliates are conducted at arm's length, 10. CEHE does not lend or borrow funds from affiliates, and 11. CEHE's affiliates do not have debt disproportionally dependent on CEHE.[577] Mr. Tietjen's other proposals are all unreasonable, unnecessary, and/or inscrutable:

- Credit Ratings and Dividend requirements – It is unreasonable to expect a company to pledge to keep its credit ratings at their current level given that many of the factors that influence a company's credit rating are out of the company's control and in the hands of the Commission.[578]
- ROE Commitment – It is incomprehensible that the Commission would prohibit CEHE from using a credit downgrade as a reason to argue for a higher ROE, particularly if the downgrade was created by the way the Commission set CEHE's rates. It would violate CEHE's rights to a fair and reasonable return. Further, Staff seems to forget that the Commission can disregard arguments it finds unpersuasive.[579]
- Non-consolidation Legal Opinion – CEHE would not realize any appreciable benefits from such a legal opinion.[580] Non-consolidation opinions are essential for a structured special purpose entity formed to issue securities to the public to monetize regulatory assets.[581] CEHE is not part of a structured special purpose entity and has issued billions of dollars of bonds to the public without a non-consolidation opinion because investors have no concerns about the consolidation of CEHE in the bankruptcy of its parent or affiliates because of the existing separateness practices and policies in place at CEHE.[582]

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[575] CEHE Ex. 43 at 19 (McRae Rebuttal.)
[576] CEHE Ex. 48 at 33 (Lapson Rebuttal). Staff also includes a statement that "Neither CNP nor any of its affiliates will issue any stock or ownership interest that supersede the foregoing obligation." Ms. Lapson could not interpret the meaning of this sentence, and Staff provided no further explanation.
[577] *Id.* at 32-34.
[578] *Id.* at 32-33.
[579] *Id.* at 33-34.
[580] *Id.* at 34.
[581] *Id.* at 37.
[582] *Id.*

- No Bankruptcy Cost Commitment – This is unnecessary given that Staff admits there is no looming danger of bankruptcy at CNP and the Commission has authority to reject such a request to recover bankruptcy costs if ever made.[583]

While Staff and TIEC both claim that their proposed financial ring-fencing measures would be beneficial to CEHE from a credit ratings perspective, at least one agency (Moody's) unequivocally stated that the proposed measures were "credit neutral" and therefore would not impact CEHE's credit rating or access to capital markets.[584] In addition, neither Staff nor TIEC evaluated the potential financial impacts to CEHE if it were ordered to implement the proposed measures, including for example costs associated with renegotiating credit agreements or obtaining a non-consolidation legal opinion.

To support its push for additional ring-fencing measures, TIEC selectively overemphasizes certain facts and mischaracterizes others. First, TIEC relies heavily on the credit ratings issued to CEHE from S&P, and the claim that those measures would boost CEHE's S&P rating by three notches.[585] This claim is dubious and it ignores the fact that CEHE already receives higher ratings from Moody's and Fitch, which are effectively three notches above what S&P issues.[586] In a scenario in which a company receives split ratings from the agencies, investors look either to the preponderance of two out of the three ratings, or the middle of three ratings.[587] Both of the two methods would result in an A- rating for CEHE based upon the Moody and Fitch ratings.[588] Further, Moody's has indicated that the ring-fencing measures proposed in this case would have no impact on its rating of CEHE.[589]

TIEC's entire argument that the Commission should take steps to separate CEHE's credit from its parent so that it can receive an A- rating is disingenuous at best given that supposed necessary ratings boost only applies to S&P and CEHE's ratings from Moody's and Fitch are already equivalent to an A-.[590] TIEC tries to bolster its argument by pointing to statements within CEHE's 2017 10-K filing as evidence CEHE admits that CNP "drags down" its credit rating.[591] The referenced statements are standard risk disclosures of the kind CEHE must make to investors

[583] *Id.* at 34.
[584] *Id.* at 40-41 & Confidential Exh. R-EL-5.
[585] TIEC Initial Brief at 42.
[586] CEHE Ex. 48 at 17 (Lapson Rebuttal).
[587] *Id.* at 18.
[588] *Id.*
[589] *Id.* at 40-41 & Confidential Exh. R-EL-5 (Lapson Rebuttal).
[590] TIEC Initial Brief at 43.
[591] *Id.*

according to SEC rules,[592] and the SEC has previously indicated in its guidance that companies should not include any mitigating factors to the listed risks.[593] So CEHE was not in a position to describe the ways in which its existing ring-fencing policies and practices ameliorate the identified risks, particularly the fact that CEHE has adhered to its practices even in times of overall economic distress.[594] In addition, in 2018, CEHE's evaluation of its risks changed and in its 2018 10-K its number one listed material risk is the regulatory environment.[595] Given that CEHE made these disclosures in 2017 and it had no impact on the credit ratings it receives from Moody's and Fitch, it has clearly not dragged CEHE's ratings down.

TIEC and Staff both misleadingly point to the metric that CNP receives 91.3% of its net income from CEHE, despite CEHE representing a little more than 1/3 of CNP's assets.[596] But a comparison of a subsidiary's net income to that of its parent is invalid and inappropriate. The net income of each subsidiary reflects the revenues and expenses of each subsidiary but does not include any allocated share of expenses that are incurred at the parent company. The parent company's net operating income is made up of the aggregate of net income of the subsidiaries, and from that the parent records the expenses incurred at the parent company. The parent's net income incorporates the profits and losses from its subsidiaries and reflects all parent level expenses and income, that are not otherwise attributed to the subsidiaries so that the comparison is distorted. The comparison that is required by the SEC for line of business reporting on Forms 10-K and 10-Q uses the comparison of net operating income, which is the appropriate comparison.[597] CEHE's net operating income in 2018 and 2017 made up approximately 75% and 55% of CNP's net operating income.[598] Further, CEHE's proportion of CNP's net operating income is necessarily reduced by CNP's acquisition of Vectren (and its relatively low risk utility business operations). Contrary to claims of increased risk by TIEC and Staff, CNP's acquisition of Vectren (and its relatively low risk utility business operations) in fact makes it even less reliant on CEHE for income.

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[592] *See* 17 C.F.R. §229.105 (2019) ("Regulation S-K").

