Control Number: 49421

Item Number: 727

Addendum StartPage: 0

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

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

OFFICE OF PUBLIC UTILITY COUNSEL'S EXCEPTIONS TO THE PROPOSAL FOR DECISION

Lori Cobos
Chief Executive & Public Counsel
State Bar No. 24042276

Cassandra Quinn
Senior Assistant Public Counsel
State Bar No. 24053435

OFFICE OF PUBLIC UTILITY COUNSEL
1701 N. Congress Avenue, Suite 9-180
P.O. Box 12397
Austin, Texas 78711-2397
512-936-7500 (Telephone)
512-936-7525 (Facsimile)
cassandra.quinn@opuc.texas.gov
opuc_eservice@opuc.texas.gov (Service)

October 10, 2019

727

TABLE OF CONTENTS

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

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

OFFICE OF PUBLIC UTILITY COUNSEL'S
EXCEPTIONS TO THE PROPOSAL FOR DECISION

The Office of Public Utility Counsel ("OPUC"), representing the interests of residential and small commercial consumers in Texas, respectfully submits these exceptions to the proposal for decision ("PFD") issued in this proceeding on September 16, 2019. OPUC is not filing exceptions on every issue in which its position was not adopted by the PFD. OPUC's exceptions are limited to the following three recommendations of the Administrative Law Judges ("ALJs") in the PFD: (1) the method of recovery for CenterPoint Energy Houston Electric, LLC's ("CenterPoint" or the "Company") regulatory assets; (2) whether long-term incentive ("LTI") compensation tied to restricted stock units ("RSUs") should be disallowed because it is financially based; and (3) the recoverable amount of vegetation management expenses. For the reasons discussed below, OPUC requests that the Public Utility Commission of Texas ("Commission") issue an order in this proceeding consistent with OPUC's exceptions.

II. RATE BASE [PO Issues 4, 5, 10, 11, 12, 13, 15, 16, 17, 18, 19, 59] [1]

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

As the PFD states, this case presented two broad contested issues regarding the method of recovery for CenterPoint's requested regulatory assets and liabilities: (1) whether to amortize the regulatory assets and liabilities over three years or five years; and (2) whether to include the regulatory assets in rate base, earning a return, or to recover each asset's exact amount, with no return, through a rider.[2] The PFD concluded that CenterPoint's regulatory assets for costs for

[1] The outline and headings of these exceptions correspond to those in the PFD.

[2] PFD at 66.

Hurricane Harvey restoration, the Medicare Part D subsidy, Smart Meter Texas ("SMT"), and retail electric provider ("REP") bad debt should be included in rate base using a three-year amortization period.[3] However, the combination of recovering the regulatory assets through rate base and using a three-year amortization period virtually guarantees that CenterPoint will over-recover the costs included in the regulatory assets. To avoid this result, OPUC re-urges its recommended methods of recovery for the regulatory assets. Specifically, as discussed in OPUC's briefs and the testimony of OPUC witness Ms. June Dively, the recoverable amounts of these costs should be recovered: (1) using a five-year amortization period, and (2) through riders, rather than base rates.[4]

The recovery of the regulatory assets through riders is most reasonable in this case. The costs included in CenterPoint's regulatory assets for Hurricane Harvey restoration, Medicare Part D, SMT, and REP bad debt are all non-recurring costs. Revenues from a rider are collected separately from base rates, which makes a rider a more appropriate method for recovering regulatory assets that include non-recurring costs.[5] Base rates are set using a utility's cost of service from a historical test year, so the expenses included in the cost of service should be representative of the amounts and types of expenses a utility incurs year after year (i.e., ongoing expenses).[6] The costs for Hurricane Harvey restoration, Medicare Part D, SMT, and REP bad debt included in CenterPoint's regulatory assets are not representative of ongoing expenses and, therefore, should not be recovered through base rates. Moreover, recovering the regulatory assets through riders would eliminate the possibility that the Company will over-recover its costs because the riders can be designed to automatically expire after the Company has recovered the costs, no more and no less.

