own generation. For example, CenterPoint faces low business and operational risk as a regulated TDU in Texas.[754] Texas TDUs have no commodity risk, resulting in low operating risks.[755]

In addition, HEB points to the fact that the Commission's regulatory oversight and rate-setting power create a low-risk environment for CenterPoint.[756] CenterPoint will always be insulated from its perceived business and regulatory risks because of the Commission's rate-setting power and PURA's mandate that the Commission set CenterPoint's revenues and rates at a level that will permit CenterPoint to earn a reasonable return on the its invested capital used and useful in providing service to the public in excess of CenterPoint's reasonable and necessary operating expenses.[757]

In addition, CenterPoint's ability to utilize regulatory cost-recovery mechanisms, like the TCRF, DCRF, and interim TCOS, reduce regulatory lag and allow CenterPoint to adjust its charges to customers to "fully recover its cost of service in a stable, predictable manner."[758] Thus, the implementation of these regulatory cost-recovery mechanisms reduces the investment risk to CenterPoint and its investors, and instead shifts the cost recovery risk from investors to ratepayers.[759]

6. Staff's Evidence and Arguments

Staff argues that the appropriate capital structure for CenterPoint consists of 60% long-term debt and 40% common equity. This recommended capital structure is consistent with long-

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[754] *See* OPUC Ex. 3 at 40 ("My [] recommendation includes my consideration of... CenterPoint[]'s low business and operating risk as a T&D utility in Texas."); *see also* TCUC Ex. 1 at 49 ("[CenterPoint]'s investment risk... is a little below the averages of the Electric and Hevert Proxy Groups."); Tr. at 561, 679.

[755] Tr. at 561, 679.

[756] HEB Initial Brief at 29.

[757] HEB Initial Brief at 30.

[758] Tr. at 565.

[759] Tr. at 616.

standing Commission precedent from Docket No. 22344, which found that a uniform capital structure consisting of 60% long-term debt and 40% common equity was appropriate for ratemaking purposes for all TDUs operating in Texas.[760]

Staff contends that the Commission's conclusion in Docket No. 22344 remains relevant because of two reasons. First, Moody's and S&P characterize the Texas regulatory environment as "constructive" or "credit positive." Second, the Commission recently stated in its Report on Alternative Ratemaking Mechanisms in Project No. 46046 that it believes that: (1) the ratemaking mechanisms for TDUs that operate in ERCOT are not in need of major revision, (2) the existing streamlined methods of recovery are generally achieving their intended purposes, and (3) the existing paradigm, in which periodic rate proceedings are used in combination with already available streamlined recovery mechanisms, is an efficient and effective way to balance the interests of all stakeholders and ensure that electric rates are just and reasonable. Staff believes all these factors reflect the low risk environment for TDUs operating in ERCOT.[761]

Staff observes that CenterPoint claims to have identified four business and regulatory risks that it faces that require adoption of its requested capital structure: elevated capital expenditures risk, risk posed by the TCJA, risk of catastrophic damage from hurricanes, and regulatory risks.[762] As for the elevated capital expenditure risk and the effect of the TCJA, the nature of the utility industry requires significant capital expenditures, and in Texas, the risk associated with the timely recovery of transmission and capital expenditures is mitigated by two mechanisms: (1) the interim TCOS mechanism, which permits CenterPoint to adjust its transmission rates twice a year to account for increases in transmission investment and transmission investment-related expenses, and (2) the DCRF mechanism, which permits CenterPoint to adjust its distribution-related rates

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[760] Staff Ex. 3A at 36. Following the unbundling of the Texas electric market in 2002, the Commission concluded that TDUs operating in Texas "would face substantially lower risks than those currently faced by the integrated utilities. *Generic Issues Associated with Applications for Approval of Unbundled Cost of Service Rate Pursuant to PURA § 39.201 and Public Utility Commission Substantive Rule § 25.244*, Docket No. 22344, Order No. 42, (Dec. 22, 2000).

[761] Staff Ex. 3A at 37.

[762] CenterPoint Ex. 27 at 2835.

once per year to account for increases in distribution investment and distribution investment related expenses.[763]

Staff notes that the risks posed by the TCJA may be mitigated through the authorized ROE or authorized depreciation rates.[764] Staff states that it is recommending the adoption of CenterPoint's proposed depreciation rates and that the effects of the TCJA be taken into account in setting the ROE. The TCJA affects all utilities, and therefore the risks posed by the TCJA have already been accounted for in Staff's estimation of CenterPoint's ROE. The objective of a comparable company analysis is to estimate the cost of equity for a subject company by estimating the cost of equity for companies with similar risk characteristics.[765]

Regarding the risk of catastrophic damage from hurricanes, Staff contends that Texas law allows utilities that suffer hurricane damage to recover storm restoration costs including carrying charges (a relief that CenterPoint is availing itself of in this very proceeding).[766]

With respect to CenterPoint's argument that the Commission should provide extraordinary relief to assist CenterPoint in maintaining an A- issuer rating. Staff witness Ordonez believed that, at a high level, it is the Commission's function to set just and reasonable rates based on PURA and the Commission's rules, and that it is the responsibility of CenterPoint's management to conduct operations in a manner that maintains CenterPoint's investment-grade rating and enhances overall creditworthiness.[767]

CenterPoint witness McRae pointed out that the average equity ratio of the companies in CenterPoint witness Hevert's proxy group, which includes vertically integrated utilities, is

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763 Staff Ex. 3A at 31.

764 CenterPoint Ex. 27 at 2841; CenterPoint Ex. 43 at 7.

765 Staff Ex. 3A at 31.

766 Staff Ex. 3A at 32.

767 Staff Ex. 3A at 33.

approximately 53%. He also pointed out that, according to the S&P Global Market Intelligence's RRA Regulatory Focus report for 2018 (2018 S&P Global Market Intelligence RRA Report), the average equity ratio for delivery-only electric utilities authorized by other state regulatory commissions for calendar year 2018 was 49.91%.[768] In addressing these arguments, Staff pointed out that CenterPoint is a TDU. Therefore, a capital structure resulting from a proxy group that includes vertically integrated utilities is inappropriate. A capital structure resulting from delivery-only electric utilities in other jurisdictions is also inappropriate because, after reviewing the financial information of the delivery-only electric utilities in the 2018 S&P Global Market Intelligence RRA Report, Staff witness Ordonez found that 14 of the 16 delivery-only electric utilities in the 2018 S&P Global Market Intelligence RRA Report purchase and sell electricity. Therefore, unlike CenterPoint, 14 of the 16 delivery-only electric utilities are exposed to commodity risk. The capital structures of the delivery-only electric utilities in the 2018 S&P Global Market Intelligence RRA Report, while a better proxy for CenterPoint than vertically integrated utilities, are not the most representative proxy for CenterPoint, which is a TDU (*i.e.*, a wires-only utility) that does not purchase and sell electricity.[769]

7. ALJs' Analysis and Recommendation

CenterPoint proposes a dramatic shift in its capital structure, moving from 55% debt and 45% equity to 50% debt and 50% equity. Virtually all of the intervenors and Staff propose an equally dramatic shift in the opposite direction, from 50% debt and 50% equity to 60% debt and 40% equity. Among those offering a primary recommendation, only OPUC proposes a capital structure approaching CenterPoint's currently approved capital structure, with that recommendation being 54.5% debt and 45.5% equity.

A closer examination of the parties' evidence and arguments, however, discloses that parties other than OPUC do not reject a capital structure approaching the current capital structure

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[768] Staff Ex. 3A at 34-35; CenterPoint Ex. 27 at 2854.

[769] Staff Ex. 3A at 35.

out of hand. TCUC, for example, makes an alternate recommendation of 0.90% short-term debt, 55.48% long-term debt, and 43.62% equity. Excluding short-term debt as discussed in Section III.B of this PFD leaves the recommended capital structure very close to CenterPoint's currently approved capital structure of 55%/45%. HEB makes a similar concession in its argument, citing with approval TCUC witness Woolridge's statement that CenterPoint is currently able to raise capital based on its Commission-approved capital structure of capital structure of 55% debt to 45% equity.[770] CenterPoint itself has presented evidence that rating agencies consider an equity ratio of 45% a credit positive event.[771]

The ALJs' view of the evidence is that both the 50%/50% advocated by CenterPoint and the 60%/40% advocated by Staff and intervenors represent extremes. One intervenor (OPUC) has openly advocated for a capital structure approximating CenterPoint's currently approved capital structure, and one has urged adoption of a similar capital structure as an alternative recommendation. Even CenterPoint has presented evidence that a 55%/45% capital structure would be a credit-positive event. The ALJs understand that Staff is urging the adoption of a capital structure that it views as being consistent with current Commission practice but, as Staff noted, this practice is not set in stone. The ALJs view the most appropriate and reasonable capital structure for CenterPoint as being 55% long-term debt and 45% equity, and recommend the Commission adopt this capital structure.

D. Overall Rate of Return [PO Issue 8]

The overall rate of return is a product of the capital structure, ROE, and cost of debt. Based on the discussion set forth above, the ALJs recommend that the Commission adopt the following overall rate of return for CenterPoint:

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[770] HEB Initial Brief at 28, *citing* TCUC Ex. 1 at 21; *see also* TIEC Ex. 5 (CenterPoint's Response to TCUC RFI 1-17) at 29 ("[CenterPoint]'s approved regulatory capital structure has supported its credit rating and financial integrity for many years.").

[771] CenterPoint Ex. 43, Confidential Exh. R-RBM-3 at 1.

Component	Cost	Weighting	Weighted Cost
Debt	4.38%	55%	2.41%
Equity	9.42%	45%	4.24%
Overall			6.65%

E. Financial Integrity [PO Issue 9]

For reasons addressed above, and after considering the financial impacts that CenterPoint's affiliates have on it (discussed below), the ALJs find that their recommended rate of return is sufficient to maintain CenterPoint's financial integrity and ability to provide reliable service at just and reasonable rates. In the rest of this section, the ALJs discuss such affiliate-related impacts and the financial protections proposed to address them.

Issue 9 in the Commission's Preliminary Order is: "Are any protections, such as financial protections, appropriate to protect CenterPoint's financial integrity and ability to provide reliable service at just and reasonable rates?" Regarding that issue, Staff and TIEC presented ring-fencing proposals.[772] HEB supports those proposals.[773] CenterPoint opposes them, arguing that: (1) the Commission lacks authority in this rate case to order ring-fencing that CenterPoint opposes; and (2) the proposals are unnecessary because CenterPoint's voluntarily-imposed ring-fencing is adequate.

The ALJs recommend that the Commission adopt most but not all of the ring-fencing proposals. The sections below discuss the Commission's authority to require ring-fencing in this case, the need for utilities with affiliates to have an adequate ring fence, financial impacts that CenterPoint's affiliates have on it, CenterPoint's current voluntary ring fence and Staff's and

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772 In a regulatory context, "ring-fencing" refers to the general concept of establishing various requirements or policies that effectively isolate and thereby insulate a regulated entity from the effects of a parent organization's financial distress and, in a worst case, bankruptcy. Staff Ex. 1A at 8.

773 Because HEB's arguments duplicate those of Staff and TIEC, they are not separately discussed.

TIEC's ring-fencing proposals, the adequacy of CenterPoint's current ring fence or the need for a stronger ring fence, and the ALJs' recommendations regarding specific ring-fencing proposals.

1. Commission Authority to Require Ring-Fencing in this Case

For reasons discussed below, the ALJs conclude that PURA grants the Commission authority to order the ring-fencing recommended in the PFD.

To date, the only Commission orders that require ring-fencing are the Oncor Ring-Fencing Orders.[774] Those requirements originally applied to Oncor and its relevant affiliates, and now apply to Oncor, a few other electric utilities that were part of a sale-transfer-merger transaction regarding Oncor, and relevant affiliates of each. Although Staff and TIEC based their proposed ring-fencing measures in this case on those approved in the Oncor cases, the Commission's authority to require such measures here presents issues of first impression, due to two factual differences between this case and the Oncor cases. First, in the Oncor cases, the utilities and affiliates required to comply with the ring-fencing committed to do so, whereas CenterPoint and its affiliates have not made any such commitment. Second, the Oncor cases involved Commission approval of transactions requiring such approval under statutes discussed below, whereas this is a rate case. CenterPoint cites both differences in arguing the Commission lacks authority to order ring-fencing in this case.

Citing the Commission's broad authority under PURA §§ 11.002 and 14.001 (quoted later in this section), Staff and TIEC argue that in a rate case, when reviewing a utility's financial risk

[774] Staff Ex. 1A at 8. *See Joint Report and Application of Oncor Electric Delivery Company LLC, Sharyland Distribution & Transmission Services, L.L.C., Sharyland Utilities, L.P., and Sempra Energy for Regulatory Approvals Under PURA §§ 14.101, 37.154, 39.262, and 39.915*, Docket No. 48929, Order (May 9, 2019); *Joint Report and Application of Oncor Electric Delivery Company LLC and Sempra Energy for Regulatory Approvals Pursuant to PURA §§ 14.101, 39.262, and 39.915*, Docket No. 47675, Order (Mar. 8, 2018); *Joint Report and Application of Oncor Electric Delivery Company LLC, Ovation Acquisition I, LLC, Ovation Acquisition II, LLC, and Shary Holdings, LLC for Regulatory Approvals Pursuant to PURA §§ 14.101, 37.154, 39.262(l)-(m), and 39.915*, Docket No. 45188, Order (Mar. 24, 2016); *Joint Report and Application of Oncor Electric Delivery Company and Texas Energy Future Holdings Limited Partnership Pursuant to PURA § 14.101*, Docket No. 34077, Order on Rehearing (Apr. 24, 2008) (collectively, Oncor Ring-Fencing Orders).

in setting just and reasonable rates, the Commission has authority to require the utility to implement protective ring-fencing mechanisms. In addition, Staff witness Darryl Tietjen quoted a CenterPoint discovery response in its last rate case, which stated:

> Ring-fencing occurs when a regulated public utility business financially separates itself from its parent or an affiliate that engages in non-regulated business. This is done mainly to protect consumers of essential services such as power, water, and basic telecommunications from financial instability or bankruptcy of the affiliate. Ring-fencing policies may be of a regulatory or financial nature....
>
> [CenterPoint] employs practices to provide a regulatory ring-fence to isolate and protect the jurisdictional regulated utility and its customers from any adverse financial impact resulting from activities of the parent company and unregulated affiliates. *In fact, PURA and the Commission's Substantive Rules require [CenterPoint] to employ such practices.*[775]

In arguing the Commission cannot order ring-fencing in this rate case, CenterPoint cites case law holding that the Commission "has only the powers that the Legislature confers upon it" and "any implied powers that are necessary to carry out the express responsibilities given to it by the Legislature."[776] PURA chapter 36, entitled "Rates," provides the Commission authority to "establish and regulate the rates of an electric utility"[777] but does not mention ring-fencing. Because the Commission previously set rates without imposing ring-fencing, CenterPoint contends, such a power is not necessary to carry out its express rate-setting responsibilities.

In contrast, CenterPoint argues, PURA expressly authorizes the Commission to interpret and enforce conditions on certain transactions requiring its approval. Section 39.262(o) provides that if an electric utility or "a person seeking to acquire or merge with an electric utility" files a stipulation, representation, or commitment in connection with a filing under §§ 39.262(l) or 14.101, the Commission may enforce the stipulation, representation, or commitment and may

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[775] Staff Ex. 1A at 10, quoting Docket No. 38339 order, CenterPoint's response to GCCC RFI 1-07 (emphasis added by Mr. Tietjen).

[776] *Public Util. Comm'n v. City Pub. Serv. Bd.*, 53 S.W.3d 310, 316 (Tex. 2001).

[777] PURA § 36.001.

reasonably interpret and enforce conditions adopted under § 39.262.[778] A court has noted that "[p]rior to the enactment of subsection 39.262(o), the Commission had no express authority to enforce stipulations filed as part of a notification of a proposed transaction under section 14.101" but "section 39.262(o) granted the additional authority to enforce stipulations made as part of a filing under section 14.101."[779] CenterPoint argues that §§ 14.101, 39.262, and 39.915 created Commission authority to enforce ring-fencing for a specific purpose: review and approval of certain transactions. CenterPoint concludes the Commission has no general implied power to enforce ring-fencing, because if it did, that specific grant of authority would be redundant and without purpose, contrary to requirements of statutory construction.

The ALJs agree with CenterPoint that PURA grants the Commission express authority, in connection with a PURA § 14.101, § 39.262, or § 39.915 transaction, to interpret and enforce conditions proposed by a party to the transaction. The ALJs find unconvincing CenterPoint's arguments that the Commission lacks implied authority to impose ring-fencing or that its authority in a rate case excludes its authority under PURA provisions that are not in chapter 36.[780]

As part of their analysis, the ALJs considered the consequences of CenterPoint's interpretation[781] if an electric utility's financial integrity or ability to provide reliable service at just and reasonable rates was in peril because its corporate parent was near bankruptcy or was

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778 PURA § 39.915 is similar. Collectively, §§ 14.101, 39.262(l), and 39.915 relate to transactions in which: (1) the electric utility will be merged or consolidated with another electric utility; (2) at least 50% of the electric utility's stock will be transferred or sold; (3) a controlling interest or operational control of the electric utility will be transferred; or (4) the electric utility sells, acquires, or leases a plant as an operating unit or system for more than $10 million. Unlike the Oncor cases, this case does not involve Commission approval of any such transaction.

779 *Nucor,* 363 S.W.3d at 883.

780 PURA does not state that in a rate case, the Commission may exercise only powers mentioned in chapter 36. Implying such a limitation would be contrary to PURA §§ 11.002 and 14.001. *See also* Tex. Gov't Code ch. 311 (Code Construction Act), § 311.021(1) ("In enacting a statute, it is presumed that... the entire statute is intended to be effective").

781 *See* Tex. Gov't Code §§ 311.023(1) and (5) (providing that matters that may be considered when construing a statute include the "object sought to be attained" and the "consequences of a particular construction").

stripping the utility of cash needed for its operations.[782] Under CenterPoint's interpretation, if evidence in a utility's rate case revealed such facts, the Commission could not require the utility to use ring-fencing: (1) by order in the rate case; or (2) at all, absent both a filing seeking Commission approval of a PURA § 14.101, § 39.262, or § 39.915 transaction, and a stipulation, representation, or commitment by a party to the transaction agreeing to the ring-fencing. Such a narrow view of Commission authority would defeat legislative purposes to protect the public and be contrary to applicable rules of statutory construction.[783]

The ALJs agree with Staff and TIEC that PURA grants the Commission broad authority under:

- § 11.002:

  (a) The purpose of this title is to establish a comprehensive and adequate regulatory system for public utilities to assure rates, operations, and services that are just and reasonable to the consumers and to the utilities.

  (b) Public utilities traditionally are by definition monopolies in the areas they serve. As a result, the normal forces of competition that regulate prices in a free enterprise society do not operate. Public agencies regulate utility rates, operations, and services as a substitute for competition.

  (c) It is the purpose of this title to grant the Public Utility Commission of Texas authority to make and enforce rules necessary to protect customers of...electric services consistent with the public interest.

- § 14.001: "The commission has the general power to regulate and supervise the business of each public utility within its jurisdiction and to do anything specifically

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782 As discussed later, testimony by CenterPoint witness Lapson, Staff witness Tietjen, and TIEC witness Griffey indicates that such a situation is possible and a reason an electric utility needs adequate ring-fencing.

783 *See, e.g.*, PURA § 11.008 ("This title shall be construed liberally to promote the effectiveness and efficiency of regulation of public utilities to the extent that this construction preserves the validity of this title and its provisions"); Tex. Gov't Code §§ 311.021(5) ("In enacting a statute, it is presumed that... public interest is favored over any private interest").

designated or implied by this title that is necessary and convenient to the exercise of that power and jurisdiction."

Specific Commission powers and duties incorporated in the broad provisions above include PURA:

- § 14.003: "The commission may: (1) require a public utility to report to the commission information relating to: ...(B) a transaction between the utility and an affiliate inside or outside this state, to the extent that the transaction is subject to the commission's jurisdiction; ... (5) require the filing of a copy of: (A) a contract or arrangement between a public utility and an affiliate;..."

- § 14.154(a): "The commission has jurisdiction over an affiliate that has a transaction with a public utility under the commission's jurisdiction to the extent of access to a record of the affiliate relating to the transaction, including a record of joint or general expenses, any portion of which may be applicable to the transaction."

- § 14.201: "A regulatory authority may inquire into the management and affairs of each public utility and shall keep itself informed as to the manner and method in which each public utility is managed and its affairs are conducted."

- § 36.003(a): "The regulatory authority shall ensure that each rate an electric utility or two or more electric utilities jointly make, demand, or receive is just and reasonable."

- § 39.157(d), requiring the Commission to adopt rules ensuring that:

  (11) a utility does not subsidize the business activities of an affiliate with revenues from a regulated service; ...

  (13) a utility and its affiliates keep separate books and records and the commission may review records relating to a transaction between a utility and an affiliate;

  (14) assets transferred or services provided between a utility and an affiliate... are priced at a level that is fair and reasonable to the customers of the utility and reflects the market value of the assets or services or the utility's fully allocated cost to provide those assets or services...[and]

(17) a utility does not allow an affiliate to obtain credit under an arrangement that would include a specific pledge of assets in the rate base of the utility or a pledge of cash reasonably necessary for utility operations.[784]

Based on these statutes, the ALJs conclude the Commission has authority in an electric utility's rate case, with or without the utility's agreement, to impose on the utility ring-fencing requirements that the evidence shows are necessary and convenient to the Commission's exercise of its express powers and duties, including those set forth above.

Some of Staff's and TIEC's ring-fencing proposals may require CNP or other CenterPoint affiliates to take or refrain from certain actions. Another issue is thus the Commission's authority to impose such requirements on a utility's affiliate in a case like this, which does not involve a PURA § 14.101, 39.262(l), or 39.915 transaction or ring-fencing to which the utility and affiliate have agreed.

Except for matters not pertinent here,[785] most relevant PURA provisions refer to electric utilities, not their affiliates. Exceptions (quoted above) include PURA §§ 14.003, 14.154(a), and 39.157(d)(11), (13), (14), and (17). Commission rules implementing those statutes, 16 TAC §§ 25.84 and 25.272, do not state that they apply to electric utility affiliates; they state that they apply to electric utilities "and transactions or activities between electric utilities and their affiliates."[786] The rules define "transaction" broadly as "[a]ny interaction between a utility and its affiliate in which a service, good, asset, product, property, right, or other item is transferred or

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[784] The Commission restated these four § 39.157 provisions in its rule. *See* 16 TAC § 25.272(d)(2)(6), (d)(7)(b), (e)(1), (e)(1)(B)-(C). Although other parts of PURA § 39.157 and 16 TAC § 25.272 refer to "competitive affiliates," these four provisions use the broader term "affiliates." The ring-fencing issue here relates to "affiliates" of CenterPoint as that term is defined in PURA § 11.003(2) and 16 TAC § 25.5(3).

