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SEPTEMBER 16, 2019

TO: Stephen Journeay, Commission Counsel **VIA EMAIL**
Commission Advising and Docket Management
William B. Travis State Office Building
1701 N. Congress, 7th Floor
Austin, Texas 78701

RE: SOAH Docket No. 473-19-3864
PUC Docket No. 49421

APPLICATION OF CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC FOR AUTHORITY TO CHANGE RATES

Enclosed is the Proposal for Decision (PFD) in the above-referenced case. By copy of this letter, the parties to this proceeding are being served with the PFD.

Please place this case on an open meeting agenda for the Commissioners' consideration. The proposed rates were suspended and the suspension period ends October 12, 2019. Please notify us and the parties of the open meeting date, as well as the deadlines for filing exceptions to the PFD, replies to the exceptions, and requests for oral argument.

Sincerely,

Steven D. Arnold
Administrative Law Judge

Elizabeth Drews
Administrative Law Judge

Meaghan Bailey
Administrative Law Judge

Enclosure
xc: All Parties of Record

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

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

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APPENDIX B: RATE SCHEDULES ....Error! Bookmark not defined.

LIST OF ACRONYMS AND ABBREVIATIONS

TERM	DEFINITION
4CP	Four-Month Coincident Peak
A&G	Administrative and General
ADFIT	Accumulated Deferred Federal Income Tax
AFUDC	Allowance for Funds Used during Construction
AIS	Asset Investment Strategy
ALJ	Administrative Law Judge
AMS	Advanced Metering System
AOCI	Accumulated Other Comprehensive Income
ARAM	Average Rate Assumption Method
ARM	Alliance for Retail Markets
ASC	Accounting Standards Codification
ASR	Alkali-Silica Reaction
BRP	Benefit Restoration Plan
BVPS	Book Value Per Share
Calpine	Calpine Corporation
CAPM	Capital Asset Pricing Model
CCN	Certificate of Convenience and Necessity
CenterPoint or CEHE	CenterPoint Energy Houston Electric, LLC
CERC	CenterPoint Energy Resources Corp.
C.F.R.	Code of Federal Regulations
CNP	CenterPoint Energy, Inc.
COH	City of Houston and Houston Coalition of Cities
CoL	Conclusion of Law
Commission	Public Utility Commission of Texas
CWIP	Construction Work in Progress
DCF	Discounted Cash Flow
DCRF	Distribution Cost Recovery Factor
DPS	Dividends Per Share
DSP	Distribution Service Provider
EBITDA	Earnings before Interest, Taxes, Depreciation, and Amortization
ECAPM	Empirical Form of the Capital Asset Pricing Model
EDIT	Excess Deferred Income Taxes
EECRF	Energy Efficiency Cost Recovery Factor
EEP	Energy Efficiency Plan
Enel X	Enel X North America, Inc.
EMR	Earnings Monitoring Report
EOP	Emergency Operations Plan
EPS	Earnings Per Share
ERCOT	Electric Reliability Council of Texas
ERISA	Employee Retirement Income Security Act

TERM	DEFINITION
ETI	Entergy Texas, Inc.
FASB	Financial Accounting Standards Board
FED	Federal Reserve System
FERC	Federal Energy Regulatory Commission
FICA	Federal Insurance Contributions Act
FIT	Federal Income Tax
Fitch	Fitch Ratings
FoF	Finding of Fact
FOMC	Federal Open Market Committee
GAAP	Generally Accepted Accounting Principles
GCCC	Gulf Coast Coalition of Cities
GDP	Gross Domestic Product
GPMG	Generation Park Management District
HEB	HEB LP
IDR	Interval Data Recorder
IRC	Internal Revenue Code
JDOA	Joint Development and Operating Agreement
kV	Kilovolt
kW	Kilowatt
kWh	Kilowatt-hour
Lidar	Light Detection and Ranging
LTI	Long-Term Incentive
McCord	McCord Development Inc.
Moody's	Moody's Investors Service
MW	Megawatt
MRP	Market Risk Premium
NARUC	National Association of Regulatory Commissioners
NESC	National Electrical Safety Code
NCP	Non-Coincident Peak
NERC	North American Electric Reliability
O&M	Operations and Maintenance
Olin	Olin Corporation
Oncor	Oncor Electric Delivery Company
OP	Ordering Paragraph
OPEB	Other Post-Employment Benefits
OPUC	Office of Public Utility Counsel
PFD	Proposal for Decision
PHFU	Plant Held for Future Use
PO	Preliminary Order
PPA	Prepaid Pension Asset
PUC	Public Utility Commission of Texas
PURA	Public Utility Regulatory Act
REP	Retail Electric Provider
RFI	Request for Information

TERM	DEFINITION
RFP	Rate Filing Package
ROE	Return on Equity
ROR	Rate of Return
S&P	Standard & Poors
SAIDI	System Average Interruption Duration Index
SAIFI	System Average Interruption Frequency Index
SCADA	Supervisory Control and Data Acquisition
SEC	U.S. Securities and Exchange Commission
SEIA	Solar Energy Industries Association
SERP	Supplemental Executive Retirement Plan
Service Company	CenterPoint Energy Service Company, LLC
SFAS	Statement of Financial Accounting Standards
SMT	Smart Meter Texas
SOAH	State Office of Administrative Hearings
SPS	Southwestern Public Service Company
Staff	Staff of the Public Utility Commission of Texas
STI	Short-Term Incentive
SWEPCO	Southwestern Electric Power Company
T&D	Transmission and Distribution
TAC	Texas Administrative Code
TCJA	Tax Cuts and Jobs Act
TCOS	Transmission Cost of Service
TCPA	Texas Competitive Power Advocates
TCRF	Transmission Cost Recovery Factor
TCUC	Texas Coast Utilities Coalition
TDU	Transmission and Distribution Utility
TEAM	Texas Energy Association for Marketers
TIEC	Texas Industrial Energy Consumers
TMT	Texas Margin Tax
TNMP	Texas New-Mexico Power Company
TSP	Transmission Service Provider
UEDIT	Unprotected Excess Deferred Income Tax
URD CLEP	Underground Residential Distribution Cable Assessment and Life Extension Program
USOA	Uniform System of Accounts
Value Line	Value Line Investment Survey
Vectren	Vectren Corporation
Walmart	Walmart Inc.
WP	Workpaper

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

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

PROPOSAL FOR DECISION

I. INTRODUCTION [PO Issues 1, 2, 3]

On April 5, 2019, CenterPoint Energy Houston Electric, LLC (CenterPoint) filed an application with the Public Utility Commission of Texas (Commission), requesting authority to change rates. CenterPoint is an investor-owned electric utility within the Electric Reliability of Texas (ERCOT) system. CenterPoint's transmission and distribution (T&D) system serves approximately 2.5 million customers over a roughly 5,000 square-mile area located in and around Houston. CenterPoint is an indirect, wholly-owned subsidiary of CenterPoint Energy, Inc. (CNP).

CenterPoint's last base rate case used a 12-month test year that ended December 31, 2009. CenterPoint's application in this base rate case uses a 12-month test year that ended December 31, 2018.

In this case, CenterPoint's requests include: (1) a prudence determination on all capital investments it made between January 1, 2010, and December 31, 2018; and (2) establishment of a new rider, Rider UEDIT, to refund to its customers unprotected excess deferred income taxes (UEDIT) resulting from the federal Tax Cuts and Jobs Act of 2017 (TCJA). Under its errata filing, CenterPoint requests to return approximately $119 million to customers, over a three-year period, through Rider UEDIT.

CenterPoint initially sought to increase its T&D revenues by approximately $161 million, inclusive of Rider UEDIT. This proposed increase comprised: (1) a net annual increase in retail

T&D rates of approximately $154.2 million over adjusted test-year revenues; and (2) an annual increase of approximately $6.8 million for wholesale transmission service.

Through its errata filing, CenterPoint requests to increase its T&D revenues by $154.6 million, inclusive of Rider UEDIT. This proposed increase comprises: (1) a net annual increase in retail T&D rates of approximately $149.2 million over adjusted test-year revenues; and (2) an annual increase of approximately $5.4 million for wholesale transmission service.

In contrast, Commission staff (Staff) and a number of intervenors request an overall rate decrease.[1] For example, Staff recommends reducing CenterPoint's overall revenues by approximately $11.1 million.[2] The municipal intervenors—City of Houston/Houston Coalition of Cities (collectively, COH), Gulf Coast Coalition of Cities (GCCC), and Texas Coast Utilities Coalition (TCUC)—recommend a base rate decrease of $130 million.[3] The Office of Public Utility Counsel (OPUC) recommends a total revenue requirement reduction of $184.9 million.[4] If the Commission disallows amounts that CenterPoint has collected from customers through its transmission cost recovery factor (TCRF) or distribution cost recovery factor (DCRF), the intervenors and Staff ask that CenterPoint also be ordered to make refunds.

A. Executive Summary

Regarding the issues in this case, except where the proposal for decision (PFD) states otherwise or to recognize flow-through impacts of the ALJs' recommendations on the issues, the Administrative Law Judges (ALJs) find that CenterPoint met its burden of proof as to its proposals (as revised by its errata or rebuttal case). In general, the PFD does not discuss uncontested issues,

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[1] The numbers included in this introduction are *not* directly comparable, for reasons detailed in the testimony. They are included here only to provide a general idea of the magnitude of the differences in the parties' positions regarding CenterPoint's proposed rate increase.

[2] Staff Ex. 2A at 51-52.

[3] *See, e.g.*, COH's Initial Brief at 7.

[4] OPUC Ex. 1 at 51.

which are incorporated in the PFD's Findings of Fact, Conclusions of Law, and Ordering Paragraphs. As detailed on the schedules attached as PFD Appendix B, the ALJs recommend an overall revenue increase of $2,644,193, or 0.11%, over the PFD-adopted present base revenues.[5]

This case involves a vast number of disputed issues. The ALJs' recommendations on some of the most significant are summarized below.

Rate Base

- The ALJs recommend disallowing T&D capital investments during 2010 through 2018 that, under applicable legal standards, CenterPoint did not prove were prudent. The largest such disallowances recommended by the ALJs are: 10% of the $54 million cost of the Underground Residential Distribution Cable Assessment and Life Extension Program (URD CLEP); 35% of the $57.5 million cost of the Major Underground Rehabilitation Program; and $1.1 million of the cost of the LaMarque Substation Project.

- The ALJs recommend disallowing from distribution invested capital $6.8 million for land not used and useful in rendering service to the public.

- The ALJs recommend disallowing $2.1 million for tools purchased for a substation, and $19.4 million for a distribution line clearance project, which CenterPoint did not prove should be capitalized instead of expensed. These costs were incurred before the test year began.

- The ALJs recommend disallowing $51.4 million of past capitalization for items that CenterPoint began capitalizing at various points since its last rate case but that were expensed in its last rate case.

- The ALJs recommend rejecting CenterPoint's request to include a $103.4 million prepaid pension asset in rate base.

- The ALJs recommend including in rate base and amortizing over three years the following regulatory assets: Hurricane Harvey, $64.3 million; Medicare Part D subsidy, $5.6 million; Smart Meter Texas (SMT), $6.9 million; retail electric

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[5] For readability, the PFD rounds up or down many numbers, and some may not reflect flow-through impacts of the ALJs' recommendations on other issues. The numerical effect of the ALJs' recommendations is shown in PFD Appendix B.

provider (REP) bad debt, $0.5 million; Benefit Restoration Plan (BRP), $6.9 million; and all regulatory assets that were not contested. The ALJs recommend rejecting CenterPoint's request for a Texas Margin Tax (TMT) regulatory asset.

- The ALJs recommend disallowing 92% of CenterPoint's requested capitalized incentive compensation.

Rate of Return:

- The ALJs recommend a return on equity (ROE) of 9.42%, which includes a three basis point reduction regarding the service quality complaint by H-E-B, LP (HEB); a cost of debt of 4.38%; a capital structure comprised of 55% long-term debt and 45% equity; and an overall rate of return of 6.65%.

Financial Integrity (Ring-Fencing Protections)

- The ALJs conclude that: (1) the Commission has authority to order CenterPoint to employ the ring-fencing measures recommended in the PFD; and (2) the evidence supports ordering most of the ring-fencing measures proposed by Staff and Texas Industrial Energy Consumers (TIEC).

Operations and Maintenance (O&M) Expenses

- The ALJs recommend rejecting COH's proposed disallowances to CenterPoint's total O&M expense and total T&D O&M.

- The ALJs recommend: (1) disallowing 92% of CenterPoint's total requested short-term incentive (STI) compensation expense; and (2) disallowing the $7.5 million portion of long-term incentive (LTI) costs tied to performance shares and approving the $3.8 million portion tied to restricted stock units.

- The ALJs recommend rejecting CenterPoint's requests to include non-deductible salaries in O&M. CenterPoint's primary request was for $1.1 million.

- The ALJs recommend disallowing $1.65 million from CenterPoint's total requested base pay to reflect 32 employee positions terminated due to CNP's acquisition of Vectren Corporation (Vectren). The ALJs recommend approving CenterPoint's annualization of payroll (minus the 32 terminated employee positions) and the 2019 Competitive Pay Adjustments awarded to its employees.

- The ALJs recommend use of CenterPoint's depreciation study results.

- The ALJs recommend rejecting CenterPoint's proposal to increase test year affiliate expense by $1.5 million related to the Vectren acquisition. The ALJs recommend disallowing affiliate carrying charges totaling $4.9 million. With those exceptions, the ALJs recommend approving CenterPoint's request relating to affiliate expense.

- The ALJs recommend disallowing $2.3 million from CenterPoint's requested amount for injuries and damages.

- The ALJs recommend disallowing $8.7 million from CenterPoint's requested amount for Hurricane Harvey restoration costs.

- The ALJs recommend SMT expense of $3.23 million.

Billing Determinants

- The ALJs recommend approving CenterPoint witness Stuart McMenamin's weather adjustment as applied to his alternative 10-year normal weather period.

- The ALJs recommend rejecting CenterPoint's request to adjust test year billing determinants based on estimated energy efficiency savings resulting from the energy efficiency programs implemented throughout the test year.

Functionalization

- The ALJs recommend functionalizing the TMT expense as 14.8% to the Transmission Service Function and 85.2% to the Distribution Service Function.

- The ALJs recommend approving Staff's proposed functionalization for the requested $146.2 million of miscellaneous general expense in Federal Energy Regulatory Commission (FERC) Account 930.2.

- The ALJs recommend functionalizing the UEDIT balance to return to customers through riders as follows: 24.5% to wholesale transmission customers and 75.5% to retail customers.

- The ALJs recommend approving CenterPoint's amended proposal to assign the costs in FERC Accounts 586 and 597 to the Meter Function.

Class Allocation

- The ALJs recommend approving: (1) the ERCOT four-month coincident-peak (4CP) method to allocate transmission costs among CenterPoint's retail customers; (2) CenterPoint's proposed allocation of Municipal Franchise Fees; (3) CenterPoint's proposed allocation method for the expenses incurred by the Transmission Accounts and Support Group in the Transmission Key Accounts Department; and (4) CenterPoint's proposed allocation method for FERC Account 907-10.

Revenue Distribution and Rate Design

- The ALJs recommend approving CenterPoint's proposed increase to the Residential Customer Charge. The ALJs recommend rejecting CenterPoint's proposal to assess the Customer charge and the Meter charge on a per-meter rather than a per-customer basis.

Rider UEDIT

- The ALJs recommend approving Rider UEDIT as a mechanism to return the UEDIT allocated to retail delivery.

- The ALJs recommend approving TIEC's proposed: (1) two-year period to return UEDIT; and (2) one-year period to return protected excess deferred income taxes (EDIT) already amortized from its protected EDIT balance under the Average Rate Assumption Method (ARAM), which CenterPoint included with UEDIT to be returned to retail customers through Rider UEDIT. The ALJs recommend: (1) using those same recovery periods for the portion of these amounts allocated to wholesale transmission; and (2) returning that portion to wholesale transmission customers through an additional, separate rider.

- GCCC requested a refund through Rider UEDIT of an additional $158 million in EDIT that CenterPoint took to income in December 2017 in response to enactment of the TCJA. The ALJs find that issue warrants further review and recommend initiating a separate proceeding to address it more fully.

Other Riders

- The ALJs recommend rejecting GCCC's proposals regarding a Merger Savings Rider (as well as GCCC's alternative proposal to treat merger savings as a known and measurable adjustment to the test year).

Baselines for Cost-Recovery Factors

- The ALJs recommend approving CenterPoint's proposal: (1) to recover its wholesale transmission expenses from customers in base rates through the Transmission charge for each delivery rate schedule; and (2) to zero out its existing TCRF. The ALJs recommend using the ERCOT 4CP method for the TCRF allocation factors.

B. Jurisdiction and Notice

These issues are uncontested and are addressed in the PFD's Findings of Fact and Conclusions of Law.

C. Procedural History

The procedural history is addressed in the PFD's findings of fact and conclusions of law and summarized below.

On April 5, 2019, CenterPoint filed its application with the Commission and each municipality in CenterPoint's service territory that has not ceded to the Commission the municipality's original jurisdiction as a local regulatory authority. CenterPoint appealed the municipalities' actions regarding its application, and the ALJs consolidated those appeals with this docket.

On April 8, 2019, the Commission referred this proceeding to the State Office of Administrative Hearings (SOAH). On May 9, 2019, the Commission issued its Preliminary Order, identifying issues to be addressed in this proceeding and issues not to be addressed.

The effective date of CenterPoint's proposed rate changes has been suspended. The suspension period ends October 12, 2019.

Intervenors in this case are: Alliance for Retail Markets (ARM); Calpine Corporation (Calpine); COH; Enel X North America, Inc. (Enel X); GCCC; Generation Park Management District (GPMD); HEB; McCord Development Inc. (McCord); OPUC; Solar Energy Industries Association (SEIA); TCUC; Texas Competitive Power Advocates (TCPA); Texas Energy Association for Marketers (TEAM); TIEC; and Walmart Inc. (Walmart). Staff also participated as a party.

On June 4, 2019, SOAH granted CenterPoint's unopposed motion and severed the issue of rate case expenses incurred in this and certain previous proceedings for consideration in a separate docket.

The hearing on the merits was convened on June 24, 2019, and adjourned on June 28, 2019.[6] On July 16, 2019, the parties filed reply briefs and the record closed.

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[6] SOAH ALJs Steven Arnold, Meaghan Bailey, and Fernando Rodriguez presided at the hearing. Judge Rodriguez retired shortly after the hearing ended. The parties were notified at the June 24, 2019 prehearing conference that SOAH ALJ Elizabeth Drews, although unable to attend the hearing, would participate in drafting the PFD. Regarding the issues she wrote in the PFD, Judge Drews has read the record in compliance with Texas Government Code § 2001.062(c) and 1 Texas Administrative Code (TAC) § 155.151(b)-(c).

II. RATE BASE [PO Issues 4, 5, 10, 11, 12, 13, 15, 16, 17, 18, 19, 59]

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

The test year used in this case is calendar year 2018. The test year used in CenterPoint's last base rate case, Docket No. 38339, was calendar year 2009.[7] CenterPoint requests inclusion in rate base of $3.036 billion of transmission plant additions and $2.345 billion of distribution plant additions made to its system during calendar years 2010 through 2018.[8] Most of these investments were not challenged. The disputes relate to whether certain investments were prudent or not used and useful. Other contested issues are whether some costs should have been expensed instead of capitalized, or should be included in rate base because of a change in capitalization policy since Docket No. 38339, even if the inclusion would over-recover costs expensed, not capitalized, in that docket.

Under its DCRF rule, 16 Texas Administrative Code (TAC) § 25.243, if the Commission determines CenterPoint recovered investments through the DCRF in violation of that rule, CenterPoint shall refund all revenues related to the investments and pay its customers carrying charges on the revenues.[9] Staff witness Brian Murphy recommended that if the Commission makes any plant disallowances, it determine the exact refund forms and amounts in a separate compliance proceeding.[10] The ALJs agree. Because the ALJs recommend some disallowances, the PFD includes a proposed ordering paragraph for initiating the compliance proceeding.