[593] *See,* Business and Financial Disclosure Required Under Regulation S-K, Exchange Act Release No. 77,599, 81 Fed. Reg. 23915, 23960 (Apr. 22, 2016). *See also* Fast Act Modernization and Simplification of Regulation S-K, Exchange Act Release No. 85,381, 84 Fed. Reg. 12674, 12688 (Apr. 2, 2019) (relocating the risk factor disclosure previously required under Item 503(c) of Regulation S-K to new Item 105 of Regulation S-K).

[594] CEHE Ex. 48 at 31-32 (Lapson Rebuttal).

[595] CEHE Ex. 84 Optionally Completing TCUC Ex. 27.

[596] *Id.* at 34.

[597] *See e.g.,* CEHE Ex. 84 Optionally Completing TCUC Ex. 27.

[598] *Id.* at 160-161.

As previously noted, CEHE currently has ring-fencing measures in place similar to that of the rest of the utility industry, and that insulate CEHE from any supposed risk posed by CNP. CEHE's evidence on this point is undisputed. TIEC claims that its proposed ring-fencing measures would protect customers from subsidizing the business ventures of CNP, but TIEC could not present any evidence to support any such subsidization, it could only provide unfounded claims intended to invoke fear of what could happen in the future. Similar to Staff's recommendations, Mr. Griffey's proposed ring-fencing measures are either already employed by CEHE or are unnecessary to provide any additional financial protections or benefits to CEHE or its customers.

- Dividend Stopper – as discussed above and in Ms. Lapson's testimony, CEHE already has indirect limitations in place regarding dividends and there is a strong economic incentive for CNP to retain equity at CEHE approximately equal to CEHE's authorized structure.[599] Mr. Griffey provides no specific parameters around how dividends should be further restricted, nor in what manner it would benefit CEHE and its customers to impose additional restrictions to what is already in place.
- Non-consolidation Opinion – as discussed above, this requirement is wholly unnecessary and provides no tangible benefit to CEHE or its customers. Contrary to Mr. Griffey's claims, there is not a single known case of involuntary or voluntary consolidation of a solvent rate-regulated US investor-owned electric or gas utility in the bankruptcy of its parent since the Great Depression.[600]
- Event of Default in CEHE Credit Agreement – Mr. Griffey mischaracterizes the provision in CEHE's credit agreement that creates an event of default upon the change of control of CNP or CEHE, as a "cross default."[601] A cross default is a situation in which the default of an entity constitutes an Event of Default in the debt of a second entity, which has immediate effects on a company's liquidity.[602] This is unlike a change of control.[603] Given the time it would take to negotiate a change of control transaction, and the time required for regulatory approvals, there would be more than enough time for CEHE to negotiate to amend or terminate and replace the credit agreement as necessary.[604] The change of control provisions in these agreements are standard and allow lenders a seat at the table of a transaction.[605]

TIEC's claim that the Commission order CEHE to employ protections that it already has in place is without reason or basis. There is no evidence to suggest that CEHE or CNP would do

[599] CEHE Ex. 48 at 36 (Lapson Rebuttal).
[600] *Id.* at 38-39.
[601] Direct Testimony of Charles S. Griffey, TIEC Ex. 4 at 21.
[602] CEHE Ex. 48 at 39 (Lapson Rebuttal).
[603] *Id.*
[604] *Id.*
[605] *Id.*

anything to erode these protections, and given that the protections have been in place even in times of general financial crises, the evidence suggests no further action is necessary.[606]

TIEC's next sleight of hand occurs when it suggests that Mr. McRae's correction of Mr. Gorman's calculations suggest that Mr. McRae agrees that Mr. Gorman's recommended ROE and capital structure will improve CEHE's stand-alone credit rating.[607] This is not true. To the contrary, Mr. McRae's rebuttal testimony makes clear that upon correction, Mr. Gorman's ROE and capital structure recommendations result in metrics far below the S&P benchmarks.[608]

While TIEC observes that a Baa rating under the Moody's methodology and a BBB rating from Fitch are investment grade ratings,[609] TIEC fails to acknowledge that "investment grade" credit ratings do not equate to "financial integrity." Simply stated, the downgrades that result from Mr. Gorman's recommendations put CEHE in a more financially risky position given CEHE's decreased cash flow from the TCJA.[610] The "maintenance" of an investment grade credit rating is also a unique and incredibly low standard for the Commission to establish for Texas electric utilities. In fact, it would result in a credit rating for CEHE that falls below every other utility in the United States [611] TIEC goes on to argue that CEHE customers would be better off with a lower credit rating than with a higher equity ratio.[612] As previously discussed, this is a short-sighted view and takes into consideration only one debt issuance.[613] In reality, utilities do not rebound quickly from credit rating downgrades, and if CEHE's rating is downgraded it could remain so through several debt issuances at higher rates.[614] As a result, customers will ultimately pay the higher costs associated with those debt issuances for the entire life of the bonds, which could be 20-30 years.[615]

Finally, none of the parties provide any reasoned legal analysis to support the authority of the Commission to impose the suggested financial ring-fencing measures. Staff cites to PURA §§ 11.002 and 14.001 as granting the Commission broad authority in reviewing a utility's

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[606] *Id.* at 36.
[607] TIEC Initial Brief at 55.
[608] CEHE Ex. 43 at 23 (McRae Rebuttal).
[609] TIEC Initial Brief at 51.
[610] CEHE Ex. 43 at 27 (McRae Rebuttal).
[611] CEHE Initial Brief at 64.
[612] TIEC Initial Brief at 51.
[613] CEHE Ex. 43 at 30 (McRae Rebuttal).
[614] *Id.*
[615] *Id.*

financial risk as part of its fundamental task of establishing just and reasonable rates.[616] While CEHE agrees that the Commission has the authority to consider a utility's financial risk, it is precisely within the context of *setting rates*, not seeking to change the fundamental structure of the utility itself. PURA §11.002 provides the purpose of PURA as protecting "the public interest inherent in rates and services of public utilities" and PURA §14.001 provides the Commission's general power to "regulate and supervise" including the jurisdiction to do "anything designated or implied by this title necessary and convenient to the exercise of that power and jurisdiction." The Commission has successfully regulated and supervised the rates and operations of utilities in Texas for over forty years without the need to impose financial ring-fencing measures in a rate proceeding, and no party has presented any compelling reason why such authority is needed now in order for the Commission to fulfill its duties.