Nevertheless, if the regulatory assets are recovered through rate base, the appropriate amortization period for the assets is a separate issue. The PFD adopted the Company's requested

---

[3] *Id.* at 67, 108.

[4] OPUC Initial Brief at 14-20; OPUC Ex. 1 (Dively Direct) at 12 (five-year amortization period), 14-16 (Hurricane Harvey regulatory asset), 18-19 (Medicare Part D regulatory asset), 28-30 (SMT regulatory asset), 32-33 (REP bad debt regulatory asset).

[5] OPUC Ex. 1 (Dively Direct) at 11; *see also Application of Southwestern Public Service Company for Authority to Change Rates*, Docket No. 43695, Order on Rehearing at Finding of Fact ("FOF") No. 210 (Feb. 23, 2016) ("The $211,911 is a one-time expense. To avoid possible over-recovery, it should be recovered not through base rates but rather through a rider set to recover that specific amount.").

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

three-year amortization period for all of the regulatory assets.[7] However, if the regulatory assets are embedded in base rates, it is even more important to use a five-year, rather than three-year, amortization period. Using a three-year amortization period increases the risk of over-recovery of the regulatory assets because transmission and distribution utilities ("TDUs"), such as CenterPoint, are only required to file a full base rate case every four years.[8] If the TDU waits the full four years, it is guaranteed at least one year of over-recovery on any regulatory asset with a three-year amortization period. A TDU that comes in earlier than the four-year maximum does not face the same risk because it can simply renew its request to include the regulatory asset in rate base for any remaining unamortized amount.

The Company provided two reasons for using a three-year amortization period rather than a five-year amortization period: (1) a three-year amortization period was used for the regulatory assets in the Company's prior rate case in Docket No. 38339, and (2) achieving intergenerational equity.[9] However, the three-year amortization period approved in Docket No. 38339 provides a prime example of the potential for over-recovery. As described in OPUC's initial brief, the Company recovered more than twice the amount of its regulatory asset for expedited switching that was approved in Docket No. 38339 because the regulatory asset was amortized over three years, but rates were in effect for eight years.[10] While TDUs must now file rate cases more frequently (i.e., at least every four years),[11] the use of a three-year amortization period remains likely to result in over-recovery because it is shorter than the time period required for TDU rate case filings. As to intergenerational equity, OPUC recognizes the importance of achieving intergenerational equity, but this goal must be balanced with moderating the impact on customer rates.[12] OPUC believes that its proposal to use a five-year amortization period prevents the Company from over-recovering the regulatory assets and appropriately balances the customer rate impact with intergenerational equity.

---

[7] PFD at 67.

[8] *See* 16 Tex. Admin. Code ("TAC") § 25.247(b)(1).

[9] *See* PFD at 75, 94, 102-03.

[10] OPUC Initial Brief at 16-17.

[11] *See* 16 TAC § 25.247(b)(1).

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

For these reasons, OPUC's primary recommendation is that the Commission authorize recovery of the regulatory assets through riders with a five-year amortization period. However, if the Commission authorizes recovery through base rates, OPUC requests that the Commission use a five-year amortization period for the regulatory assets to prevent over-recovery of the costs included in the regulatory assets.

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

B. Labor Expenses

2. Incentive Compensation

b. Long-Term Incentive Compensation

OPUC excepts to the PFD's recommendation that CenterPoint recover the $3.8 million of long-term incentive ("LTI") compensation tied to restricted stock units ("RSUs").[13] As discussed below, RSUs are financially based incentive compensation, and therefore, the expense amount for RSUs is not recoverable from customers.

In recommending recovery of the expense amount for RSUs, the PFD noted that the ALJs were persuaded by CenterPoint's arguments that RSUs are purely a time-based achievement, vesting only if an employee remains employed with CenterPoint Energy, Inc. ("CNP") for three years.[14] However, focusing solely on the vesting period does not provide an accurate picture of the nature of the compensation. In determining whether incentive compensation is financially based, it is more appropriate to consider the behavior that the compensation is designed to incentivize and whether the behavior primarily benefits the utility's shareholders or customers.