[785] The ring-fencing issue here does not involve Commission authority over: (1) affiliate expenses for which the utility seeks rate recovery; and (2) a utility's competitive affiliates. "Competitive affiliate" is defined as "an affiliate of a utility that provides services or sells products in a competitive energy-related market in this state…." PURA § 39.157(i)(1) and 16 TAC § 25.5(15).

[786] 16 TAC §§ 25.84(b)(1), 25.272(b)(1).

received by either a utility or its affiliate."[787] In discussing its authority to adopt those rules, the Commission stated its interpretation of PURA §§ 14.003, 14.154, and 39.157 as follows:

> Section 14.003 grants the commission the authority to require submission of information by the utility regarding its affiliate activities.... Section 14.154 grants the commission *limited authority over the utility's affiliates, with respect to their transactions with the utility*.... Section 39.157 grants the commission authority to take actions... to adopt rules and enforcement procedures *to govern transactions or activities between utilities and their affiliates*.[788]

The Commission also emphasized that "[n]o subsidization of affiliates from utility services is allowed in these rules," noted that § 25.272(e)(1) (regarding transactions with all affiliates) is consistent with the statutory language but disagreed "with the utilities' implication that the commission could not impose additional requirements relating to credit support," and clarified that § 25.272(e)(1) "applies to all assets, rather than 'jurisdictional capital assets.'"[789]

Based on the law discussed above, the ALJs conclude that, under the facts of this case, the Commission has authority to order CenterPoint to have specific ring-fencing measures in place. Although the Commission's authority over affiliates is limited, it includes authority to require access to the information to which the Commission has a statutory right and to order ring-fencing relating to transactions between CenterPoint and an affiliate under the rules' broad definition of "transaction" (quoted above). The Commission also has powers to enforce a violation of a Commission order.[790]

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787 16 TAC §§ 25.84(c), 25.272(c)(7).

788 Project No. 20936, *Code of Conduct for Electric Utilities pursuant to PURA Section 39.157(d)*, Order Adopting an Amendment to § 25.84 and New § 25.272 and § 25.273 as Approved at the November 18, 1999 Open Meeting and Submitted to the Secretary of State (Nov. 23, 1999) at 81-82 (emphasis added)(Project No. 20936 order).

789 Project No. 20936 order at 2, 37-38.

790 *See* PURA § 11.003(14) and ch. 15, subch. B.

2. Need for Utilities with Affiliates to Have Adequate Ring-Fencing

CenterPoint witness Lapson, Staff witness Tietjen, and TIEC witness Griffey all testified that financial instability or weakness in a utility's parent and other affiliates could affect the utility adversely and that adequate ring-fencing is necessary to address those risks. Ms. Lapson explained:

> Most retail and integrated electric utilities have an obligation to reliably operate and maintain their systems for existing customers, and expand systems to meet customer growth. All of these activities require access to funding. Thus, it is important for the utility to retain access to its own resources including its bank accounts, accounts receivable, and the ability to draw under its credit arrangements, even if its parent or a sister company is under stress. Also, most utilities must seek outside sources of capital from the debt capital market. Without adequate ring fencing, the utility's credit worthiness and access to the debt capital market could be impaired if its parent is in default or bankruptcy. Ring-fencing has been used to protect utilities from risky parents or sister companies to ensure the utility can continue to operate and serve its current and future customers.[791]

Mr. Tietjen testified:

> Given that each of these subsidiaries is a part of the overall [CNP] organization, to the degree that there are aspects of operational and financial intermingling or interdependency among the various entities, the effects of financial instability or weakness in one entity could affect not only [CNP] as the parent company, but other subsidiaries as well. In an extreme case, an event that causes severe financial distress for [CNP] could lead to its bankruptcy—a situation that, absent the present of protective measures, could impact subsidiaries like [CenterPoint] dramatically and draft them along into the bankruptcy process.[792]

Mr. Griffey stated:

> [I]f a utility is not ring-fenced, the financial and business risk of a utility's parent and affiliates can affect the credit rating of the utility even in the best of times. In

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[791] CenterPoint Ex. 48 at 21.

[792] Staff Ex. 1A at 6-7.

> financially challenging times, ring-fencing is essential to prevent a utility from being incorporated into a bankruptcy proceeding with its parent or affiliates. Giving the upstream parent full access to a utility's revenues during periods of financial distress can allow the utility to be "looted" to pay debtors and shareholders, which could prevent the utility from making investments and paying expenses necessary to provide reliable utility service. This could, in turn, compel utility regulators to take extreme and costly measures to maintain utility service, potentially at the expense of the utility's ratepayers.[793]

In short, that utilities with affiliates need adequate ring-fencing is uncontested. The dispute arises because CenterPoint contends its voluntary ring-fencing is sufficient but Staff and TIEC disagree.

3. Affiliates' Financial Impacts on CenterPoint

With $29 billion of assets, CNP is a large corporation that includes CenterPoint as a wholly-owned subsidiary and other entities.[794] The other entities include:

- CenterPoint Energy Resources Corporation, a multi-state gas distribution company;
- CenterPoint Energy Services, a natural gas marketing business that sells non-rate-regulated natural gas and related services in 33 states (as of September 2018);
- Enable Midstream Partners, LP, a publicly traded master limited partnership that owns, operates, and develops strategically located natural gas and crude oil infrastructure assets; and
- Vectren, which CenterPoint acquired in February 2019 and which includes vertically integrated electric utility operations in Indiana and Ohio.[795] Vectren also owns unregulated infrastructure/construction and energy businesses that make up about 25% of Vectren's earnings.[796]

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793 TIEC Ex. 4 at 13.

794 Staff Ex. 1A at 6; TIEC Ex. 4 at 17.

795 Staff Ex. 1A at 6-7.

796 TIEC Ex. 4 at 10-11.

In terms of corporate governance, CenterPoint is not separated from any way from CNP.[797]

Staff and TIEC note that in 2018, CenterPoint provided 91.3% of CNP's net income despite comprising only 30.5% of CNP's gross revenues and 38.9% of CNP's total assets. For two of the past three years, CNP's other business operations earned a negative net income for CNP.[798]

Recent assessments by the rating agencies reflect that CNP's early 2019 acquisition of Vectren has beneficial aspects, such as greater diversification, but raise concern such as excessive leverage (debt financing) as a result of the acquisition.[799] Assessments by the three major rating agencies also indicate CenterPoint is financially stronger than its affiliates and has a lower credit rating because of them. For example:

- In October 2018, S&P placed the credit ratings of CNP and CenterPoint on Negative Watch "due to our expectation that [CNP's] financial measures will deteriorate after using a disproportionate amount of debt to fund the Vectren acquisition, including assuming its debt."[800]

- On February 1, 2019, S&P downgraded CNP's issuer credit rating from A- to BBB+ and the rating on senior unsecured and subordinated notes from BBB+ to BBB, and lowered CenterPoint's issuer credit rating from A- to BBB+.[801] S&P explained that "[t]he downgrade reflects our view that acquisition debt will increase leverage, leading to weakened financial measures over the next several years.... In addition, the business risk profile will remain at the weaker end of the category

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797 TIEC Ex. 4 at 18.

798 Staff Ex. 13 (excerpts from 2019 Annual Report).

799 Staff Ex. 1A at 11-12, citing S&P, Moody's, and Fitch reports, some of which are confidential. *See also* CenterPoint Ex. 48a at 1-2 (confidential).

800 TIEC Ex. 5 at 23 (Mr. Gorman quoting *S&P Global Ratings:* "CenterPoint Energy Inc. and Subsidiaries Still CreditWatch Negative; Senior Unsecured Debt Rated 'BBB+', Watch Negative" (Oct. 3, 2018) at 2).

801 Staff Ex. 1A at 12; TIEC Ex. 4 at 10. S&P and Fitch rate "investment grade" bonds from AAA to AA to A to BBB, indicating progressively higher risk, with "+" and "-" indicating lower or higher risk, respectively. Moody's uses ratings of Aaa to Aa to A to Baa, with 1, 2, and 3 indicating lower to higher risk, respectively. The lowest investment-grade ratings are BBB- (S&P and Fitch) and Baa3 (Moody's). Bonds rated BB/Ba (S&P/Moody's) or lower are considered junk bonds; bonds rated B/B, CCC/Caa, CC/Ca, and C/C are considered speculative; and bonds with below-speculative ratings reflect insolvency. Staff Ex. 1A at 11, n. 6.

because roughly 20% of consolidated operations will continue to consist of non-utility operations."[802]

- On January 28, 2019, Moody's discussed how the Vectren acquisition factored into its downgrade of CNP's Issuer Rating and Senior Unsecured Rating from Baa1 to Baa2 and of CNP's subordinated debt rating from Baa2 to Baa3.[803] Moody's and Fitch did not downgrade CenterPoint because, unlike S&P, they evaluate the companies individually. Moody's and Fitch currently rate CenterPoint two notches above CNP.[804]

- On August 14, 2018, Moody's stated: "On 23 April 2018, CenterPoint announced the acquisition of Vectren for $8.5 billion. The negative outlook reflects the financing plans associated with Vectren, as the company plans to fund the $8.5 billion acquisition with $6.0 billion of debt (approximately 70% of the total financing mix, including $2.5 billion assumed debt and $3.5 billion of incremental debt) and $2.5 billion of new equity (approximately 30% of the total financing mix). The outlook reflects our expectation that on a pro forma basis, the increased leverage resulting from the Vectren acquisition will put downward pressure on consolidated key credit metrics and increase CNP's ratio of holding company debt to consolidated debt to over 25%."[805]

- On August 14, 2018, Fitch stated: "In April 2018, Fitch affirmed CNP's 'BBB' long-term Issuer Default Rating (IDR) and revised the Outlook to Stable from Positive following an announcement that it will acquire 100% of Vectren Corporation's equity interest." Fitch explained that "the meaningful increase in leverage, relatively complex corporate structure and exposure to Vectren's power generation and non-utility operations, limit any upward migration of CNP's ratings at this time."[806]

- Multiple ratings agency reports have commented on the risk that CNP's other subsidiaries impose on CNP.[807]

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[802] TIEC Ex. 5 at 24 (Mr. Gorman quoting S&P Global RatingsDirect, "Research Update: CenterPoint Energy Inc. and Subsidiaries Ratings Lowered to 'BBB+' from 'A-'; Outlook Stable" (Feb. 4, 2019) at 3-4). *See also* Staff Ex. 1B at 2 (quoting S&P) (confidential) and 23-30 (S&P report) (confidential); TIEC Ex. 4a at 2 (confidential).

[803] Staff Ex. 1A at 11. *See also* Staff Ex. 1B at 3-7 (Moody's report) (confidential).

[804] CenterPoint Ex. 48 at 15-16.

[805] CenterPoint Ex. 48 at 75 (Moody's report entitled "Rating Action: Moody's assigns Baa3 rating to CenterPoint Energy's Series A preferred stock" (Aug. 14, 2018)).

[806] CenterPoint Ex. 48 at 80 (Fitch report entitled "Fitch Rates CenterPoint Energy's Series A Preferred Stock 'BB+'" (Aug. 14, 2018)).

[807] *See, e.g.*, CenterPoint Ex. 1a, Sch. II-C-2.10 (confidential).

4. CenterPoint's Voluntary Ring Fence and Staff's and TIEC's Proposals

a. Summary of the Current and Proposed Ring-Fencing Measures

Staff witness Tietjen recommended that the Commission order CenterPoint to employ its current voluntary ring-fencing and order additional ring-fencing. He testified that his proposed ring-fencing measures were all approved by the Commission (in the Oncor Ring-Fencing Orders).[808]

Staff Proposed Ring-Fencing[809]
<u>Staff Proposed Ring-Fencing Currently Employed by CenterPoint:</u> 1. ***Cross-Default Provisions***. CenterPoint's credit agreements and indentures must not contain cross-default provisions by which a default by CNP or its other affiliates would cause a default at CenterPoint. 2. ***Financial Covenant***. The financial covenant in CenterPoint's credit agreement must not be related to any entity other than CenterPoint. 3. ***Asset Pledges and Debt Guarantees***. CenterPoint must not pledge its assets in respect of or guarantee any debt or obligation of any of its affiliates or CNP. CenterPoint is prohibited from pledging, mortgaging, hypothecating, or granting a lien upon the property of CenterPoint, with only a few exceptions stated in its credit agreement, such as the first mortgage and general mortgage. 4. ***Stand-Alone Credit Facility***. CenterPoint must maintain its own stand-alone credit facility, and CenterPoint must not share its credit facility with any regulated or unregulated affiliate. 5. ***Security for CenterPoint's Bonds***. CenterPoint's first mortgage bonds and general mortgage bonds shall be secured only with CenterPoint's assets. 6. ***Security for Affiliates' Debts***. No CenterPoint assets may be used to secure the debt of CNP or its non-CenterPoint affiliates.

[808] Staff Ex. 1A at 8.

[809] Staff Ex. 1A at 13-16.

Additional Staff Proposed Ring-Fencing:

1. ***Dividend Restriction***. CenterPoint must limit the payment of dividends by CenterPoint to an amount not to exceed CenterPoint's net income (as determined in accordance with generally accepted accounting principles).

2. ***CenterPoint Credit Ratings and Suspension of Distributions***. CenterPoint must work to ensure that its credit ratings at all three major ratings agencies (S&P, Moody's, and Fitch) remain at or above CenterPoint's current credit ratings. If CenterPoint's credit rating at any one of the three major ratings agencies falls below BBB+[810] (or its equivalent) for CenterPoint's senior secured debt, then CenterPoint must suspend payment of dividends or other distributions, except for contractual tax payments, until otherwise allowed by the Commission. CenterPoint must notify the Commission if its credit issuer rating or corporate rating as rated by any of the three major rating agencies falls below investment-grade level.

3. ***Debt-to-Equity Ratio***. CenterPoint's debt must be limited so that its debt-to-equity ratio is at or below the debt-to-equity ratio established from time to time by the Commission for ratemaking purposes in CenterPoint rate proceedings. The Commission has authority to determine what types of debt and equity are included in a utility's debt-to-equity ratio. CenterPoint must not make any payment of dividends or other distributions, except for contractual tax payments, where such dividends or other distributions would cause CenterPoint to be out of compliance with the Commission-approved debt-to-equity ratio. Additionally, neither CNP nor any of its affiliates may issue stock or ownership interest that supersedes the foregoing obligations of CenterPoint.

4. ***Regulatory ROE***. If CenterPoint's issuer credit rating is not maintained as investment grade by S&P, Moody's, and Fitch, CenterPoint must not use its below-investment-grade ratings to justify an argument in favor of a higher regulatory ROE.

5. ***Stand-Alone Credit Rating***. Except as may be otherwise ordered by the Commission, CNP must take the actions necessary to ensure the existence of a CenterPoint stand-alone credit rating.

6. ***Holding out Credit as Available to Pay Debt***. CenterPoint must not hold out its credit as being available to pay the debt of any CNP affiliates.

7. ***Commingling***. CenterPoint must not commingle its assets with those of other CNP affiliates.

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[810] Mr. Tietjen testified: "This rating is two notches above the minimum investment-grade rating. The Commission may conclude a higher rating is appropriate for this threshold." Staff Ex. 1A at 15, n. 14. His statement was not further addressed.

8. ***Pledging of Assets***. CenterPoint must not pledge its assets with respect to, or guarantee, any debt or obligation of CenterPoint affiliates.

9. ***Affiliate Asset Transfer***. CenterPoint must not transfer any material assets or facilities to any affiliates, other than a transfer that is on an arm's-length basis consistent with the Commission's affiliate standards applicable to CenterPoint, regardless of whether such affiliate standards would apply to the particular transaction.

10. ***Inter-Company Lending and Borrowing***. CenterPoint must not lend money to or borrow money from CNP affiliates.

11. ***Debt Disproportionally Dependent on CenterPoint***. Without prior approval of the Commission, neither CNP nor any affiliate of CNP (excluding CenterPoint) may incur, guaranty, or pledge assets in respect of any incremental new debt that is dependent on: (1) the revenues of CenterPoint in more than a proportionate degree than the other revenues of CNP; or (2) the stock of CenterPoint.

12. ***Non-Consolidation Legal Opinion***. CNP must obtain a non-consolidation legal opinion that provides that, in the event of a bankruptcy of CNP or any of its affiliates, a bankruptcy court will not consolidate the assets and liabilities of CenterPoint with CNP or any of its affiliates.

13. ***Bankruptcy Costs***. CenterPoint must not seek to recover any costs associated with a bankruptcy of CNP or any of its affiliates.

As shown above, Mr. Tietjen described his first list of six measures as being part of CenterPoint's voluntary ring fence, which he proposed be made mandatory. Ms. Lapson testified that some of the "additional" measures he proposed in his second list above are also the same as or similar to CenterPoint's current practices and thus it is unnecessary to order them. Using Mr. Tietjen's numbering, she explained that:

1. CenterPoint is limited by a negative covenant in its Revolving Credit Agreement that prevents it from issuing dividends if its ratio of debt to total capital exceeds 65%.

3. CenterPoint generally follows limiting its debt to an amount no higher than the debt-to-equity ratio authorized by the Commission.

5. CenterPoint maintains three credit ratings separate from CNP.

7. CenterPoint does not commingle assets with affiliates.

8. CenterPoint does not pledge assets with respect to any debt obligation of its affiliates.

9. CenterPoint transactions with affiliates are conducted at arm's length.

10. CenterPoint does not lend or borrow funds from affiliates.

11. CenterPoint's affiliates do not have debt disproportionally dependent on CenterPoint.[811]

Mr. Griffey modeled his ring-fencing proposals after *selected* measures in Oncor's ring-fence. His proposals are listed below:

TIEC Proposed Ring-Fencing[812]
<u>TIEC Proposed Ring-Fencing Currently Employed by CenterPoint:</u> 1. ***Financial Covenants and Rating-Agency Triggers***. CenterPoint shall not include in its debt or credit agreements any financial covenants or rating-agency triggers related to any other entity. 2. ***Debt Guarantees and Asset Pledges***. CenterPoint shall not guarantee the debt of or pledge any assets for entities other than CenterPoint. 3. ***Sharing of Credit Facilities***. CenterPoint shall not share credit facilities with CNP or any affiliate. 4. ***Registrations with Credit Rating Agencies***. CenterPoint shall maintain its registrations with all three major credit rating agencies. 5. ***Stand-alone Credit Rating***. CenterPoint shall maintain a stand-alone credit rating.
<u>Additional TIEC Proposed Ring-Fencing:</u> 1. ***Dividend Stopper***. CenterPoint should adopt a dividend stopper that will prevent CenterPoint from losing the cash flow necessary to support reliability if CNP has credit

[811] *See* CenterPoint Ex. 48 at 32-35.

[812] TIC Ex. 4 at 19-23.

issues. If there are provisions in CNP's credit facilities or debt instruments that prohibit CenterPoint from having a dividend stopper, they should be renegotiated.

2. ***Non-Consolidation Opinion***. CenterPoint should have a non-consolidation opinion that indicates it will not be consolidated with its parent or non-subsidiary affiliates in the event of their bankruptcy.

3. ***Definition of "Event of Default."*** CenterPoint's credit agreement should be amended so "Event of Default" is no longer defined to include (a) a change in control of CNP (as defined in the agreement) or (b) CNP ceasing to own and control 100% of the outstanding common capital stock of CenterPoint.

b. CenterPoint's Criticisms of Specific Proposed Ring-Fencing Measures

Ms. Lapson criticized the enumerated proposals in Mr. Tietjen's second list (his additional measures) as follows:

2. It is unreasonable to expect a company to pledge to keep its credit ratings at their current level because many factors that influence its credit rating are up to the Commission, not the company.

4. It is incomprehensible to prohibit CenterPoint from using a credit downgrade as a reason to argue for a higher ROE, particularly if the downgrade resulted from the Commission's rate-setting decisions. Such a prohibition would violate CenterPoint's rights to a fair and reasonable return. In a rate proceeding, the Commission can disregard arguments it finds unpersuasive.

12. CenterPoint does not have a non-consolidation opinion with respect to CNP or other affiliates, except it has such opinions with respect to issuers of securitization bonds. CenterPoint would not realize any appreciable benefits from having a non-consolidation legal opinion. Non-consolidation opinions are essential for a structured special-purpose entity formed to issue securities to the public to monetize regulatory assets. CenterPoint has issued billions of dollars of bonds to the public without having any non-consolidation opinion. Investors are not concerned about CenterPoint being consolidated in a bankruptcy of its parent or affiliates. Since the Great Depression, no solvent rate-regulated U.S. investor-owned electric or gas utility has been consolidated (voluntarily or involuntarily) in the bankruptcy of its parent. The reason is that solvent utilities have considerable value as going concerns, and bankruptcy proceedings chew up value that would otherwise be available for restructuring and reorganization of the debtor.

13. Requiring CenterPoint not to seek recovery of bankruptcy costs is unnecessary because the Commission would have authority to reject such a request if it were ever made.[813]

Ms. Lapson criticized specific proposals in Mr. Griffey's second list (his additional measures) as follows:

1. A dividend stopper is unnecessary because CenterPoint has dividend limitations in place (described above) and CNP has a strong economic incentive to retain equity at CenterPoint approximately equal to CenterPoint's authorized structure. Mr. Griffey did not specify how his proposed limit on dividends would work or suggest any triggering mechanism.

2. (See above regarding Mr. Tietjen's proposal to require a non-consolidation opinion.)

3. Mr. Griffey mischaracterized as a "cross default" the provision in CenterPoint's credit agreement that creates an event of default upon a change of control of CNP or CenterPoint.[814] A cross default occurs when an entity's default constitutes an Event of Default in the debt of a second entity, which has immediate effects on a company's liquidity. In contrast, negotiating a change-of-control transaction would take several months and obtaining regulatory approvals would take at least six months. This would give CenterPoint more than enough time to negotiate to amend or to terminate and replace the credit agreement as necessary. The Commission could also reject or impose conditions on a change of control it is asked to approve. The change-of-control provisions in CenterPoint's agreements are standard and allow lenders a seat at the table during negotiation of a transaction that might materially change the circumstances or nature of the borrower.[815]

5. Adequacy of Existing Ring Fence or Need for Stronger Ring Fence

Mr. Griffey testified that rating agencies often notch a utility's credit rating downward if the parent has higher financial or business risk. This may occur even if a utility would have a

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[813] CenterPoint Ex. 48 at 32-34, 37-38.

[814] TIEC Ex. 4 at 21.