In summary there is no legitimate factual or legal basis for the imposition of financial or ring-fencing provisions as proposed by TIEC and Staff, and such proposals should be rejected.

IV. Operating and Maintenance Expenses [PO Issues 4, 5, 21, 22, 25, 26, 28, 29, 33, 35, 36, 38, 39, 54, 55]

Ratemaking relies on establishing a level of costs the utility is likely to experience at the time new rates are implemented.[617] PURA requires an electric utility's rates to be based upon the utility's cost of service, which consists of allowable expenses and return on invested capital.[618] In computing a utility's allowable expenses, "only the electric utility's historical test year expenses as adjusted for known and measurable changes will be considered."[619] Consistent with this statutory authority, the Commission's cost of service rule, 16 TAC § 25.231, states in pertinent part, as follows:

> (a) Components of cost of service. Except as provided for in subsection (c)(2) of this section, relating to invested capital; rate base, and §23.23(b) of this title, (relating to Rate Design), *rates are to be based upon an electric utility's cost of rendering service to the public during a historical test year, adjusted for known and measurable changes.* The two components of cost of service are allowable expenses and return on invested capital (emphasis added).[620]
>
> (b) Allowable expenses. Only those expenses which are reasonable and necessary to provide service to the public shall be included in allowable expenses. *In computing an electric utility's allowable expenses, only the electric utility's historical test year*

[616] Staff Initial Brief at 36 fn. 156.
[617] Rebuttal Testimony of John J. Reed, CEHE Ex. 40 at 9-10 (Bates Pages).
[618] PURA § 36.051.
[619] 16 TAC § 25.231(b).
[620] *Id.* § 25.231.

> *expenses as adjusted for known and measurable changes will be considered*, except as provided for in any section of these rules dealing with fuel expenses (emphasis added).[621]

The Texas Supreme Court has confirmed that "future rates are made on the basis of past costs" where "changes occurring *after* the test period, if known, may be taken into consideration" by the Commission "to make the test year data as representative as possible of the cost situation that is apt to prevail in the future."[622] In this respect, the Commission has recognized two kinds of known and measurable changes to test year data: changes that are "actually realized" after the test year but before the rate year, and changes that "can be anticipated with reasonable certainty."[623] With regard to "anticipated" changes, the Commission has defined these as "those that will occur, can be measured, will affect future revenue requirements, and are a basis for determining forward-looking rates."[624] Thus, consistent with the standard described by the Texas Supreme Court above, the Commission looks to ensure that O&M is as representative as possible of future costs.

A. Unlike COH's proposal, CEHE's Requested O&M Expense Complies with PURA, Commission Rules, and the Commission's RFP Instructions.

In this case, CEHE complied with PURA, 16 TAC § 25.231, and the Commission's RFP Instructions by relying on a historic 12-month test year ended December 31, 2018, to establish its requested O&M expenses. CEHE has also shown that each of its proposed adjustments to test year data are known, measurable, and representative of the cost situation likely to prevail in the future. In contrast, COH's proposal to ignore CEHE's 2018 test year and instead rely on 2017 expenses escalated by 2.6% to establish CEHE's test year O&M expense violates the requirements of PURA and the Commission's cost of service rule.[625] While COH has espoused a variety of theories to bolster its contention that CEHE's test year O&M costs should be ignored,[626] COH fails to cite any case law supporting a conclusion that the Commission may ignore the statutorily required use of a historic test year to establish rates. COH also offers no factual basis to support a conclusion that its proposal would establish a level of O&M representative of CEHE's actual cost

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[621] *Id.*
[622] *Suburban Util. Corp. v. Public Util. Comm'n*, 652 S.W.2d 358, 366 (Tex. 1983) (emphasis added).
[623] *Application of AEP Texas Central Company for Authority to Change Rates*, Docket No. 28840, Order at Conclusions of Law 32-34 (Aug. 15, 2005) (quoting *Suburban*, 652 S.W.2d at 362); *see Fed. Power Commission v. United Gas Pipe Line Co.*, 386 U.S. 237, 242 (1967).
[624] *Application of Oncor Electric Delivery Company LLC for Rate Case Expenses Pertaining to PUC Docket No. 35717*, Docket No. 36530, Order at 3 (Sep. 21, 2009).
[625] COH/HCC Ex. 1 at 13 (Norwood Direct).
[626] COH/HCC Initial Brief at 20-23.

to operate and maintain its transmission and distribution system. In fact, COH does not challenge any specific O&M expense incurred by CEHE during the test year. Stated differently, COH has not identified a single, specific O&M expense incurred by CEHE's High Voltage Operations, Distribution Operations, or Service Company during the test year that it contends was not reasonable and necessary. Instead, COH merely opines that CEHE's test year costs are too high because they exceed the Company's average O&M expenses over the four years preceding 2018.[627] This is not a sufficient basis on which to ignore CEHE's actual test year costs. COH's proposed adjustment to reduce CEHE's requested O&M expense by $44.3 million dollars (excluding ERCOT charges) should be rejected.[628]

B. CEHE's Requested Test Year O&M Expense Accurately Reflects its Cost to Operate and Maintain its System

The evidence proves that CEHE effectively controls its operating costs while continuing to provide safe and reliable service at reasonable rates and has a number of processes and procedures in place to ensure the Company's costs are properly managed and remain at reasonable levels. The testimonies of Mr. Pryor, Mr. Narendorf, Ms. Bodden, Ms. Sugarek, Ms. James and CEHE witness Michelle M. Townsend discuss various cost control initiatives implemented by CEHE, as well as the Company's efforts and processes to monitor and control costs on a daily basis. Despite continuous cost control efforts, operating expenses associated with new installations, regulatory compliance, and maintenance activities are rising as the Company responds to growth in its service territory. These costs are necessary to serve continuous customer and load growth and to sustain CEHE's commitment to safety and reliability. While COH makes every effort to dismiss the impact that customer and load growth has had on the Company's test year O&M expense, COH cannot escape the fact that the Company's annual O&M expense has been increasing due to customer and load growth, increased circuit miles (both overhead and underground circuits), increased number of transformers, and increasing labor costs. The facts show that:

- CEHE now serves 359,525 more residential customers and 41,991 more commercial customers than it did on December 31, 2009;[629]

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[627] *Id.* at 20.
[628] *Id.*
[629] CEHE Ex. 9 at 593 (Bodden Direct); CEHE Ex. 7 at 175 (Pryor Direct).