Applicable legal standards and specific T&D capital projects in dispute are discussed below.

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[7] In Application of CenterPoint Electric Delivery Company, LLC for Authority to Change Rates, Docket No. 38339, Order on Rehearing (Jun. 23, 2011)(Docket No. 38339 order).

[8] CenterPoint Ex. 7 at 184; CenterPoint Ex. 8 at 343.

[9] 16 TAC § 25.243(f). Subsection (f) also sets out the methodology for determining the carrying charges.

[10] Staff Ex. 2A at 74.

1. Prudence Issues

a. Burden of Proof, Used-and-Useful Requirement, and Prudence Standard

PURA provides that "[i]n a proceeding involving a proposed rate change, the electric utility has the burden of proving that... the rate change is just and reasonable."[11] Regarding T&D plant in service, as well as other rate case issues, the utility has the burden of proof, including the burden of persuasion, which never shifts.[12] The utility bears the burden to prove each dollar of cost was reasonably and prudently invested, and enjoys no presumption that the costs reflected in its books were prudently incurred by simply opening its books to inspection.[13] The 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."[14] If the utility's direct case makes a prima facie showing, the burden of production (also known as the burden of going forward with the evidence) shifts to other parties.[15]

To be included in rate base as plant in service, a utility's invested capital must also be used and useful in providing service to the public.[16]

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[11] Public Utility Regulatory Act (PURA), Tex. Util. Code § 36.006.

[12] *Entergy Gulf States, Inc. v. Pub. Util. Comm'n*, 112 S.W.3d 208, 214-15 (Tex. App.—Austin 2003, pet. denied). *See also Dispute between the US Department of Energy and Southwestern Public Service Company Concerning the Pantex Facility and Pantex Wind Farm (Severed from Docket 47527)*, PUC Docket No. 48440, SOAH Docket No. 473-18-4107, Order (Dec. 10, 2018) at FoF No. 9, Conclusion of Law (CoL) Nos. 6, 8, and PFD (Oct. 10, 2018) at 5.

[13] *Entergy Gulf States*, 112 S.W.3d at 214, citing *Public Util. Comm'n v. Houston Lighting & Power Co.*, 778 S.W.2d 195, 198 (Tex.App.—Austin 1989, no writ). *See also Gulf States Utils. Co. v. Pub. Util. Comm'n*, 841 S.W.2d 459, 475 (Tex. App—Austin 1992, writ denied); PURA §§ 36.051, .057(a); 16 TAC § 25.231(b).

[14] *Entergy Tex., Inc. v. Pub. Util. Comm'n*, 490 S.W.3d 224, 240 (Tex. App.—Austin 2014, pet. denied); *see also Entergy Gulf States*, 112 S.W.3d at 214.

[15] *Entergy Texas*, 490 S.W.3d at 240; *Entergy Gulf States*, 112 S.W.3d at 214-15. *See also Complaint of McCord Development, Inc. Against CenterPoint Energy Houston Electric, LLC*, SOAH Docket No. 473-19-0578, PUC Docket No. 48583, SOAH Order No. 4 (May 3, 2019) (discussing generally burden of proof, burden of persuasion, and burden of production); 1 TAC § 155.427.

[16] PURA § 36.051; 16 TAC § 25.231(c)(2).

In addition, the costs must be prudently incurred. The legal standard for determining prudence is well established:

> Prudence is 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.[17]

"The 'prudence' standard explicitly incorporates a utility's reasonableness and, by speaking in terms of available alternatives, implicitly recognizes that an expense must be necessary."[18] "What is prudent, reasonable, and necessary depends on circumstances. The prudence standard does not require perfection."[19]

> There may be more than one prudent option within the range available to a utility in a given context. Any choice within the select range of reasonable options is prudent, and the Commission should not substitute its judgment for that of the utility. The reasonableness of an action or decision must be judged in light of the circumstances, information, and available options existing at the time, without benefit of hindsight.[20]

The Commission and the Austin court of appeals in *Gulf States* have also addressed how a utility may make the required showing of prudence:

> A utility may demonstrate the prudence of its decision-making through contemporaneous evidence. Alternatively, the utility may obtain an independent, retrospective analysis that demonstrates that a reasonable utility manager, having investigated all relevant factors and alternatives, as they existed at the time the

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[17] *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449, Order on Rehearing (Mar. 19, 2018)(Docket No. 46449 order) at CoL No. 15, citing *Gulf States*, 841 S.W.2d at 475.

[18] *Nucor Steel v. Pub. Util. Comm'n*, 26 S.W.3d 742, 748 (Tex. App.—Austin 2000, pet. denied).

[19] *Nucor*, 26 S.W.3d at 749.

[20] Docket No. 46449, order at CoL No. 16, citing *Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at 5 (Mar. 6, 2014)(Docket No. 40443 order), citing *Nucor,* 26 S.W.3d at 752.

> decision was made, would have found the utility's actual decision to be a reasonably prudent course.[21]

"[A]n attempt to demonstrate prudent decision-making by retrospective analysis is inherently defensive and hence more suspect."[22] If the utility does not produce contemporaneous evidence to support its decision-making, the lack of documentation impedes the Commission's ability to determine whether the utility conducted a reasoned investigation of all relevant factors and alternatives before reaching its decision.[23]

b. Underground Residential Distribution Cable Assessment and Life Extension Program and Major Underground Rehabilitation Program

Arguing CenterPoint did not meet its burden of proof on prudence, COH witness Scott Norwood recommended disallowance of the entire cost ($111.5 million) of two programs to support the condition or reliability of CenterPoint's underground facilities:

- URD CLEP (Project No. ABCA) ($54 million); and
- Major Underground Rehabilitation Program (Project No. CE1B) ($57.5 million).[24]

Because, in this proceeding, CenterPoint failed to meet its burden to prove the prudence of the entire cost of the programs, the ALJs recommend a 10% disallowance for the URD CLEP ($5.4 million) and a 35% disallowance for the Major Underground Rehabilitation Program ($20.1 million).

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[21] Docket No. 46449, order at CoL No. 17, citing *Gulf States*, 841 S.W.2d at 476.

[22] *Gulf States*, 841 S.W.2d at 476.

[23] *Gulf States*, 841 S.W.2d at 476.

[24] COH Ex. 1 at 16-18, Exh. SN-8 (CenterPoint response to COH Request for Information (RFI) 13-2, Att. 1).

i. COH's Bases for Its Proposed Disallowances, in General

From 2010 through 2018, the Major Underground Rehabilitation Program and the URD CLEP were CenterPoint's sixth and seventh most expensive distribution projects.[25] Mr. Norwood characterized the information CenterPoint provided to support the prudence of these programs as superficial and deficient. He opined that CenterPoint provided only short direct testimony that did not address the programs' prudence in any detail, and in discovery provided only summary results of analyses developed with CenterPoint's Asset Investment Strategy (AIS) software.[26]

Mr. Norwood noted the AIS software ranks capital investment projects based on a value-to-cost ratio, with value determined based on estimates of four benefits—load at risk (the primary benefit), reliability, design criteria, and supplemental. In discovery, CenterPoint indicated that none of these benefits represents expected monetary benefit to its customers.[27] Mr. Norwood stated that the AIS software results do not measure whether any investment will be economically beneficial to customers, unlike cost-benefit analysis techniques the Commission has traditionally relied on in determining whether major utility investments were prudent. He concluded it was unreasonable for CenterPoint to rely on the AIS software results as a primary indicator of the prudence of capital projects under review in this case.[28]

In addition, Mr. Norwood observed that the AIS software results CenterPoint provided rendered value-to-cost ratios of 0.02 for the URD CLEP and 0.04 for the Major Underground Rehabilitation Program. He stated that those results show very little load-at-risk benefit for the cost invested and do not demonstrate prudence of the projects.[29]

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[25] COH Ex. 1, Exh. SN-8 (CenterPoint response to COH RFI 13-02, Att. 1); Tr. at 195, 1108-09.

[26] COH Ex. 1 at 14, 17, citing direct testimony of Randal M. Pryor (CenterPoint Ex. 7 at 183-90, 202-03), Julienne P. Sugarek (CenterPoint Ex. 10 at 670-76), and Martin W. Narendorf, Jr. (CenterPoint Ex. 8 at 343).

[27] COH Ex. 1 at 14-15, Exh. SN-6 (CenterPoint response to COH RFI 13-6), Exh. SN-7 (CenterPoint response to COH RFIs 13-1, 13-3, 13-4).

[28] COH Ex. 1 at 15.

[29] COH Ex. 1 at 17, Exh. SN-9 (excerpts of CenterPoint response to COH RFI 1-22).

Mr. Norwood testified that CenterPoint's System Average Interruption Duration Index (SAIDI) (excluding scheduled outages and major events) has averaged 119 minutes per year over the last three years, which translates to very good average customer service reliability of 99.98%. He also cited CenterPoint discovery responses stating that underground cable failures contributed only about five minutes per year to its SAIDI from 2010 through 2018 and that there is no direct correlation between the capital dollars spent on the programs and impact on its SAIDI. Under these circumstances, Mr. Norwood found it questionable whether customers would even notice the reliability effects of the URD CLEP and the Major Underground Rehabilitation Program.[30]

Citing testimony by CenterPoint witnesses, COH argues CenterPoint did not prove its large expenditures on the URD CLEP and the Major Underground Rehabilitation Program were justified either to address load growth or to improve reliability. For example, Ms. Bodden testified that CenterPoint's load growth averaged only 1% from 2009 to 2018.[31] She stated that CenterPoint's SAIDI as a whole, from 2008 to 2014, averaged less than 100 minutes per year—below the Commission standard.[32] Julienne P. Sugarek agreed that CenterPoint's average customer service reliability over the last three years was 99.98%, its SAIDI performance was better than the Commission standard for eight of the last ten years, and CenterPoint consistently received the lowest annual penalties among major ERCOT utilities.[33] Randal M. Pryor testified that CenterPoint's underground cable infrastructure has fewer outages than its overhead distribution circuits.[34] Martin W. Narendorf, Jr., stated that underground assets are well protected from external elements and can maintain cooler temperatures, which helps extend the useful life of the cable.[35]

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[30] COH Ex. 1 at 9, 16-17, Exh. SN-10 (CenterPoint response to COH RFI 10-23), Exh. SN-11 (CenterPoint response to COH RFI 10-27).

[31] Tr. at 212.

[32] Tr. at 214-16.

[33] Tr. at 1247-49.

[34] Tr. at 1115-16.

[35] CenterPoint Ex. 32 at 9.

In rebuttal testimony, Mr. Narendorf stated that the URD CLEP and the Major Underground Rehabilitation Program have a positive and direct reliability impact. He indicated the impact cannot be directly calculated because the programs are proactive: they resolve problems before they occur.[36]

The ALJs' recommended disallowances for the URD CLEP and Major Underground Rehabilitation Program are based on the evidence discussed above and in sections that follow. Here, the ALJs find the programs have reliability benefits. CenterPoint's underground infrastructure is more reliable than its overhead facilities, but both wear out. Identifying underground equipment that has failed or is likely to fail soon is costlier and more time-consuming than for overhead facilities. Unplanned service outages can cause customers and the public significant harm, which increases with the length of the outage. For those reasons, addressing reliability risks proactively is more important for underground facilities than for overhead facilities. CenterPoint's commendable level of reliability may suggest the URD CLEP and Major Underground Rehabilitation Program are excessive, as COH contends, or that they are working, as CenterPoint contends. Because these reliability programs are proactive, their benefits, while real, may be difficult to quantify. CenterPoint's burden of proof, however, includes demonstrating the programs' high costs are necessary. The URD CLEP and Major Underground Rehabilitation Program are among CenterPoint's most expensive distribution projects. As discussed below, CenterPoint's evidence does not: (1) explain in any detail why the costs are so high or why such high costs are cost-beneficial; or (2) provide contemporaneous documentation or otherwise show what options CenterPoint considered and why it was prudent to use these programs (including details thereof) instead of other options during the time periods at issue.

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[36] CenterPoint Ex. 32 at 12-13.

ii. Timing of CenterPoint's Production of Information to Support the Prudence of the Programs, in General

COH complains that CenterPoint waited until rebuttal to support the prudence of these two major programs, presenting information that was not contained in CenterPoint's direct testimony on those matters and that COH specifically requested, but CenterPoint did not supply, in discovery. The ALJs find COH's complaint to be valid regarding the Major Underground Rehabilitation Program, and much less so regarding the URD CLEP. As discussed below, for the URD CLEP, CenterPoint provided significant information in its direct case supporting the prudence of the program, which it identified in response to a COH request for information (RFI) asking which parts of its direct case provide such support. In contrast, CenterPoint provided no such information concerning the Major Underground Rehabilitation Program either in its direct case or in response to another COH RFI specifically requesting that information.

Mr. Norwood's direct testimony discusses and attaches part of CenterPoint's response to COH RFI 1-22. That RFI asked CenterPoint to "*[p]rovide cost/benefit analysis and other information supporting the prudence* of each [CenterPoint] distribution capital project having a total cost of more than $5 million that was placed in service since 2009."[37] As indicated above, the URD CLEP and the Major Underground Rehabilitation Program each had a total cost since 2009 that was more than ten times the RFI's $5 million threshold. As Mr. Norwood discussed in his direct testimony, CenterPoint's response to this RFI provided its AIS software results.[38] In his rebuttal testimony, Mr. Narendorf nevertheless faulted Mr. Norwood for assuming the AIS software results CenterPoint provided were supplied to support the prudence of the programs:

> Mr. Norwood's conclusion incorrectly assumes that CenterPoint Houston relies on its AIS tool to evaluate the prudence of undertaking a capital project. This is incorrect.... [T]he AIS tool should not be misconstrued as a tool utilized by [CenterPoint] to justify capital investments.... AIS is a tool that is simply used in the optimization of [CenterPoint's] annual capital portfolio. All of the capital

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[37] COH Ex. 10 (CenterPoint response to COH RFI 1-22) (emphasis added).

[38] COH Ex. 1 at 17, 42-44, Exh. SN-9.

> projects entered into the AIS tool are developed, analyzed, and justified apart from the AIS process.[39]

Other evidence about the timing of CenterPoint's production of information to support the prudence of the URD CLEP and the Major Underground Rehabilitation Program is addressed below, along with the ALJs' prudence analysis for each program.

iii. URD CLEP

COH RFI 15-2 asked CenterPoint to "identify the *specific portions of [CenterPoint's] testimony, exhibits, and workpapers supporting the prudence* of costs incurred" for certain projects, including the two programs at issue.[40] Regarding the URD CLEP, CenterPoint's RFI response listed certain pages in the direct testimony of Mr. Pryor and Ms. Sugarek.[41] Regarding the URD CLEP, those pages of Ms. Sugarek's testimony simply refer to Mr. Pryor's testimony.

In the pages of Mr. Pryor's direct testimony listed in the RFI response, he provided general information about CenterPoint's distribution capital investments from 2010 through 2018 and made a conclusory statement they were all prudently incurred. More specific to the URD CLEP, his direct testimony provides the following information:

- Underground rehabilitation costs are primarily caused by the aging of the underground distribution system. Past loop failures indicate that URD loops over 35 years old have the highest probability of failure within CenterPoint's distribution system, and as underground cable approaches and exceeds 30 years of age, it is more likely to fail. When failure occurs, it typically requires replacement of one span of cable isolated between transformers.

[39] CenterPoint Ex. 32 at 5-6

[40] COH Ex. 33 (CenterPoint response to COH RFI 15-02 (emphasis added)).

[41] COH Ex. 33, referencing direct testimony of Mr. Pryor (CenterPoint Ex. 7 at 15-22, 34-35 (Bates 183-90, 202-03)) and Ms Sugarek (CenterPoint Ex. 10 at 9-15 (Bates 670-76)).

- CenterPoint facilities installed during the economic boom of the late 1970s and early 1980s are aging, especially in residential areas served by URD facilities. CenterPoint has more than 18,000 URD loops, comprising more than 13,000 miles of cable and associated distribution equipment. Currently, 27% of these loops have cables that are at least 35 years old, which cause 44% of system outages.

- During 2010 through 2018, CenterPoint replaced approximately 1,300 URD cables to maintain service.

- Historically, CenterPoint replaced an average of 35 URD loops annually, based on the loop's age, the loop's reliability performance, and whether it was served by large step-down transformers. At that rate, it would take more than 100 years to replace these loops, while the rest of the URD system continues to grow and age.

- To address this issue before it could become a major threat to reliability, CenterPoint began its URD CLEP program in 2013. Using IMCORP's Factory Grade® cable assessment technology, this proactive approach brought positive results:

    - CenterPoint was able to assess and extend the life of more than ten times as many loops as it had been replacing annually, while significantly reducing costs and improving system reliability.

    - IMCORP provides a 15-year guarantee on all assessed loops. Once spans have been assessed and the appropriate corrective actions have been completed, all spans within the entire loop are guaranteed to perform to the original manufacturer's standards.

    - These corrective actions are expected to extend the useful life of the cable system by eradicating or replacing spans that are near or at imminent risk of failure.

    - As a result of the URD CLEP, CenterPoint is systematically reducing the backlog of aging 35-year cable and related systems.

    - The URD CLEP program proactively identifies potential failures in aged underground cable and other URD components that do not meet specifications before they can occur. This allows CenterPoint to make prudent investments in its URD infrastructure and prevent future outages where they are most likely.[42]

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[42] CenterPoint Ex. 7 at 183-90, 203-04.

Applying the law on burden of proof and prudence previously discussed, the ALJs find that the pages of Mr. Pryor's direct testimony listed in CenterPoint's response to COH RFI 15-2, summarized above, provide significant evidence to support the prudence of the URD CLEP. Those pages discuss what the problem is, why it is important, why CenterPoint is approaching it proactively, and in broad terms why the expenditures are high (the infrastructure is aged and the new program is resolving a backlog of work to be done). On the other hand, in response to COH RFI 1-22, which specifically requested information supporting the program's prudence, CenterPoint provided the AIS software results, which COH and CenterPoint agree are not appropriate for that purpose. That RFI response, the pages of Mr. Pryor's testimony listed in the RFI response, and Mr. Narendorf's rebuttal testimony do not prove the prudence of the URD CLEP's entire cost. For example, they do not provide contemporaneous documentation or otherwise explain what options CenterPoint considered and why it was prudent to use the URD CLEP (including details of that program) instead of other options during the time period at issue. Based on the evidence, the ALJs do not recommend either allowing the program's entire cost (CenterPoint's position) or disallowing all of it (COH's position). Finding CenterPoint proved the program is important and beneficial but failed to prove the prudence of its entire cost in this proceeding, the ALJs recommend a 10% prudence disallowance.

iv. Major Underground Rehabilitation Program

In his rebuttal testimony, Mr. Narendorf disputed Mr. Norwood's opinion that CenterPoint had not provided enough documentation to justify the cost of the Major Underground Rehabilitation Program. Mr. Narendorf indicated the cost is supported by CenterPoint's books and records and capital project reports included in its rate filing package (RFP) in Workpaper (WP) RMP-2. Regarding CenterPoint's books and records, the ALJs note there is no presumption that costs reflected therein were prudently incurred simply because the books are open to inspection.[43] Moreover, COH RFI 15-2 asked CenterPoint to identify the "specific portions of [CenterPoint's] testimony, exhibits, and workpapers supporting the prudence of costs incurred" for the Major

[43] *Entergy Gulf States* 112 S.W.3d at 214.