[815] CenterPoint Ex. 48 at 36-40.

higher credit rating on a stand-alone basis, if its parent has a lower credit rating and is depending on dividends from the utility.[816]

Mr. Griffey opined that CNP depends on dividends from CenterPoint to maintain its cash flows and support its credit rating.[817] He and Mr. Tietjen also testified that CenterPoint's association with CNP hurt its credit rating, particularly in light of the recent Vectren acquisition.[818] TIEC cites CenterPoint witness McRae's statement that "S&P's currently stand-alone rating for [CenterPoint] is a+."[819] In February 2019, when S&P considered CenterPoint along with its affiliates, CenterPoint's bond rating was BBB+.[820]

Mr. Griffey testified that lower credit ratings generally provide a higher cost of debt. For example, Moody's has noted that greater CNP reliance on dividends from CenterPoint would be credit-negative for CenterPoint and could result in a downgrade. He noted the Commission does not know CNP's future plans regarding leverage, the size or type of its unregulated businesses, or other risks that could affect CenterPoint. Mr. Griffey opined that a stronger ring fence would improve CenterPoint's credit strength based on cash-flow-to-debt ratios by eliminating linkage with CNP, which is dragging down CenterPoint's ratings. He commented that CNP is unlikely to adopt stronger ring-fencing on its own, "since the parent company benefits from having fewer restrictions on its ability to declare dividends, borrow based on [CenterPoint's] revenues, or otherwise take advantage of credit linkage between CNP and [CenterPoint]."[821]

Ms. Lapson objected that Staff and TIEC focus almost exclusively on S&P's credit rating analysis. She explained S&P uses a consolidated rating methodology to evaluate the credit profiles

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816 TIEC Ex. 4 at 12.

817 TIEC Ex. 4 at 10.

818 TIEC Ex. 4 at 10-11; Staff Ex. 1A at 11-13.

819 CenterPoint Ex. 43 at 23.

820 TIEC Ex. 5 at 25.

821 TIEC Ex. 4 at 7-8, 11-12, 18, 21, 23.

of utilities, whereas Fitch and Moody's rate CenterPoint primarily on its separate financial condition. Ms. Lapson testified that S&P's approach is unlikely to have affected marketability or cost of CenterPoint's debt, because (1) the other two major ratings agencies gave CenterPoint equivalent ratings of A3 and A-; and (2) investors favor research on U.S. rate-regulated utilities that focuses on the business and financial condition of the individual entities, instead of a consolidated approach. Ms. Lapson testified that when a company has a "split rating" among the ratings agencies, as CenterPoint does, investors either consider the preponderance of two out of three ratings and disregard the third, or consider the average rating. Either method results in an A- rating for CenterPoint.[822] S&P currently rates CenterPoint on the low volatility table, indicating the lowest level of business risk.[823]

Mr. Griffey opined that because of CenterPoint's association with its affiliates, ratepayers are not getting the full benefit of what they are paying for through rates.[824] Mr. Tietjen testified that, as the three major rating agencies' actions and statements illustrate, the transactions, business, operations, and leveraging activities of a utility's parent and its subsidiaries can affect rate elements such as the utility's capital structure, cost of equity, and cost of debt.[825] Ms. Lapson responded that the Commission would have full authority in a future rate case to review CenterPoint's claims and reject recovery of any costs it finds unreasonable.[826]

Mr. Tietjen concluded his proposals would provide effective, meaningful separation between CenterPoint and CNP because they are based on Oncor's ring fence, which proved instrumental in insulating Oncor from its parent's bankruptcy. The 2007 acquisition of Oncor's parent was the largest leveraged buyout in history. Mr. Tietjen opined that when the Commission approved the acquisition and Oncor's ring fence, interested parties did not consider the bankruptcy

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[822] CenterPoint Ex. 48 at 10-11, 17-18.

[823] CenterPoint Ex. 43 at 19.

[824] TIEC Ex. 4 at 12.

[825] Staff Ex. 1A at 12-13.

[826] CenterPoint Ex. 48 at 27.

to be likely; if they had, the acquisition would not have happened. Oncor's parent did not declare bankruptcy until seven years later. Throughout the three-year bankruptcy process, Oncor remained separate from the legal wrangling and maintained its stand-alone credit status, financial stability, and ability to provide reliable service at just and reasonable rates. Mr. Tietjen stated that, although the Commission may have ordered the ring-fencing "largely out of an abundance of caution, in the end the Commission's prudence and foresight paid off."[827]

Mr. Griffey provided similar testimony about Oncor's ring fence and the bankruptcy of Oncor's parent. He also stated that having a non-consolidation opinion is important because it provides some assurance as to the validity of CenterPoint's financial separation and puts the parent's creditors and investors on notice they cannot access the utility's assets in the event of an affiliate's bankruptcy.[828]

Ms. Lapson responded that in 2007, the private equity purchasers of Oncor's parent used only about $4 billion in equity to fund a $45 billion transaction. Moody's rated the senior bonds used to fund the transaction at B2, which is deeply speculative, and rated additional debt issued at intermediate holding companies at Ca, which is deeply speculative and indicates a high likelihood of default.[829]

Ms. Lapson provided a table setting out CenterPoint's current voluntary ring-fencing practices.[830] She concluded they separate CenterPoint adequately from its affiliates, protect it from being subject to an involuntary bankruptcy, and allow it to maintain access to funding and liquidity in the event an affiliate experiences financial distress. She described CenterPoint's current ring fence as similar to that of most other U.S. rate-regulated electric and gas utilities. Ms. Lapson stated that CNP and CenterPoint deal with each other prudently, observing necessary legal

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[827] Staff Ex. 1A at 17-18.

[828] TIEC Ex. 4 at 3, 13, 15, 22-23.

[829] CenterPoint Ex. 48 at 29.

[830] CenterPoint Ex. 48 at 96-98 (Exh. R-EL-4).

formalities to maintain separation. Noting Moody's and Fitch currently rate CenterPoint two notches above CNP, Ms. Lapson opined that those two rating agencies have confidence in CenterPoint's viability on its own and its insulation from its affiliates.[831]

Noting that CenterPoint's current ring-fencing measures are voluntary and subject to change, Mr. Tietjen and Mr. Griffey recommended that the Commission order such measures in this case.[832] Ms. Lapson responded that during the "profound capital market disruption" following September 2008 and during 2009, CNP and CenterPoint continued to follow prudent practices.[833]

The ALJs note that S&P and Moody's made significant statements relating to the sufficiency of CenterPoint's current ring fence or impacts of the ring-fencing proposals here. The ALJs considered those statements but have not stated them in the PFD because those exhibits are confidential.[834]

In its 2017 Form 10-K filing with the SEC, CenterPoint stated that:

- "***The creditworthiness and liquidity of our parent company and our affiliates could affect our creditworthiness and liquidity.***"[835]
- "***[CNP] can exercise substantial control over our dividend policy and business and operations and could do so in a manner that is adverse to our interests.***"[836]

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[831] CenterPoint Ex. 48 at 21-22, 25-26.

[832] Staff Ex. 1A at 15; TIEC Ex. 4 at 23.

[833] CenterPoint Ex. 48 at 31-32.

[834] CenterPoint Ex. 43, Exh. R-RBM-4 at 5 (S&P Global Ratings—CenterPoint Energy Houston Electric LLC (Mar. 22, 2019) (confidential); CenterPoint Ex. 49a at 6-7 (Moody's Credit Outlook issuer comment (June 17, 2019)) (confidential). The ALJs recommend reviewing the latter exhibit (Moody's report) and not only CenterPoint Ex. 48a at 3 (testimony quoting from that report) (confidential) because the quotation omits significant statements in the Moody's report.

[835] TIEC Ex. 6 (CenterPoint Form 10-k for the fiscal year ended Dec. 31, 2017) at 8 (emphasis in original).

[836] TIEC Ex. 6 at 7 (emphasis in original).

- "Our management could decide to increase our dividends to [CNP] to support its cash needs. This could adversely affect our liquidity."[837]

Based on all of the evidence, the ALJs find that CenterPoint's statements to the U.S. Securities and Exchange Commission (SEC) in 2017 remain accurate. The ALJs do not find it credible that the financial community simply disregards S&P's expressions of concern and downgrade of CNP and CenterPoint. S&P is one of the three major credit rating agencies and all three have expressed some concerns about CenterPoint's riskier affiliates. Moody's downgraded CNP because of the Vectren acquisition. Moody's and Fitch currently rate CNP two notches below CenterPoint. The facts that S&P uses a consolidated rating methodology but Fitch and Moody's rate CenterPoint mainly on its own financial condition does not mean CenterPoint's affiliates do not pose actual risks that warrant the Commission requiring a stronger ring fence.

CenterPoint is a wholly-owned subsidiary of CNP and they are not separate in terms of corporate governance. CenterPoint will continue to require capital to meet the demands of its service area. CNP has been depending on net income from CenterPoint. CNP's net income from other business operations has been negative. CNP undertook a disproportionately debt-financed acquisition of Vectren, including assuming its debt, which led to a rating downgrade of CNP and CenterPoint. CenterPoint's financial strength could be used to support affiliates in financial distress or finance their higher-risk business ventures. The risk to CenterPoint's customers is especially high if its parent were to enter bankruptcy. Although the Commission sets CenterPoint's rates, the regulatory process takes time. Without a strong enough ring fence, CenterPoint's financial condition could be weakened to the point of requiring higher rates to provide reliable service.

The evidence does not show that any changes to CenterPoint's ring fence are planned or that CNP is in financial distress or near bankruptcy. CNP has investment-grade ratings and is less risky than Oncor's parent was when the Commission ordered Oncor's ring fence. On the other

[837] TIEC Ex. 6 at 7.

hand, the ALJs find Mr. Tietjen's testimony on that point persuasive. When the acquisition of Oncor's parent occurred, bankruptcy was not expected and did not occur until seven years later. Throughout the three-year bankruptcy process, the ring fence insulated Oncor, protecting its financial integrity and allowing it to provide reliable service at just and reasonable rates. As Mr. Griffey observed, the Commission does not know CNP's future plans regarding leverage, the size or type of its unregulated businesses, or other risks that could affect CenterPoint.

CenterPoint argues that Staff and TIEC did not evaluate potential financial impacts to CenterPoint if it were ordered to implement the ring-fencing proposals, such as costs of renegotiating credit agreements or obtaining a non-consolidation legal opinion. The evidence does not reveal such costs and impacts. Early in the case, the Commission's Preliminary Order identified whether to require additional financial protections as an issue. Predictably, Staff and TIEC proposed making CenterPoint's voluntary ring fence mandatory and adding other measures from Oncor's ring fence. CenterPoint presented substantial rebuttal testimony opposing those proposals but did not show or quantify costs or other financial detriments to it if the Commission adopts the proposals.

Overall, the evidence shows significant benefits to ordering the ring-fencing recommended in this PFD and no convincing reason not to do so. Because CenterPoint's current ring-fencing measures are voluntary, the Commission cannot currently prevent them from being weakened. In addition, CenterPoint's existing ring fence lacks significant protections present in Oncor's ring fence.[838] The evidence shows that a stronger ring fence will improve CenterPoint's financial integrity and ability to provide reliable service at just and reasonable rates, and CenterPoint will be much better protected if its affiliates were to experience serious financial distress or bankruptcy.

[838] Mr. Griffey included a table summarizing the differences. *See* TIEC Ex. 4 at 19-20.

6. ALJs' Analysis and Recommendation about Specific Proposals

As Staff and TIEC proposed, the ALJs recommend that the Commission order CenterPoint to employ its currently voluntary ring-fencing measures. The evidence reveals no persuasive reason not to order those measures and shows significant benefits if the Commission does order them. The ALJs also recommend ordering most of the additional ring-fencing measures proposed by Staff or TIEC.

The ALJs recommend that the Commission order the following measures in CenterPoint's current ring fence:

- CenterPoint's credit agreements and indentures shall not contain cross-default provisions by which a default by CNP or its other affiliates would cause a default at CenterPoint.
- The financial covenant in CenterPoint's credit agreement shall not be related to any entity other than CenterPoint. CenterPoint shall not include in its debt or credit agreements any financial covenants or rating-agency triggers related to any entity other than CenterPoint.
- CenterPoint shall not pledge its assets in respect of or guaranty any debt or obligation of any of its affiliates. CenterPoint shall not pledge, mortgage, hypothecate, or grant a lien upon the property of CenterPoint except pursuant to an exception in effect in CenterPoint's current credit agreement, such as the first mortgage and general mortgage.
- CenterPoint shall maintain its own stand-alone credit facility, and CenterPoint shall not share its credit facility with any regulated or unregulated affiliate.
- CenterPoint shall maintain its registrations with all three major credit rating agencies.
- CenterPoint shall maintain a stand-alone credit rating.
- CenterPoint's first mortgage bonds and general mortgage bonds shall be secured only with CenterPoint's assets.
- No CenterPoint assets may be used to secure the debt of CNP or its non-CenterPoint affiliates.

- CenterPoint shall not commingle its assets with those of other CNP affiliates.

- CenterPoint shall not lend money to or borrow money from CNP affiliates.[839]

Based on the evidence, the ALJs recommend adopting the following additional ring-fencing measures proposed by Staff or TIEC:

- CenterPoint shall limit its payment of dividends to an amount not to exceed its net income (as determined in accordance with GAAP).[840]

- CenterPoint shall work to ensure that its credit ratings at all three major ratings agencies (S&P, Moody's, and Fitch) remain at or above CenterPoint's current credit ratings.[841] If CenterPoint's credit rating at any one of the three major ratings agencies falls below BBB+ (or its equivalent) for CenterPoint's senior secured debt, then CenterPoint shall suspend payment of dividends or other distributions, except for contractual tax payments, until otherwise allowed by the Commission. CenterPoint shall notify the Commission if its credit issuer rating or corporate rating as rated by any of the three major rating agencies falls below investment-grade level.

- CenterPoint's debt shall be limited so that its debt-to-equity ratio is at or below the debt-to-equity ratio established from time to time by the Commission for ratemaking purposes in CenterPoint rate proceedings. The Commission has authority to determine what types of debt and equity are included in a utility's debt-to-equity ratio. CenterPoint shall not make any payment of dividends or other distributions, except for contractual tax payments, where such dividends or other distributions would cause CenterPoint to be out of compliance with the Commission-approved debt-to-equity ratio. Additionally, neither CNP nor any of its affiliates may issue a stock or ownership interest that supersedes the foregoing obligations of CenterPoint.

- CenterPoint shall not hold out its credit as being available to pay the debt of any affiliates.

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[839] The ALJs' recommendations combine Mr. Tietjen's and Mr. Griffey's ring-fencing proposals with some wording changes. CenterPoint did not challenge their testimony that it was using measures they listed as its current measures. The ALJs also included in this list some additional Staff or TIEC proposals that Ms. Lapson indicated are the same as or similar to CenterPoint's current ring-fencing measures.

[840] Regarding this measure, the ALJs recommend using Mr. Tietjen's language because it is clearer and more specific than Mr. Griffey's language.

[841] Regarding Ms. Lapson's criticism of this measure, the ALJs note that "work to ensure" does not mean "ensure."

- Without prior approval of the Commission, neither CNP nor any affiliate of CNP (excluding CenterPoint) may incur, guaranty, or pledge assets in respect of any incremental new debt that is dependent on: (1) the revenues of CenterPoint in more than a proportionate degree than the other revenues of CenterPoint; or (2) the stock of CenterPoint.

- CNP shall obtain a non-consolidation legal opinion that provides that, in the event of a bankruptcy of CNP or any of its affiliates, a bankruptcy court will not consolidate the assets and liabilities of CenterPoint with CNP or any of its affiliates.[842]

In the following Staff proposal, the language the ALJs show in strike-through seems to impose requirements at odds with applicable affiliate standards. Oncor agreed to the deleted language; CenterPoint has not. Based on the evidence, the ALJs recommend adopting this proposal after deleting the stricken-through language:

- CenterPoint shall not transfer any material assets or facilities to any affiliates, other than a transfer that is on an arm's-length basis consistent with the Commission's affiliate standards applicable to CenterPoint~~, regardless of whether such affiliate standards would apply to the particular transaction~~.

CenterPoint objected to ring-fencing proposals that would prohibit it from presenting certain arguments in a future Commission case. Absent CenterPoint's agreement, the ALJs find no basis to bar it from making such arguments, which the Commission may accept or reject after considering the evidence and briefing in that case. Accordingly, the ALJs recommend not adopting the following measures proposed by Staff:

- If CenterPoint's issuer credit rating is not maintained as investment grade by S&P, Moody's, and Fitch, CenterPoint must not use its below-investment-grade ratings to justify an argument in favor of a higher regulatory ROE.

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842 Ms. Lapson testified that investors have strong economic reasons not to want a solvent utility consolidated in an affiliate's bankruptcy and that no consolidation in that circumstance has happened since the Great Depression. The ALJs still find value in clarifying that consolidation would not be an option, especially given the importance to the Commission's duties under PURA of CenterPoint not being consolidated in an affiliate's bankruptcy. The ALJs find the evidence shows benefit, and is insufficient to show harm, from imposing this requirement.

- CenterPoint must not seek to recover any costs associated with a bankruptcy of CNP or any of its affiliates.

Based on Ms. Lapson's testimony about it, the ALJs recommend not adopting the following measure proposed by Mr. Griffey.

- CenterPoint's credit agreement shall be amended so the definition of an "Event of Default" no longer includes (a) a change in control of CNP (as defined in the agreement) or (b) CNP ceasing to own and control 100% of the outstanding common capital stock of CenterPoint.

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

A. Total O&M Expense

The legal standard regarding allowable O&M expenses, and COH's proposed $44.3 million adjustment to O&M expenses in general, are discussed below.

PURA § 36.051 requires that an electric utility's rates be based on its reasonable and necessary expenses and return on its invested capital. 16 TAC § 25.231 provides:

> (a) Components of cost of service. Except as provided for in [Commission rules relating to invested capital, rate base, and rate design], rates are to be based upon an electric utility's cost of rendering service to the public during a historical test year, adjusted for known and measurable changes. The two components of cost of service are allowable expenses and return on invested capital.
>
> (b) Allowable expenses. Only those expenses which are reasonable and necessary to provide service to the public shall be included in allowable expenses. In computing an electric utility's allowable expenses, only the electric utility's historical test year expenses as adjusted for known and measurable changes will be considered, except as provided for [in Commission rules relating to fuel expenses].

"Test year" means ["t]he most recent 12 months for which operating data for an electric utility... are available and shall commence with a calendar or fiscal year quarter."[843] The Commission has defined "known and measurable changes" as "those that will occur, can be measured, will affect future revenue requirements, and are a basis for determining forward-looking rates."[844] The Commission's RFP instructions state: "For the filing of the RFP, the information reported shall be based on the Test Year.... Additionally, adjustments shall be made to the Test Year to remove nonrecurring costs and normalize extraordinary expenditures."[845]

The Texas Supreme Court has held that "future rates are made on the basis of past costs" and "[c]hanges occurring after the test period, if known, may be taken into consideration" by the Commission "to make the test year data as representative as possible of the cost situation that is apt to prevail in the future."[846] "[R]easonable operating expenses... are limited to amounts actually realized or which can be anticipated with reasonable certainty."[847] The Commission's "ratemaking power includes the discretion to disallow improper expenses."[848]

CenterPoint's RFP used a 12-month test year ended December 31, 2018, to establish its requested O&M expenses. COH witness Norwood testified CenterPoint's test year O&M cost, and thus its O&M request, was approximately $72 million higher than the average O&M expense incurred over the previous four years.[849] The test year O&M request of $650.7 million is 12.5%

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843 16 TAC § 25.5(131). *See also* PURA § 11.003(20).

844 *Application of Oncor Electric Delivery Company LLC for Rate Case Expenses Pertaining to PUC Docket No. 35717*, Docket No. 36530, Order (Sep. 21, 2009) at 3.

845 Transmission & Distribution (TDU) Investor-Owned Utilities Rate Filing Package for Cost-of-Service Determination (RFP) at 7, 9, available at http://www.puc.texas.gov/industry/electric/forms/rfp/iou_rfp_inst.pdf.

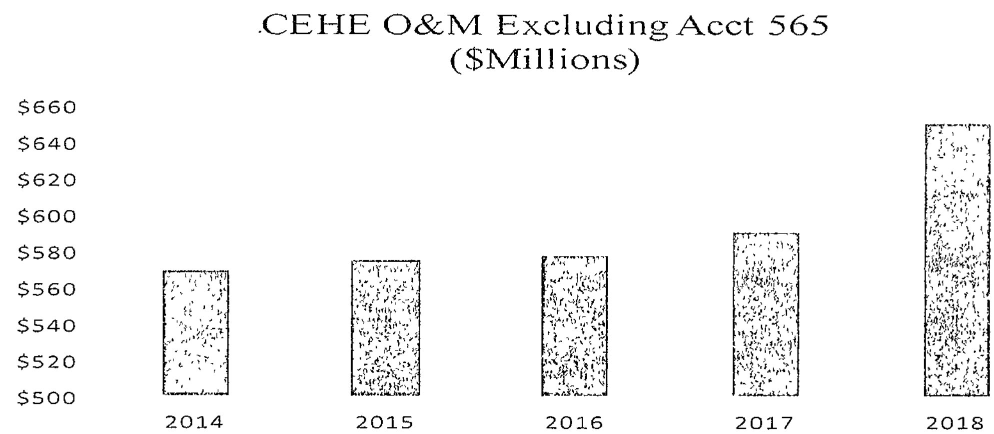
846 *Suburban Util. Corp. v. Public Util. Comm'n*, 652 S.W.2d 358, 366 (Tex. 1983).

847 *Suburban*, 652 S.W.2d at 362.

848 *Suburban*, 652 S.W.2d at 362.

849 COH Ex. 1 at 13.

higher than CenterPoint's average O&M expenses over those four years.[850] Mr. Norwood supplied the following graph:[851]



He also provided a table about the increase in CenterPoint's O&M costs since 2010:[852]

CEHE O&M Expense
2010 vs 2018
($Millions)

	2010	2018	Increase	%Increase
Transmission O&M**	$30.3	$53.8	$23.5	77.5%
Distribution O&M	$212.7	$278.0	$65.2	30.7%
Administrative & General	$230.7	$319.0	$88.2	38.2%
Total O&M	$473.7	$650.7	$177.0	37.4%

Source: CEHE's 2010 and 2018 FERC Form 1 filings, Pages 320-323.
**T ransmission operations expense excludes ERCOT charges (Acct 565).

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[850] COH Ex. 1 at 10.

[851] COH Ex. 1 at 10.

[852] COH Ex. 1 at 7.

According to Mr. Norwood, CenterPoint explained that the primary factors driving the increase in O&M expenses since Docket No. 38339 are customer growth and the need to address various reliability concerns. He found both explanations unconvincing.

Regarding customer growth, Mr. Norwood indicated CenterPoint's customer and sales growth since 2010 has been just over 2.1% per year, which he considered relatively low.[853]

Regarding reliability concerns, Mr. Norwood testified CenterPoint's SAIDI has been generally good since 2010, increased significantly in 2015, and since then has remained somewhat higher than pre-2015 levels. CenterPoint's SAIDI, excluding scheduled outages and major events, has averaged 119 minutes per year over the last three years, an average customer service reliability of 99.98%, which is very good.