- Customer growth has occurred not only in areas with existing infrastructure, but also in undeveloped locations, which require the deployment of all new infrastructure;[630]
- Over the past four years, overhead distribution pole miles (feeder-main and laterals) have increased an average of 171 miles per year, while URD circuit miles have increased an average of 257 miles per year;[631]
- To support economic growth within the City of Houston and surrounding areas, CEHE had to build or install approximately 221 new substation feeder positions to accommodate new distribution feeders, 55 new substation transformers, size upgrades for 12 substation transformers, and 6 new distribution substations.[632]

The evidence also shows that CEHE has experienced distribution growth of approximately 1,440 MW, or an average load growth of 144 MW per year since 2009. [633] While COH emphasizes on the fact that this equates to approximately 1% per year, it misrepresents in its brief that this percentage is "abnormally low" and fails to take into account the effect that this growth has on CEHE's distribution system.[634] Ms. Bodden put this load growth in perspective during the hearing explaining that an average load on a distribution substation is approximately 70 MW, which equates to approximately two new substations per year.[635] She further testified that this level of distribution load growth was substantial.[636] The evidence further shows that distribution load for the five years from 2018 through 2023, is projected to continue to grow by approximately 1,513 MW, or an average load growth of 302.6 MW or 1.8% per year.[637]

In short, it is a factual reality that an electric utility that serves more load will have increased O&M costs and will be required to make increased investments in its system.[638] The same is true for customer growth. This is particularly true where, as is the case for CEHE, the customer and load growth is not geographically concentrated or limited to residential customers, but rather has required the deployment of new infrastructure capable of serving increased customer density within the City of Houston, pasture lands housing new suburban developments, and new industrial loads along the Gulf Coast that are subject to flooding and high winds.[639] The actual effect these

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630 Tr. at 147-149 (Mercado Redirect) (Jun. 24, 2019).
631 CEHE Ex. 7 at 210-211 (Pryor Direct).
632 CEHE Ex. 9 at 596 (Bodden Direct).
633 *Id.* at 592.
634 COH/HCC Initial Brief at 20.
635 Tr. at 220 (Bodden Redirect) (Jun. 24, 2019); *See also id.* at 597-598 (Jun.26, 2019) wherein Ms. Bodden discusses some of the new substation construction that has resulted from load growth.
636 Tr. at 220 (Bodden Redirect) (Jun. 24, 2019).
637 CEHE Ex. 9 at 23 (Bodden Direct).
638 CEHE Ex. 45 at 21 (Troxle Rebuttal).
639 Tr. at 146-149 (Mercado Redirect) (Jun. 24, 2019).

drivers have and will continue to have on CEHE's ongoing expenses are not hypothetical, they are reflected in CEHE's test year costs. It is simply unrealistic to think that COH's proposal to rely on 2017 O&M expense levels as the baseline from which to establish rates in this case will be sufficient to operate and maintain CEHE's transmission and distribution system in 2020 and beyond.

Finally, while COH proposes no specific disallowance to CEHE's test year expense amounts in any specific O&M FERC account, it does generally point to seven FERC accounts that COH contends have unjustifiably increased over the average.[640] In rebuttal, CEHE presented detailed evidence identifying the factors driving these costs as well as evidence showing that the test year costs in each of those accounts were representative of current O&M conditions as well as costs that will continue to be incurred in the future.[641] As these explanations make clear, the increase in CEHE's O&M expenses is not simply due to the need to "address reliability concerns" as COH states in its brief without a supporting reference.[642] Rather, CEHE's O&M costs are being driven not only by system improvements to replace aging infrastructure, but also by new infrastructure that has been constructed and must be operated and maintained to serve the approximately 400,000 new customers that CEHE added to its system between 2010 and 2018.[643] Other O&M cost drivers were shown to include: (1) engineering and technology costs, including costs related to improvements, upgrades and maintenance of system equipment and software, as well as cyber security enhancements;[644] (2) the increased cost associated with the environmental disposal and clean-up of transformers;[645] (3) increased maintenance and repair costs, as well as corrective and preventative maintenance costs;[646] and (4) increased contractor labor costs.[647] And, all of these costs were shown to be expected to continue into the future as CEHE's technology systems are updated and maintained, CEHE's electric system ages, and labor costs continue to escalate.[648] In sum, the test year in this case is the 12 months ended December 31, 2018, and it

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[640] COH/HCC Initial Brief at 20.
[641] CEHE Ex. 31 at 20-21 (Pryor Rebuttal) addressing FERC Accounts 580, 588, 593, and 594; CEHE Ex. 32 at 29-32 (Narendorf Rebuttal) addressing FERC Accounts 560 and 570; CEHE Ex. 37 at 8-12 (Townsend Rebuttal) addressing FERC Account 930.2.
[642] COH/HCC Initial Brief at 20-21.
[643] CEHE Ex. 32 at 29-30 (Narendorf Rebuttal).
[644] CEHE Ex. 31 at 20-21 (Pryor Rebuttal).
[645] *Id.*
[646] CEHE Ex. 31 at 20-21 (Pryor Rebuttal); CEHE Ex. 32 at 30-31 (Narendorf Rebuttal).
[647] CEHE Ex. 31 at 20-22 (Pryor Rebuttal).
[648] *Id.*

serves as the most appropriate and reasonable measure of the Company's O&M expenses. For these reasons, COH's proposed O&M adjustment should be rejected.

A. Transmission and Distribution O&M Expenses [PO Issue 21]

As discussed above and in CEHE's initial brief in Section IV.A, the Company has shown that its test year High Voltage Operations O&M expenses in the amount of $58.7 million and test year Distribution Operations Division ("Distribution") O&M expenses in the amount of $206.7 million are reasonable, necessary, and representative of costs expected to prevail in the future.[649] As such, these O&M costs should be approved for recovery in this case.

B. Labor Expenses

1. Incentive Compensation

No party disputes that growth in the Houston-area economy and competition in the local job market have resulted in increased labor costs for CEHE.[650] No party disputes that robust job growth nationally and locally also coincides with a wave of retirement-eligible employees at CNP.[651] No party disputes that there is a growing industry shortage of electric utility line skills due to the aging work force and increased electric utility work in Texas and across the United States, as well as increasingly aggressive recruitment of skilled labor from California utilities.[652] Nor does any party dispute the Company's evidence showing an average increase in compensation paid to the transportation and utilities trade of 2.6% per year between 2010 and 2018.[653] And, no party suggests that CNP must be anything other than proactive in retaining current employees with specialized knowledge and experience that is not easily developed or replaced. In fact, no party challenges the Company's need to attract and retain qualified and skilled employees.