RSUs are company stock awards that must be held over a period of years (the "vesting period") before they may be received by the employee.[15] Thus, while RSUs are a "time-based achievement" in the sense that the employee does not receive them until they vest, the RSUs are more valuable to the employee at the end of that time period if the employee takes actions that increase the stock price. Therefore, the RSUs are designed to align the employees' behavior with

---

[13] *See* PFD at 248.

[14] *Id.*

[15] COH Ex. 2 (M. Garrett Direct) at 34.

actions that increase the stock price, an achievement that primarily benefits shareholders, rather than the utility's customers.

The financial-based nature of RSUs was also amply supported by the evidence. As City of Houston/Houston Coalition of Cities witness Mr. Mark Garrett testified:

> The *restricted units* are tied to financial performance because the value of these units is directly tied to the value of the Company's common stock. In other words, the *restricted units* are tied to financial performance measures since the value of the compensation the employees receive is tied to the appreciation of CNP's stock price over the vesting period.[16]

In addition, CenterPoint witness Ms. Lynne Harkel-Rumford admitted during cross-examination that the Company's LTI plan is "designed to reward participants for sustained improvements in CenterPoint's financial performance and increases in the value of CenterPoint's common stock and dividends" and that RSUs are "intended to reward employees for long term stock appreciation."[17] The Proxy Statement that accompanied CNP's notice of its annual shareholder meeting scheduled for April 25, 2019 stated that one of the goals of the executive compensation plan is to "align interests of executives with shareholders."[18] Moreover, the Proxy Statement showed that CNP executives generally have outstanding grants in any given year covering three concurrent periods.[19] Consequently, once an executive meets the initial three-year vesting period, there is a much stronger incentive to perform in a manner that keeps stock prices high over the long term, which directly benefits shareholders.[20]

Given these facts, it is reasonable to conclude that the RSUs are intended to result in employee behavior that primarily benefits the utility's shareholders rather than its customers. The fact that the RSUs vest after three years does not change their character as financially based incentive compensation. Consequently, the entire amount of CenterPoint Houston's LTI

---

[16] *Id.*

[17] Tr. at 1343-44.

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

[19] TIEC Ex. 15 at 34.

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

compensation expense that is based on the RSUs should be removed from the Company's cost of service.

H. Vegetation Management

OPUC excepts to the PFD's conclusion that CenterPoint should recover its test-year vegetation management expense amount of $35.02 million.[21] As discussed in OPUC's briefs and the testimony of OPUC witness Mr. Karl Nalepa, CenterPoint's test-year vegetation management expenses were abnormally high compared to recent years and should be normalized to better represent the expenses the Company will incur in the future.[22] As discussed below, OPUC recommends using a normalized amount of $28.126 million, which is the average vegetation management expenses incurred by the Company during the three-year period of 2015-2017.

Normalizing test-year expenses is appropriate when a utility's test-year expense amount is not representative of the expenses the utility is likely to incur in the future. In this case, CenterPoint requested its test-year vegetation management expense amount of $35.02 million.[23] However, between 2011 and 2017, the Company's annual vegetation management expenses averaged $26.78 million.[24] Thus, the 2018 expense of $35.02 million was $8.24 million, or 31%, higher than the prior seven-year average. The table below is a summary of the Company's vegetation management expenditures in prior years compared to the test year:[25]

CenterPoint Houston Annual Tree Trimming Expense

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

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

---

21 *See* PFD at 298.

22 OPUC Initial Brief at 63-65; OPUC Ex. 5 (Nalepa Direct) at 7-11.

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

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

25 OPUC Ex. 5 (Nalepa Direct) at 8.

CenterPoint did not demonstrate that the higher level of vegetation management expenses in 2018 is likely to continue in the future. The Company stated that its contractor bid prices on a per mile basis have increased since 2014 and its overhead pole miles are increasing each year.[26] However, as shown in Table 1 above, the Company's vegetation management expenses do not show a steady year-over-year increase as would be expected with a year-over-year increase in contractor bid prices and overhead pole miles. Instead, the table shows that, from 2011 to 2017, the Company's vegetation management expenses fluctuated up and down from a high of $29.45 million in 2016 to a low of $22.94 million in 2014.