Concluding CenterPoint failed to show the increases in its O&M costs were reasonable, necessary, or likely to recur, Mr. Norwood proposed establishing test year O&M expense using CenterPoint's actual 2017 expenses, escalated by 2.6%. He explained 2.6% is double the 1.3% average annual increase in CenterPoint's O&M costs over the previous four years. His proposal would reduce CenterPoint's total allowed O&M costs (excluding ERCOT charges) by $44.3 million dollars (excluding ERCOT charges) to approximately $606.4 million.[854]

Regarding customer growth, CenterPoint witnesses Mr. Pryor and Ms. Bodden testified that between January 1, 2010, and December 31, 2018, CenterPoint began serving an additional 359,525 new residential customers and 41,991 new commercial customers.[855] At the hearing, Ms. Bodden agreed that CenterPoint experienced 1% load growth from 2009 to 2018 and that from 2015 through 2018 the load growth was "essentially zero"; Mr. Pryor agreed 1% annual load

[853] COH Ex. 1 at 7.

[854] COH Ex. 1 at 13.

[855] CenterPoint Ex. 7 at 175; CenterPoint Ex. 9 at 593.

growth is not high for an electric utility; and Mr. Narendorf agreed 1% load growth is below CenterPoint's average level of growth.[856]

Ms. Bodden testified CenterPoint has experienced distribution load growth of approximately 1,440 MW, or an average load growth of 144 MW per year since 2009.[857] She considered that annual growth level to be "fairly substantial." For example, it equates to approximately two new substations per year.[858] CenterPoint projects distribution load growth from 2018 through 2023 of approximately 1,513 MW, or an average load growth of 302.6 MW or 1.8% per year.[859]

CenterPoint witness Matthew A. Troxle stated that an electric utility that serves more load will probably have increased O&M costs and be required to make increased investments in its system.[860] COH complains CenterPoint's witnesses did not support its asserted link between the O&M cost increases and load growth. At the hearing, Mr. Pryor agreed that, except for vegetation management, his direct testimony and workpapers did not discuss CenterPoint's 1% load growth compared to its proposed O&M expenses.[861] Mr. Narendorf testified he did no analysis comparing the 1% load growth to CenterPoint's O&M expense levels or transmission expenditures for 2010 through 2017.[862]

Mr. Narendorf testified that as existing infrastructure ages and new infrastructure is installed, corrective and preventative maintenance costs will increase.[863]

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856 Tr. at 212-13, 177-78, 197.

857 CenterPoint Ex. 9 at 592.

858 Tr. at 220.

859 CenterPoint Ex. 9 at 23.

860 CenterPoint Ex. 45 at 21.

861 Tr, at 180, 183-84.

862 Tr. at 201-02.

863 CenterPoint Ex. 32 at 29-30.

Mr. Norwood stated that approximately 79% of the increase in CenterPoint's total O&M cost occurs in seven FERC accounts, which increased by an average of 18.9% over the average level of expenses during the previous four years.[864] He provided this table:[865]

CEHE O&M Expense
2014-17 Average vs 2018 Request
($Millions)

FERC Acct	Description	2014-17 Avg	2018 Request	Increase	%Increase
560	Trans. Operation Super. & Engin.	$9.5	$13.3	$3.8	40.7%
570	Trans. Maint. of Station Equipment	$7.2	$10.8	$3.6	50.0%
580	Distr. Operation Super. & Engin.	$44.1	$54.2	$10.1	23.0%
588	Misc. Distribution Expenses	$29.9	$36.2	$6.3	21.0%
593	Distr. Maint. of Overhead Lines-Primary	$72.7	$85.3	$12.5	17.3%
594	Distr. Maint. of Underground Lines-Primary	$9.3	$13.2	$3.9	41.9%
930.2	Miscellaneous General Expense	$129.4	$146.2	$16.8	13.0%
	Subtotal	$302.1	$359.2	$57.1	18.9%

Source: CEHE's 2010 and 2018 FERC Form 1 filings, Pages 320-323

At the hearing, Mr. Pryor agreed CenterPoint's O&M cost was 18.9% higher for 2018 than for the average of 2014 to 2017, which is "significantly higher than [those] previous years."[866]

In rebuttal, Mr. Narendorf, Mr. Pryor, and Ms. Townsend testified about the reasonableness and factors driving increased costs in the seven FERC accounts, which the ALJs summarized in the table below:[867]

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[864] COH Ex. 1 at 13.

[865] COH Ex. 1 at 11.

[866] Tr. at 1119-20.

[867] CenterPoint Ex. 31 at 20-22; CenterPoint Ex. 32 at 29-31; CenterPoint Ex. 37 at 8-12.

FERC Account	Type of Costs	Primary Drivers for 2018 Cost Increase
560	Supervision and engineering related to transmission activities	Reassignment of FERC accounts for various CenterPoint cost centers to reflect current level of costs included in Account 560
570	Maintenance of transmission class substation equipment	Increased corrective and preventative maintenance
580	Distribution operations supervision and engineering	Increases in technology costs
588	Miscellaneous distribution expenses	Environmental costs for disposal and clean-up of transformers
593	Distribution maintenance of overhead lines-primary	Higher contractor costs for vegetation management to maintain overhead lines
594	Distribution maintenance of underground lines-primary	Contractor work related to preventative maintenance inspection program for single-source three-phase pad-mounted transformer installations used for major underground installations
930.2	Miscellaneous general expense	Increased maintenance costs for digital technologies

Mr. Narendorf testified CenterPoint has well-established, reasonable O&M practices in place for its transmission, substation, and major underground facilities.[868] Mr. Pryor and Ms. Bodden testified that CenterPoint carefully plans O&M activities in a five-year planning process adjusted annually depending on system performance. This oversight is performed through the workforce planning process, budgeting and cost control, use of contractors, the distribution planning process, and the transmission planning process.[869]

COH complains that to justify its O&M expenses, CenterPoint essentially relies on its own budgeting and internal practices as evidence. According to COH, although CenterPoint consistently argued the cost increases result from customer and load growth, CenterPoint failed to provide evidence of growth that supports the unusual 2018 O&M cost increases.

[868] CenterPoint Ex. 8 at 340.

[869] CenterPoint Ex. 8 at 357-59; CenterPoint Ex. 7 at 193-99; CenterPoint Ex. 9 at 589-606.

CenterPoint responds that: (1) Mr. Norwood's adjustment is inconsistent with the standards set forth in PURA and 16 TAC § 25.231, previously discussed; (2) COH does not challenge any specific O&M expense incurred by CenterPoint during the test year; and (3) the evidence does not show COH's proposal would establish a level of O&M expenses representative of CenterPoint's cost to operate and maintain its T&D system. The ALJs agree and for those reasons, recommend rejecting Mr. Norwood's adjustments to total O&M or total T&D O&M, which include numerous, diverse expenses.[870]

The ALJs find, however, that the sharp increase in overall O&M expenses *during the test year*, which Mr. Norwood described, is concerning and was not adequately explained by CenterPoint. In making recommendations on specific contested O&M expenses, the ALJs have considered if the evidence shows that test year numbers for those specific expenses are atypically high for CenterPoint.

B. Labor Expenses

CenterPoint requests to recover the proposed labor expense adjustments detailed below for employees who provide necessary services that enable CenterPoint to meet its customers' needs while providing safe and reliable service.[871] COH,[872] OPUC, TIEC, and Staff contest CenterPoint's request, and recommend portions of the requested costs for incentive compensation, payroll, and retirement/pension benefits be disallowed from recovery.

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[870] *See also Application of Southwestern Public Service Company for Authority to Change Rates*, Docket No. 43695, Order on Rehearing (Feb. 23, 2016)(Docket No. 43695 order), FoF Nos. 179-184 (rejecting proposed disallowance of certain O&M costs based on a benchmarking study about containing such costs because the study analyzed only comparative cost growth rates, not circumstances underlying those growth rates or whether the cost increases resulted from imprudence).

[871] CenterPoint Ex. 22 at 1838. CenterPoint's requested labor expense adjustments include compensation costs for its direct employees; CERC and Service Company employees (collectively, affiliate employees), and direct and affiliate employees operating and charging time to CenterPoint under a collective bargaining agreement (union or bargaining employees). *See, generally*, CenterPoint Exs. 15, 22.

[872] GCCC supports COH witness Mark Garrett's recommended disallowances for CenterPoint's requested labor expenses. *See* GCCC Initial Brief at 21. HEB supports COH's recommended disallowances for CenterPoint's requested incentive compensation. *See* HEB Initial Brief at 34-35.

The contested issues include CenterPoint's: (1) recommendations regarding the applicability and effects of House Bill 1767 and PURA § 14.006, (2) requests to recover financially-based incentive compensation costs, (3) proposals for payroll adjustments, and (4) requests to recover costs for its Benefits Restoration Plan.

1. Effect of House Bill 1767 and PURA § 14.006 on Electric Utility Ratemaking Proceedings

CenterPoint asserts the presumptions established in the recently-enacted House Bill (HB) 1767[873] and PURA § 14.006 should be applied. COH, OPUC, TIEC, and Staff disagree.

a. CenterPoint's Position

CenterPoint witness John Reed testified that HB 1767 creates a presumption of reasonableness and necessity for base salaries, wages, incentive compensation, and benefits for gas utilities as long as those costs are consistent with recently issued market compensation studies.[874] CenterPoint concedes that HB 1767 applies exclusively to gas utility ratemaking proceedings, but contends it is a "triggering event" that gives the Commission an opportunity to evaluate and reconsider how it has previously viewed compensation costs, including financially-based incentive costs, in electric ratemaking proceedings.[875] CenterPoint witness Reed opined that, for reasons of fairness, it would be good regulatory policy to treat gas and electric utilities similarly when establishing rates, particularly for a company like CNP that operates both gas and electric utilities in Texas.[876]

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[873] *See* CenterPoint Exs. 40, Exh. R-JJR-1 at 29.

[874] CenterPoint Exs. 39 at 8-9, 40 at 24-27, Exh. R-JJR-1 at 29-31.

[875] CenterPoint Ex. 40 at 24-26. Mr. Reed indicated that the financially-based incentive compensation pay for certain executive officers is excluded from the presumption established in HB 1767.

[876] CenterPoint Ex. 40 at 24-25.

According to Mr. Reed, the presumption in HB 1767 should apply to CenterPoint's proposed adjustments because they are based on market compensation studies and are closely tied to the compensation programs CNP offers to employees working for its gas utility.[877] In fact, Mr. Reed testified, CenterPoint's requested costs in this case are so closely tied to CNP's gas utility that some of the incentive compensation costs are "incurred under the same programs... and in some cases, even the same employees as at issue in this docket."[878] In sum, Mr. Reed recommended the Commission apply HB 1767's presumption of reasonableness and necessity to CenterPoint's requested compensation costs, including the financially-based incentive costs, and rely on that presumption to allow CenterPoint to recover those costs through rates.[879]

Additionally, CenterPoint stresses that its requests include compensation costs for direct and affiliate union employees that are the result of collective bargaining agreements (union or bargaining employees), which are presumed reasonable under PURA § 14.006.[880] CenterPoint argues that no party offered contrary evidence to overcome that presumption; any recommended disallowances for STI compensation or payroll costs for bargaining employees should be rejected.[881]

b. Other Parties' Positions

COH, OPUC, TIEC, and Staff contest CenterPoint's assertions regarding HB 1767 and argue that: (1) HB 1767 is irrelevant to the Commission's regulatory authority over electric utilities, (2) it is not the Legislature's intent for HB 1767 to apply to electric utility ratemaking

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877 CenterPoint Ex. 40 at 25.

878 Tr. at 1354.

879 Tr. 1354-56; CenterPoint Ex. 40 at 26-27.

880 CenterPoint Exs. 35 at 13, 37 at 18.

881 CenterPoint concedes the presumption established under PURA § 14.006 is a rebuttable presumption, stating that "[a] presumption is simply a rule of law requiring the trier of fact to reach a particular conclusion in the absence of evidence to the contrary." *See* CenterPoint Reply Brief at 93 (quoting *Temple Independent School Dist. v. English*, 896. S.W.2d 167, 169 (Tex. 1995)). The ALJs conclude that the presumption established under PURA § 14.006 is rebuttable.

proceedings, and (3) CenterPoint's requested compensation costs are subject to the PURA, Commission rules, and well-established Commission precedent regarding the recovery of compensation costs.[882]

COH, OPUC, TIEC, and Staff emphasize that HB 1767 is irrelevant because it is silent as to electric utilities and it did not amend PURA. These contesting parties further emphasize that the Legislature had the opportunity to pass HB 1766 or HB 1768, which were companion bills to HB 1767 and would have created an identical presumption for electric utilities, but did not do so.[883] During the hearing, CenterPoint witness Reed acknowledged that HB 1766 and HB 1768 failed to make it out of committee, and thus were not enacted into law.[884]

Additionally, OPUC and TIEC contest CenterPoint's assertions regarding the effect of PURA § 14.006 on CenterPoint's requested financially-based incentive compensation costs for the bargaining employees. OPUC argues PURA § 14.006 is inapplicable in this case because the Commission is tasked to determine not whether the compensation CenterPoint offers bargaining employees is reasonable, but whether the requested compensation costs are recoverable under 16 TAC § 25.231(b).[885] In contrast, TIEC concedes that presumption in PURA § 14.006 could apply to the costs requested for bargaining employees, but argues that CenterPoint failed to meet its burden to establish the presumption.[886] Specifically, TIEC asserts that CenterPoint "did not seem to present evidence that the STI amounts paid to its [bargaining] employees were the product of a collective bargaining agreement 'recognized by federal law,' as required by [PURA] § 14.006."[887]

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[882] COH Initial Brief at 15-18; OPUC Initial Brief at 45-48, Reply Brief at 16-18; TIEC Initial Brief at 52-53, Reply Brief at 26-29; Staff Initial Brief at 41-42, Reply Brief at 27-28. This Commission precedent (asserted by COH, OPUC, TIEC, and Staff) is discussed later in this Section.

[883] TIEC Exs. 37-38; Tr. at 1350-53.

[884] Tr. at 1353.

[885] OPUC Reply Brief at 18.

[886] TIEC Reply Brief at 27.

[887] OPUC Reply Brief at 18; TIEC Reply Brief at 27.

Alternatively, OPUC and TIEC argue that, if PURA § 14.006 does apply to those costs and they are presumed reasonable, the Commission's well-established precedent to disallow financially-based incentive compensation costs sufficiently rebuts the presumption.[888]

c. ALJs' Analysis and Recommendation

The ALJs conclude that the presumptions established under HB 1767 and PURA § 14.006 do not apply to this case and do not justify deviating from Commission precedent regarding the recovery of compensation costs.

As CenterPoint admits, HB 1767 applies exclusively to gas utility ratemaking procedures. The Legislature had an opportunity to create an identical presumption for electric utility ratemaking procedures during the same session HB 1767 was enacted but it did not do so. In sum, the ALJs reject CenterPoint's argument that HB 1767 is a "triggering event" for the Commission. and recommend that the Commission does not use it to deviate from its well-established precedent regarding the recovery of compensation in this case.

The ALJs conclude that CenterPoint's requested compensation costs for bargaining employees are presumed reasonable under PURA § 14.006.[889] That presumption is rebuttable (*i.e.*, the presumption will disappear if contrary evidence is introduced).[890] As CenterPoint recognizes, the disallowances for financially-based incentive compensation proposed by Staff, COH, OPUC, and TIEC each include costs for bargaining employees.[891] Neither Staff, COH, OPUC, nor TIEC divided its arguments or its recommended disallowances based on whether the

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888 OPUC Reply Brief at 18; TIEC Reply Brief at 27.

889 The ALJs reviewed the collective bargaining agreements sponsored by CenterPoint witness Harkel-Rumford and attached as confidential exhibits to her direct testimony. To protect their confidentiality, the ALJs limited their description of the bargaining agreements throughout this PFD to the non-confidential information provided in CenterPoint witnesses' testimony. *See* CenterPoint Exs. 22 at 1845-46, 22a, Exh. LHR-2 (confidential); 37 at 18.

890 *See Sudduth v. Commonwealth Cty. Mut. Ins. Co.*, 454 S.W.2d 196, 198 (Tex. 1970).

891 CenterPoint Reply Brief at 89.

requested costs were for bargaining or non-bargaining employees; so, the evidence and the arguments presented by those parties apply to all of the requested financially-based incentive compensation costs. Consequently, the ALJs find CenterPoint's argument that no party offered contrary evidence to rebut the PURA § 14.006 presumption lacks merit.[892] The ALJs conclude that the evidence offered by the contesting parties regarding the Commission's precedent to disallow financially-based compensation costs sufficiently rebuts the presumption of reasonableness established by PURA § 14.006. For reasons discussed later in this Section, the ALJs recommend that the Commission disallow CenterPoint's request for financially-based incentive compensation costs.

2. Incentive Compensation

a. Short-Term Incentive Compensation

CenterPoint requests recovery of STI expenses adjusted to reflect its actual performance over the last four years.[893] The requested STI expense totals $16,879,888, as illustrated below:[894]

Figure 1: Total Requested STI Expense[895]

	Union	Non-Union	Total
Direct	$1,373,759	$5,932,824	$7,306,583
Affiliate	116,563	9,456,742	9,573,305
	$1,490,322	$15,398,566	$16,879,888

CenterPoint witness Colvin explained in her rebuttal testimony that the requested STI expenses were calculated by adjusting the actual STI expenses down based on a four-year average

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[892] CenterPoint Initial Brief at 83, 92.

[893] CenterPoint Exs. 15 at 1111-13, 22 at 1848, 35 at 17.

[894] CenterPoint Ex. 35, Exh. WP R-KLC-02 at 1-56 (these amounts exclude Federal Insurance Contributions Act (FICA) and Savings Match).

[895] Tr. at 1275.

of actual STI achievement for non-union employees. According to CenterPoint witness Lynn Harkel-Rumford, CenterPoint's test year achievement level was 131%, and its four-year average reflects a reduced 122% achievement level. The average-adjusted achievement level was then reduced to the average actual achievement level of the prior three years for union employees. This additional adjustment reflects the additional achievement measures within the direct union contract. CenterPoint asserts its normalization (*i.e.*, four-year average) of its STI achievement level results in a reduction of its requested revenue requirement because a 122% achievement level results in fewer costs than the actual 131% achievement level incurred during the test year.[896]

Ms. Colvin further testified that Staff and OPUC incorrectly based their recommended STI disallowances on the actual test year STI expense rather than using the above-referenced four-year average. For this reason, she claims, their disallowances do not conform to CenterPoint's total requested STI costs. CenterPoint argues that any recommended disallowances that were not based on its total requested STI expense should be ignored.[897]

Staff disputes Ms. Colvin's assertion, and argues that its recommended STI disallowance is based on information provided by CenterPoint through discovery and that CenterPoint should not be allowed to now claim that the information it provided was inaccurate.[898] OPUC addresses Ms. Colvin's assertion in its initial brief and asserts that its recommended STI disallowance would increase if re-calculated based on CenterPoint's requested STI amount.[899]

Other than the above-referenced issues raised by Staff and OPUC, no party contests CenterPoint's total requested STI expense or underlying calculation. Upon review of the available evidence and arguments, the ALJs find that the total STI expense CenterPoint requests to recover through rates in this proceeding is $16,879,888, as calculated using the above-referenced four-year

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896 CenterPoint Exs. 35 at 15-16, 39 at 16.

897 CenterPoint Initial Brief at 83, Reply Brief at 93.

898 Staff Initial Brief at 41, Reply Brief at 29-31.

899 OPUC Initial Brief at 50-51.

average. The ALJs find that CenterPoint's requested STI expense is lower than the amounts Staff and OPUC used to formulate their recommended disallowances; thus, their recommended disallowances do not match up with CenterPoint's actual request.[900] Accordingly, the ALJs will not further discuss Staff's and OPUC's numerical recommended disallowance amounts, but will consider the underlying arguments for those disallowances.

i. Commission Precedent Regarding the Recovery of Incentive Compensation Costs

(a) CenterPoint's Position

CenterPoint witness Harkel-Rumford testified that CenterPoint's STI plan promotes expense management and operational efficiencies, which directly benefit customers through reasonable rates, safe and reliable operations, and enhanced customer service.[901] Ms. Harkel-Rumford explained that the STI payouts to employees are based on the attainment of five goals, and that each goal is weighted. She further testified that two goals were based on financial metrics (*i.e.*, CNP Core Operating Income and CNP Consolidated Diluted Earnings Per Share) and the remaining three goals were based on operational (non-financial) metrics (*i.e.*, CNP Operations and Maintenance Expenditures, Customer Satisfaction Composite, and CNP Safety Composite). CenterPoint's STI goals for the test year are set out below:

[900] Staff Ex. 4A at 15-16, Exh. at MF-11 at 57-68; OPUC Exs. 1 at 46, 2A, Exh. at WP JMD-9 (confidential).

[901] CenterPoint Exs. 22 at 1854, 39 at 8.

Figure 2: CenterPoint's STI Goals, Weighted Payout Percentages

GOAL	WEIGHTING[902]
CNP Core Operating Income	35%
CNP Consolidated Diluted Earnings Per Share	20%
CNP O&M Expenditures	25%
Customer Satisfaction Composite	10%
CNP Safety Composite	10%

Ms. Harkel-Rumford asserted that CenterPoint's requested STI costs should be approved as reasonable and necessary because: (1) they are comparable to costs offered in the market, (2) they include goals that lead to customer and shareholder benefits, and (3) they make up part of a competitive compensation plan that is necessary to attract, retain, and motivate employees.[903]

CenterPoint further contends its requested STI costs, including the financially-based costs, should be approved because they are similar to the STI costs that the Commission approved in CenterPoint's last base rate case.[904] CenterPoint concedes that the Commission has previously disallowed recovery of financially-based incentive costs for other utilities, but emphasizes that the Commission approved such costs for CenterPoint. In Docket No. 38339, the Commission found:

> 81. The evidence demonstrates that CenterPoint's STI compensation plan is a reasonable and necessary component of a total compensation package required to recruit, retain, and motivate employees.
>
> 83. The corporate and financial goals of STI are directly tied to metrics such as customer service and safety.[905]

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[902] Tr. at 1339; CenterPoint Ex. 22 at 26.

[903] CenterPoint Ex. 22 at 1854.

[904] Docket No. 38339 order, FoF Nos. 81, 83.

[905] Docket No. 38339 order, FoF Nos. 81, 83.

In sum, CenterPoint argues its requested STI costs are reasonable and necessary and its request to recover those costs is consistent with Commission precedent for CenterPoint, and should therefore be approved.

(b) Other Parties' Positions

COH, OPUC, Staff, and TIEC argue that all financially-based STI costs included in CenterPoint's request for recovery should be disallowed consistent with Commission precedent. However, the disallowances recommended by those parties vary in amount due to their differing opinions as to which of the five STI goals identified by CenterPoint should be considered or treated as a financial metric, either completely or partially.