What several parties continue to challenge in briefing, however, is a portion of the way CEHE compensates its employees—with incentive compensation tied to financial measures. However, in their pursuit to disallow all incentive compensation tied to financial measures without regard, the parties blindly over-reach with proposals that would:

- disallow $1.5 million in incentive compensation for union employees—which is presumed reasonable under PURA § 14.006;

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[649] CEHE Ex. 8 at 339 (Narendorf Direct); CEHE Ex. 7 at 171 (Pryor Direct).
[650] Direct Testimony of John J. Reed, CEHE Ex. 23 at 1904 (Bates Pages).
[651] Direct Testimony of Lynne Harkel-Rumford, CEHE Ex. 22 at 1840 (Bates Pages).
[652] CEHE Ex. 31 at 16 (Pryor Rebuttal).
[653] *Id.* at 18-19.

- disallow $1.5 million in safety and customer satisfaction related short term incentive compensation—which are undisputedly operationally based;
- disallow $2.9 million in short term incentive compensation that is properly designated as tied to O&M operational measures—not a financial measure;
- disallow $3.8 million in long-term incentive compensation that is not tied to any financial measure, rather its only trigger is time in service—also an operational measure.

Unfortunately, the zeal for this overreach appears tied to those parties' mistaken belief, and conclusory testimony, that when incentive compensation is based on financial measures or if the awarding of incentive compensation is based on a financial "trigger," customers receive no benefit. The evidence in this case demonstrates this belief is false.

The evidence in this proceeding—not a former SPS, AEP or SWEPCO proceeding, which the parties point to as "precedent" on the issue of incentive compensation[654]—shows that customers benefit from incentive compensation tied to financial measures.[655] It likewise shows that market realities and studies demonstrate CNP must provide compensation from a "total compensation" perspective—meaning the *combination* of base pay, short-term incentive compensation ("STI") and long-term incentive compensation ("LTI"), which is targeted to be at the median of the market.[656] If any one of those pay components is eliminated or reduced, CNP would not be able to offer a level of compensation that would allow it to compete for and retain the experienced and skilled personnel it must employ in order to provide safe and reliable electric service.

To this end, not surprisingly, the briefing of Intervenors and Staff continues to pit the interests of customers and shareholders against one another.[657] However, contrary to the positions advanced by TIEC, Staff, OPUC and COH, incentive pay and the goals upon which it is based are not an "either/or" issue for customers and shareholders. The evidence in this case demonstrates that *everything* the Company does impacts customers *and* shareholders and CEHE's employees know this.[658] Likewise, the Company's shareholders expect the Company's primary focus to be appropriately on its customers. If the Company does not provide safe, reliable service at a reasonable cost, neither its customers nor shareholders will be satisfied. As such, Intervenor and

[654] Staff Initial Brief at 40; OPUC Initial Brief at 46-47; TIEC Initial Brief at 52-53.
[655] CEHE Ex. 40 at 14 (Reed Rebuttal).
[656] CEHE Ex. 22 at 1840 (Harkel-Rumford Direct).
[657] Staff Initial Brief at 39-40; OPUC Initial Brief at 46; TIEC Initial Brief at 52; COH/HCC Initial Brief at 24.
[658] CEHE Ex. 40 at 14 (Reed Rebuttal).

Staff arguments that either customers or shareholders benefit over the other are seriously flawed and misguided.

The record is also clear that the "precedent" relied upon by Intervenors and Staff is not as settled as they would suggest when it comes to CEHE's recovery of incentive compensation.[659] And, that "precedent" becomes even less persuasive when viewed in light of Section 14.006 of PURA, relating to collective bargaining, and the newly enacted HB 1767, which the Governor signed in June 2019, creating a presumption of reasonableness and necessity for base salaries, wages, incentive compensation and benefits for gas utilities as long as those costs are consistent with recently issued market compensation studies.[660] Section 14.006 of PURA presumes reasonable an employee wage rate or benefit that is the product of collective bargaining.[661] In addition—with HB 1767 now enacted—the Commission has an opportunity to evaluate and reconsider the way it has viewed total compensation, including incentive pay, in a rate proceeding.[662] HB 1767 reflects a new policy pronouncement from the Legislature and Governor, which confirms that it is reasonable for a utility to rely on recent market compensation studies to determine base salaries, wages, incentive compensation and benefits.[663] While the parties' initial briefs go to great lengths to argue that HB 1767 should not be considered by the Commission on this issue, none of those parties sets forth a valid argument as to why gas and electric utilities in the State of Texas should be treated differently when establishing rates, so as to provide an undue advantage or benefit to one utility over another.[664] This is particularly true for CNP, which operates both gas and electric divisions in the state of Texas.[665]

In short, the facts and evidence in this case show that CNP and CEHE must be proactive in attracting and retaining employees in an environment where employment rates are high, there is significant competition for utility employees, and many employees are at or nearing retirement age. The record evidence, which was addressed in detail in the Company's Initial brief, supports the Company's request to recover its requested incentive compensation, payroll and benefits costs

[659] Docket No. 38339, Order on Rehearing at Findings of Fact 81 and 83.
[660] Rebuttal Testimony of Lynne Harkel-Rumford, CEHE Ex. 39 at 8 (Bates Pages); CEHE Ex. 40 at 24 (Reed Rebuttal). Financially based incentive pay for certain executive officers is excluded from that presumption. CEHE Ex. 40 at Exh. R-JJR-1 (Reed Rebuttal).
[661] PURA § 14.006.
[662] CEHE Ex. 40 at 26 (Reed Rebuttal).
[663] Tex. Util. Code § 104.060; CEHE Ex. 40 at Exh. R-JJR-1 (Reed Rebuttal).
[664] CEHE Ex. 40 at 24-25 (Reed Rebuttal).
[665] Tr. at 1354, 1356 (Reed Cross) (Jun. 28, 2019).

for direct Company employees and the CERC and Service Company employees who also provide necessary services to the Company.