Underground Rehabilitation Program. Regarding that program, CenterPoint's response to the RFI did not mention WP RMP-2 and listed only one document—a single page of Mr. Narendorf's direct testimony. That page does not mention the program.[44] Mr. Norwood reasonably concluded he was unable to affirmatively determine that the program's costs were reasonable, necessary and cost-beneficial to customers.[45]

In rebuttal testimony, Mr. Narendorf stated that if Mr. Norwood wanted more information about the Major Underground Rehabilitation Program, he could have requested it in discovery. Mr. Narendorf then testified CenterPoint did not receive a single RFI in this case seeking information about the program.[46] That testimony is inaccurate. Again, COH RFI 1-22 asked CenterPoint to "[p]rovide cost/benefit analysis and other information supporting the prudence of each [CenterPoint] distribution capital project having a total cost of more than $5 million that was placed in service since 2009." The cost of the Major Underground Rehabilitation Program was more than ten times the RFI's threshold. Mr. Narendorf was a sponsor of the RFI response.[47] In the RFI response, CenterPoint provided its AIS analysis.[48] Understandably, Mr. Norwood's testimony discussed the AIS software results provided in the RFI response and concluded they do not demonstrate prudence regarding this program. In rebuttal testimony, Mr. Narendorf then criticized Mr. Norwood on the ground he "incorrectly assumes that CenterPoint Houston relies on its AIS tool to evaluate the prudence of undertaking a capital project. This is incorrect."[49]

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[44] COH Ex. 33 (CenterPoint response to COH RFI 15-02), referencing Mr. Narendorf's direct testimony (CenterPoint Ex. 8 at 15 (Bates 343)).

[45] COH Ex. 1 at 15-18.

[46] CenterPoint Ex. 32 at 8-9.

[47] COH Ex. 33 (CenterPoint response to COH RFI 15-02), referencing Mr. Narendorf's direct testimony (CenterPoint Ex. 8 at 15 (Bates 343)).

[48] COH Ex. 10 (CenterPoint response to COH RFI 1-22).

[49] CenterPoint Ex. 32 at 5-6.

In Mr. Narendorf's rebuttal testimony, CenterPoint finally provided information to support the prudence of the Major Underground Rehabilitation Program:

- It has been in place at CenterPoint for over 30 years.

- The major underground system serves most of the central business center in downtown Houston, the Texas Medical Center, Bush Intercontinental Airport, and many other important businesses and commercial customers that depend on a continuous supply of electricity. CenterPoint's proactive inspection and maintenance of the major underground facilities that serve these customers is vital to avoid unplanned outages to them. In addition, violent failures with environmental and safety repercussions are more likely if these assets are allowed to run to failure.

- Under the program, when underground cable or equipment fails, CenterPoint tests the other cable and equipment in the area. Customers served by major underground infrastructure have redundancy in their service and are switched to another feed when there is a fault. CenterPoint performs testing then, however, because a fault typically indicates the assets are beginning to fail. If testing indicates additional problems or causes additional failures, the cable and equipment are replaced.

- The program's proactive approach avoids lengthy outages. Underground cables and equipment cannot be visually inspected and restoring service to failed major underground cable and equipment requires significant effort. Crews may need many hours to identify the fault's exact location. They must then isolate that area from the rest of the cable system and restore service to customers outside the isolated fault area as quickly as possible. They must safely and efficiently make the repairs and clear the area. The isolated fault area must then be released, reenergized, and restored to normal operation, which may require additional outages to customers.[50]

COH responds that the fact the program relates to reliability of electric service to a hospital network or important businesses is not evidence that the program—which was not proven to increase reliability—is a prudent investment.

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[50] CenterPoint Ex. 32 at 9-12.

The ALJs find that CenterPoint did not present information demonstrating the prudence of the Major Underground Rehabilitation Program in its direct case or its response to COH RFI 1-22, which expressly requested such information. CenterPoint responded to that RFI on May 6, 2019, supplying the AIS software results, which COH and CenterPoint agree are not appropriate for that purpose. CenterPoint supplied considerable information to support the program's prudence only in Mr. Narendorf's rebuttal testimony, which was filed June 19, 2019, after the June 6, 2019 deadline for COH's direct testimony and five days before the hearing began.[51] The ALJs discount the weight of that information because CenterPoint's actions prevented it from being tested in the manner provided by law, including through testimony by COH's expert witness.[52] Even Mr. Narendorf's rebuttal testimony does not address the program's cost in detail, provide contemporaneous documentation, or otherwise identify what options CenterPoint considered and why it was prudent to use the program, including details of it, instead of other options during the time period in question. The ALJs do find credible Mr. Narendorf's rebuttal testimony that the Major Underground Rehabilitation Program has been in place for 30 years and provides important safety and reliability benefits. He discussed what the problem is, why it is important, and why CenterPoint is approaching it proactively. Based on the evidence, the ALJs do not recommend either allowing the program's entire cost (CenterPoint's position) or disallowing all of it (COH's position). Finding that CenterPoint demonstrated the program provides important safety and reliability benefits but fell far short of meeting its burden to prove the entire cost of the program was prudent, the ALJs recommend a 35% disallowance.

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[51] The ALJs take official notice of the Commission interchange showing filings in this case, available at http://interchange.puc.texas.gov/Search/Filings?UtilityType=A&ControlNumber=49421&ItemMatch=Equal&DocumentType=ALL&SortOrder=Ascending.

[52] *See, e.g.*, Tex. Gov't Code § 2001.051 ("[i]n a contested case, each party is entitled to an opportunity… to respond and to present evidence and argument on each issue involved in the case"). *See also* 16 TAC §§ 22.141 and 22.144, regarding the scope of discovery and parties' obligations when served with an RFI.

c. Foundation Replacements—Project HLP/00/0801

On prudence grounds, OPUC witness Karl Nalepa recommended disallowing from plant in service $1.2 million of costs to replace certain concrete foundations. He explained the costs were incurred because of apparent errors in laying the original foundation.[53] CenterPoint identifies the projects as "HLP/00/0801" and describes them as "Foundation replacements due to Alkali-Silica Reaction (ASR) in the foundation causing large cracks in the piers/foundations. The reaction cannot be stabilized and is not reversible."[54]

Mr. Narendorf responded that CenterPoint made no errors that caused the ASR issue. He explained ASR is a condition that occurs due to the concrete materials, not the method of installation. ASR occurs between the aggregate in concrete and the cement mix. Those components contain alkalis and silicas. Mixing them can cause a chemical reaction that results in silica gel forming within the concrete. The silica gel expands and contracts with wetting and drying cycles and can cause cracking within the concrete.[55]

Mr. Narendorf testified that in 2005 or 2006, when the cracking issues associated with ASR were first identified, CenterPoint proactively replaced foundations showing effects of ASR and changed the concrete specification to reduce the risk of an ASR occurring in newly poured concrete at its facilities. He indicated the simplest fix was to add fly ash from coal plants across the nation, but the fly ash supply is diminishing as those plants retire. There are now also chemical additives that can be added to the concrete mix to mitigate, but not eliminate, the potential risk of an ASR developing.[56]

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[53] OPUC Ex. 5 at 38.

[54] CenterPoint Ex. 7, WP RMP-2 at 281 (2015 Capital Project List at 8).

[55] CenterPoint Ex. 32 at 15; Tr. at 1177-80.

[56] CenterPoint Ex. 32 at 15-16; Tr. at 1179-80.

At the hearing, Mr. Narendorf testified that CenterPoint has been aware of the ASR issue since shortly after 2005, when some cracked foundations at one of its substations required CenterPoint to mitigate in order to continue operating safely and reliably at that substation. He stated that the ASR problem has been growing over time because the industry has used up the rock aggregate materials that have low alkaline contents.[57]

Mr. Nalepa's $1.2 million disallowance was based on costs incurred in 2015. At the hearing, Mr. Narendorf testified that the costs for these replacements were incurred in 2015, 2016, and 2017.[58] In post-hearing briefing, OPUC argues CenterPoint has not explained why its actions from 2015 to 2017 were ineffective. As OPUC points out, CenterPoint's schedules show that for HLP/00/0801, with the same project description, the cost of ASR foundation replacements increased from $0 in 2014, to $1,190,140 in 2015, $2,965,940 in 2016, and $4,723,139 in 2017. CenterPoint did not incur ASR-related costs in 2010 through 2014, and did not have any ASR-related project costs in 2018.[59] Arguing CenterPoint did not meet its burden to prove the foundation replacements were not caused by imprudence, OPUC recommends reducing plant in service by $8,879,219 for the 2015 to 2017 ASR-related foundation replacements. CenterPoint objects to OPUC's proposed $8,879,219 disallowance for 2015 through 2017 as untimely and based in part on facts not in evidence.

The ALJs find CenterPoint met its burden of proof on this issue. Mr. Nalepa testified the replacements were necessary because of apparent errors in laying the original foundation.[60] Mr. Narendorf explained credibly and in detail that the problems were not caused by CenterPoint errors in laying the original foundation or in using the concrete mixture that caused the ASR. In addition, Mr. Nalepa recommended only a $1,190,140 disallowance for 2015. The schedules

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[57] Tr. at 1178-80.

[58] Tr. at 1175-77.

[59] CenterPoint Ex. 7, WP RMP-2 at 267-73 (2014 Capital Project List at 1-7), 281 (2015 Capital Project List at 8), 290 (2016 Capital Project List at 7), 299 (2017 Capital Project List at 8).

[60] OPUC Ex. 5 at 38.

regarding 2014 to 2017 cited in OPUC's post-hearing briefing were attached to Mr. Pryor's direct testimony and showed the totals, with identical project descriptions, for the ASR-related foundation replacements for 2015-2017.[61] At the hearing, Mr. Narendorf testified that the ASR problem has been growing over time because the industry used up the rock aggregate materials with low alkaline contents, the supply of fly ash is diminishing as coal plants retire, and now there are chemical additives that can be added to the concrete mixture to mitigate, but not eliminate, the potential risk of an ASR.[62] OPUC did not argue until after the hearing that CenterPoint failed to prove why its actions to address issues with the concrete mixture were ineffective.[63] The evidence indicates the ASR problem has been increasing and the solution evolving as circumstances change, and that the new chemical additives mitigate, but do not eliminate, the risk of ASR. The ALJs recommend no disallowance regarding this issue.

d. Capital Project Oversight and Budget Estimation

i. Capital Cost Variances in General

OPUC witness Nalepa and Staff witness Tom Sweatman recommended prudence disallowances for certain capital projects, citing large variations between each project's initial estimated cost and actual cost. They opined the overruns resulted from imprudence, but used the variations in different ways to quantify their recommended disallowances:

- For each such project for which Mr. Nalepa recommended a disallowance, he recommended disallowing the difference between the project's initial estimated cost and its actual cost.[64]

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[61] CenterPoint Ex. 7, WP RMP-2 at 281 (2015 Capital Project List at 8), 290 (2016 Capital Project List at 7), 299 (2017 Capital Project List at 8).

[62] Tr. at 1178-80.

[63] *See*, *e.g.*, Tex. Gov't Code § 2001.051.

[64] OPUC Ex. 5 at 39.

- Mr. Sweatman testified it may be reasonable for a project's final cost to differ somewhat from the initial estimate. Accordingly, he proposed limiting the allowed amount to 10% above the initial estimate, absent a well-substantiated justification for recovering a larger amount. He based that proposal on: (1) his experience of project involvement and management; (2) his review of numerous certificate of convenience and necessity (CCN) dockets, in which companies typically include a 10-15% contingency for cost overruns; and (3) a Commission rule[65] allowing a contingency of not more than 10% for nuclear decommissioning cost overruns. Consequently, for each project for which Mr. Sweatman recommended a disallowance, he proposed disallowing 90% of the difference between the initial estimated cost and the actual cost.[66]

Mr. Narendorf regarded Mr. Nalepa's and Mr. Sweatman's use of initial cost estimates to be unreasonable. He explained that initial estimates rely heavily on assumptions because they are developed before detailed engineering or construction analysis, without geotechnical or subsurface engineering data or right-of-way research, and with very limited construction input. For substations, initial estimates are usually made at least 18 months before construction and are based on projected costs, rule-of-thumb guidelines, and preliminary understanding of actual conditions and project scope. For these reasons, Mr. Narendorf opined that any comparison between estimated and final actual cost should be based on the final estimated cost, not the initial estimated cost. He testified he would agree with Mr. Sweatman that 10-15% is a reasonable expectation for contingency or cost variance in a transmission or substation project if the comparison is between a project's final estimated cost and actual cost. In addition, Mr. Narendorf stated the utility should have the opportunity to rebut a 10% contingency cap on cost-recovery by presenting well-substantiated reasons for the overrun.[67]

The ALJs applied the law regarding burden of proof and prudence, previously discussed, in determining whether to recommend a disallowance and, if so, in what amount. The ALJs recognize that actual costs should mirror final estimated costs more closely than initial estimated

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[65] 16 TAC § 25.304(h)(2)(A).

[66] Staff Ex. 8 at 6.

[67] CenterPoint Ex. 32 at 19-21.

costs and that actual costs may be significantly higher than initial estimated costs for reasons not involving imprudence. The ALJs find, however, that comparisons both between initial estimated costs and actual costs, and between final estimated costs and actual costs, may provide useful information. If imprudence occurred, it might occur before the final cost estimate and its impacts could be hidden if only the final cost estimate is considered. The ALJs do not recommend a disallowance if the evidence shows imprudence did not cause the overrun. If the ALJs recommend a disallowance, the amount they recommend depends on what they conclude about the evidence relevant to the cost impact of the imprudence.

Mr. Narendorf testified that, excluding customer-funded projects, CenterPoint had an average cost variance of -8.5% for all transmission lines reported on its monthly construction progress reports filed between January 1, 2010, and December 31, 2018. He noted that the budget variances identified by Mr. Nalepa and Mr. Sweatman represent 0.12% and 0.68%, respectively, of the $3.0 billion high voltage operations capital for which CenterPoint seeks recovery. He concluded these data prove it manages its projects prudently.[68] Similarly, CenterPoint emphasizes that most of its transmission and distribution plant investment has not been challenged. The ALJs recommend inclusion in rate base of all uncontested plant-in-service amounts. Regarding the projects in dispute, the ALJs applied the legal standards (discussed previously) to the facts that the evidence shows about each project.

Mr. Nalepa and Mr. Sweatman both proposed disallowances for the Alexander Island and La Marque Substations. In addition, Mr. Sweatman proposed disallowances for the Dow Substation, W.A. Parish Substation, Jones Creek, Springwoods, and Tanner projects.[69] Each of these projects is discussed below.

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[68] CenterPoint Ex. 32 at 18, 28, 81-82 (Exh. R-MWN-2).

[69] After reviewing information provided in Mr. Narendorf's rebuttal testimony, Mr. Sweatman withdrew his recommended disallowances for four other projects: two Sandy Point substation projects, Flewellen-Fort Bend, and Fort Bend-Rosenberg. Staff Ex. 8B at 4. These projects are not further discussed.

ii. Alexander Island and La Marque Substations

Mr. Nalepa and Mr. Sweatman proposed disallowances for the Alexander Island and La Marque Substations, explaining:

- ***Alexander Island Substation***. The filed initial estimated project cost for this substation was \$358,000; the actual cost was \$732,052, a 104.5% difference. In response to Staff RFI 6-24, CenterPoint explained: "Foundations were staked with the wrong line pull orientation which wasn't discovered until after the foundations were built. Foundations were removed and reconstructed. Structures had to be modified and some additional material had to be ordered." Mr. Nalepa recommended a disallowance of \$374,052 and Mr. Sweatman recommended a disallowance of \$338,252, due to the foundations having been mistakenly located in the wrong place, then having to be removed and replaced.[70]

- ***La Marque Substation***. The initial estimated project cost for this substation was \$1,446,000; the actual cost was \$2,773,369, a 91.8% difference. In response to Staff RFI 6-24, CenterPoint explained: "Tower design and location changed during detailed engineering phase which led to some material errors. One angle structure had to be removed and replaced." Mr. Nalepa recommended a disallowance of \$1,327,369 and Mr. Sweatman recommended a disallowance of \$1,182,769, due to design and location errors that should have been identified earlier and corrected.[71]

Regarding both substations, Mr. Narendorf testified that, although CenterPoint's response to Staff RFI 6-24 discusses construction errors, they were not the sole reason for the difference between the initial cost estimates and the actual costs.[72] In rebuttal testimony, he provided additional information:

- ***Alexander Island Substation***. Before construction, CenterPoint provided an updated final cost estimate of \$536,000. The final cost estimate was developed after detailed engineering and construction input and reflected cost increases due to scope changes. During construction, two flat tap structure foundations were staked in the wrong direction, requiring rework. While some material had to be reordered,

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[70] Staff Ex. 8 at 7; Staff Ex. 8A (enlarged copy of Att. TS-4); OPUC Ex. 5 at 39, Att. KJN-3 at 88-89 (CenterPoint response to Staff RFI 6-24).

[71] Staff Ex. 8 at 7; Staff Ex. 8A; OPUC Ex. 5 at 39, Att. KJN-3 at 88-89 (CenterPoint response to Staff RFI 6-24).

[72] CenterPoint Ex. 32 at 17, 71-72 (Exh. R-MWN-1, CenterPoint response to Staff RFI 6-24).

CenterPoint was able to chip out stub angles and reuse them on the new foundations, saving money on the material reorder.[73]

- ***La Marque Substation***. The final cost estimate was the same as the initial cost estimate of $1,446,000. The original estimate provided for four structures, but after detailed engineering, seven structures were ultimately required. During construction, one structure had to be moved and rotated to avoid underground utilities. One structure was staked in close proximity to the next, requiring one foundation to be rebuilt.[74]

OPUC asserts that construction errors are not prudent. CenterPoint correctly notes that the prudence standard does not require perfection. If CenterPoint fails to show the construction errors were not caused by imprudence, however, CenterPoint has not met its burden of proof.

OPUC contends CenterPoint's actions to mitigate the cost of construction errors do not make them prudent; it simply means their cost is lower than if the mitigation measures had not been used. The ALJs agree.

OPUC also argues CenterPoint has the burden of proof to show its entire requested amount is prudent. Consequently, if CenterPoint cannot isolate the part of its capital investment that was prudent from the part that was not prudent, it has failed to meet its burden of proof. The ALJs generally agree but have recommended partial disallowances if they find that is supported by the evidence.

Regarding the Alexander Island Substation, the ALJs recommend a disallowance of $196,052, which is the difference between the final estimated cost of $536,000 and the actual cost of $732,052. Mr. Narendorf testified the final estimate was prepared before construction and reflected detailed engineering and construction input and cost increases due to scope changes. The ALJs conclude the difference between the final estimate and the actual cost is a reasonable

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[73] CenterPoint Ex. 32 at 17, 71-72 (Exh. R-MWN-1, CenterPoint response to Staff RFI 6-24), 81-82 (Exh. R-MWN-2).

[74] CenterPoint Ex. 32 at 17-18, 71-72 (Exh. R-MWN-1, CenterPoint response to Staff RFI 6-24), 81-82 (Exh. R-MWN-2).

approximation of the impact of the construction errors, which CenterPoint failed to prove were not caused by imprudence.

Regarding the La Marque Substation, the ALJs recommend accepting Mr. Sweatman's proposed disallowance of $1,182,769. That amount is 90% of the difference between the initial and final estimated cost (which were both $1,446,000) and the actual cost of $2,773,369. CenterPoint failed to prove: (1) that the construction errors were not caused by imprudence; and (2) the amount of the cost increase that resulted not from imprudence, but rather from the need to build seven structures instead of four. Given that need, the ALJs find Mr. Sweatman's proposed disallowance (90% of the difference between the estimated costs and the actual cost) to be more reasonable than Mr. Nalepa's larger proposed disallowance.

iii. Dow Substation

The initial cost estimate for the Dow Substation was $48,000, and the actual cost was $72,463, a 51.0% difference.[75] Mr. Narendorf testified this was a customer-funded project whose costs CenterPoint did not include in rate base.[76] Staff still recommends a disallowance of $19,663,[77] arguing CenterPoint provided contradictory RFI responses. In response to Staff RFI 6-24, however, CenterPoint stated that "[t]he final actual project cost was paid in full by the customer for this project. The company is not seeking recovery of these costs in this case[.]"[78] In response to Staff RFI 1-38, CenterPoint stated that "[t]he project carried systemwide benefit and was not specific to a single customer."[79] The ALJs do not find these RFI responses necessarily contradictory. The substation could be 100% customer-funded and still carry systemwide benefit

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75 Staff Ex. 8A.