COH, OPUC, Staff, and TIEC each argue that CenterPoint's request to recover the STI costs tied to its self-identified financial goals (*i.e.,* CNP Core Operating Income and CNP Consolidated Diluted Earnings Per Share) conflicts with well-established Commission precedent and should be excluded from CenterPoint's rates. The parties reference multiple electric rate proceedings wherein the Commission has disallowed the recovery of financially-based incentive costs and excluded those costs from rates.[906] For example, in 2005, in Docket No. 28840, the Commission entered the following findings of fact:

> 169. The financial measures are of more immediate benefit to shareholders, and the operating measures are of more immediate benefit to ratepayers.
>
> 170. Incentives to achieve operational measures are necessary and reasonable to provide T&D services, but those to achieve financial measures are not.[907]

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[906] Docket No. 40443 order at FoF Nos. 214-220; *Application of Entergy Texas, Inc. for Rate Case Expenses Pertaining to PUC Docket No. 39896*, Docket No. 40295, Order at 2 (May 21, 2013); *Application of Entergy Texas, Inc. for Authority to Change Rates*, Docket No. 39896, Order on Rehearing at FoF Nos. 127-133 (Nov. 2, 2012) (Docket No. 39896 order); Docket No. 38339 order at FoF Nos. 81-83; *Application of Oncor Electric Delivery Company, LLC for Authority to Change Rates*, Docket No. 35717, Order on Rehearing at FoF Nos. 92-93 (Nov. 30, 2009).

[907] *Application of AEP Texas Central Company for Authority to Change Rates*, Docket No. 28840, Order at FoF Nos. 169-70 (Aug. 15, 2005) (Docket No. 28840 Order).

In 2008, in Docket No. 33309, the Commission disallowed financially-based incentive compensation for a TDU, finding that:

> 82. TCC's [AEP Texas Central Company, predecessor of AEP] inclusion of annual and long-term incentive compensation related to financial incentives in cost of service is unreasonable because it is not necessary for the provision of T&D utility services.[908]

In 2016, in Docket No. 43695, the Commission stated:

> It is well-established that a utility may not include in its rates the costs of incentives that are tied to financial performance measures...when a utility elects to adopt a compensation plan that involves both financially-based and performance-based metrics, the utility still must show it has removed all aspects of the financially-based goals from its requested expense.[909]

The Commission's most recent decision in a base rate case, Docket No. 46449, decided in 2018, found:

> 194. The Commission has repeatedly ruled that a utility cannot recover the cost of financially-based incentive compensation because financial measures are of more immediate benefit to shareholders and financial measures are not necessary or reasonable to provide utility services.[910]

Additionally, COH, Staff, and TIEC dispute CenterPoint's argument that its requested STI expenses should be approved to be consistent with the Commission's decision in Docket No. 38339.[911] Staff notes the Commission's decision in that docket is nearly ten years old and does not reflect recent decisions on this issue.[912] COH and TIEC assert that the Commission approved CenterPoint's financially-based STI expenses in Docket No. 38339 because no party

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[908] Docket No. 33309 order at FoF No. 82.

[909] Docket No. 43695 order at 5.

[910] Docket No. 46449 order at 34, FoF No. 194.

[911] TIEC Initial Brief at 52-54; Staff Initial Brief at 40; COH Reply Brief at 16.

[912] Staff Initial Brief at 40.

offered evidence to show the expenses were unreasonable and unnecessary. COH and TIEC refer to the PFD in Docket No. 38339, wherein the ALJs found:

> According to CenterPoint, the evidence provided by [CenterPoint] proving that STI is reasonable and necessary is undisputed in the record. *TIEC presented no evidence as to the nature of the goals it contended constituted impermissible financial goals. As a consequence, the ALJs find that TIEC's challenge to CenterPoint's inclusion of STI expenses fails and, therefore, recommend that the Commission find that CenterPoint's STI expenses are recoverable.*[913]

In sum, Staff, COH, OPUC, and TIEC recommend that the Commission disallow the requested STI expenses that are tied to CenterPoint's self-identified financial goals. COH, OPUC, and TIEC use CenterPoint's actual payout percentages for the test year, rather than the percentages proposed by CenterPoint (as shown in figure 2 above), to calculate their recommended disallowance for these goals.[914] The actual per-goal payout-percentages for the test year are illustrated below:

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913 COH Ex. 2 at 15-16; TIEC Initial Brief at 53 (quoting Docket No. 38339, CenterPoint's Initial Post-Hearing Brief at 94 (Oct. 22, 2010) ("No party disputes the Company's STI costs."); Docket No. 38339, PFD at 68 (Dec. 3, 2010) (emphasis added by TIEC).

914 COH Ex. 2 at 32; OPUC Ex. 1 at 46; TIEC Ex. 3 at 13-14. Staff does not recommend a specific disallowance amount or percentage.

Figure 3: Actual Test Year STI Payout Percentages

GOAL	WEIGHTING[915]
CNP Core Operating Income	38.44%
CNP Consolidated Diluted Earnings Per Share	30.51%
CNP O&M Expenditures	13.74%
Customer Satisfaction Composite	7.09%
CNP Safety Composite	10.22%

Thus, COH, OPUC, and TIEC recommend that 69% of CenterPoint's requested STI costs be disallowed to reflect the financially-based costs tied to the two financial metric STI goals established by CenterPoint.[916] This recommended disallowance would result in an approximate $11.648 million decrease from CenterPoint's total STI request.[917]

The ALJs recommend that the Commission disallow the STI costs associated with CenterPoint's self-identified financially-based STI goals for CNP Core Operating Income and CNP Consolidated Diluted Earnings Per Share. The ALJs address this recommendation in greater detail later in this Section.

915 OPUC Ex. 2A, Exh. at WP JMD-9 (confidential); Staff Ex. 4A, Exh. MF-11; COH Ex. 2 at 25, Exh. MG-2.3; TIEC Ex. 3 at 13.

916 OPUC Initial Brief at 50-51; OPUC Ex. 1 at 45; COH Initial Brief at 24; COH Ex. 2 at 25; TIEC Initial Brief at 52-54.

917 TIEC Initial Brief at 54.

ii. Is the STI Goal for CNP O&M Expenditures Financially- or Operationally-Based?

(a) CenterPoint's Position

CenterPoint disagrees with the assertion made by Staff, COH, and OPUC that the STI goal for O&M Expenditures Goal should be considered a financial metric. CenterPoint concedes that the O&M Expenditures Goal benefits shareholders, but maintains that it is an operational metric, and that the associated costs should not be disallowed as financially-based incentive costs. CenterPoint asserts that achievement of this goal helps limit the growth in CenterPoint's overall revenue requirement, which positively impacts rates and promotes long-term benefits for customers.[918]

(b) Other Parties' Positions

Staff, COH, and OPUC recommend that the STI costs tied to the CNP Operations and Maintenance Expenditures goal (O&M Expenditures Goal) should be categorized as financially-based, and thus disallowed as well. Staff, COH, and OPUC disagree with CenterPoint's characterization of this goal as operational. They argue that it is financially-based because its achievement levels are based on the savings of O&M expenses, which maximizes CenterPoint's profit and has a direct and immediate benefit on its shareholders, but not ratepayers.[919]

Additionally, OPUC asserts that this goal is similar to the O&M growth management performance measure that SPS voluntarily removed from its annual incentive plan in Docket No. 43695 in an attempt to remove all financially-based costs from its request for recovery, and that CenterPoint fails to explain how its O&M Expenditures Goal differs.[920] OPUC further

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[918] CenterPoint Ex. 39 at 15.

[919] Staff Ex. 4A at 16-17; OPUC Ex. 1 at 45; COH Ex. 2 at 25.

[920] Docket No. 43695 PFD at 88.

contends that CenterPoint fails to explain how it treats the cost savings generated from meeting the O&M Expenditures Goal; thus, there is no way to know if the cost savings are used for a purpose that benefits CenterPoint's customers.[921]

According to COH's and OPUC's use of the test year payout percentages (as shown in Figure 3 above), this would result in an additional 14% disallowance of CenterPoint's total STI request.[922] Thus, the total percentage amount that COH and OPUC recommend should be disallowed from CenterPoint's STI request based on the costs tied to its financially-based STI goals (*i.e.*, CNP Core Operating Income, CNP Consolidated Diluted Earnings Per Share, and O&M Expenditures Goal) totals approximately 83%.[923]

The ALJs recommend that the Commission disallow the STI expenses tied to the O&M Expenditures Goal. The ALJs address this recommendation in greater detail later in this Section.

iii. Effect of the Financial Trigger for Operationally-Based STI Costs

(a) CenterPoint's Position

CenterPoint disagrees with the partial disallowance for costs tied to the STI goals for Customer Satisfaction Composite and CNP Safety Composite based on the overall STI financial trigger as recommended by COH and Staff (and supported by OPUC). CenterPoint argues this recommended partial disallowance should be rejected because it is arbitrary and because neither Staff nor COH dispute the traditional understanding that customers are the direct beneficiaries of operational and safety goals.[924] CenterPoint further argues that Staff and COH based this

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921 Staff Ex. 4A at 17.

922 COH Initial Brief at 24; COH Ex. 2 at 25.

923 COH Ex. 2 at 25; OPUC Ex. 1 at 45.

924 CenterPoint Ex. 39 at 19.

recommended partial disallowance on Commission decisions for other utilities without adequately considering whether those decisions reflect sound policy, given the facts of this case. CenterPoint points to the Commission's approval of the STI plan in Docket No. 38339 in which CenterPoint included a similar funding requirement.[925]

(b) Other Parties' Positions

Staff and COH argue that because CenterPoint's overall STI plan is subject to a financial trigger, 50% of CenterPoint's requested STI expenses for the costs tied to the operationally-based STI goals (*i.e.*, Customer Satisfaction Composite and CNP Safety Composite) should be disallowed. Staff and COH reference CenterPoint witness Harkel-Rumford's testimony asserting that a minimum level of core operating income must be achieved before the STI plan is funded, including both the financially- and operationally-based goals.[926] Staff and COH argue that because the goals are subject to the financial trigger, they are indirectly financially-based and should be adjusted to reflect the effect of that financial trigger.[927] OPUC supports Staff's and COH's recommended partial disallowance.[928]

Staff, COH, and OPUC point to the Commission's decisions in Docket Nos. 43695 and 46449 to support their recommended partial disallowance.[929] The contesting parties assert that the Commission approved OPUC's similar partial disallowance in Docket No. 43695, disallowing a portion of the operationally-based goals within SPS's annual incentive plan, in order to reflect the financial effect caused by the financially-based trigger SPS implemented for those goals.[930] Specifically, the Commission found:

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[925] CenterPoint Ex. 39 at 19.

[926] Tr. at 1340.

[927] Staff Ex. 4A at 14; COH Ex. 2 at 25.

[928] OPUC Initial Brief at 50.

[929] Staff Ex. 4A at 13-14.

[930] Docket No. 43695 order at 5, FoF Nos. 83A -85A.

83A. SPS's Annual Incentive Plan includes both financially-based and performance based goals.

83B. Compensation to employees under the Annual Incentive Plan is based in part on an earnings-per-share trigger.

84A. A certain amount of incentive to achieve operational measures is reasonable and necessary to the provision of electric service. However, SPS failed to prove its proposal removed all the costs associated with the financially-based components of the Annual Incentive Plan.

85A. [OPUC's] alternatively-recommended adjustment to eliminate $2,604,995 associated with the Annual Incentive Plan, plus corresponding flow through reductions, results in allowable expense for the plan that is reasonable and necessary to the provision of electric service, and should be included in the cost of service.

Staff, COH, and OPUC also assert that the Commission made a similar decision in Docket No. 46449, and disallowed a portion of Southwestern Electric Power Company's (SWEPCO's) performance-based STI goals in order to reflect the financial effect of the earnings-per-share trigger SWEPCO had implemented for those goals.[931]

Staff and COH (as supported by OPUC) recommend that the Commission apply the partial-disallowance methodology approved in Docket Nos. 43695 and 46449 to this case and disallow the costs tied to CenterPoint's operationally-based STI goals (*i.e.*, Customer Satisfaction Composite and CNP Safety Composite) that are subject to a financial trigger. Thus, the total overall percentage of CenterPoint's STI request that COH and OPUC recommend should be disallowed (based on the total disallowance for the costs tied to CenterPoint's financially-based STI goals and a 50% disallowance of the costs tied to the remaining operationally-based goals) is 92%.[932]

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[931] Docket No. 46449 order at FoF Nos. 194-99.

[932] The ALJs calculated this number by adding the actual test-year-payout percentages for CenterPoint's Customer Satisfaction Composite and CNP Safety Composite goals, and then dividing that number by .50 ((7.09% + 10.22%) / .50 = 8.655%). The ALJs rounded the resulting percentage to 9%, and added it to the 83% recommended disallowance proposed by COH and OPUC.

The ALJs recommend the Commission disallow 50% of the expenses tied to CenterPoint's operationally-based goals in order to reflect the effect of the financial trigger. Accordingly, the ALJs recommend that the Commission disallow approximately 92% of CenterPoint's total STI request. The ALJs address this recommendation in greater detail below.

iv. ALJs' Analysis and Recommendation

The ALJs find that the Commission's precedent on this issue is well-established and unambiguous, and that CenterPoint failed to meet its burden to remove all aspects of the financially-based goals from its request to recover the above-referenced STI expense.[933] Further, the ALJs are not persuaded by CenterPoint's arguments as to why the requested financially-based STI costs or the operationally-based costs subject to a financial trigger should be approved in opposition to that precedent. Accordingly, the ALJs recommend that the Commission disallow all of CenterPoint's requested financially-based STI costs (*i.e.*, the costs tied to the CNP Core Operating Income, CNP Consolidated Diluted Earnings Per Share, and CNP O&M Expenditures goals) and 50% of its operationally-based costs which are subject to a financial trigger (*i.e.*, Customer Satisfaction Composite and CNP Safety Composite). The ALJs' recommended adjustment would result in an approximate 92% decrease to CenterPoint's total requested recovery for STI costs.

The ALJs conclude that the costs tied to CenterPoint's self-identified financially-based STI goals should be disallowed, as proposed by Staff, TIEC, OPUC, and COH (and supported by GCCC and HEB). Under the Commission's rules, only expenses that are reasonable and necessary to provide service to the public shall be included in rates to be recovered by a utility.[934] The ALJs recognize the Commission's long-standing precedent to disallow financially-based incentive compensation costs because: (1) those costs are not considered to be reasonable and necessary to provide service to the public, and (2) they provide more immediate benefits to shareholders, rather

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933 Docket No. 43695 order at 5.

934 16 TAC § 25.231(b).

than ratepayers.[935] The ALJs reject CenterPoint's argument that the Commission's decision in Docket No. 38339 created a CenterPoint-specific precedent regarding the recovery of financially-based incentive costs that should be repeated in this case.

Additionally, the ALJs are not persuaded by CenterPoint's arguments that costs tied to its self-identified financially-based STI goals were reasonable and necessary to provide service to the public. The Commission has repeatedly and consistently found that those costs are impermissible. Accordingly, the ALJs reject CenterPoint's arguments that the costs tied to its two self-identified financially-based goals should be approved.

The ALJs further conclude that CenterPoint's O&M Expenditures Goal is a financial metric and that the costs tied to that goal should be disallowed, as proposed by Staff, OPUC, and COH (and supported by GCCC and HEB). The ALJs find that the achievement of this goal, more directly and immediately, benefits the shareholders instead of the customers. Accordingly, the ALJs find that the goal is financially-based, and that the associated costs should be disallowed. CenterPoint's ratepayers might benefit from the achievement of this goal (*i.e.*, reduced O&M expenses may mean a lower overall revenue requirement) but that benefit might not be achieved and would not benefit customers until CenterPoint's next rate case. In contrast, the savings of O&M expenses achieved by this goal result in a financial benefit immediately available to CenterPoint and its shareholders.

The ALJs conclude that 50% of the costs tied to CenterPoint's operationally-based goals should be disallowed so as to reflect the effect of the financial trigger that CenterPoint implemented for those costs.

The ALJs conclude that the recommended partial disallowance for the operationally-based STI costs dependent on a financial trigger, as proposed by COH and Staff (and supported by OPUC, GCCC, and HEB) is consistent with Commission precedent. In Docket Nos. 43695 and

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[935] Docket No. 28840 order at FoF Nos. 169-70.

46449, the Commission found that the use of a financial trigger as the determining factor on whether an incentive compensation plan will be funded is considered to be a financially-based measure, which should be excluded from recovery in rates. In this case, the financial trigger is tied to operationally-based goals. The issue here, therefore, is what adjustment should be applied in order to remove the effect of the financial trigger. CenterPoint did not address that issue but Staff and COH did (as supported by OPUC, GCCC, and HEB). Finding these parties' proposal regarding this issue to be reasonable and consistent with Commission precedent, the ALJs recommend that the Commission disallow 50% of the requested STI expenses tied to CenterPoint's operational goals: Customer Satisfaction Composite and CNP Safety Composite.

Furthermore, CenterPoint failed to address or offer evidence regarding the difference in its estimated STI weighting percentages (Figure 2 above) and its actual test year payout percentages per goal (Figure 3 above), which were contested by OPUC, TIEC, and COH (and supported by GCCC and HEB). The ALJs find merit in utilizing the per-goal actual payout percentages rather than the unexplained, estimated weighted percentages. In sum, the ALJs recommend that the Commission disallow 92% of CenterPoint's total requested STI expense because those costs are impermissible financially-based incentive costs.

b. Long-Term Incentive Compensation

i. Other Parties' Positions

Staff, OPUC, TIEC, and COH argue that CenterPoint's requested LTI expense, which totals approximately $11.25 million, includes solely financially-based incentive costs and should be disallowed consistent with Commission precedent. In response to CenterPoint's request to recover costs for the performance shares portion of its LTI plan (approximately $7.5 million), each of the contesting parties points to CenterPoint's admission that those costs are financially-based.[936]

[936] Tr. 1343; *see, e.g.,* CenterPoint Ex. 39 at 23; Staff Ex. 4A at 56-78; TIEC Ex. 15 at 34; COH Ex. 2 at 35 (quoting the LTI Plan provided in response to Staff RFI 3-03); CenterPoint Initial Brief at 88.

Additionally, OPUC argues that the Commission denied CenterPoint's request to recover LTI costs in Docket No. 38339 because it found the LTI Plan was based on financially-based performance metrics. OPUC contends the basis for that Commission decision has not changed.[937]

Staff, OPUC, TIEC, and COH also argue that CenterPoint's proposed restricted stock units (RSUs) portion of the LTI plan (approximately $3.8 million) consists of financially-based incentive costs. COH argues the RSUs are a financially-based goal because the degree of compensation paid out to the employees is dependent upon the growth and appreciation of CNP's stock price over a three-year vesting period. OPUC and TIEC make similar arguments, and reference CNP's statement to its shareholders that, "[t]he restricted stock units are intended to retain executive officers and *reward them for long-term stock appreciation*."[938] Additionally, Staff asserts that CenterPoint admitted that the RSUs are financially-based in its response to Staff RFI 3-01 and TIEC RFI 1-09. In response to Staff RFI 3-03, which requested information for "all amounts included in rates in CenterPoint's request relating to financially-based incentive compensation," CenterPoint stated:

> Please see the response to TIEC 01-09 for the long-term incentive amounts for both direct and affiliate. Long-term incentive goals are all financially-based and are recorded in FERC account 9200 for direct and 9302 for affiliate.[939]

Staff asserts that CenterPoint then provided the full LTI amount being requested ($11.25 million) in response to TIEC RFI 01-09. Thus, Staff argues that CenterPoint cannot argue that the RSUs are not financially-based metrics. In sum, Staff, OPUC, TIEC, and COH (as supported by GCCC and HEB) contend that RSUs, like the performance shares, are financially-motivated because their value directly relates to stock price and awarded dividends, which benefit shareholders and not customers, and should be disallowed.

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[937] Docket No. 38339 order at FoF No. 82.

[938] TIEC Ex. 15 at 34 (emphasis added by TIEC).

[939] COH Ex. 2 at 33-34; Tr. at 1343; Staff Ex. 4A at 57-63.

ii. CenterPoint's Position

CenterPoint disagrees with the recommended disallowances, and asserts the Commission should approve its request to recover $11.25 million for LTI costs. CenterPoint witness Harkel-Rumford indicated that both forms of the LTI plan are necessary to attract and maintain qualified employees and to focus employee efforts on sustained improvements in CNP's and CenterPoint's long-term performance.[940] CenterPoint admits that the performance shares portion of its LTI plan is financially-based, but argues that the current economic conditions and employment market support approval of the costs.[941]

Conversely, CenterPoint argues that the RSUs have no correlation to the achievement of financial goals and should not be considered a financially-based metric simply because they are paid out in the form of stock.[942] CenterPoint asserts RSUs are purely a time-based achievement and that the payout is only triggered if an employee remains with CNP for a three-year period.[943] CenterPoint points to the Commission's decision in Docket No. 46449, wherein the Commission approved similar LTI costs and found that the requested "restricted stock units are not based on financial measures...and are appropriate to include in SWEPCO's rates.[944]

In sum, CenterPoint argues that the costs included in its LTI plan, including performance shares, are reasonable and necessary, and should be recovered in full for the following reasons:

- The specific purpose of the LTI plan is to focus employee attention toward ensuring sustained improvements in performance over longer periods of time;

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[940] CenterPoint Ex. 22 at 29.

[941] CenterPoint witness Harkel-Rumford admitted that the performance shares portion of the LTI plan are measured by pre-determined financial performance metrics such as total shareholder returns and utility net income. *See* CenterPoint Ex. 39 at 20.

[942] CenterPoint Ex. 39 at 24-25.

[943] CenterPoint Reply Brief at 95; CenterPoint Ex. 39 at 24-25.

[944] Docket No. 46449 order at FoF No. 199.

- The goals associated with performance-based LTI motivate participating employees to effectively manage operations because achievement of financial goals enables CNP and CenterPoint to adequately maintain CenterPoint's assets and provide safe and reliable electric service to customers with a focus on controlling costs;

- Customers necessarily benefit from CNP and CenterPoint recruiting and retaining key employees who are motivated to make positive strategic decisions that will benefit CenterPoint and its customers over the long run;

- The market requires that a significant portion of the total compensation for senior executives and management is at-risk pay; and

- This "pay for performance" philosophy is consistent with the market and requires that senior executives and management meet established goals related to customer and shareholder expectations.[945]

iii. ALJs' Analysis and Recommendation

The ALJs conclude that the evidence supports a partial disallowance of CenterPoint's requested LTI expense. The ALJs recommend that the Commission disallow the $7.5 million tied to performance shares and approve the $3.8 million tied to RSUs.

The ALJs are not persuaded by CenterPoint's argument that the current economic conditions or employment market justify a departure from the Commission's well-established precedent. However, the ALJs are persuaded by CenterPoint's arguments that the RSUs are purely a time-based achievement, vesting only if an employee remains employed with CNP for three years. Although the value of the RSUs is tied to financial measures, which typically benefit shareholders, that is not what triggers the RSU payout to employees. The ALJs' recommendation is consistent with the Commission's recent decisions to approve LTI expenses for RSU payouts in Docket Nos. 40443 and 46449.[946]

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[945] CenterPoint Ex. 39 at 20-22, Exh. MG 2.5.