a. Short-Term Incentive Compensation

As an initial matter, it remains undisputed through the parties' briefing that in the Company's last rate case in Docket No. 38339, the Commission approved recovery of all STI costs and found that STI was a reasonable and necessary component of a total compensation package required to recruit, retain, and motivate employees.[666] The Commission also found that the corporate and financial goals of STI are directly tied to metrics such as customer service and safety.[667] It is likewise undisputed that, since Docket No. 38339, the Company's overall STI plan purpose has remained the same and continues to rely on a plan concept that aligns customer, shareholder and employee interests.[668]

Yet the parties' briefing continues to ignore this reality in favor of relying on Commission decisions related to other utilities in which costs tied to financially-based STI goals were disallowed because—unlike either Docket No. 38339 or this docket—there was no testimony presented that those STI goals benefited customers. The Commission's findings for CEHE, however, affirmatively support recovery of all STI costs, including those based on the achievement of financial goals. Thus, the Company's request in this case to recover STI, which includes a reduction to test year amounts to reflect a 122% achievement level (rather than the actual 131% achievement for the test year), is consistent with Commission precedent for CEHE.

Further, while OPUC and Staff express frustration over their misunderstandings on the exact amount of the Company's STI request in this case,[669] the evidence of that amount is clear in the record. The Company's requested STI costs, as presented in TIEC's brief,[670] are:

Figure 1. Requested STI Expense Amounts (in Thousands)[671]

	Union	Non-Union	Total[672]
Direct	$1,374	$5,933	$7,307
Affiliate	117	9,461	9,578
	$1,491	$15,394	$16,885

[666] Docket No. 38339, Order on Rehearing at Finding of Fact 81.
[667] *Id.* at Finding of Fact 83.
[668] CEHE Ex. 22 at 1853 (Harkel-Rumford Direct).
[669] OPUC Initial Brief at 50; Staff Initial Brief at 41.
[670] TIEC Initial Brief at 53.
[671] CEHE Ex. 35 at 17 (Colvin Rebuttal); These amounts exclude FICA and Savings Match.
[672] *Id.*; *See* WP R-KLC-02 Requested STI Expense Calculation.

The components of the Company's STI plan are also clear. The 2018 STI Plan goals are as follows and are consistent with goals used by most of CNP's peer utilities:[673]

GOAL	WEIGHTING
CNP Core Operating Income	35%
CNP Consolidated Diluted Earnings Per Share	20%
CNP O&M Expenditures	25%
Customer Satisfaction Composite	10%
CNP Safety Composite	10%

Accordingly, disallowances proposed by OPUC, COH and Staff that are based on other amounts or percentages should be ignored.[674]

It is also undisputed that the Intervenor and Staff proposals include STI costs for union employees, which are presumed reasonable under PURA § 14.006. A presumption is simply a rule of law requiring the trier of fact to reach a particular conclusion in the absence of evidence to the contrary.[675] Yet, no party offered evidence contrary to the presumption that the Company's collective bargaining agreement and its associated compensation amounts were reasonable. In fact, during the hearing, TIEC's witness admitted she had not reviewed PURA § 14.006.[676] After the presumption of reasonableness for union costs that are the product of a collective bargaining agreement was brought to her attention, she confirmed that her recommendation to disallow union STI costs was contrary to Texas law.[677] Thus, at a minimum, Intervenor and Staff recommendations to disallow union STI costs should not be adopted.

In addition, OPUC and Staff would continue to treat the STI goal for CNP O&M Expenditures as a financial measure.[678] The evidence demonstrates that it is not. Rather, the record demonstrates that:

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[673] CEHE Ex. 22 at 1853-1854 & Confidential Exhs. LHR-5 and LHR-6 (Harkel-Rumford Direct).
[674] *See* OPUC Initial Brief at 48 (suggesting that the Company's total STI expense is $29,462,931); Staff Initial Brief at 41 (using $17,300,749 as the total STI amount); and COH/HCC Initial Brief at 23; As the Company explained in its Initial Brief, Staff, OPUC, and TIEC initially incorrectly base their direct STI disallowances on the Company's test year amounts rather than the four-year average STI achievement level. For this reason, the amounts they identify in their testimonies do not reflect the Company's requested STI amounts.
[675] *Temple Independent School Dist. v. English*, 896 S.W.2d 167, 169 (Tex. 1995).
[676] Tr. at 437-438 (LaConte Cross) (Jun. 25, 2019).
[677] *Id.* at 438, 446.
[678] OPUC Initial Brief at 50 (recommending a disallowance of 82.68%); Staff Initial Brief at 41-42.

- O&M expense is an operational metric because it is critical for CNP to operate efficiently, effectively and safely to meet the expectations for the O&M goal;[679]
- the calculation of this metric starts with total O&M that is then adjusted to remove items that have revenue offsets or are outside of employees' control;[680]
- the O&M goal motivates employees to find operational efficiencies that benefit customers through reasonable rates, safe and reliable operations and enhanced customer service.[681]
- in communications with employees, CNP explains this is an operational goal;[682] and
- to the extent the employee efforts help the Company successfully manage O&M expenses, those efforts help limit the growth in the overall revenue requirement and therefore reduce customer rates.

In short, simply because a goal is measured in dollars does not make it a financial goal. Rather than reach the default decision urged by parties in their briefing that there is no way customers benefit from financial goals, ample evidence in this case shows that customers directly benefit from employees' focus on financial goals. This evidence—along with undisputed evidence showing the competitiveness of the job markets in which CNP and CEHE compete for employees, the newly enacted HB 1767, and the threat of impending retirements—weighs against the disallowances Intervenors and Staff propose.