76 CenterPoint Ex. 32 at 24.

77 Staff Ex. 8A.

78 Staff Ex. 8 at 62.

79 Staff Ex. 8 at 26.

not specific to a single customer. Mr. Narendorf credibly testified the project was customer-funded and was not included in rate base. The ALJs recommend not making this proposed disallowance.

iv. W.A. Parish Substation

The initial estimate for the W.A. Parish Substation was $380,000; the actual cost was $420,531, a 10.7% difference.[80] CenterPoint explained: "There were no major scope changes to this project, but a variety of small cost differences due to labor and materials resulted in a 10.7% cost difference."[81] Mr. Sweatman recommended a disallowance of $2,531[82] because he found this explanation insufficient.[83] Mr. Narendorf testified the project's actual cost was 5.7% below its final estimated cost.[84] As Mr. Sweatman testified, CenterPoint's explanation—"a variety of small cost differences due to labor and materials"—is insufficient to meet its burden of proof on prudence. The ALJs recommend making this disallowance.

v. Jones Creek

The initial estimate for the Jones Creek project was $52,900,000; the actual cost was $68,422,609, a 29.3% difference.[85] CenterPoint explained: "The Jones Creek substation project included in [CenterPoint's] response to [Staff RFI] 1-38 covered only the transmission work to connect Jones Creek Substation. No substation construction costs were included."[86] Mr. Sweatman recommended a disallowance of $10,232,609.[87] He reasoned that CenterPoint's explanation covered only the transmission work to connect Jones Creek Substation, for which the

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[80] Staff Ex. 8A.

[81] CenterPoint Ex. 32 at 71-72 (Exh. R-MWN-1, CenterPoint response to Staff RFI 6-24).

[82] Staff Ex. 8A.

[83] Staff Ex. 8 at 8.

[84] CenterPoint Ex. 32 at 25, 71 (Exh. R-MWN-1, CenterPoint response to Staff RFI 6-24), 81-82 (Exh. R-MWN-2).

[85] Staff Ex. 8A.

[86] CenterPoint Ex. 32 at 71-72 (Exh. R-MWN-1, CenterPoint response to Staff RFI 6-24).

[87] Staff Ex. 8A.

cost overrun was less than 10% of the estimate, and not the cost overrun for the entire project, which was 89% of the estimate. He also testified CenterPoint did not explain why the substation was needed.[88]

In her direct testimony, Ms. Bodden stated that the Jones Creek Substation was built in 2017 to support load growth and to resolve reliability concerns on the system. The cost of the new substation was $66.2 million. The project was reviewed by the ERCOT Regional Planning Group.[89]

Mr. Narendorf attached to his direct testimony a 20-page July 1, 2014 CenterPoint document about the Jones Creek project. It lists components of the project, including a new 345 kilovolt (kV)/138 kV Jones Creek Substation. It discusses CenterPoint's study and rejection of alternatives to the project. The document indicates the Jones Creek project was needed to serve a new 721 megawatt (MW) load associated with a proposed natural gas liquefaction and export facility being developed by Freeport LNG in the Freeport area.[90]

In his rebuttal testimony, Mr. Narendorf cited CenterPoint's response to Staff RFI 11-2.[91] It states:

> As area load steadily increased throughout the development of the Jones Creek Project, design modifications were necessary to address common tower design criteria violations as well as the need for an additional auto at the substation. The geotech and subsurface engineering data, which was not available prior to project approval, indicated a need for substantially larger foundations than originally estimated. Wetland mitigation requirements also exceeded original estimates. Due to permitting issues, a distribution substation needed to be added to the site and elevated 8' above sea level. Additional permitting issues eliminated the original plans to utilize low water crossings, so [CenterPoint] constructed two bridges

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[88] Staff Ex. 8 at 8-9 (citing CenterPoint responses to Staff RFIs 1-38 and 11-2).

[89] CenterPoint Ex. 9 at 606.

[90] CenterPoint Ex. 8 at 415-35 (WP-MWN-3).

[91] CenterPoint Ex. 32 at 25.

> across tidal influence canals. During construction, third party facilities incorrectly installed in our easements halted construction while we coordinated to have them removed.[92]

Mr. Narendorf testified CenterPoint has not yet constructed the distribution substation at the Jones Creek site, but the need was anticipated at the time, so preliminary site work was performed. He indicated the Jones Creek project had many scope changes throughout the project that caused costs to increase.[93]

Mr. Narendorf's testimony is corroborated by an April 12, 2017 presentation used to obtain approval by CenterPoint's Executive Committee of project cost variances. It 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 elevated eight feet above sea level. Additional permitting issues eliminated the original plan to utilize low water crossings, so CenterPoint had to construct two bridges across tidal influence canals. A chain link fence was replaced with a security fence. Area load increased and required design modifications. Geotech and subsurface engineering data, which were not available for foundation estimates, revealed a need for larger foundations than originally estimated.[94]

The evidence, including contemporaneous documentation and other information provided in CenterPoint's direct and rebuttal cases and discovery responses, supports CenterPoint's position that the cost increases resulted, not from imprudence, but rather from the developments discussed above. Finding CenterPoint met its burden of proof, the ALJs recommend rejecting this disallowance.

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[92] CenterPoint Ex. 32 at 78 (CenterPoint response to Staff RFI 11-2).

[93] CenterPoint Ex. 32 at 25-26.

[94] CenterPoint Ex. 32 at 83-98 (Exh. R-MWN-3).

vi. Springwoods

The initial estimate for the Springwoods project was $11,600,000; the actual cost was $13,505,096, a 15.8% variance.[95] Mr. Sweatman recommended a disallowance of $745,096.[96] He explained that CenterPoint indicated the 15.8% cost overrun was for the transmission construction only, not the entire project, but failed to explain the transmission cost overrun.[97]

In rebuttal testimony, Mr. Narendorf cited CenterPoint's response to Staff RFI 7-24, which stated: "The Springwoods substation project included in [CenterPoint's] response to [Staff RFI] 1-37 covered only the transmission work to connect Springwoods Substation. No substation construction costs were included. The initial filed estimate for the project was $9,547,000 and the final actual project cost was $8,593,292, representing a -10% difference."[98] Mr. Narendorf also cited CenterPoint's response to Staff RFI 5-8, which indicated that the initial estimated cost for the substation-only part of Springwoods was $10.6 million and the actual cost was $11.8 million.[99] He testified the cost variance for the construction of the Springwoods substation inside the fence was primarily driven by increased site improvement costs for vegetation clearing, additional dirt backfill quantities ($800,000), and a wire-wall security fence ($300,000), for a total of $1,100,000 not included in the initial estimate.[100]

The evidence indicates $1,100,000 of the variation over the initial cost estimate resulted not from imprudence but rather from developments described in Mr. Narendorf's rebuttal testimony. The remaining $805,096 of cost increases are within Mr. Sweatman's recommended

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[95] Staff Ex. 8A.

[96] Staff Ex. 8A.

[97] Staff Ex. 8 at 9.

[98] CenterPoint Ex. 32 at 71-72 (Exh. R-MWN-1, CenterPoint response to Staff RFI 6-24).

[99] CenterPoint Ex. 32 at 26, 66-68 (Exh. R-MWN-1, CenterPoint response to Staff RFI 5-8).

[100] CenterPoint Ex. 32 at 26.

10% contingency amount. The ALJs conclude CenterPoint met its burden of proof and recommend rejecting this disallowance.

vii. Tanner

The initial estimate for the Tanner project was $11,000,000; the actual cost was $12,790,474, a 16.3% variance.[101] Mr. Sweatman recommended a disallowance of $690,474.[102] He stated that CenterPoint indicated the 16.3% cost overrun was for transmission construction only, not the entire project, but provided no explanation of the transmission cost overrun.[103]

In rebuttal testimony, Mr. Narendorf cited CenterPoint's response to Staff RFI 6-24, which states: "The Tanner substation project included in [CenterPoint's] response to [Staff RFI] 1-38 covered only the transmission work to connect Tanner Substation. No substation construction costs were included. The initial filed estimate for the project was $7,417,000 and the final actual project cost was $6,641,378, representing a -10.5% difference."[104] Mr. Narendorf also cited CenterPoint's response to Staff RFI 5-8, which indicated the initial estimated cost for the substation-only part of Springwoods was $13.3 million and the actual cost was $11.7 million, representing a -12.6% difference.[105] He described changes in facts that caused actual costs to be below estimated costs, including site improvements and removal of a mulch yard that ultimately were not needed. He indicated, however, that the estimated cost did not include site security ($250,000), additional construction and commissioning resources to meet the schedule ($150,000), and the increased cost for the substation power transformers ($430,000).[106]

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101 Staff Ex. 8A.

102 Staff Ex. 8A.

103 Staff Ex. 8 at 9.

104 CenterPoint Ex. 32 at 26, 71-72 (Exh. R-MWN-1, CenterPoint response to Staff RFI 6-24).

105 CenterPoint Ex. 32 at 26, 66-68 (Exh. R-MWN-1, CenterPoint response to Staff RFI 5-8).

106 CenterPoint Ex. 32 at 26-27.

For the reasons identified by Mr. Narendorf, the ALJs find CenterPoint met its burden of proof regarding the Tanner project and recommend rejecting this disallowance.

2. Land Costs

Staff witness Blake Ianni recommended a \$8,160 disallowance from transmission invested capital because, in discovery, CenterPoint agreed it erroneously classified this project, GRP 855, Land Rights, as a 2010 capital cost when it should have been classified as an expense that year.[107] In rebuttal testimony, CenterPoint witness Kristie L. Colvin agreed with that adjustment.[108] The ALJs recommend making that disallowance.

Mr. Ianni also recommended disallowing from distribution invested capital \$6,795,685.47 in land costs. In discovery, CenterPoint indicated the land was purchased for three separate substation projects currently under construction and expected to be completed in late 2019 or early 2020. Mr. Ianni concluded the costs were for land not used and useful in rendering service to the public as required by 16 TAC § 25.231(c)(2).[109]

Ms. Colvin testified that if the land were not already included in FERC Account 3600, Land and Land Rights, it would be classified as Plant Held for Future Use in FERC Account 1050. Under the FERC Uniform System of Accounts (USOA), Account 1050 shall include the original cost of land and land rights held for future use under a defined plan. Ms. Colvin testified that a defined plan exists for these assets, because substation projects are currently under construction on the three tracts of land.[110] CenterPoint notes that 16 TAC § 25.72 requires it to keep its books and records in compliance with the FERC USOA for public utilities.

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[107] Staff Ex. 6 at 6.

[108] CenterPoint Ex. 35 at 54.

[109] Staff Ex. 6 at 7-8, 25 (CenterPoint response to Staff RFI 5-09).

[110] CenterPoint Ex. 35 at 54.

Staff objects that CenterPoint did not classify the costs as Plant Held for Future Use and did not provide detailed descriptions (acreage, what specific substations, etc.) for these lands, as it did in its rate application for every other land cost CenterPoint seeks to include in Plant Held for Future Use.[111] Staff contends it needed that information to determine the appropriateness of the land costs and whether they are properly included as Plant Held for Future Use.

The ALJs recommend making this disallowance. For the reason Mr. Ianni identified, the ALJs conclude the land is not used and useful in rendering service to the public, as required by PURA § 36.051 and 16 TAC § 25.231(c)(2). In its application, CenterPoint did not ask that the land be considered Plant Held for Future Use, unlike other land that was not yet used and useful. For the land at issue, CenterPoint made that request for the first time in its rebuttal case. That timing denied Staff the ability to conduct discovery and to address that request in its own testimony.[112] Moreover, the Commission's RFP instructions require:

> **II-B-6: Plant Held for Future Use (see attached form)**
>
> This schedule shall show the amount of Electric Plant Held for Future Use (EPHFU) requested in cost of service, functionalized pursuant to General Instruction No. 11. Supporting workpapers that fully and clearly explain the functionalization of each account or subaccount shall be included in the workpaper section, and any functionalization factors shall be referenced to the appropriate factors in Schedule II-F.[113]

Because CenterPoint did not meet its burden to prove the land is used and useful in rendering service to the public or meets Commission requirements relating to Plant Held for Future Use, the ALJs recommend making this disallowance.

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[111] CenterPoint Ex. 1 at 5,696 (WP/WP II-B-6 Adj. 1 at 5).

[112] *See, e.g.*, Tex. Gov't Code § 2001.051.

[113] The ALJs take official notice of the quoted portion of the Commission form, which is available at http://www.puc.texas.gov/industry/electric/forms/rfp/iou_rfp_inst.pdf.

3. Capital Project Accounting

OPUC and Staff object that CenterPoint capitalized some items it should have expensed. Before addressing those items, the PFD discusses general standards relating to capitalizing or expensing an expenditure.

a. General Standards Regarding Capitalizing or Expensing an Item

Ms. Colvin noted a Commission rule requires CenterPoint to keep its books and records in compliance with the FERC USOA for public utilities.[114] CenterPoint's capitalization policy addresses whether to treat an expenditure as a capital addition or an expense. Ms. Colvin stated that the policy was developed in accordance with FERC standards and generally accepted accounting principles (GAAP). CenterPoint routinely monitors and reviews its accounting policies and practices for compliance with FERC standards and GAAP.[115]

Mr. Pryor testified that a project is either capital or O&M expense, but not both. He stated that CenterPoint does not capitalize O&M costs. He described CenterPoint's processes, controls, and training related to work orders to ensure proper classification of T&D capital investment.[116]

Mr. Nalepa stated that capital costs are generally associated with major assets that will be used over time or extend the productive life of a previously-purchased asset. Conversely, operating expenses are incurred to run the day-to-day operations of a utility. They are recurring in nature and are used to maintain a capital asset. Mr. Nalepa noted that a utility earns a return on its capital assets and recovers depreciation expense that represents the reduction in the asset's value

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[114] CenterPoint Ex. 35 at 59, citing 16 TAC § 25.72.

[115] CenterPoint Ex. 12 at 926-27; CenterPoint Ex. 35 at 59.

[116] CenterPoint Ex. 7 at 190-93; CenterPoint Ex. 31 at 14.

due to wear and tear over the asset's life. He stated it is inappropriate to allow a utility to recover in rates a return or depreciation expense on costs that should not be capitalized.[117]

b. URD CLEP

Ms. Colvin indicated that in a 2009 letter order, FERC clarified that underground cable assessment costs could be capitalized if the following criteria were met:

1. The cost must be in connection with a one-time major rehabilitation project of an electric cable system and involve significant replacements and modifications of facilities;
2. The project must extend the overall system's useful life and serviceability;
3. The costs are incurred subsequent to determining the need for the project;
4. The utility must have in place appropriate internal controls to distinguish between expenses incurred related to ongoing assessment and capital costs that are part of the rehabilitation project; and
5. The utility must have in place internal controls that clearly define the scope and budget of the rehabilitation project, its completion date, and how costs are assigned to construction projects.[118]

Ms. Colvin testified that, in 2013, CenterPoint updated its capitalization policy to be consistent with that FERC guidance. Also in 2013, CenterPoint implemented the URD CLEP program to determine the specific location of cables needing to be repaired or replaced. Ms. Colvin testified the program is not a routine maintenance program, was implemented specifically as part of a large capital project, and meets all FERC and CenterPoint criteria for capitalization.[119]

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[117] OPUC Ex. 5 at 36.

[118] CenterPoint Ex. 12 at 938-39, citing *IMCORP's Request for Confirmation of Accounting Rule under AC09-27*, Docket No. AC09-27-000 (FERC Jan. 8, 2009) (*IMCORP* Letter Order).

[119] CenterPoint Ex. 12 at 939-40.

Mr. Nalepa opined that CenterPoint did not properly apply the FERC guidance in capitalizing these costs. According to Mr. Nalepa, FERC did not advocate capitalizing 100% of the program assessment costs, only the costs associated with specific rehabilitation projects. He testified that in fact, CenterPoint established separate projects when major rehabilitation work was necessary. Mr. Nalepa also objected that the program assessment was planned to be an 18-year project, not a one-time major rehabilitation project as Ms. Colvin testified. Mr. Nalepa concluded the program is much more like an ongoing program that FERC has confirmed should be expensed.[120]

Ms. Colvin responded that the underground cable assessment program is a discrete project associated with specific rehabilitation of CenterPoint's underground cable assets. Although it is a multi-year project, it is not an ongoing inspection program that revisits the same assets on a regular and reoccurring basis. Instead, each segment of underground cable is assessed one time and the results are used to determine the need for capital rehabilitation. The project will extend the electric cable system's useful life beyond the estimated service list.[121]

Other evidence describing the program is discussed earlier in the PFD. The ALJs conclude CenterPoint met its burden of proof on this issue. For example, the *IMCORP* Letter Order states: "The purpose of these capitalized cable assessments would generally be to determine the specific location of underground cables that need to be repaired or replaced."[122] It continues: "Evidence supporting the need for a major underground rehabilitation project includes...a significant amount of underground cable lines that are at the end of their service lives...."[123] The evidence indicates the program meets the criteria in the *IMCORP* Letter Order.

[120] OPUC Ex. 5 at 29, 31.

[121] CenterPoint Ex. 35 at 56-57.

[122] *IMCORP* Letter Order at 2. The *IMCORP* Letter Order states that it is issued pursuant to authority delegated by FERC and that "[t]his letter order constitutes final agency action."

[123] *IMCORP* Letter Order at 3, n. 4.

c. Overhead Distribution System (AB1Z) and Substation Projects (HLP/00/0011 and HLP/00/0012)

Mr. Nalepa proposed reducing plant in service by $13,850,004 for three projects he opined should have been expensed instead of capitalized, explaining they are recurring expenses, routine or corrective in nature, and intended to maintain a capital asset. He noted CenterPoint's project descriptions characterize the three projects as routine or corrective:

- AB1Z—proactive routine capital replacements to the overhead distribution system.
- HLP/00/0011—unscheduled substation corrective projects. Small, unscheduled corrective type projects and unforeseen equipment failures. These projects involve replacement of equipment and/or structures.
- HLP/00/0012—scheduled substation corrective projects. Small, scheduled corrective projects. These projects involve replacement of equipment and/or structures.[124]

Mr. Nalepa provided a table to show that CenterPoint has generally incurred costs for these projects every year since 2010:[125]

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

[124] OPUC Ex. 5 at 35-37; CenterPoint Ex. 7, WP RMP-2 at 248-307 (2010-2018 Capital Project Lists). In post-hearing briefing, OPUC states that the first project is identified as AB1Z in the 2010 to 2017 Capital Project Lists, but as AB1X in the 2018 Capital Project List.

[125] OPUC Ex. 5 at 37.

CenterPoint's capitalization policy treats equipment and structures differently depending on whether they are classified as Retirement Units, Substantial Minor Items, or Less than Substantial Minor Items. The following table is used to determine the treatment:[126]

Property Item Type	**Adding Property**	**Removing & Replacing Property**	**Removing Property––No Replacement**
Retirement Unit	Capitalize	Capitalize	Capitalize
Substantial Minor Item of Property	Capitalize	Expense (Capitalize a Betterment)	Expense
Less than a Substantial Item of Property	Expense (Capitalize if installing new facilities or part of a capital work order)	Expense (Capitalize if installing new facilities or part of a capital work order)	Expense

Ms. Colvin testified that although a project may be labeled as routine or corrective, the work is appropriately classified as capital if retirement units are replaced. According to Ms. Colvin, under the FERC USOA, all property is considered to be either a discrete retirement unit or a minor item of property. Replacements of defined retirement units are required to be capitalized. When a defined retirement unit is added to or retired from electric plant, FERC requires that the cost of that activity be applied to the appropriate capital account.[127]

CenterPoint argues that whether the costs are recurring in nature is irrelevant because, given the size of its system, corrective projects involving replacement of equipment and/or structures are frequent activities. Mr. Pryor and Mr. Narendorf criticized Mr. Nalepa's use of project descriptions to determine the nature of the work performed. Mr. Pryor and Mr. Narendorf stated that a project description provides a general description of the work performed; whether it

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[126] CenterPoint Ex. 12 at 967-70, Exh. KLC-11. *See also* CenterPoint Ex. 12 at 974 (Exh. KLC-11, Capitalization Policy); CenterPoint Ex. 35 at 122 (Exh. R-KLC-07, Code of Federal Regulations (C.F.R.) excerpt). Consistent with the C.F.R. excerpt, CenterPoint's capitalization policy defines "Betterment" to include that "the primary aim is to make the affected [retirement unit] more efficient, of greater durability, or of a greater capacity." CenterPoint's policy also establishes a minimum cost threshold.