[946] Docket No. 40443 order at 13, FoF No. 202; Docket No. 46449 order at FoF No. 199.

3. Executive Employee Related Expenses

a. COH's Position

COH recommends (and GCCC supports) that CenterPoint's non-qualified compensation expenses, in the form of executive salaries in excess of $1 million, should be excluded from rates, for a total decrease to CenterPoint's request of $1,143,619.[947] COH witness Mark Garrett stated that in 2017, the TCJA made salaries in excess of $1 million non-deductible, and that CenterPoint identified $1.143 million in allocated, non-deductible salaries.[948] According to Mr. Garrett, salaries in excess of $1 million are not necessary for the provision of electric service, but rather discretionary costs designed to attract, retain, and reward executive employees for the primary purpose of increasing CenterPoint's stock price. Mr. Garrett was of the opinion that those costs should be borne by the shareholders, not the ratepayers.[949] Mr. Garrett asserted that not every cost included within executive compensation is presumed to be a cost appropriately passed on to ratepayers, because officers for a company have a fiduciary duty to put the company's interest first.

b. CenterPoint's Position

CenterPoint disputes COH's recommendation for the following reasons: (1) the TCJA had no effect on the existing $1 million cap on executive salaries for tax deductibility purposes; (2) the $1 million cap is unrelated to defining what is reasonable, necessary, or competitive compensation for executives; (3) executive salaries were developed using market studies to ensure they targeted the median of the market; (4) CNP officers demonstrate a balanced loyalty to all stakeholders, including customers; (5) Mr. Garrett's recommendation conflicts with HB 1767; (6) the amount of

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[947] COH Ex. 2 at 46-47. COH does not contest that CNP uses a market-based approach to ensure salaries for executive positions target the median of the market, or that its Compensation Board retains a third-party consultant so as to ensure that the compensation offered to senior executives remains competitive. *See* CenterPoint Ex. 22 at 1844.

[948] COH Ex. 2 at 46-47, Exh. MG 2.5.

[949] COH Ex. 2 at 46-47.

non-deductible salaries Mr. Garrett identified for disallowance is inaccurate; and (7) Mr. Garrett's assertion that executives will necessarily put CenterPoint's interests above the customers is incorrect.[950] For these reasons, CenterPoint asserts that its request to recover its portion of the base pay amounts for the one employee whose pay exceeds $1 million is reasonable and should be approved.

For clarification, CenterPoint witness Townsend testified that Mr. Garrett misinterpreted CenterPoint's identification of $1.143 million non-deductible salaries, and that the identified amount is an aggregate amount that represents the total for five executives, not a single individual.[951] She further testified that within CNP and its affiliates, only one executive has a base salary over $1 million, and that CenterPoint receives an allocated 54.20% share of that cost.[952] According to Ms. Townsend, if the Commission adopts COH's recommendation, the only amount that should be adjusted is the amount of that single employee's salary that exceeds $1 million, as adjusted to reflect CenterPoint's allocated percentage, which totals $132,786.

c. ALJs' Analysis and Recommendation

The ALJs recommend that the Commission disallow $1,143,619 in non-deductible salaries from CenterPoint's request. After reviewing the available evidence and arguments presented by the parties, the ALJs find CenterPoint's alternative argument to disallow only $132,786 as a non-deductible salary amount implausible. It is not apparent, for example, how the $1.143 million CenterPoint identified as non-deductible salaries represents an aggregate for five executives if only one executive has a salary base over $1 million. CenterPoint failed to meet its burden to show that

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[950] CenterPoint Exs. 39 at 26-28, 37 at 19.

[951] CenterPoint Ex. 37 at 19.

[952] CenterPoint Ex. 37 at 19. Ms. Townsend referred to the "2019 Proxy Statement on page 41" as evidence for her assertions on this matter; however, that document was neither described further nor attached to her rebuttal or direct testimony. CenterPoint also refers to the "CNP Proxy Statement" in its initial brief, but only cites to Ms. Townsend's rebuttal to support its assertions on the matter. *See* CenterPoint Initial Brief at 97.

the annual salary amount exceeding $1 million is reasonable and necessary to provide service to its customers.

4. Payroll Adjustments

CenterPoint requests recovery for December 2018 (*i.e.*, end of the test year) annualized base salary amounts, and a 3% Competitive Pay Adjustment (CPA) increase to employee base pay.[953] CenterPoint's proposed salary and CPA adjustment is illustrated below:

Wage Adjustment[954]
(In Thousands, excluding STI)

		Non-Union	Union	Total
Direct	Salary Adjustment	$ 437	$ 2,126	$ 2,563
Direct	CPA Adjustment	1,200	1,971	3,171
	Total Direct	1,637	4,097	5,734
	Total Affiliate	3,066	499	3,565
	Total Wage Adjustment	**$ 4,703**	**$ 4,596**	**$ 9,299**
Direct	FICA Tax	22	(14)	8
Direct	Savings	(15)	169	154
	Grand Total	**$ 4,710**	**$ 4,751**	**$ 9,461**

a. Staff's Position

Staff disputes CenterPoint's proposed payroll adjustments. Staff witness Filarowicz argues that the salary costs for CenterPoint's 32 full-time employees (FTEs) terminated due to CNP's acquisition of Vectren should be removed from CenterPoint's requested rate base because those costs will no longer be incurred. This recommended disallowance would result in an approximate $1.65 million decrease in CenterPoint's proposed base pay. According to Mr. Filarowicz,

953 CenterPoint Ex. 35 at 10-11.

954 CenterPoint Exs. 1, Exhs. WP-1 Adj, 4, WP-D-3 Adj. 2, 35 at 10.

CenterPoint should have reflected the reduced employee headcount due to the Vectren acquisition as a known and measurable adjustment to its request. Mr. Filarowicz cited to CenterPoint's acknowledgement that CNP entered into an agreement and plan of merger with Vectren in April 2018, within the test year, and that the termination of those 32 employees resulted from the Vectren acquisition on February 1, 2019.[955]

Additionally, Staff disputes CenterPoint's alternative request to include the severance costs for the above-referenced 32 employees within its cost of service.[956] Staff argues that CenterPoint fails to demonstrate that the Vectren-related severance costs are: (1) ongoing and representative of costs that CenterPoint will continue to incur in the rate year and each year going forward, or (2) reasonable and necessary expenses that should be borne by the ratepayers.

b. COH's Position

COH also disputes CenterPoint's proposed payroll adjustments, and recommends that the post-test-year adjustment for the CPA increase be rejected and removed from the requested expenses. COH's recommended disallowance would result in a total decrease of $3,192,000 to CenterPoint's proposed adjustment for direct payroll, and a total decrease of $1,522,000 for allocated payroll from CNP.[957] GCCC supports COH's recommended disallowance.

COH witness Mark Garrett disputed CenterPoint's annualized December 2018 payroll adjustment because, as he testified, "an annualization that applies a nominal mid-year pay increase across earlier parts of the year should be measured to ensure that the resulting payroll is representative of year-end expense levels." Moreover, he disputed CenterPoint's proposed CPA

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[955] Staff Ex. 4A at 25-26, Exh. MF-14 at 95-99. *See* CenterPoint Ex. 19 at 18.

[956] Staff Initial Brief at 46.

[957] COH's recommended disallowance would reduce CenterPoint's direct payroll expense increase requested by $2,965,000 and reduce the direct payroll tax expense requested by $227,000. The removal would also reduce CNP (affiliate) payroll expense increase requested by $1,414,000 and CNP (affiliate) payroll tax expense increase requested by $108,000. *See* COH Ex. 2 at 50.

adjustment, and asserted that "a projected additional increase for future pay raises based on the nominal increase rate is almost never appropriate because it ignores offsetting factors that tend to keep payroll costs in check," such as employee turnover, workforce reorganization, gains in productivity, and capitalization ratio changes.[958] According to Mr. Garrett, these offsetting factors impact overall payroll cost levels as much or more than pay raises and often lower overall expense levels. Mr. Garrett also argued against the CPA post-test year adjustments because, in his opinion, it is better not to reach beyond the test year for increases in one area without considering changes to all other areas over the same period of time.[959]

c. CenterPoint's Position

CenterPoint requests that the Commission reject Staff's and COH's recommended disallowances concerning its payroll adjustments. CenterPoint argues that Staff's recommendation to remove $1.65 million in base pay to reflect the post-test-year Vectren-related termination of 32 employees should not be adopted because it was a post-test-year change, and because CenterPoint did not incorporate the other Vectren-related post-test-year changes in its adjustment of test year costs. CenterPoint witness Colvin testified that the above-referenced 32 individuals were active CenterPoint employees at the end of the test year when payroll costs were annualized; thus, the annualized December 2018 payroll did not reflect the employee headcount reduction due to their subsequent Vectren-related termination.[960]

Ms. Colvin further testified that if the Commission adopts Staff's recommendation, it is reasonable and necessary for the Commission also to approve the corresponding $3.9 million in severance costs CenterPoint incurred for those employees.[961]

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[958] COH Ex. 2 at 49.

[959] COH Ex. 2 at 49-50.

[960] CenterPoint Ex. 35 at 19.

[961] *See* CenterPoint Reply Brief at 98, Exs. 35 at 20, 39 at 30.

CenterPoint witness Harkel-Rumford testified that the provision of severance pay for those employees was fair, reasonable, and consistent with market practices. She further testified that CenterPoint has previously implemented programs or operational changes to reduce costs or to streamline staffing that have similarly impacted employees, which, she asserted, confirms that severance costs are a recurring expense for CenterPoint. Ms. Harkel-Rumford also indicated that CenterPoint's request for recovery included other severance costs (unrelated to the Vectren acquisition) which were not challenged.[962]

Additionally, CenterPoint disagrees with COH's recommendation to disallow its proposed CPA adjustment. CenterPoint argues that the annualized December 2018 payroll is a reasonable way to adjust test year wages based on known and measurable adjustments for the number of employees and salary amounts. CenterPoint further argues that its proposed CPA adjustment was a known and measureable change and that it was included as a post-test year increase consistent with the Commission's decision in Docket No. 46449. In that docket the Commission found:

> 191. SWEPCO's proposed base payroll is based on the salaries of its employees for the final pay period at the end of the test year (annualization) plus [post-test-year] pay increase of 3.5% for which all increases were approved and then implemented by April 2017.
>
> 192. Because these payroll increases were awarded in 2017, they represent appropriate known and measurable changes.
>
> 193. SWEPCO's calculation in this proceeding matched the adjustment approved in Docket No. 40443, which is to annualize salaries of employees on the payroll at the end of the test year and then apply a known and measurable increase that was awarded post-test year.[963]

CenterPoint witness Colvin testified that CenterPoint simply took the actual payroll for December 2018, which included the CPA awarded during the test year, and annualized it to reflect

[962] CenterPoint Ex. 39 at 29-30.

[963] Docket No. 46449 order at FoF Nos. 191-93.

the actual number of employees at the end of the test year.[964] Ms. Colvin explained that CenterPoint then applied a 3% percent CPA increase to reflect the CPA that occurred on March 20, or April 1, 2019, for non-union employees, which they receive every year (the employees receive the CPA in either March or April of every year depending on the individual employee's pay schedule).[965] CenterPoint witness Townsend testified that the union contracts for the bargaining employees contain a provision that contractually obligates CenterPoint to increase affiliate wages for those employees every year (date varies due to the individual agreements).[966] As a result, CenterPoint argues the 2019 CPA was not a prospective increase, but an actual, known, and measurable increase.

Moreover, CenterPoint asserts the requested CPA adjustment for non-bargaining employees is reasonable under PURA § 14.006, and that the CPA for non-union employees is reasonable and should be approved.[967] CenterPoint witness Harkel-Rumford testified that the CPA is reviewed annually to determine how much of an increase is needed to maintain the competitiveness of non-union base salaries. She further explained that CNP's senior management and Human Resources division consider the following factors prior to finalizing the CPA amount awarded to employees: third-party surveys of competitive trends, turnover statistics, negotiated labor agreements, market economic data, financial ability to pay, and CNP's overall plans and expenses.[968]

d. ALJs' Analysis and Recommendation

The ALJs recommend that the Commission disallow the $1.65 million in CenterPoint's requested base pay that relates to the 32 employee positions that were terminated due to the Vectren

[964] CenterPoint Exs. 35 at 10-12, 37 at 18.

[965] CenterPoint Exs. 35 at 11; 22 at 1845-47.

[966] CenterPoint Ex. 37 at 18. *See*, *e.g.*, CenterPoint Exs. 22 at 1845-47, 22a, Exh. LHR-2 (confidential).

[967] CenterPoint Exs. 22 at 1846, 35 at 13.

[968] CenterPoint Ex. 22 at 1846.

acquisition on February 1, 2019, and reject CenterPoint's argument to approve the corresponding severance costs. Furthermore, the ALJs recommend that the Commission approve CenterPoint's December 2018 annualization of payroll (minus 32 employees) and the corresponding 2019 CPA adjustments awarded to those employees.

The ALJs are not persuaded by CenterPoint's arguments opposing Staff's recommended disallowance because Staff did not include any other Vectren-related post-test-year changes in its adjustment of test year costs. Under 16 TAC § 25.231(a), CenterPoint's rates are to be based on its cost of rendering service to the public during a historical test year, adjusted for known and measurable changes.[969] CNP entered the agreement to acquire Vectren in April 2018 and the acquisition closed February 1, 2019. Based on the available evidence, the ALJs find that the 32 Vectren-related terminations should have been reflected as known and measurable changes to employee headcount. Similarly, in Docket No. 39896, the Commission found that Entergy Texas Inc.'s (ETI's) annualized payroll costs should be updated to reflect its most recent post-test-year employee headcount. In that docket the Commission found:

> 124. [ETI] proposed adjustments to its test-year payroll costs to reflect: (a) changes to employee headcount levels at ETI and Entergy Services, Inc. (ESI); and (b) approved wage increases set to go in effect after the end of the test-year.
>
> 125. The proposed payroll adjustments are reasonable but should be updated to reflect the most recent available information on headcount levels as proposed by Commission Staff.[970]

Additionally, the ALJs reject CenterPoint's alternative request to include the corresponding severance costs because, other than general statements as to the amount, there is no evidence to prove those costs and they are not representative of future rates.

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[969] 16 TAC § 25.231(a).

[970] Docket No. 39896 order at FoF Nos. 124-25.

The ALJs agree with CenterPoint's action to annualize the December 2018 payroll, including the 2018 CPA, and its inclusion of the 2019 CPA. However, as discussed above, the ALJs conclude that these amounts need to be re-calculated to reflect the $1.65 million decrease in base pay for the 32 Vectren-related terminations. The ALJs are persuaded by CenterPoint's arguments that annualizing the end of test-end payroll (with the exception that the most recent employee headcount should be used) and including a non-prospective post-test-year wage increase is consistent with Commission precedent. In addition to Docket No. 46449, referenced by CenterPoint, the Commission has approved similar payroll adjustments in Docket Nos. 39896 and 40443. In Docket No. 46449, the Commission found that because the proposed post-test year salary increases were awarded, they represented appropriate known and measurable adjustments to test-year expenses.[971] In this case, the 2018 CPA was awarded and properly included in CenterPoint's annualization of payroll. The 2019 CPA consisted of a wage increase that the non-union employees receive every year, and that CenterPoint is contractually obligated to give the bargaining employees. The ALJs conclude that CNP takes into account sufficient factors when determining the CPA amount that will be awarded to non-union employees each year. Accordingly, the ALJs conclude that Commission should approve CenterPoint's annualized payroll and CPA adjustments once CenterPoint has adjusted its request to reflect the reduced employee headcount.

5. Benefit Restoration Plan Expenses

a. Staff's and COH's Position

Staff and COH (and supported by GCCC) dispute the approximate $1,783,000 CenterPoint requests to recover its BRP expenses,[972] and recommend a complete disallowance of those costs. CenterPoint describes the BRP as a non-qualified retirement plan (pension plan) for certain employees whose retirement benefits under the traditional plan were lost due to the Internal

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[971] Docket No. 40443 order at FoF Nos. 6, 210-11.

[972] Staff Ex. 4A at 19, Exh. MF-12 at 69-70.

Revenue Code (IRC) income limits.[973] Staff and COH assert Commission precedent supports their recommendation, and state that the Commission has repeatedly found that non-qualified pension expenses "are not reasonable or necessary to provide utility service to the public, are not in the public interest, and should not be included in [...] cost of service."[974] Therefore, both parties assert the BRP costs are unreasonable and unnecessary for CenterPoint's service to customers and thus, should be borne by the shareholders, not the ratepayers.

b. CenterPoint's Position

CenterPoint witness Harkel-Rumford stated that the BRP is not a "traditional supplemental executive retirement plan (SERP) that provides benefits over and above those available to other employees." She further testified the BRP is necessary to attract and maintain high-level employees at a compensation level commensurate with their level of responsibility.[975] For this reason, CenterPoint asserts that Staff's and COH's position that shareholders, rather than ratepayers, should be responsible for the BRP costs conflicts with the overall standard that reasonable and necessary costs must be recoverable through rates. CenterPoint witness Harkel-Rumford testified that the "[BRP] costs are a reasonable and necessary part of compensating high-level employees."[976]

c. ALJs' Analysis and Recommendation

The ALJs recommend that the Commission disallow CenterPoint's requested BRP costs totaling approximately $1,783,000, as proposed by Staff and COH (and supported by GCCC). Although CenterPoint asserts the BRP is not a "traditional SERP," it failed to prove how it differs. As with traditional SERPs, the BRP consists of non-qualified retirement expenses for high-level

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[973] CenterPoint Ex. 39 at 25.

[974] Docket No. 46449 order at FoF No. 204; Docket No. 40443 order at FoF No. 227.

[975] CenterPoint Ex. 39 at 25-26.

[976] CenterPoint Ex. 39 at 26.

employees whose benefits are limited by the IRC based on their annual compensation amounts. The Commission disallowed the recovery of SERP costs in Docket Nos. 40443 and 46449, concluding that the non-qualified executive benefits are not reasonable or necessary to provide utility service to the public, are not in the public interest, and should not be included in SWEPCO's cost of service.[977]

Similarly, in Docket No. 39896, the Commission disallowed the recovery of SERP costs on the basis that:

> 140. ETI provides non-qualified supplemental executive retirement plans *for highly compensated individuals...because of limitations imposed under the Internal Revenue Code,* would otherwise not receive retirement benefits on their annual compensation over $245,000 per year.
>
> 141. ETI's non-qualified supplemental executive retirement plans are discretionary costs *designed to attract, retain, and reward highly compensated employees whose interests are more closely aligned with those of the shareholders than the customers.*
>
> 142. ETI's non-qualified executive retirement benefits in the amount of $2,114,931 *are not reasonable or necessary to provide utility service to the public, not in the public interest, and should not be included in ETI's cost of service*.[978]

CenterPoint did not provide sufficient evidence to show why the Commission's prior decisions to disallow SERP costs should not apply to its requested BRP costs. Thus, the ALJs conclude the requested BRP costs should be disallowed for the same reasons the Commission has previously disallowed SERP costs.

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[977] Docket No. 40443 order at FoF No. 227; Docket No. 46449 order at FoF No. 204.

[978] Docket No. 39896 order at 25-26, FoF Nos. 140-42 (emphasis added).

C. Depreciation [PO Issue 25]

Depreciation is the process used for recovering the cost of electric plant in service. It is a system of accounting that aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It focuses on allocation rather than valuation. The FERC USOA defines depreciation, as applied to depreciable electric plant, as:

> the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of electric plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities.[979]

Depreciation of electric plant is based on selected lives. The recovery period depends upon the type of property analyzed. The selection of the number of years for the recovery period is not a pure science, and different recovery periods may be determined based upon the individual property analyzed. Electric property is recovered ratably and systematically over the number of years determined for cost recovery.

In the context of utility rate-making, depreciation is essentially a cost allocation system designed to measure the rate by which a utility, such as CenterPoint, may recover its capital investment in a rational and systematic manner. Fundamental to depreciation analysis is the study of historical utility plant data in order to project how long the property will survive in the future, *i.e.*, its estimated service life.

One method used to make this type of projection is the "retirement rate method." Under the retirement rate method, the company's original property data, including additions, retirements,

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979 18 C.F.R. Part 101, Def. 12.

transfers, and other transactions, are organized by the year the property was placed into service (vintage year) and when it was either retired or transferred (transaction year). These data are then organized into what is known as an Observed Life Table (OLT), which shows the percentage of property surviving at each age interval. The OLT depicts patterns of retirement for a property type known as a survivor curve, of which the most commonly known are "Iowa" curves. The appropriateness of a particular survivor curve can be established by mathematical calculations such as the conformance index (CI) and retirements experience index (REI). The CI is a measure of how closely a particular curve fits the OLT data and the REI is a measure of whether the history of an account is long enough to provide a sufficient amount of data for review.[980]

The other type of method used to project how long property is expected to last into the future is referred to as "actuarial" analysis. Actuarial analysis requires "aged" data. "Aged" data refers to a collection of property data for which the dates of placements, retirements, transfers, and other actions are known. When a utility keeps aged data, it keeps track of not only when the asset was retired, but also when it was placed into service, or the "vintage" year. When aged data are not available, but the year-end data are known, depreciation analysts must "simulate" an actuarial analysis by estimating the proportion of each vintage group contributed to the year-end balances. For this reason, simulated data are not as reliable as aged data.[981]

To analyze accounts that do not contain aged data, analysts use the "simulated plant record" (SPR) method of analysis.[982] The actuarial method also requires the use of survivor curves in order to "smooth out" the data. The appropriateness of a particular survivor curve can be established by means of visually fitting the curve to the data and also mathematically by use of the sum of squared difference (SSD) method.

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[980] TCUC Ex. 2 at 8, 16-17 and App. D at 81-83.

[981] TCUC Ex. 2 at 8.

[982] TCUC Ex. 2 at 8.

Depreciation rates are intended to provide recovery of invested capital, cost of removal, and credit for salvage over the expected life of the applicable property. CenterPoint calculated its depreciation expense based on a new depreciation study using depreciable plant in service as of December 31, 2017, and intangible plant in service as of December 31, 2018. The results of CenterPoint's depreciation study, performed by witness Dane Watson, support CenterPoint's request to recover an annualized depreciation and amortization expense of approximately \$378 million, which represents an overall increase of approximately \$2.5 million compared to its annualized depreciation and amortization expense at prior depreciation rates.[983] TCUC recommends a \$34.6 million reduction to CenterPoint's proposed depreciation expense,[984] based on what it claims are errors in Mr. Watson's analysis. Staff witness Reginald Tuvilla reviewed Mr. Watson's study and, after conducting his own SPR and actuarial analysis, recommended no changes to Mr. Watson's service lives, net salvage rates, or resulting depreciation rates.[985] No party contests CenterPoint's proposed net salvage rates. Only TCUC challenged Mr. Watson's service lives, and only for nine accounts.[986]

As discussed below, the ALJs find that Mr. Watson's depreciation study results in fair and reasonable depreciation expense for CenterPoint. With respect to the nine challenged accounts, the ALJs find that CenterPoint's analysis presents the more reasonable results and recommend that the Commission adopt CenterPoint's proposed life curves for each of the nine accounts.