Similarly, Staff and COH unreasonably propose to disallow half of the Company's STI tied to operational goals simply because a funding trigger exists for STI.[683] The evidence demonstrates that for STI payments to be made, CNP must achieve a threshold level of core operating income.[684] This "trigger" simply ensures that CNP is financially healthy and able to support all of its operations, before awarding incentive pay (*i.e.* that it can afford to make the payment).[685] This is precisely the type of prudent, responsible financial decision-making that should be encouraged, rather than challenged, by parties. Both COH and Staff acknowledge customers are the direct beneficiaries of operational, safety, and customer satisfaction metrics.[686] Thus, there should be no disallowance for STI tied to operational or safety measures.[687]

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[679] CEHE Ex. 39 at 15 (Harkel-Rumford Rebuttal).
[680] *Id.*
[681] *Id.*
[682] Tr. at 307 (Harkel-Rumford Cross) (Jun. 25, 2019).
[683] COH/HCC Initial Brief at 24; Staff Initial Brief at 42.
[684] Tr. at 313, 315-316 (Harkel-Rumford Cross) (Jun. 25, 2019).
[685] *Id.*
[686] CEHE Ex. 39 at 19 (Harkel-Rumford Rebuttal).
[687] *Id.*

As the Company noted in its initial brief, requested STI amounts for goals that are properly considered to be operational, safety, and customer satisfaction are as follows:[688]

	Overall O&M Expenditures	Customer Satisfaction	Overall Safety Performance	**Totals by Employee Type**
Direct - Union	$302,210	$127,615	$118,360	**$548,185**
Direct - Non-Union	$1,305,149	$551,130	$511,158	**$2,367,437**
Affiliate - Union	$15,969	$8,276	$12,006	**$36,251**
Affiliate - Non-Union	$1,296,209	$671,758	$974,522	**$2,942,489**
Totals by Goal	**$2,919,537**	**$1,358,779**	**$1,616,046**	

b. Long-Term Incentive Compensation

Intervenors and Staff also continue to take the position that all LTI costs are based on the achievement of financial goals and should not be recovered through rates.[689] However, the evidence produced by the Company demonstrates that restricted stock units ("RSUs") are not tied to any financial goals.[690]

RSUs, which make up 30% of the LTI award for officers and directors for 2018-2020, are time-based. In addition, 100% of the LTI award for employees below the director level is time-based. An LTI-eligible employee must remain with CNP during that three-year period to be eligible to receive RSUs.[691] The Company's requested LTI expenses related to RSUs are $3.8 million and have no correlation to the achievement of financial goals.[692] And, the fact that the award for this time-based accomplishment is in the form of stock does not make RSUs a financially-based component of LTI.[693] In addition, the Commission has previously approved

[688] CEHE Ex. 35 at WP R-KLC-02 (Colvin Rebuttal) for Direct and Service Company amounts. For CERC STI amounts, refer to Staff Ex. 15A at Att. 2, STI tab (page 2 of 2), cell H73. The Affiliate amounts by goal were calculated using the Percent of Overall Funding by Goal shown on Staff Ex. 15A at Att. 1 (page 3 of 3) multiplied by the total Affiliate amounts for Service Company and CERC. The Percent of Overall Funding by Goal was 13.7% for Overall O&M Expenditures, 7.1% for Customer Satisfaction, and 10.3% for Overall Safety Performance. The total Affiliate-Union amount for Service Company is $116,563 as shown on WP R-KLC-02. The total Affiliate-Non-Union amount for Service Company is $9,456,742 and for CERC is $4,641.

[689] Staff Initial Brief at 42-43; COH/HCC Initial Brief at 24-25; OPUC Initial Brief at 51; TIEC Initial Brief at 54.

[690] CEHE Ex. 22 at 1858-1859, Confidential Exh. LHR-8 (Harkel-Rumford Direct), CEHE Ex. 39 at 23 (Harkel-Rumford Rebuttal).

[691] CEHE Ex. 39 at 23 (Harkel-Rumford Rebuttal).

[692] CEHE Ex. 35 at 18 (Colvin Rebuttal).

[693] CEHE Ex. 39 at 25 (Harkel-Rumford Rebuttal).

recovery of costs for RSUs that are part of an LTI plan and are not financially-based.[694] Therefore, even if the Commission were to adopt the Intervenor and Staff recommendations to disallow LTI costs based on financial goals, it would not be appropriate to disallow costs related to the restricted stock awards.

More broadly, the evidence demonstrates that the Company's LTI plan is reasonable and LTI costs should be recovered in full. Specifically, the record demonstrates that:

- the specific purpose of the LTI plan is to focus employee attention toward ensuring sustained improvements in performance over longer periods of time;[695]
- the goals associated with performance-based LTI motivate participating employees to effectively manage operations because achievement of financial goals enables CNP and CEHE to adequately maintain CEHE's assets and provide safe and reliable electric service to customers with a focus on controlling costs;[696]
- customers necessarily benefit from CNP and CEHE recruiting and retaining key employees who are motivated to make positive strategic decisions that will benefit the Company and its customers over the long run;[697]
- the market requires that a significant portion of the total compensation for senior executives and management is at-risk pay;[698] and
- this "pay for performance" philosophy is consistent with the market and requires that senior executives and management meet established goals related to customer and shareholder expectations.[699]

In sum, the Intervenor and Staff arguments in opposition to the Company's request to recover LTI costs continue to default to inaccurate notions that only shareholders benefit from LTI plan goals. In fact, their unwillingness to acknowledge that 30% of the LTI plan does not depend in any way on financial goals illustrates their default mindset and inability to weigh and consider what the evidence actually shows. The evidence demonstrates that the Company needs qualified employees who maintain levels of system reliability, who are responsive to customers' needs, and who can prudently manage the needed enhancement of the grid to meet customer demand. For these reasons, the Company's request to recover all its LTI costs should be granted.[700]

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694 CEHE Ex. 40 at 8 (Reed Rebuttal), citing to *Application of Southwestern Electric Power Company for Authority to Change Rates,* Docket No. 46449, Order at Finding of Fact 199 (Jan. 11, 2018).
695 CEHE Ex. 39 at 20 (Harkel-Rumford Rebuttal).
696 *Id.* at 21.
697 *Id.*
698 *Id.* at 22.
699 *Id.*
700 Direct Testimony of Mark Garrett, COH/HCC Ex. 2 at Exh. MG-24 (LTI Total of $11.3 million minus $3.8 million for RSUs).

2. Executive Employee Related Expenses

COH challenges the Company's request to recover reasonable benefits costs for executives related to the BRP. The BRP is a non-qualified plan for the retirement or pension plan for certain employees whose retirement benefits under the traditional plan have been negatively impacted by reaching certain limits contained in the Internal Revenue Code.[701] In Section IV.B.5 (Other Benefits) in its initial brief, CEHE fully addressed the arguments COH puts forth.[702] In the interest of efficiency, CEHE will not repeat those arguments here.