[127] CenterPoint Ex. 35 at 51-52, 122-23, Exh. R-KLC-07 (C.F.R. excerpt).

should be capitalized is driven by the FERC USOA.[128] Mr. Pryor noted that the project descriptions attached to his direct testimony describe the work performed as including "replacement of equipment and or structures."[129]

Mr. Pryor testified that CenterPoint's RFP and supporting workpapers identify every capital project on CenterPoint's books and records during the time period at issue. The project costs are summarized in CenterPoint's schedules and workpapers. The individual costs are included in individual work orders and invoices regarding each capital project.[130]

Regarding the first project at issue, Mr. Pryor explained there are two AB1Z WBS accounts, Capital AB1Z and O&M AB1Z. To ensure work orders are settled correctly, the system verifies whether capital materials are installed and/or removed. If a capital order is created, but capital items are not used or removed, the system will reject the order and require the costs to be transferred to an expense order. Mr. Pryor testified that in each instance, CenterPoint reviewed the work orders and projects to ensure the costs were eligible for recovery through the DCRF, rather than relying only on the project description language. For example, for Project AB1C, work order 83307305 (one of many work orders attached to his direct testimony) indicates it captures costs for removing a stepdown bank and converting everything behind it to 35 kV. He testified that the poles, wire, and transformers are retirement units, which were replaced as part of this work and qualify for capital treatment.[131]

Regarding the other two projects, Mr. Narendorf testified Project HLP/00/0011 includes capital labor and equipment costs incurred while replacing failed equipment on an unscheduled basis. Such equipment includes breakers, micro-processor relays, power line carrier systems, Supervisory Control and Data Acquisition (SCADA) sets, disconnect switches, and other essential

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[128] CenterPoint Ex. 31 at 13; CenterPoint Ex. 32 at 15.

[129] CenterPoint Ex. 31 at 12; CenterPoint Ex. 2, voluminous WP RMP-2.

[130] CenterPoint Ex. 31 at 15.

[131] CenterPoint Ex. 31 at 13-14, 31-34 (Exh. R-RMP-3, work order 83307305); CenterPoint Ex. 7, WP-RMP-2.

substation capital equipment that has failed. He concluded these costs are properly capitalized. Project HLP/00/0012 involves scheduled replacement of equipment and structures such as battery banks, battery chargers, addition or upgrade of carrier systems, "varmint" control fence installation, relay scheme upgrades, and SCADA replacements. Mr. Narendorf testified the work included in this project is retirement unit replacement work, not repair of existing equipment, so it is properly capitalized and not expensed.[132]

OPUC notes that HLP/00/0011 and HLP/00/0012 are identified as "small" corrective projects, which suggests they are generally minor items. OPUC concedes a project description should not be the sole basis for determining whether work should be capitalized or expensed, but contends it provides some indication of the type of work performed. OPUC argues CenterPoint did not indicate the classification of each item included within these projects. OPUC concludes CenterPoint did not provide enough information to meet its burden to prove the full amount of costs for each project should be capitalized, rather than expensed.

The ALJs conclude that CenterPoint met its burden of proof on this issue. It presented testimony and documentation to show its capitalization policy relative to these projects is consistent with FERC requirements. For a system the size of CenterPoint's, that costs are incurred in each project each year is not surprising. The work orders contain more detailed and definitive information on the work performed than the brief, general project descriptions. The evidence indicates CenterPoint examined the work orders before classifying the costs as capital items; it does not show Mr. Nalepa performed such an examination.

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[132] CenterPoint Ex. 32 at 14-15.

d. Capital Projects ENTD086—Corporate Website Redesign and S/101318/CG/Tools

CenterPoint capitalized the cost of a project titled "corporate website redesign."[133] Mr. Nalepa testified that a utility can capitalize computers and computer software, but that website redesign service is more properly recorded in an expense account, such as FERC Account No. 923, Outside Services. He recommended reducing CenterPoint's plant in service by $7,086,684 for the cost of the website redesign project.[134] Because CenterPoint incurred this expense outside the test year, OPUC contends it should be disallowed.

Ms. Colvin testified the website rebuild activities are properly classified as an asset under GAAP. Citing Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 350-50-25-15, she explained that GAAP requires some of the costs to be expensed and others capitalized, depending on the stage of the website development project. In her opinion, CenterPoint appropriately capitalized costs incurred during the application development stage as outlined in the GAAP standard.[135]

FASB ASC 350-50-25-15 states that:

> 25-15 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 certain costs related to upgrades and enhancements to be capitalized if it is probable that they will result in added functionality) ....
>
> 25-16 The determination of whether a change to website software results in an upgrade or enhancement... is a matter of judgment based on the specific facts and circumstances. Paragraph 350-40-25-10 states that entities that cannot separate internal costs on a reasonably cost-effective basis between maintenance and

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[133] CenterPoint Ex. 7 at 52, 267, WP RMP-2 (2014 Capital Project Lists, Project ENTD086).

[134] OPUC Ex. 5 at 37.

[135] CenterPoint Ex. 35 at 52, 131-37, Exh. R-KLC-08.

relatively minor upgrades and enhancements shall expense such costs as incurred.[136]

CenterPoint cites RFP Schedule V-K-5.2, Line No. 17, which includes the following services/costs description for the Corporate Website Rebuild: "Replatform corporate website, mobile enable corporate sites and enhance customer experience for power alert notifications and online customer self service as well as electric customer registration."

The ALJs find CenterPoint met its burden of proof on this issue. The evidence indicates this was a rebuild of the corporate website to add functionality, as required for capitalization under FASB ASC 350-50.[137]

Mr. Nalepa also recommended a $2,127,089 disallowance for tools purchased for a substation. He testified tools used to maintain capital assets are typically expensed under FERC rules, not capitalized.[138]

Ms. Colvin testified that under the FERC USOA, the cost of tools and equipment used in construction and/or repair work is eligible for capitalization to FERC Account 3940.[139] She indicated that the tools included in this account are not simple hand tools; each has a value of more than $500 and is expected to provide multiple years of benefit. She concluded it is appropriate to capitalize the tools and allocate the costs over the period the tools are expected to provide benefits.[140]

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136 CenterPoint Ex. 35 at 134, Exh. R-KLC-08.

137 CenterPoint Ex. 2 at 991, Sch. V-K-5.2, Item 17 (errata).

138 OPUC Ex. 5 at 37-38.

139 The ALJs infer Ms. Colvin was referring to CenterPoint Ex. 35, 128, Exh. R-KLC-07 (C.F.R. excerpt), "394 Tools, shop, and garage equipment," which states it shall include "the cost of tools, implements, and equipment used in construction, repair work, general shops and garages and not specifically provided for or includible in other accounts."

140 CenterPoint Ex. 35 at 52-53, 121-30 (Exh. R-KLC-07, C.F.R. excerpt).

The ALJs did not find evidence showing the tools are used in construction and/or repair work, as the FERC USOA classification cited by Ms. Colvin requires. Because CenterPoint did not meet its burden of proof, the ALJs recommend making this disallowance.

e. Distribution Line Clearance Project

Mr. Ianni recommended a total disallowance (comprising years 2014 to 2017) of $19,376,931 for Project No. HLP/00/1055, on the ground that amount was capitalized and should have been treated as O&M expense.[141] He cited CenterPoint's response to Staff RFI 6-22, set out in pertinent part below:

> **For the project listed under Project Number HLP/00/1055 and described in the WP RMP-2 Capital Project List Summaries (years 2014-2017) as "Distribution line clearance corrections between transmission and distribution facilities to meet National Electrical Safety Code (NESC) requirements" (and also found in the "WP RMP-2 Capital Project List Detail" spreadsheets for these years).**
>
> **a. When were the associated transmission and distribution lines placed into service?**
>
> Project 1055 represents [CenterPoint's] Lidar [Light Detection and Ranging] based Transmission Line Clearance Program. [CenterPoint] performs Lidar surveys on approximately 20% of the transmission system each year to identify and correct NESC transmission line clearance issues. During the 2014-2017 time period, 204 transmission line clearance issues, involving 158 distribution circuits and 69 transmission circuits, were addressed by modifications to distribution facilities. In addition, 85 transmission clearance issues were resolved by modifications to 55 transmission circuits. Information on the in-service dates for the transmission lines and distribution lines is not readily available.

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[141] Staff Ex. 6 at 12-13.

> **c. Please elaborate on why these corrections were necessary and explain how CenterPoint became aware of the need to correct this clearance.**
>
> [CenterPoint's] Transmission Line Clearance Program (1055) utilizes LIDAR technology to determine clearances as compared to the NESC standard at the time of survey. Approximately 20% of the transmission system is surveyed each year. Clearance corrections are addressed by modifications to transmission facilities, distribution facilities, or both.
>
> **e. Why does CenterPoint believe this work should be capitalized instead of treated as an operation or maintenance expense?**
>
> This work should be capitalized because the modifications *included* the replacement of poles, pole hardware, conductors, and other capital facilities.[142]

Mr. Ianni explained that the RFI response indicates this is an ongoing project for work on existing lines to maintain compliance with NESC clearance standards and is more appropriately categorized as O&M expense. He also objected that the above RFI response states CenterPoint could not provide specific in-service dates for when the lines were originally built.[143]

Mr. Ianni testified the $19,376,931 comprises hundreds of itemized work orders that CenterPoint broke down annually and, further, biannually, in detailed project lists for 2014-2017. He stated that due to the sheer scope of the master project label, he was unable to determine from the voluminous spreadsheets: (1) the exact amounts assigned to distribution as opposed to transmission; and (2) the exact amounts charged to specific distribution and transmission FERC accounts. CenterPoint's RFI response did not provide that information. Mr. Ianni therefore recommended splitting the total project costs 50/50 between distribution and transmission. He recommended removing $4,844,232.75 from each of four FERC accounts: 364 (poles, towers, and fixtures), 365 (overhead conductors and devices), 355 (poles and fixtures), and 356 (overhead conductors and devices). He selected those four accounts based on the project description and

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[142] CenterPoint Ex. 32 at 69-70 (CenterPoint response to Staff RFI 6-22) (emphasis added).

[143] Staff Ex. 6 at 12-13. *See also* CenterPoint Ex. 32 at 69-70 (CenterPoint response to Staff RFI 6-22); CenterPoint Ex. 7, WP RMP-2 (Capital Project List Summaries for 2014-2017).

because the voluminous workpapers indicated CenterPoint charged a number of the hundreds of work orders associated with Project No. HLP/00/1055 to them. Because the costs were all incurred before the test year, Mr. Ianni recommended they be disallowed, not reclassified to O&M.[144]

Citing the response to Staff RFI 6-22, Ms. Colvin testified that CenterPoint performs Lidar surveys on about 20% of the transmission system each year to identify and remediate transmission line clearance issues. She stated: "Once the issues are identified, the resulting capital work charged to Project 1055 *includes* the replacement of poles, conductors, and other capital assets." These items are classified as retirement units on CenterPoint's continuing property records. Per the FERC USOA, when a defined retirement unit is added to or retired from electric plant, the cost is required to be applied to the appropriate capital account. Ms. Colvin testified that although Project 1055 represents ongoing project work to maintain clearance with NESC clearance standards, the work is appropriately classified as capital when retirement units are replaced.[145]

Mr. Narendorf opined that specific in-service dates of the T&D lines that needed to be modified are immaterial to the nature of the work being performed. Similarly, he testified that "the work associated with this project *includes* modifications to, not maintenance of, existing transmission and distribution circuits which *includes* the replacement of retirement units such as poles, towers, conductors, and other capital facilities."[146] Staff observes CenterPoint's response to Staff RFI 6-22 does not mention towers. Staff argues the modifications are ongoing and analogous to vegetation management expenses, which are classified as O&M expenses because they can be predicted in a reasonable manner. Citing CenterPoint's response to Staff RFI 6-22, Staff concludes the corrections are maintenance expenses incurred to preserve the operating efficiency or physical condition of the facilities.

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[144] Staff Ex. 6 at 12-14, Att. BPI-6 (CenterPoint response to Staff RFI 6-22); CenterPoint Ex. 7, WP RMP-2 (Capital Project List Summaries for 2014-2017).

[145] CenterPoint Ex. 35 at 54-55 (emphasis added).

[146] CenterPoint Ex. 32 at 13-14 (emphasis added).

In its brief, Staff cites and attaches an excerpt from *Accounting for Public Utilities*,[147] which states, "Removal or replacement of a part of the unit, for example a downguy or brace, is considered a maintenance expense and does not affect the asset value." CenterPoint contends the excerpt actually supports CenterPoint's position. The excerpt states that a "... pole is a unit of property, including the pole itself, the crossarm, down guys, anchors, 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."

The ALJs recommend making this disallowance. Mr. Ianni persuasively testified that this project includes a vast number of small items, that he reviewed the voluminous information CenterPoint provided, and that neither such review nor CenterPoint's response to Staff RFI 6-22 provided the information needed to support CenterPoint's position or to understand what amounts were being charged to specific transmission and distribution FERC accounts. Asked in discovery to explain why it believes this work should be capitalized instead of included in O&M, CenterPoint gave this one-sentence response: "This work should be capitalized because the modifications included the replacement of poles, pole hardware, conductors, and other capital facilities." CenterPoint's repeated references in its discovery response and testimony to this project *including* modifications or replacements are insufficient to meet its burden to prove all of these costs were properly capitalized.

4. Changes in Capitalization Policy

Since its last rate case, CenterPoint changed its capitalization policy for some items to capitalize them rather than expense them. CenterPoint did so for luminaires in 2014,

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[147] Robert L. Hahne & Gregory E. Aliff, *Accounting for Public Utilities*, § 16.17 Continuing Property Records System at 512-13, Release 33 (2016). That excerpt is not in evidence, but no party objected to Staff's citing and attaching it; Staff's initial brief and CenterPoint's reply brief each contend it supports their position; and CenterPoint refers to it as a treatise. Accordingly, the ALJs take official notice of it.

microprocessor control devices in 2017, program assessment costs (underground cable life extension) in 2013, and certain overhead construction costs in 2014.[148]

The issue here is not whether CenterPoint should have changed its policy to capitalize some items it previously expensed. The issue is whether, as OPUC argues, the rate treatment of such changes should be prospective, to avoid over-recovery because CenterPoint began capitalizing the items partway through the period its rates that included the items as expenses were in effect.

Mr. Nalepa recommended disallowing $51,417,754 for items previously expensed that CenterPoint began capitalizing at some point after its last rate case:[149]

Capitalized Expenses Due to Change in Policy ($)

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

Ms. Colvin testified CenterPoint's financial records, which reflect its capitalization policy, must follow the FERC USOA and comply with GAAP. She explained that CenterPoint routinely monitors and reviews its accounting policies and practices for compliance with GAAP and FERC

[148] CenterPoint Ex. 12 at 927-31.

[149] OPUC Ex. 5 at 32. Mr. Nalepa testified that this issue was contested in each of CenterPoint's prior DCRF filings since 2015, but each case settled and the issue was deferred to this base rate case. OPUC Ex. 5 at 29-30.

standards. Changes are made, when necessary, to ensure costs continue to be categorized and accounted for consistent with the work being performed and the FERC USOA. In Ms. Colvin's view, the historical costs used to calculate CenterPoint's base rates in its last rate case are used as representative of the cost of providing electric service during the time those base rates were in effect. The expenses used to calculate the base rates are not subject to reconciliation against the actual expenses CenterPoint incurred during a particular time period.[150]

The fact CenterPoint is required to maintain its records in accordance with the FERC USOA and GAAP is not the issue. The issue is the appropriate ratemaking treatment. CenterPoint asks to include in rate base in this case its past capitalization of costs, which began at various points during the eight years since its last rate case. Throughout those eight years, CenterPoint has charged rates that included such costs as allowable expenses. Given these facts, the ALJs agree with OPUC that including in rate base CenterPoint's past capitalization of these costs could result in over-recovery. The ALJs recommend making this disallowance.

B. Indirect Corporate Costs

Under PURA § 36.210(a) and 16 TAC § 25.243(b)(3), a utility shall not recover indirect corporate costs through its DCRF. COH argues that CenterPoint recovered indirect corporate costs through its DCRF; CenterPoint contends it did not.

In response to COH RFI 15-6 requesting the portion of *corporate costs* included in each DCRF filing, CenterPoint provided amounts totaling $2,602,580, broken out by account (Accounts Payable, Property Accounting, and Call Center) and prior CenterPoint DCRF proceeding (Docket

[150] CenterPoint Ex. 35 at 55-56, 58-60.

Nos. 44572, 45747, 47032, and 48226).[151] Citing the RFI response, Mr. Norwood concluded that amount was *indirect corporate costs* and thus improperly included in CenterPoint's past DCRF charges.[152]

CenterPoint witness Michelle M. Townsend noted that, in adopting 16 TAC § 25.243, the Commission clarified the meaning of "indirect corporate costs":

> After reviewing PURA § 36.210, the commission concludes that the purpose of this section's exclusion of indirect corporate costs is to circumscribe the commission's discretion in expanding the definition of distribution invested capital beyond the well-established standards in the FERC USOA. As a result, PURA § 36.210 prohibits the commission from categorizing as distribution invested capital corporate aircraft and artwork or other invested capital that arguably is indirectly necessary to provide distribution service.[153]

Ms. Townsend stated that the corporate costs associated with Accounts Payable, Property Accounting, and Call Center, identified in CenterPoint's response to COH RFI 15-6, are directly assigned to capital work by those departments and are not indirect corporate costs. She testified CenterPoint does not assign indirect corporate costs to capital projects because indirect corporate costs are costs that cannot be directly assigned. She indicated that in each of its four prior DCRF cases, CenterPoint attested that its DCRF excluded indirect corporate costs as required by 16 TAC § 25.243(b)(3). Ms. Townsend opined that the work done by Property Accounting, Accounts Payable and Call Center is all work performed based on capital activity and is not an activity or

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151 COH Ex. 1, Exh. SN-13 (CenterPoint response to COH RFI 15-6, referencing *Application of CenterPoint Energy Houston Electric, LLC for Approval of a Distribution Cost Recovery Factor Pursuant to P.U.C. Subst. R. 25.243*, Docket No. 44572, order (Aug. 5, 2015)(Docket No. 44572 order); *Application of CenterPoint Energy Houston Electric, LLC to Amend Its Distribution Cost Recovery Factor and to Reconcile Docket No. 44572 Revenues*, Docket No. 45747, order (Jul. 20, 2016)(Docket No. 45747 order); *Application of CenterPoint Energy Houston Electric, LLC for Approval to Amend Its Distribution Cost Recovery Factor*, Docket No. 47032, order (Jul. 28, 2017)(Docket No. 47032 order); *Application of CenterPoint Energy Houston Electric, LLC to Amend Its Distribution Cost Recovery Factor*, Docket No. 48226, order (Aug. 30, 2018)(Docket No. 48226 order)).

152 COH Ex. 1 at 19-22. Mr. Norwood proposed that amount (with associated carrying charges) be refunded over one year, using a DCRF credit rider, with DCRF credit factors that reflect cost allocations and billing units consistent with CenterPoint's approved DCRF.

153 CenterPoint Ex. 37 at 5-6 (quoting from *Rulemaking Related to Periodic Rate Adjustments*, Project No. 39465, Order Adopting New § 25.243 as approved at the September 15, 2011 Open Meeting at 33 (Sept. 22, 2011)).

cost such as corporate aircraft or artwork, which the Commission order (quoted above) adopting the rule cited as examples of indirect corporate costs.[154]

After reviewing the testimony, the RFI response, 16 TAC § 25.243, and the Commission preamble adopting it, the ALJs find CenterPoint met its burden of proof on this issue. The evidence does not indicate it recovered indirect corporate costs through the DCRF in violation of PURA § 36.210(a) and 16 TAC § 25.243(b)(3). The ALJs thus recommend rejecting this proposed disallowance.