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983 CenterPoint Ex. 25; CenterPoint Ex. 2 (Errata) at 313-16, Sch. II-E-1 & 1478-79, WP/II-E-1 Adj 1 & 1480, WP/II-E-1 Adj 1a.

984 CenterPoint's total proposed depreciation and amortization expense based on test year plant balances is approximately \$378 million, which represents an overall increase of approximately \$2.5 million compared to CenterPoint's depreciation and amortization expense included in existing rates. CenterPoint Ex. 2 (Errata) at 313-16, Sch. II-E-1 & 1478-79, WP/II-E-1 Adj 1 & 1480, WP/II-E-1 Adj 1a. Staff's Initial Brief references a depreciation expense amount of \$366 million, which is the total accrual based on the plant balances used in the study periods relied on by Mr. Watson. TCUC references a depreciation expense amount of approximately \$325 million, which is the total accrual based on the plant balances used in the study periods relied on by Mr. Watson, excluding the amortization expense associated with intangible plant.

985 Staff Ex. 9 at 6.

986 GCCC witness Kollen calculated a reduction in transmission depreciation expense of \$5.941 million and a reduction in distribution depreciation expense of \$31.025 million using Mr. Garrett's recommended depreciation rates. GCCC Ex. 1 at 50. Mr. Kollen calculated the effect on depreciation expense using CenterPoint's December 31, 2018 plant balance less the adjustments to plant recommended by COH witnesses Mark Garrett and Norwood.

1. Study Methodology

TCUC witness David Garrett's analysis challenged one account in which actuarial analysis was used (Account 390 – Structures and Improvements) and eight account in which SPR was employed. The dispute regarding the methodology employed relates only to the SPR methodology.

The SPR method of depreciation analysis is based on "unaged" data, which are less reliable than "aged" data because the age of an asset is not known when it is retired. In this case, CenterPoint maintained "aged" data for its general accounts, but not for its T&D accounts,[987] simply because the system that they use does not capture it.[988] It is uncontested that other utilities keep track of aged data for these accounts and that it is not uncommon in the industry for aged data to be maintained for these accounts.[989] Moreover, as conceded by Mr. Watson, "aged" data are more robust in comparison to "unaged" data.[990]

Because CenterPoint did not maintain aged actuarial data for any of its transmission and distribution accounts,[991] TCUC witness Garrett used CenterPoint's SPR data and then employed service lives approved by various regulatory commissions in cases involving three utilities Mr. Garrett contended are similar to CenterPoint—SWEPCO, Oklahoma Gas & Electric Company (OG&E), and the Public Service Company of Oklahoma (PSO). Similarities claimed by TCUC among the utilities used as a peer group and CenterPoint are:

- They are electric utilities, which means they all utilize similar types of assets.[992]

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987 TCUC Ex. 2 at 8.

988 Tr. at 326.

989 Tr. at 327.

990 Tr. at 325; CenterPoint Ex. 41 at 14.

991 TCUC Ex. 2 at 8.

992 Tr. at 851.

- The service lives of the assets at issue in this proceeding, for the utilities in the peer group of utilities, were approved within the past two years, demonstrating that any recent trends in the service lives of the assets for the accounts at issue are taken into account.[993]

- One of the utilities, SWEPCO, is an electric utility located in Texas, and its service area is adjacent to CenterPoint's service area.[994] The other utilities in the study, OG&E and PSO, are located in Oklahoma, relatively close to CenterPoint's service area.

CenterPoint argues that TCUC's approach represents a significant departure from well-established depreciation practices and the depreciation methodologies relied on by this Commission in prior cases.[995]

Mr. Garrett contended that because CenterPoint's CI[996] results for *some* (but not all) accounts are average or low, *all* of Mr. Watson's SPR analysis and the data on which it is based, are "unreliable."[997] He also argued that Mr. Watson should not rely on operational information from CenterPoint because CenterPoint personnel would not be objective in their input.[998]

- CenterPoint's employees are by definition not capable of rendering an independent, objective opinion regarding the expected service lives of CenterPoint's assets based on personal experience and are not subject to cross examination.[999]

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993 See TCUC Ex. 2 at n. 28, citing Final Order No. 662059, *Application of Oklahoma Gas and Electric Company*, Docket No. PUD 201500273 (Mar. 20, 2017)), FN 32 (citing Final Order No. 672864, *Application of Public Service Company of Oklahoma*, Docket No. PUD 201700151 (Jan. 31, 2018)); and FN 34 (citing Docket No. 46449 order).

994 Tr. at 852.

995 CenterPoint Initial Brief at 100.

996 The CI is one measure used to evaluate the SPR analyses and how well CenterPoint's actual data conform to the simulated Iowa Curves. Visual matching between actual and calculated balances is then used to expand the analysis, and review of CenterPoint's actual assets and experience are also used to confirm the recommendation. CenterPoint Ex. 25, Exh. DAW-1 at 2476-79; CenterPoint Ex. 41 at 12-13.

997 TCUC Ex. 2 at 18-19, 25, 28-29, 32.

998 TCUC Reply Brief at 22-24.

999 TCUC Reply Brief at 23.

- The record is devoid of precisely what these individuals communicated to Mr. Watson.[1000] Nor does the record reveal how much experience the interviewees had on the job or the details of their job duties.[1001]

- Many of the interviews were conducted in group sessions where Mr. Watson divulged his own preliminary findings to the group,[1002] impairing the independence of the opinions.

- Some of the information may be tainted by "unintended bias" where for example an employee may have inordinate experience with faltering equipment and may have a skewed notion of how a particular piece of equipment lasts.[1003]

At the hearing, Mr. Watson explained how he validated the information he included in his study to ensure the reasonableness of his recommendations.[1004] He explained that he was not aware of CenterPoint personnel ever fabricating information to manipulate service lives and that he validated the integrity of all information he included in his study.[1005]

SPR data are reliable and, as recognized by both Mr. Watson[1006] and Staff witness Tuvilla[1007] at the hearing, are regularly used by depreciation experts and produce results that can be as accurate and reliable as those using actuarial analysis. CenterPoint has been using the SPR analyses and underlying data since at least 1985.[1008] TCUC's critiques of CenterPoint's methodology are not supported by the credible evidence and are contrary to Commission precedent.[1009]

1000 Tr. at 346-47.

1001 Tr. at 338.

1002 Tr. at 332.

1003 Tr. at 351.

1004 Tr. at 342-45, 349-53.

1005 Tr. at 342-45, 349-53.

1006 Tr. at 325, 329, 342-45, 349-53.

1007 Tr. at 838-39.

1008 CenterPoint Ex. 41 at 4.

1009 *See, e.g.*, *Application of AEP Texas Central Company for Authority to Change Rates*, Docket No. 28840, PFD on Remand at 58 (Nov. 16, 2004) (indicating a preference for using a utility's own data to establish depreciation rates over that of other utilities); CenterPoint Ex. 41 at 15, citing *City of Amarillo v. Railroad Commission*, 894 S.W.2d

2. Specific Account Challenges

TCUC challenged depreciation rates for nine specific accounts, of which one used the actuarial method and the remaining eight used the SPR methodology.

a. Account 390 – Structures and Improvements (Actuarial)

CenterPoint witness Watson proposed use of an R4-50 curve for Account 390[1010] and TCUC witness David Garrett recommended use of an R2-58 curve for this account.[1011] Mr. Garrett contended that CenterPoint's R4-50 curve does not provide as good a fit in the middle portion of the curve but does provide a better fit with the end of the curve.[1012] In contrast, TCUC's recommended R2-58 curve has a better fit at the beginning and middle of the curve, but does not track the data as closely toward the end of the curve. According to Mr. Garrett, it is methodologically sound to ignore the tail-end of a curve such as here because the tail end has fewer dollars exposed to retirement in comparison to other parts of the curve.[1013] In addition, the R2-58 curve is mathematically a better fit based on the SSD calculation. In this case, the SSD for CenterPoint's R4-50 curve is 0.1442 whereas TCUC's R2-58 curve has an SSD of 58.[1014]

CenterPoint responds that this account includes building structures and improvements, both large and small; Mr. Garrett ignored life expectations for shorter-lived assets in this account like HVAC, chillers, roofs, fencing, water systems, lighting systems, elevators, fire protection systems, and other capitalized assets that will likely be replaced prior to the building shell.[1015] It

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491, 501 (Tex. App.—Austin 1995, writ denied) ("[D]epreciation rates are company and account specific."); Docket No. 28840, PFD on Remand at 68).

[1010] CenterPoint Ex. 41 at 53-56.

[1011] TCUC Ex. 2 at 12, 16.

[1012] TCUC Ex. 2 at 12.

[1013] TCUC Ex. 2 at 12.

[1014] TCUC Ex. 2 at 16.

[1015] CenterPoint Ex. 41 at 56.

also argues that Mr. Garrett excluded a significant portion of the actuarial life curve, ignoring all assets that are more than 50 years old.[1016] He also inappropriately limited his analysis to a single band.[1017] Finally, Mr. Garrett relied entirely on mathematical curve fitting despite recommendations by depreciation authorities to use both mathematical and visual curve fitting in actuarial analysis.[1018]

CenterPoint's analysis of this account is the more realistic and provides the best fit. Mr. Garrett did omit significant portions of the assets in this account from his analysis (both in terms of the type of asset and the life of the asset), which is the principal reason for rejecting his analysis. When the correct assets are considered, the R4-50 curve recommended by CenterPoint is the more appropriate and is what the ALJs recommend.

b. Account 353 – Transmission Station Equipment (SPR)

For Account 353, TCUC recommends the R0.5-56 curve instead of CenterPoint's proposed R0.5-53 curve. According to Mr. Garrett, the highest CI score in the overall band for CenterPoint's proposed R0.5-53 curve is 26, which rates as "poor" under the commonly accepted scale developed by Alex Bauhan. In addition, a 53-year service life for this account is much shorter than the average approved service life of 61 years of the three utilities in Mr. Garrett's study and is much lower than the 73 years than the Commission approved for SWEPCO. Mr. Garrett contended that his recommended curve is more reasonable than CenterPoint's curve because it uses CenterPoint's own simulated historical data, even though those data are flawed in comparison to actuarial data, and are closer to industry norms.[1019]

1016 CenterPoint Ex. 41 at 51-52.

1017 CenterPoint Ex. 41 at 53-55.

1018 CenterPoint Ex. 41 at 53-54.

1019 TCUC Ex. 2 at 21.

CenterPoint questions why Mr. Garrett dismissed CenterPoint-specific SPR analysis as unreliable despite the fact that 30-year and 40-year bands exhibit good and excellent CI results. Even if the account had consistently low CI results, CenterPoint argues that it would indicate a need to rely *more*, not less, on information about its specific plant assets, which Mr. Garrett also ignored.[1020] Principal among the information ignored by Mr. Garrett is that this account has recently been incorporating more electronics and newer style breakers that have a shorter expected life.[1021] Further, CenterPoint notes that Mr. Garrett did not explain why his life expectations, which exceed the demonstrations of the SPR analysis, are operationally justified, choosing instead to rely on service lives approved for SWEPCO and OG&E, without any evidence to support those comparisons.[1022]

The fact that the property in this account is changing (incorporating newer electronic devices with shorter service lives) and Mr. Garrett ignored that change is the principal reason that the ALJs find in favor of CenterPoint on this issue. To the extent the goal of depreciation is to establish a reasonable fund with which to replace assets on retirement, taking into account the changing character of the assets to be replaced is critical. Therefore, the ALJs recommend adoption of the R0.5-53 curve proposed by CenterPoint.

c. Account 354 – Transmission Towers and Fixtures (SPR)

For Account 354, TCUC recommends the R2-66 curve instead of CenterPoint's proposed R2.5-59 curve. A 59-year service life is lower than the average service life of 66 years for the three utilities in Mr. Garrett's comparison and is much lower than the approved 75 years recommended by PSO's own witnesses based on the company's actuarial data.[1023] Further, while there are several curves that would produce satisfactory results under the CI and REI scales,

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1020 CenterPoint Ex. 41 at 27-28.

1021 CenterPoint Ex. 25 at 2489-90, Exh. DAW-1; CenterPoint Ex. 41 at 28.

1022 CenterPoint Ex. 41 at 28-29.

1023 TCUC Ex. 2 at 20 and 23-24.

TCUC's curve has a higher CI (75 in comparison to 73 for CenterPoint's proposed curve) and also has an excellent REI score of 86.[1024]

CenterPoint argues that Mr. Garrett ignored the high CI and REI results from Mr. Watson's recommendation and instead relied on the approved service life of a single Oklahoma utility to increase the average service life for this account, without any evidence to support the comparisons. CenterPoint also notes that Mr. Garrett failed to justify the low REI results from his recommendation.[1025] Mr. Garrett ignored plant characteristics and recent experience that suggest a shorter service life for this account, including electrical capacity upgrades, the impacts of chemical reactions and higher loading on foundations, and the fact that CenterPoint will replace all or a portion of the structure when having to replace the foundations.[1026]

TCUC's analysis ignores characteristics of the plant included in this account, as well as CenterPoint's experience with that plant, which demonstrates that CenterPoint's proposed R2.5-59 curve is the most appropriate to be used. Accordingly, the ALJs recommend that the Commission adopt the rate proposed by CenterPoint.

d. Account 362 – Distribution Station Equipment

For Account 362, TCUC recommends the R0.5-55 curve instead of CenterPoint's proposed R1-48 curve. TCUC's recommended service life of 55 years is much less than the average of 66 years in Mr. Garrett's comparative analysis and is identical to the 55 years that the Commission approved for SWEPCO.[1027] Moreover, TCUC's recommended curve has a "good" CI score of 55 and an "excellent" REI score of 89.[1028] TCUC's curve considers CenterPoint's SPR data, yet

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[1024] TCUC Ex. 2 at 24.

[1025] TCUC Ex. 2 at 24.

[1026] CenterPoint Ex. 41 at 31; CenterPoint Ex. 25 at 2491, Exh. DAW-1.

[1027] TCUC Ex. 2 at 20, 25.

[1028] TCUC Ex. 2 at 25.

because TCUC believes that these data are relatively unreliable, it also considers the service lives approved for other utilities based on actuarial data as more reasonable than CenterPoint's proposed curve.

Mr. Watson's proposed curve and life produce CIs that are in the good or excellent range with an REI close to 100 and in every band are higher than Mr. Garrett's.[1029] CenterPoint interviews indicate plans to replace switchboard panels and move to a higher level of electronics in substations, which may limit asset life now and in the future.[1030] Many of the same factors affecting transmission substations are affecting distribution substations, but distribution substations tend to have shorter lives, as reflected in Mr. Watson's recommendation (53 years vs. 48 years for Account 353).[1031] Mr. Garrett recommended a longer service life for this account compared to Account 353 (56 years vs. 55 years).[1032]

Much as with the Transmission Station Equipment account, CenterPoint's evidence and arguments present the more persuasive case regarding Distribution Station Equipment. For the same reasons as regarding Transmission Station Equipment, the ALJs recommend that the Commission employ CenterPoint's proposed R1-48 curve.

e. Account 364 – Distribution Poles, Tower, and Fixtures (SPR)

For Account 364, TCUC recommends the R0.5-45 curve instead of CenterPoint's proposed R0.5-35 curve. CenterPoint's CI is only 16, which under the applicable SPR method criteria is a

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1029 CenterPoint Ex. 41 at 33.

1030 CenterPoint Ex. 41 at 33-34; CenterPoint Ex. 25 at 2503, Exh. DAW-1.

1031 CenterPoint Ex. 41 at 33; CenterPoint Ex. 25 at 2503, Exh. DAW-1. For example, distribution-level assets experience more fault current than transmission and will, consequently, have a shorter life. CenterPoint Ex. 25 at 2503, Exh. DAW-1.

1032 CenterPoint Ex. 41 at 33.

"poor" fit.[1033] The Commission approved a 55-year service life for this account for SWEPCO based on actuarial data, which is longer than TCUC's recommendation of a 45-year service life in this case.[1034] Further, the mathematical Iowa Curve analysis of SWEPCO's actuarial data showed that the service life could have been as high as 63 years.[1035] OG&E also has a 55-year approved service life.[1036] TCUC argues that CenterPoint's proposed curve is inferior to TCUC's curve because it is not based on actuarial data and is 20 years shorter than for the utilities in Mr. Garrett's comparison group.

According to CenterPoint, there is no operational reason the life should increase by 10 years (nearly 30%) as Mr. Garrett proposed.[1037] CenterPoint uses wood poles in this account, which are being impacted by high water tables, high acidity levels in the soil, other coastal conditions and high humidity. Also, materials used for newer poles are shortening the lives, and more pole contacts and more frequent inspections result in more replacements, causing a decreasing service life.[1038] According to CenterPoint, the low CI results in this account are indicative of these changing life characteristics,[1039] not "unreliable" data. Mr. Garrett's proposed curve produces a lower CI and REI than Mr. Watson's.[1040]

As CenterPoint notes, its analysis takes into account the changing conditions that impact the service lives of assets in this account. Whether made from wood or newer materials, the evidence considered by CenterPoint's analysis demonstrates shorter service lives. As a result, the ALJs find that CenterPoint's proposed R0.5-35 curve is the more reasonable and recommend that the Commission adopt it.

1033 TCUC Ex. 2 at 26.

1034 TCUC Ex. 2 at 26.

1035 TCUC Ex. 2 at 26.

1036 TCUC Ex. 2 at 28.

1037 CenterPoint Reply Brief at 103.

1038 CenterPoint Ex. 41 at 36.

1039 CenterPoint Ex. 41 at 35-36.

1040 CenterPoint Ex. 41 at 36.

f. Account 365 – Distribution Overhead Conductors and Devices (SPR)

For Account 365, TCUC recommends the R0.5-40 curve instead of CenterPoint's proposed R0.5-38 curve. Although CenterPoint bases its proposed curve on the fact it was the "top ranked" choice, that does not mean it is the best choice. The CI for CenterPoint's curve is only 21, which ranks as "poor." In addition, 38 years is much shorter than the approved lives for SWEPCO, PSO, and OG&E, which are 44, 46 and 54 years respectively.[1041] TCUC contends that its proposed 40-year curve is a reasonable compromise between CenterPoint's proposal and the approved lives for other utilities.

CenterPoint notes that Mr. Watson's proposed curve produces the highest CI and REI results. Low CI results indicate changing life characteristics of the assets in the account, not that the data are "unreliable." For instance, CenterPoint engineers estimate that the insulated wire now being used will allow current conductors to last approximately 40 years; however, lightning strikes, wind, automobile strikes to poles, and environmental conditions have a dampening effect on the life, which Mr. Watson accounted for in his study.[1042] Also, the increasing level of electronic equipment in the account (such as sensors, motors, and sectionalizing equipment with a much shorter life) is providing downward pressure on the service life.[1043]

Although CenterPoint is using more modern equipment that will extend the service lives of assets in this account, there are also phenomena depressing the expected service lives, which CenterPoint also recognized in its analysis. The CI and REI results derived from Mr. Watson's analysis demonstrate that his analysis produces the more reasonable result. Accordingly, the ALJs recommend that the Commission adopt CenterPoint's proposed R0.5-38 curve.

[1041] TCUC Ex. 2 at 28-29.

[1042] CenterPoint Ex. 41 at 37-39.

[1043] CenterPoint Ex. 41 at 39; CenterPoint Ex. 25 at 2506, Exh. DAW-1.

g. Account 366 – Distribution Underground Conduit (SPR)

For Account 366, TCUC recommends the S1-65 curve instead of CenterPoint's proposed R2.5-62 curve. CenterPoint's proposed curve is significantly shorter than the approved service lives of the other utilities in Mr. Garrett's comparison group. To compare, SWEPCO's own witness proposed a 70-year life, which the Commission approved. PSO has a much longer 78-year service life for this account. Both of these estimates were based on actuarial data. Further, TCUC's curve ranks as "excellent" in both the CI and REI scales.[1044] In addition, a 65-year life is a conservative recommendation given the longer approved lives for SWEPCO and PSO.

While CenterPoint input and the SPR analysis support extending the service life for these assets, as Mr. Watson proposed, they do not support extending the lives as much as Mr. Garrett recommended. Mr. Watson's proposed life produces a much higher CI and REI result than Mr. Garrett's. Mr. Garrett's dispersion curve anticipates assets in this account surviving to nearly age 130, which is unreasonable.[1045] Mr. Watson's dispersions curve anticipates more realistic expectations.

CenterPoint's proposed life curve reflects the actual conditions affecting CenterPoint's assets in this account, while Mr. Garrett's reflects only experiences of utilities within his peer group. As a consequence, CenterPoint's proposed R2.5-62 curve is more reasonable and the ALJs recommend the Commission adopt it.

h. Account 367 – Distribution Underground Conductor and Devices (SPR)

For Account 367, TCUC recommends the L0-42 curve instead of CenterPoint's proposed R0.5-38 curve. Even though CenterPoint's curve may have been the top-ranked curve in the SPR

[1044] TCUC Ex. 2 at 30-31.

[1045] CenterPoint Ex. 41 at 41-42.

analysis, it has a CI score of 23 which is "poor."[1046] Further, the approved lives for this account for SWEPCO, PSO, and OG&E are 45, 65 and 64 years respectively, are based on actuarial data, and are much longer than the 38 years proposed by CenterPoint.[1047] TCUC's proposed 42-year service life is derived from CenterPoint's SPR analysis, but moves CenterPoint's proposal closer to the range of reasonableness for this account.

Underground conductor life is increasing due to newer conduit technology that better protects the cable. However, CenterPoint's more recent shift to direct-burying cable will also shorten the cable life. CenterPoint contends that Mr. Watson's recommendation reconciles these retirement forces.[1048] Mr. Garrett did not provide any information demonstrating whether his "peer group" utilities are subject to the same retirement forces and company practices (*e.g.*, placing cable in conduit or direct-burying). Mr. Garrett's dispersion curve anticipates assets surviving to nearly age 160, which is CenterPoint contends is unreasonable.[1049] Mr. Watson's dispersions curve anticipates more realistic expectations.[1050]

TCUC's proposed curve appears to be based principally on Mr. Garrett's peer group. CenterPoint's, on the other hand, reflects and balances the actual factors affecting CenterPoint's assets that fall within this account. As a consequence, CenterPoint's proposed R0.5-38 curve is the more reasonable of the two and the ALJs recommend the Commission adopt CenterPoint's proposed curve.

[1046] CenterPoint Ex. 41 at 32.

[1047] CenterPoint Ex. 41 at 32.

[1048] CenterPoint Reply Brief at 104.

[1049] CenterPoint Ex. 41 at 44-46.