3. Payroll Adjustments

COH disputes known and measurable adjustments CEHE made to test year payroll to annualize December 2018 payroll and make an adjustment for the Competitive Pay Adjustment ("CPA") that occurred shortly after the test year ended.[703] CEHE thoroughly addressed these issues in its initial brief and will not repeat the same arguments here.[704] It is worth noting, however, that COH's reference to a "nominal mid-year pay increase" is not what actually occurred or what the evidence shows. Instead, using December 2018 salaries necessarily included the CPA or "pay increase" that occurred in March or April of 2018.[705] In addition, COH objects to the adjustment for the 3% CPA, calling it a "prospective increase."[706] Yet, there is nothing "prospective" about that adjustment. The evidence shows the adjustment for the 2019 CPA was actual, known and measurable. Non-union employees received a CPA on April 1, and union employees received a CPA on May 26 based on requirements in the IBEW Local 66 union contract to increase direct wages for union employees every year.[707] Thus, Mr. Garrett's opposition to the union pay increase conflicts with the presumption of reasonableness for union wages that is contained in PURA § 14.006 and must also be rejected on that basis.[708] CEHE's payroll adjustments are a reasonable way to adjust test year wages based on known and measurable adjustments that reflect the costs that are likely to exist at the time new rates are implemented. CEHE's request should be adopted, and COH's arguments should be rejected.

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[701] CEHE Ex. 39 at 25 (Harkel-Rumford Rebuttal).
[702] CEHE Initial Brief at 97-99.
[703] COH/HCC Initial Brief at 26-27.
[704] CEHE Initial Brief at 92-95.
[705] CEHE Ex. 35 at 11 (Colvin Rebuttal).
[706] COH/HCC Initial Brief at 26.
[707] CEHE Ex. 35 at 11 (Colvin Rebuttal).
[708] *Id.* at 13-14 (Colvin Rebuttal). *See also* CEHE Initial Brief at 93, which contains a chart showing amounts of Union salary and CPA adjustments, among other union employee-related amounts.

Staff noted that issues related to 32 employees who were terminated as a result of the Vectren acquisition relate to payroll.[709] Staff addressed those issues in Section IV.D.1 of its brief, related to Affiliate Expense issues.[710] Because the 32 employees at issue were direct CEHE employees, not affiliate employees, CEHE addressed this issue in Section IV.B.3.d (Adjustment for Changes to CEHE Headcount) of its initial brief. In its initial brief, CEHE explained why reducing payroll costs by $1.65 million related to salaries for the 32 CEHE employees would not be reasonable and it continues to oppose such an adjustment.[711] In addition, if the Commission did approve that decrease in base pay amounts, it would be reasonable to also approve an increase in costs for the related $3.9 million in severance expense that CEHE incurred related to the 32 employees.[712] Staff, however, characterizes severance costs as a "one-time expense" as a result of the Vectren acquisition.[713] To the contrary, the evidence shows that providing severance pay for employees whose jobs were impacted through no fault of their own is both fair and reasonable, and it is consistent with market practices.[714] In addition, providing severance pay helps soften the impact of a termination, retains goodwill between the company and the employee, acknowledges employee loyalty, and helps promote an amicable termination process.[715] Also, the Company has in the past had instances where employees were impacted by a program or operational change that was implemented to reduce costs or to streamline staffing. This past experience confirms severance costs are a recurring expense.[716] Moreover, other severance costs unrelated to the 32 CEHE employees who were terminated after the Vectren acquisition are included in the Company's request, and no party has challenged those costs.[717] Because severance expenses are recurring and CEHE incurred severance costs to achieve the reduction in base pay that Staff argues for, equity supports including the severance costs along with the decrease in base pay if Staff's position is adopted.

4. Pension and Other Postemployment Benefits (OPEB) Expense

In this section of its initial brief, Staff addresses CEHE's request to recover reasonable benefits costs for executives related to the BRP. This is the same issue COH addressed in Section

[709] Staff Initial Brief at 43.
[710] *Id.* at 46-47.
[711] CEHE Initial Brief at 95-96.
[712] CEHE Ex. 35 at 20 (Colvin Rebuttal).
[713] Staff Initial Brief at 46.
[714] CEHE Ex. 39 at 30 (Harkel-Rumford Rebuttal).
[715] *Id.*
[716] *Id.*
[717] *Id*; CEHE Ex. 35 at 19-20 (Colvin Rebuttal).

IV.B.2 of its brief, as noted above. CEHE responded to the arguments Staff raises on this issue in its initial brief at Section IV.B.5 (Other Benefits).[718] In the interest of efficiency, CEHE will not repeat those arguments here.

5. Other Benefits

In this section of its initial brief, COH addresses executive salaries.[719] To support its argument, COH claims that executive base pay in excess of $1 million is not necessary for the provision of service because executives—in this instance only one CNP employee—must put the interests of the Company first due to a duty of loyalty.[720] COH made this argument for several types of labor costs related to executives, including BRP costs and financially-based incentive compensation.[721] COH's theory that executives will necessarily put the interests of the Company first (ahead of customers and other stakeholders) is not supported by the evidence related to actual CNP and CEHE employees. As CEHE witness Lynne Harkel-Rumford testified, she has observed the behavior of CNP officers that demonstrates a balanced loyalty to all stakeholders, including customers.[722] From her perspective, as someone who administers compensation programs for employees, the Company's compensation and benefits package is designed to drive all employees, including officers or executives, to focus their efforts for the benefit of the Company *and* its customers.[723] In addition, CNP provides reasonable levels of compensation and benefits at the median of the market that are competitive with peer companies and are not overvalued at the expense of customers.[724] CEHE also addresses COH's arguments on this issue in Section IV.B.3.e (Executive Base Pay) of its initial brief.[725] The evidence, including evidence addressed in CEHE's initial brief, shows it is reasonable for CEHE to recover its allocated portion of the base salary for the only CNP executive whose salary exceeds $1 million. That allocated portion is only $132,786 and should be recovered through rates.[726]

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[718] CEHE Initial Brief at 97-99.
[719] COH/HCC Initial Brief at 27.
[720] *Id.*
[721] COH/HCC Ex. 2 at 43, 46 (Garrett Direct).
[722] CEHE Ex. 39 at 26 (Harkel-Rumford Rebuttal).
[723] *Id.* at 26-27.
[724] *Id.* at 27.
[725] CEHE Initial Brief at 96-97.
[726] CEHE Ex. 37 at 19 (Townsend Rebuttal).