C. Prepaid Pension Asset

1. Undisputed PPA Computation Error

CenterPoint initially sought to include a $176.3 million prepaid pension asset (PPA) in rate base, encompassing the excess amount of non-ratepayer contributions to its pension plan over the actuarially-determined pension expense for the same period. GCCC claims CenterPoint's proposed PPA should be rejected because the requested balance amount is the result of three computation errors. CenterPoint acknowledges one error, and admits the proposed PPA should be corrected to remove the capitalized portion identified as construction work in progress (CWIP), consistent with Commission Docket Nos. 33309 and 39896.[155] CenterPoint asserts that the CWIP amount that should be excluded from the PPA amount totals $72.9 million.[156] Thus, based on the information provided by CenterPoint, the ALJs find that the total amount of CenterPoint's revised proposed PPA is approximately $103.4 million.

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[154] CenterPoint Ex. 37 at 5-7.

[155] *Application of AEP Texas Central Company for Authority to Change Rates,* Docket No. 33309, Order at Rehearing FoF Nos. 29-32 (Docket No. 33309 order); *Application of Entergy Texas, Inc. for Authority to Change Rates*, Docket No. 39896, Order (Docket No. 39896 order) on Rehearing at FoF Nos. 24-28 (Nov. 2, 2012).

[156] In its Reply Brief, CenterPoint stated the CWIP amount totaled $72.9 million. *See* CenterPoint Reply Brief at 28, *supra* n. 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."

If the proposed PPA (minus the CWIP amount) is approved, CenterPoint also seeks approval to apply and recover an allowance for funds used during construction (AFUDC) on the excluded CWIP amount, consistent with the Commission's prior decisions for other utilities.[157] CenterPoint's request to accrue AFDUC on the excluded CWIP amount is uncontested.

For the reasons discussed below, the ALJs recommend that the Commission reject CenterPoint's revised $103.4 million proposed PPA.

2. GCCC's Objections to CenterPoint's Computation of the PPA

In addition to the uncontested error discussed above, GCCC claims CenterPoint committed two errors in its PPA calculation, which, if corrected, would reduce the PPA balance amount to $0; thereby negating the need to include it in rate base. According to GCCC witness Lane Kollen, CenterPoint's calculation incorrectly: (1) includes a 13-month average for the PPA balance amount, rather than the actual 12-month test year; and (2) double-counts the return on unrealized (or unrecognized) losses already included in CenterPoint's share of CNP's pension cost, which CNP charges to CenterPoint.[158] Alternatively, GCCC argues that, if the Commission allows CenterPoint to include the requested PPA in rate base, the Commission should: (1) net the associated accumulated deferred income tax (ADFIT);[159] and (2) subtract CenterPoint's prepaid BRP pension and postretirement benefit liability from rate base, in the amounts suggested by Mr. Kollen.[160]

Mr. Kollen testified that, generally, if a PPA is included in rate base, it should be calculated consistently with the utility's pension expense. According to Mr. Kollen, CenterPoint failed to do this. He claimed that instead, CenterPoint inconsistently calculated the proposed PPA using a

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157 Docket No. 39896 order at 2, FoF No. 29 Docket No. 40443 order at FoF No. 137.

158 GCCC Ex. 1 at 18-24.

159 GCCC Ex. 1 at 27, 40. CenterPoint did not address Mr. Kollen's instruction to remove the related ADFIT liability.

160 The ALJs address the prepaid BRP pension and postretirement benefit liability issue later in Section II.

13-month average (Dec. 31, 2017 to Dec. 31, 2018) rather than the 12-month test year (Jan. 1, 2018, to Dec. 31, 2018) it used to calculate its pension expense. GCCC does not challenge CenterPoint's claim that it was required to use a 13-month average pursuant to the Commission's RFP instructions for Prepayments, but argues it was inappropriate to do so in light of its pension expense adjustment, as discussed below:

> [CenterPoint's] reliance on the 13-month average pursuant to Commission rule may be appropriate if [CenterPoint] had not sought to adjust the per books pension expense in the test year to reflect the 2019 forecast. However, those are not the facts in this case. Neither the Commission rule nor common sense dictate that rate base be limited to a 13-month average during the historic test year while adjusting the pension expense to reflect the 2019 forecast.[161]

GCCC claims that CenterPoint's use of the inconsistent time periods (13-month average vs. 12-month test year) directly conflict with CenterPoint witness George Sanger's definition of a PPA as "the accumulation of past plan Contributions minus the accumulation of Pension Expense *recorded over the same period*."[162] Mr. Kollen testified that CenterPoint should have used the actual 12-month test year PPA balance amount for its calculation instead, which totaled $170.369 million on December 31, 2018.[163]

More importantly, GCCC asserts the proposed PPA results in a double-counting of return on unrealized losses, which if included in rate bases, would be duplicative and unfair to ratepayers. GCCC witness Kollen claimed the double-counting occurs because CenterPoint incorrectly treats CNP's accounting entry for unrealized losses as equivalent to non-ratepayer cash contributions to its pension fund, which make up the proposed PPA. Rather, GCCC argues that, through a mere accounting entry, CNP turned its unrealized losses into a regulatory asset and that it is CenterPoint's inclusion of those unrealized losses in its PPA that results in a double-counting of

[161] GCCC Initial Brief at 8.

[162] GCCC Ex. 1 at 19, 40. *See* CenterPoint Ex. 46 at 5 (emphasis added by GCCC).

[163] GCCC Ex. 1 at 17. CenterPoint witness George Sanger confirmed that CenterPoint's PPA balance amount was $170.369 million on December 31, 2018. *See* CenterPoint Ex. 1a, Exh. II-D-3.8.1. at 8 (confidential).

return. Mr. Kollen testified that on December 31, 2018, CenterPoint recorded $370.442 million in unrealized losses in its accounting books in Accumulated Other Comprehensive Income (AOCI) as a reduction to common equity. However, according to Mr. Kollen, CNP then removed those unrealized losses from common equity (thereby increasing its common equity), and recorded them as a regulatory asset. It is Mr. Kollen's understanding that this "so-called regulatory asset," as recorded in CNP's accounting books, is merely an accounting entry used to reclassify the unrealized losses from the AOCI component of common equity to an asset, instead of a reduction to common equity, and that it is CenterPoint's share of this "asset" that it seeks to include in rate base as a PPA.[164] Mr. Kollen stressed that this "asset" has no economic effect and will reverse over time as the unrealized gains and losses are recognized in future pension costs (*i.e.*, through return on plan assets and amortization of the unrealized gains and losses).[165]

In its reply brief, GCCC works through the calculations provided in CenterPoint's PPA Analysis exhibit[166] to demonstrate that the proposed PPA is composed of the remaining amount of $370.442 million unrealized losses recorded as AOCI by CNP. GCCC states that CenterPoint: (1) has not issued debt or common equity to finance the proposed PPA; (2) has not recorded an intercompany liability to pay CNP for its unrealized losses; and (3) is not charged a return by CNP with regard to those unrealized losses.[167] Rather, Mr. Kollen testified that CenterPoint "pays" for the unrealized losses through its allocated share of CNP's pension cost, which includes amortization of those unrealized losses.[168]

CenterPoint disagrees with Mr. Kollen's allegation that it should not have used a 13-month average to calculate the PPA and maintains that it was required to do so by the Commission's RFP

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164 GCCC Ex. 1 at 22.

165 GCCC Ex. 1 at 22-23.

166 CenterPoint Ex. 12, Exh. KLC-09 at 965.

167 *See* CenterPoint Ex. 46 at 9.

168 GCCC Ex. 1 at 23.

instructions.[169] CenterPoint also argues that GCCC's argument lacks a proper basis because there is no requirement that a consistent calculation method must be used to ensure the calculation for an expense items matches the calculation for a rate base item.

Additionally, CenterPoint disagrees with Mr. Kollen that the proposed PPA double-counts the return on unrealized losses because, as CenterPoint claims, the proposed PPA is actuarially calculated and does not include unrealized losses; therefore, it would not cause the alleged double-counting.[170] CenterPoint witness Sanger stated that Mr. Kollen needlessly complicated this issue by using an alternative and confusing method to calculate CenterPoint's PPA (*i.e.*, summing the funded status of the pension plan and the AOCI amounts) instead of using Mr. Sanger's simple method (*i.e.*, calculating the amount of contributions to the pension plan that exceed the actuarially calculated pension expense).[171] Although Mr. Sanger asserted his method was less complex than Mr. Kollen's, he explained that both methods produce the same mathematical outcome.[172] According to Mr. Sanger, the proposed PPA consists of CNP's federally-mandated contributions to CenterPoint's pension plan (made on behalf of CenterPoint under the Employee Retirement Income Security Act of 1974 (ERISA)) that have exceeded the pension expense due to requirements to fund the plan with cash faster than the pension expense accruals, as actuarially calculated.[173]

Mr. Sanger testified that unrecognized loss occurs when the pension plan experience differs from actuarial assumptions and that the resulting unrealized losses or gains are not immediately recognized, but rather deferred and amortized in future pension expense over several years.[174]

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169 CenterPoint Ex. 35 at 50.

170 CenterPoint Reply Brief at 29. CenterPoint witness Sanger actuarially calculated CenterPoint's pension expense under Accounting Standards Codification Topic 715 (FAS 715), which is the accounting standard issued by the FASB and includes the GAAP.

171 CenterPoint Ex. 46 at 7-9.

172 GCCC does not dispute this assertion.

173 Mr. Sanger testified that CNP was federally mandated under the ERISA to contribute a mandatory minimum amount to CenterPoint's pension fund.

174 CenterPoint Ex. 46 at 7.

Based on his understanding, Mr. Sanger opined that the unrealized losses will be the same regardless of the magnitude of CNP's contributions to the pension plan and that the amortization of unrealized loss in pension expense is unaffected by CNP's federally-mandated contributions. Thus, Mr. Sanger asserted that CNP's pension plan contributions do not impact unrealized loss and there would be no double-counting of return on those prepaid contributions.[175]

Mr. Sanger also testified that, contrary to Mr. Kollen's assertions, it is irrelevant that CenterPoint is not charged a return by CNP. However, he pointed out that CenterPoint has been penalized by CNP's prepayments to its pension plan. Specifically, because CenterPoint does not earn a compensatory return on the PPA in rate base, it forgoes a return on the cash contributions to the pension plan without receiving the corresponding benefit of reduced pension expense and related cost recovery.

3. ALJs' Analysis and Recommendation

The ALJs conclude that CenterPoint did not provide sufficient evidence to overcome GCCC's testimony that inclusion of the proposed PPA in rate base would result in a double-counting of the return on unrealized losses and would therefore be duplicative and unfair to ratepayers.[176] Accordingly, the ALJs recommend that the Commission reject CenterPoint's request to include the proposed PPA in rate base.

In its arguments against Mr. Kollen's allegations, CenterPoint made the following statements regarding its proposed PPA:

- GCCC erroneously claims the requested prepaid pension asset included the $370.442 million of unrealized loss in the pension plan at December 31, 2018.

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[175] CenterPoint Ex. 46 at 7-9.

[176] Although irrelevant to their ultimate decision on this issue, the ALJs acknowledge that CenterPoint's use of a 13-month average to calculate a PPA is appropriate. *See* Docket No. 43695, Order on Rehearing at FoF Nos. 54, 64-65.

- The prepaid pension asset... is actuarially calculated and shown in the actuarial study and does not include the unrealized loss.[177]

- The prepaid pension asset exists because cumulative cash contributions to the pension plan have exceeded the cumulative actuarially determined pension expense over the same period.

- Both unrealized gains and unrealized losses should be kept out of rate base.

- [CenterPoint]... does not include the... positive $370.442 million unrealized loss in any rate filing because to do so would be double counting.[178]

After review of the available evidence and arguments presented by the parties, the ALJs conclude there is insufficient evidence to support these statements. Rather, the ALJs find that the evidence indicates a portion of the $370.442 million unrealized losses, recorded as AOCI by CNP, is the funding source for CenterPoint's proposed PPA. Furthermore, the ALJs conclude that CenterPoint failed to meet its burden to sufficiently negate GCCC's allegation that the inclusion of the proposed PPA (as comprising unrealized losses) in rate base would result in a duplicative and unfair double-counting. The ALJs find that CenterPoint's assertion above, confirming that a double-counting would result from including the unrealized losses in its rate filing, supports their decision to recommend rejection of the proposed PPA.

CenterPoint's PPA exhibit sets out CenterPoint's PPA balance amounts since Docket No. 38339.[179]

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[177] CenterPoint witness Sanger's actuarial study is confidential. Therefore, the ALJs have limited their description of the actuarial study and ultimate findings to the non-confidential statements and exhibits included within Mr. Sanger's and Ms. Colvin's testimony regarding the study.

[178] CenterPoint Initial Brief at 24-26; CenterPoint Reply Brief at 28-29, 32.

[179] CenterPoint Ex. 12, Exh. KLC-09 at 965.

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC
PREPAID PENSION ANALYSIS
(Thousands of Dollars)

		2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
ACTUARIAL EXPENSE (INCOME)	[1]	42,859	31,134	27,128	29,778	24,761	26,420	34,770	44,105	41,372	24,190
PENSION EXPENSE AS INCLUDED IN RATES		5,881	20,255	20,255	20,255	20,255	20,255	20,255	20,255	20,255	20,255
CONTRIBUTIONS TO TRUST/PLAN	[2]	5,155	-	26,655	30,258	33,536	35,584	16,042	-	17,712	26,854
NET FUNDED (UNFUNDED) STATUS	[3]	(135,749)	(148,880)	(194,915)	(214,789)	(105,799)	(179,448)	(203,390)	(219,396)	(164,084)	(200,073)
LESS ACCUMULATED UNRECOGNIZED GAINS/LOSSES OR ASSET AMOUNT	[4]	403,135	385,132	430,694	451,048	350,833	433,646	438,860	410,761	331,789	370,442
PREPAID (ACCRUED) PENSION COST	[5]	267,386	236,252	235,779	236,259	245,034	254,198	235,470	191,365	167,705	170,369

Notes All amounts excluded BRP unless noted
[1] CEHE's share of total CNP pension expense per actuarial report
[2] CEHE's share of total CNP contribution per actuarial report
[3] The difference between the fair value of plan assets and projected benefit obligation at end of year
This is CEHE's portion of CNP's net pension asset(liability) since the adoption of FAS 158 in 2006
[4] This amount has been treated as a regulatory asset since the adoption of FAS 158 in 2006 Prior to that date, this was accounted for off balance sheet
[5] The difference between the cumulative pension cost recognized and actual pension amount funded

For the following discussion, the ALJs will focus on the last column of the graph above, which denotes the applicable 2018 test year values, and the second to last column, which denotes the 2017 values. The Notes section, located in the bottom left corner of the exhibit, identifies the values listed in rows 1-5. For the 2018 test year, row 1 shows CenterPoint's actuarially calculated pension expense as $24.190 million (listed as the top numerical value for row 1). Row 2 shows the amount of pension plan contributions as $26.854 million.[180] Row 3 shows the funded status of the pension plan (*i.e.*, the difference between the fair value of plan assets and projected benefit obligations at the end of the year) as *negative* $200.073 million. Row 4 shows the accumulated unrecognized gains/losses (recorded by CNP as AOCI) as $370.442 million. The Notes section further indicates that this amount has been treated as a regulatory asset since the adoption of FAS 158 in 2006, as alleged by GCCC. Finally, Row 5 shows the uncontested prepaid balance asset amount on December 31, 2018, as $170.369 million.[181]

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[180] Neither CenterPoint nor any of its witnesses asserted that the proposed PPA included any contributions other than CNP's ERISA-required contributions.

[181] GCCC witness Kollen and CenterPoint witness Sanger agree on this amount. *See* CenterPoint Reply Brief at 29.

Mr. Sanger testified that the PPA balance amount (row 5) could be calculated using Mr. Kollen's method by summing the funded status (row 3) and the unrealized losses/AOCI (row 4). That calculation produces the uncontested $170.369 PPA balance amount on December 31, 2018, and illustrates that the funding source for the PPA is composed of the remaining amount of unrealized losses, recorded as AOCI, after subtracting the *negative* funded status amount.[182] Moreover, the values identified in rows 1, 2, and 5 are consistent with another exhibit sponsored by CenterPoint witness Colvin and provided below:[183]

Prepaid Pension Asset

	Pension Cost	Contribution	Prepaid Pension Asset
Balance at December 31, 2017			167,705,000
Balance at January 31, 2018	2,015,833		165,689,167
Balance at February 28, 2018	2,015,833		163,673,334
Balance at March 31, 2018	2,015,833	26,855,000	188,512,501
Balance at April 30, 2018	2,015,833		186,496,668
Balance at May 31, 2018	2,015,833		184,480,835
Balance at June 30, 2018	2,015,833		182,465,002
Balance at July 31, 2018	2,015,833		180,449,169
Balance at August 31, 2018	2,015,833		178,433,336
Balance at September 30, 2018	2,015,833		176,417,503
Balance at October 31, 2018	2,015,833		174,401,670
Balance at November 30, 2018	2,015,833		172,385,837
Balance at December 31, 2018	2,015,833		170,370,004
13-Month Average Balance	**24,189,996**		**176,267,694**
Balance at January 31, 2019	3,305,500		167,064,504
Balance at February 28, 2019			167,064,504
Balance at March 31, 2019			167,064,504

This exhibit provided above does not include the numerical values for the funded status (row 3) or the unrealized losses/AOCI (row 4), as illustrated in the prior exhibit; however, it incorporates the uncontested $167.705 million PPA balance amount at December 31, 2017, listed as the first value in the last column. That uncontested PPA balance amount was included within CenterPoint's 13-month average calculation for the proposed PPA. By referring back to the prior

[182] (200.073 million) + 370.442 million = 170.369 million.

[183] GCCC witness Kollen and CenterPoint witness Sanger, who is the enrolled actuary for the pension plan, agree on this balance amount. CenterPoint Ex. 1 at 5742, Exh. WP/WP II-B-10 Adj. 3. The numbers may be off by "1" due to rounding.

CenterPoint exhibit, one can calculate that uncontested PPA amount by summing the 2017 *negative* funded status value (row 3) and the 2017 unrealized losses/AOCI value (row 4).[184] Thus, although it is not apparent on its face, the PPA balance amount as listed in the above-referenced exhibit includes unrealized losses.

Consequently, the ALJs find that CenterPoint's assertion that the proposed PPA does not include unrealized losses implausible and refer back to CenterPoint's admission that to include unrealized losses in a rate filing would be double-counting. Consistent with Mr. Kollen's understanding, the ALJs recognize that CenterPoint is not requesting to include the entire $370.442 million of unrealized losses in rate base, rather just a portion (as illustrated through CenterPoint's above-referenced exhibits). Additionally, the ALJs find that Mr. Sanger's rebuttal testimony did not address Mr. Kollen's specific concerns regarding the inclusion of unrealized losses in the PPA that he identified in his direct testimony. In fact, the section of Mr. Sanger's testimony concerning the PPA did not even address the specific unrealized losses referenced by Mr. Kollen. Rather, in a separate section of his testimony, Mr. Sanger addressed the "$370.442 million in the Pension Plan" so as to explain that neither CenterPoint nor Mr. Kollen supported the inclusion of those unrealized losses in rate base.[185]

In sum, the ALJs recommend rejection of CenterPoint's proposed PPA because CenterPoint failed to meet its burden to overcome GCCC's evidence that its inclusion in rate base would double-count the return of unrealized losses and negatively reflect ratepayers.

D. Other Prepayments

Prepayments are expenditures for goods or services that a utility pays in advance in one accounting period to be recovered from ratepayers in a future period. Prepayments are included

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[184] *Negative* $164.084 million (row 3 - funded status) + $331.789 million (row 4 - unrealized losses/AOCI) = $167.705 million prepaid pension asset balance amount.