[1050] CenterPoint Reply Brief at 104.

i. Account 368 – Distribution Line Transformers (SPR)

For Account 368, TCUC recommends the L0-32 curve instead of CenterPoint's proposed R1-28 curve. While CenterPoint's curve has a 51 CI score, that is still a "fair" score. TCUC's curve has a superior CI score of 40 and REI score of 100. Moreover, CenterPoint's 28-year service life is much less than the approved service lives based on actuarial data for SWEPCO, PSO, and OG&E which are 50, 36, and 44 years respectively. In fact, the Commission found that it would be reasonable to use a 55-year life in the case of SWEPCO.[1051] Even though TCUC's recommended curve is substantially shorter than the approved service life for other utilities in Mr. Garrett's comparison, it is more reasonable than CenterPoint's proposed curve.

CenterPoint responds that the CI results for Mr. Watson's recommendations are significantly higher than Mr. Garrett's, and Mr. Watson's dispersion curve reflects a more reasonable result for life expectation for this account.[1052]

Neither party presented significant argument or evidence about this account, but based on what little each presented, it supports CenterPoint's contentions that Mr. Watson's recommendation is higher than that of Mr. Garrett and that his dispersion curve does reflect a more reasonable result. Accordingly, the ALJs recommend the Commission adopt CenterPoint's proposed R1-28 curve for this account.

3. Amortization Expense

CenterPoint proposes to amortize its PURA Pension and OPEB, and Hurricane Ike regulatory liabilities and the Hurricane Harvey, Medicare Part D, TMT, SMT, REP Bad Debt, and Expedited Switching Costs regulatory assets over a three-year period, which it claims is consistent with treatment approved in Docket No. 38339. Additionally, CenterPoint asserts that amortizing

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[1051] TCUC Ex. 2 at 33.

[1052] CenterPoint Ex. 41 at 48-49.

regulatory assets and liabilities over the same period provides equitable treatment for both customers and CenterPoint.[1053]

Staff witness Filarowicz recommended that CenterPoint's regulatory assets and liabilities be amortized over a five-year period in order to minimize CenterPoint's opportunity to over-collect. Mr. Filarowicz stressed his recommendation accounts for the likelihood that there will be more than three years between the Commission's final decision in this proceeding and the final order in its next base rate case.[1054] Alternatively, OPUC witness Dively recommended removing CenterPoint's Hurricane Harvey, Medicare Part D, SMT, and REP Bad Debt assets from rate base to be recovered through a rider over a five-year period.[1055] Unlike Staff witness Filarowicz, Ms. Dively did not recommend extending the amortization period for CenterPoint's regulatory liabilities.

Other than the maximum period prescribed in 16 TAC § 25.247, the length of time the base rates set in this case will be in effect before the Commission sets new rates in CenterPoint's next rate case is uncertain. As previously discussed in Section II of this PFD, the ALJs recommend that the Commission approve a three-year amortization period for CenterPoint's PURA Pension and OPEB, and Hurricane Ike regulatory liabilities and its Hurricane Harvey, Medicare Part D, SMT, REP Bad Debt, and Expedited Switching Costs regulatory assets.[1056]

D. Affiliate Expenses [PO Issues 35, 36]

PURA § 36.058 allows a utility to recover expenses paid by the utility to an affiliate if it demonstrates that its payments are "reasonable and necessary for each item or class of items as

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[1053] CenterPoint Ex. 35 at 42.

[1054] Staff Ex. 4A at 31-32.

[1055] OPUC Ex. 1 at 14-15.

[1056] *See* Section II of this PFD. Note, the ALJs recommend that the Commission reject CenterPoint's TMT asset request.

determined by the commission."[1057] To recover these expenses, the utility must demonstrate two things: (1) the reasonableness and necessity of each item or class of items allowed; and (2) that the price to the electric utility is not higher than the prices charged by the supplying affiliate to its other affiliates or divisions or to a nonaffiliated person within the same market area or having the same market conditions.[1058]

CenterPoint's affiliate costs totaled $293.4 million for the test year.[1059] The evidence demonstrates that CenterPoint Energy Service Company, LLC (Service Company) and CenterPoint Energy Resources Corp. (CERC) provided services to CenterPoint during the test year.[1060] Service Company and CERC are subsidiaries of CNP.[1061] Services provided by Service Company included Corporate Services, Business and Operations Support, Technology Operations, and Regulated Operations Management.[1062] CERC provided operational support in the form of periodic IDR meter reading, GIS and computer-aided design services, fleet services, broadband services, damage prevention compliance reporting, and line locating.[1063] No party challenged the reasonableness, necessity, or allocation methodology of any service.

[1057] *See* PURA § 36.058(a)(1)-(2); *see also* 16 TAC § 25.231(b)(1)(A) (referring to PURA § 36.058 for cost of service standards for affiliate expenses); *Cities of Corpus Christi v. Pub. Util. Comm'n*, No. 03-06-00585-CV, 2008 WL 615417, at *10 (Tex. App.—Austin 2008, no pet. h) (noting that under PURA § 36.058 "the Commission may not include affiliate costs in a utility's rates unless the Commission makes a specific finding of reasonableness and necessity for each item or class of items, and also finds that the price charged by the affiliate to the utility is no higher than the price charged by the affiliate to other purchasers"); *Railroad Comm'n of Texas v. Rio Grande Valley Gas Co.*, 683 S.W.2d 783 (Tex. App.—Austin 1984, no writ).

[1058] *See* PURA § 36.058(c).

[1059] CenterPoint Ex. 15 at 1067-1115; CenterPoint Ex. 12 at 918-26; CenterPoint Ex. 27 at 2862-75; CenterPoint Ex. 19 at 1668-78; CenterPoint Ex. 20 at 1695-1703; CenterPoint Ex. 13 at 993-96; CenterPoint Ex. 16 at 1559-71; CenterPoint Ex. 17 at 1582-86; CenterPoint Ex. 18 at 1654; CenterPoint Ex. 22 at 1835-39; CenterPoint Ex. 21 at 1771-38.

[1060] CenterPoint Ex. 15 at 1070.

[1061] CenterPoint Ex. 15 at 1118, Exh. MMT-1.

[1062] CenterPoint Ex. 15 at 1071.

[1063] CenterPoint Ex. 15 at 1071-72.

The unchallenged evidence demonstrates that:

- The provision of affiliate services to CenterPoint is pursuant to Service Level Agreements (SLAs) that are executed annually between the Service Company, CERC and CNP affiliates;[1064]

- The SLAs require that (1) the price charged for each service will be the same as that charged to every other CNP business unit for like services for a given period; (2) amounts charged for items not allowed for recovery in regulated rates must be separately identified and billed separately so that the amounts can be reported as required; (3) amounts charged must be reasonable and necessary in order to provide that service; and (4) any allocation should reasonably approximate the actual costs incurred in providing that service;[1065]

- Service Company's rigorous budgeting preparation and review process, prior to approval, encourages the Service Company functions to be disciplined and careful in establishing their budgets;[1066]

- Prior to the start of the annual budget process and on a monthly basis, function leaders are monitoring actual costs to the budgeted amounts;[1067]

- As an additional cost control measure, and on a monthly basis, CenterPoint also monitors the costs it receives from Service Company;[1068]

- Before expenses are processed, three committees, the Executive Committee, the Risk Oversight Committee and the Commitment Review Team, provide thorough corporate review, oversight and control of significant expenditures for all business units and Service Company expenses;[1069]

- Financial system controls, processed through SAP automation, assure that formulaic affiliate billings are accurate and timely;[1070]

[1064] CenterPoint Ex. 15 at 1090.

[1065] CenterPoint Ex. 15 at.1090.

[1066] CenterPoint Ex. 15 at 1094.

[1067] CenterPoint Ex. 15 at.1094.

[1068] CenterPoint Ex. 15 at 1094.

[1069] CenterPoint Ex. 15 at 1095-96.

[1070] CenterPoint Ex. 15 at 1097.

- All costs for a given service that are directly related to affiliates, including CenterPoint, are directly billed at cost;[1071] and
- If allocated, costs are not higher than the prices charged by Service Company and CERC for the same class of items to [CenterPoint's] affiliates or divisions.[1072]

Thus, it is clear that no party challenged the evidence presented by CenterPoint demonstrating that, with respect to affiliate expenses: (1) each class of items was reasonable and necessary; and (2) the price charged to CenterPoint was not higher than the prices charged by Service Company and CERC to CenterPoint's other affiliates or divisions or to a nonaffiliated person within the same market area or having the same market conditions.[1073] Similarly, no party challenged the fact that a centralized corporate support services structure allows CNP to leverage resources across multiple business units, thereby giving the business units access to specialized skills and resources in an efficient and cost-effective manner.[1074] Accordingly, the vast majority of the affiliate corporate support services charged to CenterPoint during the test-year and included in CenterPoint's revenue requirement, which totaled $293.4 million, are unchallenged and CenterPoint has met its burden under PURA § 36.058 to recover its reasonable and necessary affiliate costs.[1075]

The areas that remain in controversy are (1) the adjustment proposed by CenterPoint to reflect the impact of the Vectren transaction; (2) the compensation allowable for use of affiliate capital.[1076]

[1071] CenterPoint Ex. 15 at 1099.

[1072] CenterPoint Ex. 15 at. 1099.

[1073] PURA § 36.058(c).

[1074] CenterPoint Ex. 15 at 1074.

[1075] CenterPoint Ex. 15 at 1067-1552; CenterPoint Ex. 12 at 920-26; CenterPoint Ex. 27 at 2862-75; CenterPoint Ex. 19 at 1668-78; CenterPoint Ex. 20 at 1695-1703; CenterPoint Ex. 13 at 993-96; CenterPoint Ex. 16 at 1559-71; CenterPoint Ex. 17 at 1582-86; CenterPoint Ex. 18 at 1654; CenterPoint Ex. 22 at 1835-39; CenterPoint Ex. 21 at 1711-38.

[1076] Staff and intervenors also challenge service company pension and benefit costs and affiliate labor costs. Although these are affiliate expenses, to which the ALJs have applied the legal standards relating to affiliate expenses, because of commonality of law and facts, they are discussed in Section IV.B, dealing with CenterPoint's labor expenses.

1. CenterPoint's Vectren Acquisition Adjustment

CenterPoint made a $1.6 million adjustment increasing affiliate expenses to reflect Service Company time that CenterPoint asserts would normally be billed to CenterPoint but, during part of the test year, was instead billed to the Vectren merger. OPUC opposes this adjustment as not known and measurable. As discussed below, the ALJs agree with OPUC and recommend rejecting this adjustment.[1077]

CenterPoint and Service Company are wholly owned subsidiaries of CNP. On February 1, 2019, CNP completed a merger with Vectren.[1078] Ms. Townsend testified that all Service Company employees who work on services for CenterPoint charge their labor and time directly to CenterPoint. During the latter part of 2018, several Service Company employees worked on Vectren integration planning instead of normal daily activities for CenterPoint and other business units. CenterPoint made an adjustment increasing affiliate expenses by $1.6 million to reflect Service Company employee labor that would have been billed to CenterPoint during this time if the Vectren merger had not occurred. Ms. Townsend testified that all labor and time spent on integration activities in 2018 were specifically tracked in SAP to the individual orders created solely for Vectren merger transactions. According to Ms. Townsend, normally during this part of the test year, CenterPoint would have received an additional $1.6 million of labor billings from Service Company.[1079]

Ms. Dively testified the $1.6 million adjustment comprised a revenue requirement increase of $1,512,347 charged to accounts for affiliate expenses and $60,941 charged to CWIP and not included in rate base. She recommended disallowing the entire adjustment, which she stated would reduce revenue requirement by $1,523,202, comprised of the $1,512,347 and the related TMT of $10,855. She presented the following reasons for her recommendation:

[1077] GCCC's request for a merger savings rider related to the Vectren acquisition is addressed in PFD Section IX.B.

[1078] OPUC Ex. 1 at 46.

[1079] CenterPoint Ex. 15 at 1111-12.

- The amount of the adjustment is an estimate and not known and measurable.
- CNP expects to realize savings from the merger and such analysis is typical of pre-acquisition activities.
- When CNP acquired Vectren, it added an entirely new service area with over one million customers.
- The acquisition has already caused a reduction of 32 FTEs.
- CNP knows the affiliate charges to Vectren will increase and the affiliate charges to CenterPoint will decrease.
- Although the merger's integration planning phase has ended, its implementation phase is ongoing. During the integration planning phase, Service Company billed functions such as customer solutions, technology, and human resources. Considering the type of functions billed, it is reasonable to assume some will be billed as part of implementing the merger.[1080]

Ms. Dively explained: "There is no real way to know if all of the employee time would have been billed to [CenterPoint] absent the Vectren acquisition, or will be billed to [CenterPoint] in future." She cited Ms. Townsend's direct testimony that "[t]his adjustment identified the time billed to integration activities by Service Company employees and calculated *an estimate* of the portion that would have been billed to [CenterPoint] using 2018 planned billings."[1081] Ms. Dively also noted that in discovery, CenterPoint indicated that Service Company expects CenterPoint to realize cost savings related to the Vectren acquisition, that the full amount is not known at this time, but that the acquisition had resulted in a reduction of 32 FTEs.[1082] OPUC also cites another CenterPoint discovery response, which includes a projection of the cost savings that will result from the synergies achieved through the merger.[1083] OPUC also cites rebuttal testimony by CenterPoint witness Jeffrey Myerson that CNP estimates the Vectren merger cost savings to it and

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1080 OPUC Ex. 1 at 46-50.

1081 OPUC Ex. 1 at 46-49, quoting CenterPoint Ex. 15 at 46 (emphasis added).

1082 OPUC Ex. 1 at 48-49, 76 (Att. JMD-9, CenterPoint response to OPUC RFI 1-12), 90 (Att. JMD-12, CenterPoint response to Staff RFI 2-15).

1083 OPUC Ex. 1B, HSPM Att. JMD-11 (CenterPoint response to GCCC RFI 1-14). This sentence of the PFD uses the public description of the RFI response in OPUC's brief.

all its affiliates at $50-$100 million annually and more than $75 million in 2020 (pre-tax and excluding some one-time acquisition costs).[1084]

Ms. Townsend responded the adjustment is calculated based on CenterPoint's portion of total test year billings from Service Company after removing integration planning billings. She regarded the calculation as a reasonable approach to normalizing billings to CenterPoint for integration planning activities. She stated the estimate is based on a reasonable assumption those employees would have performed the work had they not been involved with the integration planning during the test year. Ms. Townsend opined the amounts are known and measurable with reasonable accuracy because CenterPoint knows: (1) the direct charges that Service Company employees billed to work on Vectren integration activities; (2) that work on those activities are not part of the normal daily activities Service Company provides to CenterPoint or other business units; (3) the 2018 Service Company planned billing to CenterPoint; and (4) the amounts actually billed to CenterPoint as a result of Service Company employees being reassigned to support the Vectren transaction. She concluded the adjustment was calculated with reasonable accuracy.[1085]

The ALJs recommend rejecting CenterPoint's adjustment. CenterPoint did not meet its burden to prove the adjustment is known and measurable.[1086] The Commission has defined "known and measurable changes" as "those that will occur, can be measured, will affect future revenue requirements, and are a basis for determining forward-looking rates."[1087] CenterPoint calculated the adjustment using some components that were known but also estimates and assumptions. In addition, the evidence indicates the amounts Service Company normally billed to CenterPoint are likely to be lower due to the merger savings.

[1084] CenterPoint Ex. 47 at 13.

[1085] CenterPoint Ex. 37 at 16-17, 30-34 (Exh. R-MMT-2 (CenterPoint's response to GCCC RFI 1-13)).

[1086] 16 TAC § 25.231(a)-(b).

[1087] *Application of Oncor Electric Delivery Company LLC for Rate Case Expenses Pertaining to PUC Docket No. 35717*, Docket No. 36530 Order on Rehearing (Nov. 2, 2009).

2. Compensation for Use of Capital/Affiliate Carrying Charges

OPUC and Staff also continue to propose an adjustment related to compensation for use of affiliate capital.[1088] Specifically, OPUC proposes to exclude $7,786,463 from CenterPoint's cost of service, while Staff asks the Commission to disallow $4,942,320 instead.[1089] Neither OPUC nor Staff challenges the legitimacy of the payments—which are for carrying charges associated with affiliate or shared assets. OPUC and Staff also do not dispute that: (1) the Service Company assets at issue are used and useful and held for the benefit of the business units, including CenterPoint;[1090] (2) the costs for these assets are no different than utility-owned assets for which an equity return is earned; and (3) the costs of these assets were prudently incurred.[1091] Instead OPUC argues that CenterPoint did not meet its affiliate burden under PURA and Staff argues that the equity portion of carrying charges on Service Company's assets should be disallowed.[1092]

The disallowance recommended by OPUC comprises a $7,786,463 reduction to O&M expenses and a corresponding $56,000 reduction to the TMT expense.[1093] The $7,786,463 billed to CenterPoint by its affiliate, Service Company, represents a return on assets that are held by Service Company and used to provide bundled services to its affiliates (including CenterPoint).[1094] OPUC contends that CenterPoint has admitted that this expense was not separately identified in Schedule V-K-7 of CenterPoint's RFP and was instead buried in the costs allocated to the Finance, Technology Operations, and Business Operations Support service classes included in the schedule.[1095] Consequently, it was only through discovery that CenterPoint revealed the specific

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[1088] OPUC Initial Brief at 55-58; Staff Initial Brief at 47-48.

[1089] OPUC Initial Brief at 55; Staff Initial Brief at 47.

[1090] CenterPoint Ex. 37 at 13-14.

[1091] CenterPoint Ex. 37 at 13.

[1092] OPUC Initial Brief at 55; Staff Initial Brief at 47.

[1093] OPUC Ex. 1 at 40.

[1094] OPUC Ex. 1 at Att. JMD-6.

[1095] CenterPoint Ex. 37 at 15.

assets on which the return was paid, the amount of return paid to the Service Company, and how the return was calculated.[1096] OPUC also argues:

- CenterPoint indicated that the value of the Service Company assets was determined using the "Estimated Net Book Value as of 12/31/2017," which is "calculated during the planning process using the June 30, 2017 Net Book Value and adjusted for the remaining 2017 depreciation and adjustments."[1097] However, CenterPoint did not provide the data underlying the calculations thereby precluding a review of the original cost, depreciation, and adjustments used to reach the net book value.[1098]

- CenterPoint did not explain why it applied the overall rate of return to the estimated net book value for 2017, rather than the actual net book value as of December 31, 2018, which is the value that coincides with CenterPoint's test year for this case.[1099]

- It was unreasonable for CenterPoint to pay a return on shared assets that was computed using an overall rate of return of 11.37%.[1100] This return is significantly higher than both CenterPoint's currently-authorized return of 8.21%[1101] and CenterPoint's requested return of 7.39%.

- The tax gross-up factor of 1.6044 appears to be based on a 35% federal tax rate (rather than the current 21%) plus about 4.29% in undisclosed other taxes.[1102]

Staff adopts a different approach to the issue, recommending an adjustment of ($4,942,320) to remove the equity portion of carrying charges associated with affiliate or shared assets, as identified by CenterPoint in discovery.[1103] Staff's recommendation follows the precedent in

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1096 OPUC Ex. 1 Atts. JMD-6 through JMD-8.

1097 OPUC Ex. 1 at 38.

1098 OPUC Ex. 1 at 38.

1099 OPUC Ex. 1 at 38-39.

1100 OPUC Ex.1 at 39 and Att. JMD-8.

1101 Docket No. 38339 order, FoF No. 75A.

1102 OPUC Ex. 1 at 39.

1103 Staff Ex. 4A at 101 (Att. MF-15, CenterPoint's response to Staff RFI 2-37).

Docket Nos. 43695 and 46449, in which the Commission disallowed such carrying charges on affiliate assets, finding that such "carrying costs are unnecessary and unreasonable." [1104]

With respect to OPUC's position, CenterPoint argues that it is undisputed that it followed the Commission's Schedule V-K-7 RFP Instructions, which require CenterPoint to list services by class and service category.[1105] CenterPoint also argues that it is likewise undisputed that compensation for use of capital is a return on investment applied to the Service Company assets.[1106] It is not a class or service category. Rather, it is a cost associated with several of the classes and service categories.[1107] Therefore, it was not separately identified on the V-K-7 schedule, but rather was included as part of the cost allocation amounts assigned to the Finance, Technology Operations, and Business Operations Services service class totals on that schedule.[1108] In short, CenterPoint claims that the evidence demonstrates that CenterPoint was not required to separately identify compensation for use of capital as an affiliate class or service, as OPUC alleges. The Shared Services amounts identified on V-K-7 are fully eligible for recovery in CenterPoint's rates and satisfy the applicable affiliate standard.

With respect to Staff's position, CenterPoint contends that Staff relies on Commission decisions in cases not involving CenterPoint, with different facts and different evidence.[1109] In this proceeding, CenterPoint has shown that Service Company assets are used and useful and held for the benefit of the business units, including CenterPoint.[1110] These assets include hardware assets such as Network Equipment, Telephone Infrastructure, and Enterprise Servers, as well as software assets for SAP upgrades, Microsoft enhancements and Filenet.[1111] CenterPoint has also

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[1104] *See* Staff Ex. 4A at 101, citing Docket No. 43695 order, FoF No. 137, and Docket No. 46449 order, FoF No. 212.

[1105] CenterPoint Ex. 37 at 15.

[1106] CenterPoint Ex. 37 at 15.

[1107] CenterPoint Ex. 37 at 15.

[1108] CenterPoint Ex. 37 at 15.

[1109] Staff Initial Brief at 48.

[1110] CenterPoint Ex. 37 at 13-14.

[1111] CenterPoint Ex. 37 at 14.

shown that costs Service Company incurs for these assets are no different than utility-owned assets for which an equity return is earned, and that the costs of these assets were prudently incurred.[1112] Therefore, just as a return is earned on the assets held by CenterPoint, the assets held by Service Company for the benefit of CenterPoint should earn a return.[1113]

OPUC and Staff are challenging the same charges, except that OPUC is challenging the cost of debt and the cost of equity carrying charges and Staff's challenge is limited to the cost of equity carrying charges.[1114] Put another way, both are challenging the inclusion of $4,942,320 attributable to equity and only OPUC is challenging the remaining $2,844,143 of debt charges included in affiliate charges.

OPUC's challenge rests on its contentions that CenterPoint failed to adequately describe the carrying costs in Schedule V-K-7. But CenterPoint notes, correctly, that the carrying costs are not a class or service category and are not, therefore, required to be listed separately on Schedule V-K-7. The failure to list the charges separately is not grounds for disallowance.

Staff, on the other hand, has presented a legal argument compelling adoption of its position. In both the cases cited by Staff, the Commission directly addressed the question of whether equity return should be recovered through affiliate charges, and in both cases the Commission held that the cost of profit to an affiliate is unreasonable and unnecessary, and, therefore, fails to meet the test for recovery as an affiliate expense. CenterPoint argued little more than it was not a party to those cases. Staff's position comports with Commission precedent. Accordingly, the ALJs recommend that the Commission disallow affiliate carrying charges totaling $4,942,320.

[1112] CenterPoint Ex. 37 at 13.

[1113] CenterPoint Ex. 37 at 13.

[1114] *See* Staff Ex. 4A at 101.