[185] CenterPoint Ex. 46 at 14-15.

in rate base using a 13-month average balance for the test year. CenterPoint requested a total adjusted test year balance for Other Prepayments of $14.1 million, which comprises $5.9 million of insurance, $5.3 million of other taxes, and $2.9 million of other miscellaneous items.[186] Of these items, the only one in dispute is the $5.3 million of other taxes, specifically Texas franchise taxes.

OPUC witness June M. Dively initially recommended an adjustment to Prepayments for Other Taxes on the ground CenterPoint made an extra quarterly payment of franchise taxes. Her adjustment would reduce rate base by $883,056 ($5,308,505 - $4,425,449).[187]

Citing CenterPoint's response to OPUC RFI 5-03, Ms. Colvin responded that CenterPoint pays franchise taxes monthly, not quarterly. Certain franchise taxes are required to be paid on the first day of every month. To be timely, a prepayment is made only when the first day of the month occurs on a Saturday, Sunday, or Monday (if it is a holiday). Consequently, the 13-month average is calculated based on prepayments recorded for those months in which CenterPoint had to prepay for an expense that occurs in the following month.[188]

After filing Ms. Dively's testimony, OPUC received CenterPoint's response to OPUC RFI 5-03, which made clear her assumption was incorrect; the prepayments were not made quarterly.[189] In its initial brief, OPUC withdrew her proposed adjustment and instead made a new proposal.

Under Commission rules, a utility may include in rate base a working capital allowance, which may include "reasonable prepayments for operating expenses."[190] OPUC argues that prepayments for taxes are considered working capital because a utility can use the money owed to

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[186] CenterPoint Ex. 12 at 901; RFP Sch. II-B-10.

[187] OPUC Ex. 1 at 34-35.

[188] CenterPoint Ex. 35 at 49.

[189] Tr. at 1307-08.

[190] 16 TAC § 25.231(c)(2)(B), (B)(ii).

the taxing authority until the taxes are actually paid. This is reflected in FERC's USOA, which groups Account 165, Prepayments, under "Current and Accrued Assets."[191] According to OPUC, because CenterPoint prepays its franchise taxes only when the first day of the month falls on a Saturday, Sunday, or Monday that is a holiday, it pays its franchise taxes at most two to four days in advance. To show that, OPUC's brief includes this table:[192]

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

OPUC argues that the amount of time between when these franchise taxes are processed and when they are due to the taxing authority (which represents weekend days, not business days) is too short for them to have cleared CenterPoint's bank account. OPUC infers CenterPoint has no meaningful opportunity to use these funds as working capital (as it would if it made franchise tax payments quarterly). OPUC concludes CenterPoint should not be allowed to earn a return on the 13-month average of these franchise tax prepayments. OPUC thus recommends removing $5,308,505—the full amount of the Other Taxes in Prepayments—from CenterPoint's working capital allowance.

CenterPoint complains that OPUC presented this argument for the first time in its initial brief and cites no evidence for it.

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[191] 18 C.F.R. Part 101, Balance Sheet Chart of Accounts.

[192] Tr. at 1309.

The ALJs recommend rejecting OPUC's current proposal because it was first made after the hearing. That timing denied CenterPoint an opportunity to cross-examine and to present evidence rebutting it.[193] OPUC's argument also makes assumptions that lack evidentiary support, such as the time required to clear CenterPoint's bank account.

E. Regulatory Assets and Liabilities [PO Issues 18, 19, 34, 41, 54, 59]

The PFD addresses all disputed issues relating to regulatory assets and liabilities in the sections that follow, which discuss specific regulatory assets or liabilities. Issues relating to UEDIT are addressed in PFD Section IX.A, regarding Rider UEDIT.

This case also presents two broad contested issues: (1) whether to amortize regulatory assets and liabilities over three years or five years; and (2) whether to include regulatory assets in rate base, earning a return, or to recover the asset's exact amount, with no return, through a rider. Regarding those broad issues, the parties' positions are summarized below:

- OPUC witness Dively recommended that the Commission reject CenterPoint's proposal to include its costs related to Hurricane Harvey restoration, the Medicare Part D subsidy, and SMT in rate base with a three-year amortization period. Instead, she proposed that they be recovered through three separate riders with a five-year amortization period.[194]

- Staff generally asserts that all of CenterPoint's regulatory assets and liabilities (including the assets for which Ms. Dively made her proposal above) should be amortized over five years. Staff is not opposed to the use of riders to recover those assets, but cautions that it may be desirable to limit the number of separate riders at any given time.[195]

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[193] *See, e.g.,* Tex. Gov't Code §§ 2001.051, 2001.087 ("[i]n a contested case, a party may conduct cross-examination required for a full and true disclosure of the facts").

[194] OPUC Ex. 1 at 5.

[195] Staff Ex. 4A at 31-32; Staff Initial Brief at 18, 21-22, 45.

- CenterPoint contests Ms. Dively's proposal to exclude those assets from rate base and instead recover them through separate riders, with no return. In the alternative, if the Commission approves Ms. Dively's rider proposal, CenterPoint requests that the costs for each of its regulatory assets and liabilities (with two exceptions) be included in a single rider to be amortized over three years. The exceptions are the TMT and UEDIT.[196]

- In general, OPUC is not opposed to CenterPoint's alternative proposal, so long as the regulatory assets and liabilities are not included in a single rider and the period of amortization for the riders is five years.[197]

For the reasons discussed in their individual subsections below, the ALJs recommend that CenterPoint's costs for Hurricane Harvey restoration, the Medicare Part D subsidy, and SMT be included in rate base with a three-year amortization period. Thus, the ALJs recommend that the Commission reject OPUC's and Staff's recommendations to amortize the assets over five years and to implement riders to recover those costs.

1. Protected Excess Deferred Income Tax

CenterPoint witness Charles W. Pringle testified its entire TCJA-related protected EDIT balance of $562.5 million must be returned to customers under the ARAM.[198] This amount will be reflected in rate base through ADFIT as the balance is returned to customers. No party contested CenterPoint's proposals on those matters, which the ALJs recommend be approved.

CenterPoint requests the ability, in future DCRF cases, to adjust its protected EDIT regulatory liability in rate base when calculating the DCRF rate. Ms. Colvin testified this treatment recognizes the benefit customers receive from return of protected EDIT as that return occurs over time.[199] CenterPoint requests a finding to that effect, to provide clarity regarding treatment of

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[196] CenterPoint Ex. 35 at 45.

[197] OPUC Initial Brief at 19.

[198] CenterPoint Ex. 13 at 1020. The ALJs address EDIT here and UEDIT in PFD Section IX.A.

[199] CenterPoint Ex. 12 at 937.

EDIT in future DCRF cases. This issue was not contested and the ALJs include such a finding in their findings of fact.

2. Hurricane Harvey Regulatory Asset

CenterPoint seeks to include a $73 million Hurricane Harvey regulatory asset in rate base, comprising $64.3 million of deferred system restoration costs and $8.7 million of related carrying costs, and to amortize the asset over three years.[200] OPUC challenges CenterPoint's requested asset amount (including both restoration expenses and carrying costs). GCCC challenges CenterPoint's requested carrying costs, but does not object to the amount of CenterPoint's requested system restoration expenses. On the other hand, Staff supports CenterPoint's total requested asset amount (including both restoration expenses and carrying costs).[201]

Additionally, OPUC and GCCC challenge CenterPoint's requested cost-recovery mechanism for the asset and recommend that it be established in a rider with an extended five-year amortization period. Staff does not oppose this recommendation, but cautions that it may be wise to limit the amount of separate riders established at any given time.[202]

a. OPUC's Objections to the Requested O&M Expense Amount

OPUC asserts CenterPoint's requested system restoration expenses should be reduced by $9.505 million because CenterPoint has claimed certain expenses without sufficiently validating the cost. OPUC argues that it identified expenses for which CenterPoint has no documentation to prove they are reasonable and necessary, and should thus be excluded from the requested

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200 CenterPoint Initial Brief at 32; CenterPoint Exs. 12 at 870, 35 at 8.

201 Staff Initial Brief at 18, 49.

202 Staff Ex. 3A at 18, 39. The ALJs note that Staff witness Marc Filarowicz recommended that all of CenterPoint's regulatory assets (including the requested Hurricane Harvey asset) and liabilities should be amortized over five years, rather than the three-year period CenterPoint proposes. *See* Staff Ex. 4A at 31.

regulatory asset.[203] OPUC relies on the results of the Hurricane Harvey Emergency Operation Plan (EOP) Expense Validation Review (Audit) as the basis for its recommended disallowance. OPUC witness Nalepa conceded that the Audit concluded that CenterPoint's EOP expense validation provided reasonable justification for Hurricane Harvey-related expenses; but, he stressed the Audit also identified numerous instances where CenterPoint's costs were incorrect or inadequately documented.[204] He testified the costs identified by the Audit primarily consisted of: EOP hotel expenses; EOP catering and logistics expenses; and EOP OnePay expenses.[205] Thus, according to OPUC, CenterPoint failed to sufficiently prove that those expenses identified by the Audit are reasonable and necessary.

In response, CenterPoint concedes that $96,696 in expenses, and associated carrying costs, should be excluded from the regulatory asset as those costs include invoices with unresolved discrepancies; hotel occupancy taxes and catering expenses with inconsistent contract rate documentation; employee awards and gifts; and expensed capital costs.[206] CenterPoint contests the remainder of OPUC's recommended disallowance, and argues that OPUC's recommendation mischaracterizes the Audit's findings. CenterPoint admits that the Audit identified some opportunities for improvement in the documentation and control process, but argues that determination is not the ratemaking standard by which the Commission should approve or disallow expenses for its requested Hurricane Harvey asset and does not undercut the reliability of the underlying data.[207] As CenterPoint witness Kelly Gauger testified, "[a]though certain items lacked *full* documentation, sufficient documentation did exist to conclude that these expenses were incurred in support of Hurricane Harvey storm restoration efforts and were valid and appropriate."[208] For example, Ms. Gauger stated that Audit staff was able to confirm most of the

[203] OPUC Initial Brief at 58-60.

[204] OPUC Ex. 5 at 16-18, Exh. Attachment KJN-3 (confidential).

[205] OPUC witness Nalepa explained that the EOP OnePay is an expense approval and reimbursement system.

[206] CenterPoint Initial Brief at 33 (responding to OPUC Ex. 5A at 15-18).

[207] CenterPoint Initial Brief at 33.

[208] CenterPoint Ex. 38 at 6.

hotel expenses because they were for reserved room blocks, during the response period, and conformed to the agreed rates. And, while OPUC correctly points out that $1.52 million worth of invoices were not signed when services were rendered, Ms. Gauger asserted they were ultimately signed while the restoration efforts were ongoing.[209]

Moreover, CenterPoint disputed OPUC witness Nalepa's computation method for his recommended disallowance because he extrapolated or grossed-up the Audit findings, which relied on judgmental sampling, to the entire population of certain cost categories.[210] CenterPoint witness Gauger stated that such a gross-up is not appropriate when judgmental sampling is used.[211]

OPUC responds that, because CenterPoint's judgmental sampling did not sample every invoice, Mr. Nalepa's computation method was a necessary and reasonable way to estimate the portion of expenses that did not have adequate documentation. Alternatively, OPUC asserts that if the amounts are not grossed-up, the total amount of the invoices identified by the audit as lacking documentation should be excluded.

The ALJs recommend that the Commission approve CenterPoint's requested $64.3 million of deferred system restoration costs, net the $96,696 CenterPoint agreed to exclude. This recommendation is discussed in more detail below.

b. OPUC's and GCCC's Objections to the Requested Carrying Costs

OPUC and GCCC assert that CenterPoint's request for $8.7 million in Hurricane Harvey-related carrying costs should be rejected in its entirety. They argue that CenterPoint first presented its request for carrying costs in its Errata 1 filing on May 20, 2019, but that the request was improper because it was not made to correct an error. Rather, they assert CenterPoint's request

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209 CenterPoint Ex. 38 at 6, 8.

210 OPUC Ex. 5 at 16-17.

211 CenterPoint Ex. 38 at 10-11.

was simply a new proposal.[212] GCCC witness Kollen stressed that CenterPoint did not file revised schedules and workpapers contemporaneously with its Errata 1 filing, but rather eleven days later on May 31, 2019, and that CenterPoint filed no direct testimony in support of its request.[213] Mr. Kollen referenced CenterPoint's response to a Staff RFI, Staff 8-14, in which CenterPoint stated that it had "inadvertently excluded the carrying charges from its initial filing."[214] Mr. Kollen also claimed that during the parties' June 4, 2019 technical conference CenterPoint stated that its review of Staff RFI 8-14 caused it to consider whether it should seek recovery of carrying charges.[215] Based on this information, Mr. Kollen opined that CenterPoint's omission of carrying charges in its original RFP was not "inadvertent," but rather "an opportunistic attempt to increase its revenue requirement…."[216]

GCCC argues that CenterPoint's request to recover carrying costs should be rejected because CenterPoint relies on PURA § 36.402, which is inapplicable.[217] GCCC explains that, although PURA §§ 36.401-.403 do provide authority for deferral and recovery of carrying costs on qualified storms, they do so only in conjunction with securitization financing of such qualified costs, and there is a $100 million threshold requirement to qualify. As Mr. Kollen testified, CenterPoint's total $73 million request does not meet that threshold and therefore those statutory provisions do not apply. Mr. Kollen reiterates this argument to differentiate the current proceeding from CenterPoint's Hurricane Ike recovery costs, which the Commission approved in Docket

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[212] GCCC Ex. 1 at 12-13.

[213] GCCC Ex. 1 at 9-10.

[214] GCCC Ex. 1, Exh. Att. B at 98.

[215] CenterPoint corroborates Mr. Kollen's statement in its reply brief, which states that CenterPoint "identified the need to request carrying charges in the course of responding to a discovery response from Staff." CenterPoint Reply Brief at 41.

[216] GCCC Ex. 1 at 13.

[217] OPUC witness Nalepa testified that CenterPoint's Errata 1 filing did not identify the legal authority that CenterPoint relies on to recover carrying charges, but that CenterPoint indicated at the June 4, 2019 technical conference that it was relying on PURA §§ 36.401-.403, which authorize electric utilities to securitize storm restoration costs.

No. 36918.[218] Specifically, Mr. Kollen emphasized that in that docket, CenterPoint sought recovery of $677 million of restoration costs, including carrying costs, which clearly met the $100 million statutory threshold for securitization financing.[219]

Additionally, in the event the Commission approves CenterPoint's request for carrying costs, OPUC requests that CenterPoint's computation of its carrying costs be corrected prior to inclusion in the asset, which would result in a $1.275 million reduction.[220] OPUC notes that PURA § 36.402(b) applies exclusively to securitized system restoration costs rather than base-rate proceedings, but suggests it could provide guidance on calculating CenterPoint's requested carrying costs.[221] According to OPUC witness Nalepa, CenterPoint calculated the carrying costs using a monthly compound interest formula which would result in an over-recovery of the asset.[222] He recommended that CenterPoint should instead use a "simple interest" formula that mimics the methodology used to calculate the return component of CenterPoint's cost of service.[223] Mr. Nalepa testified that under his simple formula the total balance amount for carrying costs would be $8.616 million, which is a $0.126 million reduction to CenterPoint's request.

CenterPoint strongly objects to GCCC's and OPUC's arguments regarding whether its request for carrying charges was appropriately presented in the Errata 1 filing. Simply, CenterPoint claims that its request was a correction of an oversight error, and thus properly included in errata.

CenterPoint argues that GCCC's position that PURA §§ 36.401-403 does not support its request to recover carrying costs is flawed. CenterPoint asserts that although the relevant PURA

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[218] *See Application of CenterPoint Energy Houston Electric, LLC for Determination of Hurricane Restoration Costs*, Docket No. 36918, Order (Oct. 14, 2009).

[219] GCCC Ex. 1 at 12.

[220] OPUC Initial Brief at 23; GCCC Initial Brief at 29.

[221] OPUC Initial Brief at 23.

[222] OPUC Ex. 5 at 21.

[223] OPUC Ex. 5 at 21.

subchapter is called "Securitization for Recovery of System Restoration Costs" the statutory language within that subchapter is not limited to securitization proceedings. CenterPoint refers to the plain language of PURA §§ 36.405(a) and 36.402(b) set out in relevant part below for support.

> PURA § 36.405(a):
>
> An electric utility is entitled to recover system restoration costs consistent with the provisions of this subchapter and *is entitled to seek recovery of amounts not recovered under this subchapter*, including system restoration costs not yet incurred at the time an application is filed under Subsection (b), *in its next base rate proceeding or through any other proceeding authorized by Subchapter C or D.*[224]
>
> PURA § 36.402(b):
>
> *System restoration costs shall include carrying costs* at the electric utility's weighted average cost of capital as last approved by the commission in a general rate proceeding from the date on which the system restoration costs were incurred until the date that transition bonds are issued or *until system restoration costs are otherwise recovered pursuant to the provisions of this subchapter.*[225]

Additionally, CenterPoint asserts PURA § 36.402(b) provides for the recovery of carrying charges for storm restoration costs under $100 million due to the statute's reference to transition bonds, which CenterPoint asserts are issued following a securitization proceeding, or "until system restoration costs are otherwise recovered."[226]

CenterPoint also challenges OPUC witness Nalepa's recommendation that a "simple formula" be used to compute the carrying costs instead of CenterPoint's compounded method. More specifically, CenterPoint argues its compounded method: (1) reflects the actual carrying costs; (2) is supported by Staff; and (3) is consistent with Commission practice.[227]

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[224] Emphasis added by CenterPoint.

[225] Emphasis added by CenterPoint.

[226] CenterPoint Initial Brief at 34.

[227] The ALJs note that CenterPoint cited a document not in evidence as support of its assertion that its use of a compounded method to compute carrying costs is consistent with Commission practice; thus, the ALJs did not rely on that document in making their recommendation.

In sum, CenterPoint emphasizes Staff's support for its recovery of the identified carrying costs and the Commission's prior approval of a similar CenterPoint request for Hurricane Ike recovery costs, including carrying costs.[228] Specifically, Staff witness Jorge Ordonez testified that he recommended the Commission approve CenterPoint's carrying costs "because PURA § 36.402 expressly provides for such recovery" and because he believed "it is important to assure utilities that the Commission will allow them to recover prudently incurred costs, including carrying costs, associated with hurricane restoration."[229]

The ALJs recommend that the Commission reject CenterPoint's request to recover $8.7 million in Hurricane Harvey-related carrying costs. This recommendation is discussed in detail below.

c. Contested Cost-Recovery Method

OPUC witness Dively and GCCC witness Kollen recommended that the requested asset be removed from rate base and recovered via a hurricane cost recovery factor rider (Rider HCRF) with an extended five-year amortization period.[230] Ms. Dively favored a rate rider approach for this asset due to its large balance amount and because the costs consist of one-time expenses. Under Ms. Dively's recommended approach, OPUC contends, CenterPoint will not over-recover the asset and the extended recovery period will mitigate the rate impact to customers. Ms. Dively referred to Docket No. 48401 as an example of a similar HCRF rider (albeit much smaller)

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[228] Docket No. 36918, Final Order at FoF No. 24.

[229] Staff Ex. 3A at 39.

[230] OPUC Ex. 1 at 15-16. In its initial brief, OPUC asserts that if its recommendation regarding Rider HCRF is adopted, then all issues associated with the Hurricane Harvey asset, including carrying costs, should be addressed in a separate compliance docket. OPUC supports this approach as it is consistent with Docket No. 48401, and asserts it would provide for a deliberate and thorough review of: (1) whether CenterPoint should be permitted to recover carrying charges, and (2) whether CenterPoint's requested $8.7 million amount and carrying charge rate applied are reasonable. *See* OPUC Initial Brief at 22; *Application of Texas-New Mexico Power Company for Authority to Change Rates*, Docket No. 48401, Order at FoF No. 64 (Dec. 20, 2018)(Docket No. 48401 order). The ALJs do not recommend that Rider HCRF be established; thus, the ALJs do not further address OPUC's request for a separate compliance docket as described above.

approved by the Commission to be amortized over five years.[231] OPUC recognizes Docket No. 48401 was resolved through a Commission-approved settlement and is not precedential.

Similarly, Mr. Kollen testified that a rate rider is necessary to guarantee that CenterPoint recovers the costs deferred to the regulatory asset and the related return on the asset, no more and no less. He indicated that this guarantee of "no more, no less" was the reason CenterPoint proposed a rider as the mechanism through which to return UEDIT to its customers (Rider UEDIT is discussed later in this PFD). It is Mr. Kollen's understanding that if CenterPoint's proposal is approved, CenterPoint will over-recover "potentially in the tens of millions of dollars" because the revenue requirement will be set at the peak of the cost curve, which will continue to be recovered until base rates are reset, presumably in CenterPoint's next base rate case.[232] He emphasized his concern regarding this potential outcome due to the assets' large balance amount.

In contrast, CenterPoint maintains that a three-year amortization is reasonable and consistent with the Commission's decision regarding its regulatory assets approved in Docket No. 38339.[233] CenterPoint contests the parties' concern regarding its potential over-recovery of the requested asset and refers to PURA § 36.065 (relating to pension and other postemployment benefits) as an example of a regulatory asset authorized by PURA even though it creates a situation where a utility may experience an over- or under-recovery over the life of the asset.

In response to Mr. Kollen's comparison of CenterPoint's proposals for the Hurricane Harvey asset and Rider UEDIT, CenterPoint stresses that the balance amount for Rider UEDIT is expected to change over time, perhaps significantly so. CenterPoint asserts that this variability is conducive to a rider so that CenterPoint can track and record any over- or under-recovery of amounts collected under Rider UEDIT compared to the actual net liability amount.[234] The balance

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231 *See* Docket No. 48401, order at FoF No. 62.

232 GCCC Ex. 1 at 37.

233 CenterPoint Initial Brief at 30-31.

234 CenterPoint Ex. 12 at 910.

amount for the requested Hurricane Harvey asset is not expected to change, thus CenterPoint asserts a rate rider is not necessary.

d. ALJs' Analysis and Recommendation

The ALJs recommend that the Commission approve CenterPoint's request to establish a Hurricane Harvey regulatory asset in rate base encompassing CenterPoint's $64.3 million system restoration costs, net a reduction of $96,696, and that the Commission include that asset in rate base to be amortized over a three-year period. Additionally, the ALJs recommend that the Commission reject CenterPoint's request to recover its identified $8.7 million carrying costs.

The ALJs conclude that CenterPoint met its burden to overcome OPUC's testimony recommending disallowance of system restoration expenses. The ALJs found CenterPoint's evidence regarding how it validated its Harvey restoration experiences through a multi-layered approach to be compelling. CenterPoint implemented a multi-step process which reviewed its system restoration expenses through: (1) its robust system of pre-existing internal controls; (2) the efforts of the Hurricane Harvey expense validation team; and (3) the Audit itself. When weighed with the other record evidence, the ALJs find CenterPoint's requested system restoration expenses to be reasonable and necessary.

The ALJs acknowledge OPUC's and GCCC's arguments about not receiving notice of CenterPoint's request to recover carrying costs until its Errata 1 filing; however, the ALJs do not find it appropriate to reject CenterPoint's request on that basis alone. The ALJs find that the lack of evidence supporting the carrying costs and the lack of authority to recover those costs are sufficient bases on which to recommend rejection. The ALJs agree with GCCC witness Kollen that the specific statutory authority relied on by CenterPoint is inapplicable in this case. Securitized bonds have not been issued for these funds and the amounts incurred are below the statutory threshold.

Finally, nothing about the Hurricane Harvey-related asset, in the abstract, requires that it be recovered by a rider as opposed to a three-year recovery through base rates. The expenses were already booked (deferred), and can be calculated as a lump sum at this time. By contrast to a variable expense, in which a rider might be particularly appropriate, the fixed expense of the Hurricane Harvey relief asset is amenable to recovery through base rates.

3. Medicare Part D Regulatory Asset

CenterPoint seeks to include in rate base a Medicare Part D regulatory asset of $33.2 million, amortized over a three-year period. GCCC opposes any recovery of the regulatory asset and, in the alternative, argues that the asset should be only $5.572 million. OPUC proposes amortizing the regulatory asset over a five-year period and recovering it through a rider, without any return. For reasons discussed below, the ALJs recommend including in rate base a Medicare Part D regulatory asset of $5.572 million, amortized over a three-year period.

a. Relevant Docket No. 38339 Order Language

The Commission's RFP instructions for transmission and distribution utilities state: "For each item the utility claims as a regulatory asset, the utility shall specifically identify the Commission order (including applicable pages) or other authority upon which this claim is based."[235] CenterPoint cites the Docket No. 38339 order as its authority for claiming the Medicare Part D regulatory asset.

The Docket No. 38339 order discussed federal statutes adopted in 2003 and 2010 relevant to the Medicare Part D regulatory asset, stated the Commission's decisions about the statutes' effect on rates set in that case, and discussed CenterPoint's next base rate case, which is this case. The parties here present different interpretations of pertinent language in that order. Because that language is important to the issues in dispute, it is set forth below:

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[235] OPUC Ex. 1 at 10.

> The Medicare Prescription Drug Improvement and Modernization Act of 2003 [2003 Medicare act] expanded Medicare to include prescription drug benefits for retirees equivalent to Medicare Part D benefits. This Act also provides for a 28% nontaxable subsidy for an employer's cost for providing prescription drugs to its retirees and this subsidy did not diminish the tax deductibility of the subsidized prescription drug benefits paid by CenterPoint. The Patient Protection and Affordable Care Act and Health Care and Education Reconciliation Act of 2010 [collectively, 2010 health care acts] will eliminate the non-taxable status of the subsidy beginning January 1, 2013. The actual amounts of the Medicare Part D subsidy received prior to January 1, 2013 will continue to be nontaxable, while amounts received during 2013 and beyond will effectively become taxable. Consequently, CenterPoint will experience a Medicare Part D subsidy expense increase January 1, 2013.[236]

As GCCC, OPUC, and Staff had recommended in Docket No. 38339, the Commission did not include the increase in Medicare Part D subsidy expense in the rates set in that case. The Commission explained: "The termination date of the subsidy is December 31, 2012, nearly two years in the future. It is not in the public interest to approve expenses that will be incurred that far in the future in the rates set in this proceeding."[237]

The Docket No. 38339 order also discussed the Medicare Part D regulatory asset CenterPoint proposed in that case:

> CenterPoint 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. The receivable was reduced by the estimated Medicare Part D subsidy amounts that will be received in 2010, 2011 and 2012.[238]

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[236] Docket No. 38339 order at 21, FoF No. 67 (bracketed abbreviations added, footnotes omitted).

[237] Docket No. 38339 order at 9.

[238] Docket No. 38339 order at 9 (footnotes omitted).

The Commission ruled on CenterPoint's regulatory asset request as follows:

> The Commission... does not allow recovery of the three-year amortization of the \$9.3 million regulatory asset in the rates set in this proceeding. 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 [D] 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.*[239]

Finding of Fact No. 159A from that order, quoted below, is similar to the underlined language above but omits the words "continue to." As discussed below, whether computation of the regulatory asset should begin in 2004, as CenterPoint advocates, or in 2013, as GCCC advocates, depends on the interpretation of the pertinent order language, especially Finding of Fact No. 159A and the similar language boldfaced above.

Relevant findings of fact in the Docket No. 38339 order include the following:

> 147. The [2003 Medicare act] expanded Medicare to include prescription drug coverage.
>
> 148. CenterPoint began receiving a subsidy from the federal government equal to 28% of the cost of providing such coverage (the Medicare Part D subsidy).
>
> 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

[239] Docket No. 38339 order at 9-10 (footnote omitted, emphasis added).

and afterwards but nevertheless was required to be accrued under FASB Statement No. 106.

152. In 2010, Congress passed [the 2010 health care acts] that caused the Medicare Part D subsidy to be effectively taxable for tax years beginning after December 31, 2012.

153. The amount of Medicare Part D subsidy receipts that CenterPoint will receive in 2010, 2011, and 2012, which will continue to be non-taxable under the health care legislation, has already been fully reflected in the income tax calculations CenterPoint has recorded in its financial statements in years prior to 2010.

154. The health care acts effectively changed the tax rate applicable to the Medicare Part D subsidy from 0% to 35%.

155. The Commission has permitted the effects of changes in tax rates or tax laws to be recovered in rates charged to customers.

156. The effects of the health care acts have been reflected in CenterPoint's financial statements for the three months ended March 31, 2010, in accordance with GAAP.

159A. It is appropriate for CenterPoint to monitor and accrue the difference between what its rates assume the Medicare Part [D] 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.

b. GCCC's Proposal to Allow No Recovery of the Regulatory Asset

In this case, CenterPoint asks to include a Medicare Part D regulatory asset of $33.2 million (grossed-up) in rate base.[240] CenterPoint seeks to amortize this amount over three years through an amortization expense of $11.068 million.[241]

GCCC witness Kollen agreed with CenterPoint that the Docket No. 38339 order authorized it to record a Medicare Part D regulatory asset. As discussed below, however, he contended the

[240] CenterPoint Ex. 13 at 989, 1027-28.

[241] GCCC Ex. 1 at 27, citing CenterPoint workpapers (redacted), Tab WP CWP-01.

regulatory asset authorized by the order differs significantly from the regulatory asset CenterPoint sought in Docket No. 38339 and again in this case. Mr. Kollen also objected that in the present case, CenterPoint committed five errors in calculating the regulatory asset and did not provide information needed to correct the calculation. For those reasons, his primary recommendation was not to reflect any Medicare Part D regulatory asset in rates. In the alternative, he calculated a $5.572 million Medicare Part D regulatory asset using the data he was provided.[242]

As discussed later in the PFD, the ALJs find CenterPoint met its burden of proof regarding four of the five errors alleged by Mr. Kollen. The ALJs recommend accepting only his first alleged error—that the computation should begin in 2013 instead of 2004. Because, given the evidence, the ALJs find it unreasonable to deny CenterPoint any recovery of the regulatory asset, the ALJs recommend rejecting Mr. Kollen's primary recommendation. His alternative recommendation, a Medicare Part D regulatory asset of $5.572 million, is discussed below.

c. GCCC's Objections to CenterPoint's Computation of the Regulatory Asset

Regarding computation of the Medicare Part D regulatory asset, Mr. Pringle summarized the steps CenterPoint took after the Docket No. 38339 order:

- CenterPoint determined the actual permanent differences claimed on its tax returns from 2004 through 2010, reduced for actual non-taxable Medicare Part D subsidy receipts CenterPoint received for the same time period. The permanent differences claimed on the tax return were actuarially determined estimated receipts that were treated as adjustments to income tax expense, based on the assumption they would not be taxable when collected in future periods. In CenterPoint's 2006 and 2009 rate cases, tax expense was reduced reflecting that treatment.

- CenterPoint added to that number the $6.5 million permanent adjustment included in rates for the period 2011-2018, because that permanent tax benefit was included in rates in Docket No. 38339 and those rates took effect in 2011 and are expected to be in effect through 2019.

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242 GCCC Ex. 1 at 28, 30.

- CenterPoint reduced the permanent adjustment for 2011-2018 for actual Medicare Part D subsidy cash receipts received through the end of 2012, because those receipts were before the Health Care acts took effect and were non-taxable.

- The Medicare Part D subsidy permanent item for each year from 2004 through 2018 was then tax-effected at the rate in effect during the time the benefit was recognized. For 2004 through 2017, that rate was 35%; for 2018, it was 21%. The resulting calculation is a regulatory asset before gross-up of $26.2 million through 2018.

- Because that is a tax number, it was grossed-up using the current 21% tax rate (calculated as 1/(1- 21%)). After gross-up, the regulatory asset to be recovered from customers is $33.2 million.

- Because CenterPoint proposes recovery of the regulatory asset over a three-year period, it included 1/3 of the regulatory asset before gross-up, or $8.7 million, as an adjustment to increase tax expense in the test year.

- CenterPoint will continue to record changes to the Medicare Part D regulatory asset beyond the test year. The regulatory asset accrued from the end of the test year to the implementation date of new rates will be deferred for a future base rate recovery.[243]

As noted above, Mr. Kollen alleged CenterPoint made five errors in its computation of the Medicare Part D regulatory asset. They were:

1. CenterPoint included the years 2004 through 2012 in computing the regulatory asset.

2. CenterPoint did not offset the temporary difference reflected in the income tax expense allowed in rates in Docket No. 38339 by the changes in the temporary differences each year of 2013 through 2018.

3. CenterPoint did not update the Medicare Part D subsidy based on actual reports for each of those years.

4. CenterPoint did not offset the actual cash subsidies received from the federal government for each year of 2013 through 2018 as CenterPoint did for the years 2004 through 2012.

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[243] CenterPoint Ex. 13 at 1032-33.

5. CenterPoint did not remove the portion of this amount that was capitalized to CWIP.[244]

Each alleged error is discussed below.

i. Start Date

The first error that Mr. Kollen alleged CenterPoint made in calculating the Medicare Part D regulatory asset is that the computation begins in 2004, instead of in 2013.

In his direct testimony, Mr. Pringle discussed why CenterPoint computed the Medicare Part D regulatory asset beginning in 2004. He stated that under the 2003 Medicare act, and prior to the 2010 health care acts, receipt of the Medicare Part D subsidy was not taxable and did not reduce deductibility of drug benefits paid by CenterPoint. Because CenterPoint kept its books on an accrual basis, it created a customer-favorable permanent book/tax difference from 2004 through 2009 for the full amount—$28.6 million—of all anticipated Medicare Part D subsidies it expected ever to receive. That amount was not limited to subsidies to be received from 2004 through 2009; it included subsidies to be received well into this century.[245]

More specifically, Mr. Pringle stated, only $5.4 million of the $28.6 million permanent difference related to subsidies CenterPoint actually received from 2004 through 2009. The rest related to amounts that were anticipated to be received in 2010 and afterward, but were required to be accounted for as accrued under SFAS 106. CenterPoint expected to receive an estimated $6.0 million in subsidies in 2010-2012, with the remaining $17.2 million beginning only after 2012.[246]

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244 GCCC Ex. 1 at 29-30.

245 CenterPoint Ex. 13 at 1027-28.

246 CenterPoint Ex. 13 at 1029.

Mr. Pringle testified that when the 2010 health care acts made the Medicare Part D subsidy, after 2012, effectively taxable for accounting and financial statement purposes, those acts changed the assumptions as to the non-taxability of the subsidy for anticipated receipts of the subsidy after 2012. Although Medicare Part D subsidies actually received from 2004 through 2012 remained nontaxable, there was no longer a permanent item to consider in the income tax calculation for the subsidies to be received in 2013 and beyond. Effectively, the $17.2 million permanent difference became a temporary difference. As required by SFAS 106 and ASC 740, in 2010, CenterPoint made an entry reducing the ADFIT asset due to future Medicare Part D subsidy receipts received in and after 2013 now being taxable. Because CenterPoint believed the financial impacts from the tax law change would be recoverable in future rates, it established a regulatory asset. The regulatory asset was calculated by tax-effecting the $17.2 million temporary difference—that is, multiplying the $17.2 million by the 35% federal tax rate then in effect—to arrive at an ADFIT balance of $6.0 million. After a tax gross-up, the resulting regulatory asset was about $9.3 million.[247]

Mr. Pringle noted that in Docket No. 38339, the Commission concluded the year-end 2012 change making the Medicare Part D subsidy taxable was too far in the future to recover the regulatory asset in rates set in that case. Consequently, the order required CenterPoint to include the test-year Medicare Part D subsidy permanent adjustment (benefit) of $6.5 million as a reduction to taxable income in the income tax calculation, even though the permanent difference would no longer be available after 2012. The $6.5 million currently in rates was the 2009 test year actuarially-determined permanent benefit CenterPoint anticipated it would receive before the law changed. Using the 35% tax rate in effect for Docket No. 38339 and the associated tax gross-up factor of 1.53845, the annual revenue requirement reduction due to this permanent item is $3.5 million. This reduction to income tax expense is still in current rates, even though the Medicare Part D subsidy has been effectively taxable since 2013.[248]

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[247] CenterPoint Ex. 13 at 1027-30.

[248] CenterPoint Ex. 13 at 1030-31.

Citing Mr. Pringle's direct testimony, CenterPoint argues Mr. Kollen's proposal conflicts with the GAAP treatment of the 2003 Medicare act and the 2010 health care acts.

Citing Finding of Fact No. 159A of the Docket No. 38339 order (quoted earlier), CenterPoint also contends the Commission recognized that setting rates in that docket that did not reflect the health care acts would create a timing issue for CenterPoint with respect to the Medicare Part D subsidy. Consequently, CenterPoint contends the order authorized it to "continue to monitor and accrue" the difference—between what its rates had assumed the Medicare Part D subsidy expense would be and what CenterPoint was required to pay—as a regulatory asset to be addressed in its next rate case. CenterPoint noted that customers have benefited, and continue to benefit, from a $6.5 million reduction in taxable income in the income tax expense calculation as a result of the Commission's approach in Docket No. 38339.[249]

GCCC witness Kollen opined that in the Docket No. 38339 order, the Commission rejected CenterPoint's approach of computing the Medicare Part D regulatory asset beginning in 2004, instead of in 2013. After quoting Finding of Fact No. 159A, Mr. Kollen testified: "In other words, starting in January 2013, [CenterPoint] was authorized to defer the increase in income tax expense due to the taxability of the Medicare Part D subsidies, which became effective on January 1, 2013."[250]

GCCC argues that under the order, the Medicare Part D subsidy itself is irrelevant to computation of the regulatory asset; the issues are when the subsidy was taxable, and the increase in income tax expense once it became taxable. The order stated the subsidy did not become taxable until 2013 and was not taxable when the base revenue requirement was set based on the 2009 historic test year. GCCC contends the Commission concluded there was nothing to defer before 2013. According to GCCC, the Commission did not authorize a regulatory asset for the period before 2013, did not include CenterPoint's proposed regulatory asset in rate base, and did not let

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249 CenterPoint Ex. 13 at 1030-31.

250 GCCC Ex. 1 at 27-29.

CenterPoint amortize and recover its proposed regulatory asset. Instead, the Commission authorized CenterPoint to defer the increase in income tax expense for future consideration starting in 2013 due to the change in federal tax law.

In the Docket No. 38339 order's phrase "continue to monitor and accrue," GCCC argues "continue" modifies "monitor" but not "accrue." According to GCCC, "continue" cannot refer to "accrue," because the order's directive is to "accrue the difference between what [CenterPoint's] rates assume the Medicare Part [D] subsidy tax expense would be and the reality of what CenterPoint is required to pay." GCCC observes that in that phrase, "rates assume" is present tense and thus does not refer to the past. GCCC contends the phrase "the reality of what CenterPoint is required to pay" refers to the future because CenterPoint was not required to pay any tax on the subsidy until 2013, as the order repeatedly stated. GCCC concludes that under the order, CenterPoint was to accrue the difference between what its rates assume the Medicare Part D subsidy tax expense would be what CenterPoint is required to pay once the tax became payable, in 2013. GCCC also contends the Commission could not in 2011, and cannot now, retroactively establish a regulatory asset to allow a utility to recover expenses that it did not incur in prior years.[251]

In his rebuttal testimony, Mr. Pringle responded that the Docket No. 38339 order addressed the issue of when the impacts of the health care acts should be reflected in rates. The order does not state that only the impact of the acts from 2013 forward can be recovered or included in computing the Medicare Part D regulatory asset. Finding of Fact No. 159A does not mention years 2004 through 2012 or state the recoverable regulatory asset should be computed only for years beginning on or after January 1, 2013. That finding refers to "rates," not "rates to be established in a rate proceeding after 2012." Since 2004, CenterPoint's rates have assumed that Medicare Part D subsidies are not taxable. Mr. Pringle opined that, as reflected in Finding of Fact No. 159A, all

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