In the PFD, the ALJs agreed with OPUC that CenterPoint's annual vegetation management expenses reflect fluctuation, but they nevertheless concluded that the Company met its burden to show that the 2018 vegetation management expenses were reasonable, necessary and representative of expected future costs.[27] The ALJs did not find evidence to support that the 2018 vegetation management expense amount was inflated due to "catch-up" work resulting from Hurricane Harvey in 2017. However, even if "catch-up" work was not the cause of the increased vegetation management expense in 2018, the remaining factors that the ALJs relied on to reach their conclusion do not demonstrate that the Company met its burden of proof regarding the substantially higher than average test-year expense amount.

One of the factors that the ALJs relied on to reach their conclusion was the increase in reactive tree trimming activities since 2014.[28] However, if earlier data points are included in the analysis, it is clear that there is not a steady upward trend. As shown in the chart above, the annual expense amounts for reactive tree trimming in 2011, 2012, and 2013 were each higher than the amount in 2014. Thus, the annual expense amounts show fluctuations when looking at a longer period.

Another factor that the ALJs relied on to reach their conclusion is that the "the amount of miles proactively trimmed in 2018 (5,357 miles) is not an uncommonly large number for CenterPoint," as compared to miles trimmed in 2011 (5,606 miles), 2013 (5,074 miles), and 2014

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

[27] PFD at 299.

[28] *Id.*

(5,139 miles).[29] However, in those past years, CenterPoint was able to trim comparable miles at much less expense. As shown in the table above, the Company's expense for proactive tree trimming in those years was $20.39 million, $19.89 million, and $18.98 million, respectively, compared to the Company's expense for proactive tree trimming in the test year of $28.02 million. Thus, looking jointly at the miles trimmed and the annual vegetation management expense illustrates that 2018 is not representative compared to prior years.

The ALJs also noted that the vegetation management expense amount that CenterPoint has already spent on proactive tree trimming in 2019 is similar to the amount spent in 2018. However, the Company's actual budgeted amount for vegetation management in 2019 is $34.033 million, which is $0.987 million less than the Company's requested test-year amount.[30] Thus, the Company's 2019 vegetation management expenses also indicate that the test-year expense amount is on the high end.

Given all of these factors, normalization of vegetation management expense is warranted in this case. To normalize the vegetation management expenses, OPUC witness Mr. Nalepa recommended that vegetation management expenses be set at $28.126 million, which is $6.896 million less than the Company's request of $35.02 million. This recommendation is based on the average vegetation management expenses incurred by the Company during the three-year period of 2015-2017. The use of average vegetation management expenditures addresses the year-to-year variation in expenses. The ALJs criticized using multi-year averages that included 2017 because the Company testified that 2017 was not a representative year due to Hurricane Harvey.[31] While a different normalization period could be used to determine the amount of vegetation management expenses, OPUC notes that its proposed three-year normalization period reflects the next highest annual expenditures (excluding 2012, a year in which the Company had unusually high hazard tree removal costs). In addition, the average vegetation management expenditures consist of expenses made in the years immediately before the 2018 test year and reflect the most recent tree trimming activity.

---

[29] *Id.*

[30] CEHE Ex. 31 (Pryor Rebuttal) at 25.

[31] PFD at 297-98.

The Company has the burden of proof to demonstrate that its requested expenses are reasonable and necessary. In this case, the Company has not shown that its test-year level of vegetation management expenses is representative of its expected annual expenses in the future. Therefore, the amount that the Company has requested is not reasonable and necessary. Accordingly, OPUC requests that the Commission adopt OPUC witness Mr. Nalepa's proposed adjustment that normalizes vegetation management expenses to an amount of $28.126 million.

CONCLUSION

For the reasons stated herein, OPUC respectfully requests that the PFD be modified to include findings of fact and conclusions of law consistent with these exceptions and that OPUC be granted any other relief to which it may be entitled.

Respectfully submitted,

Lori Cobos
Chief Executive & Public Counsel
State Bar No. 24042276

Cassandra Quinn
Senior Assistant Public Counsel
State Bar No. 24053435

OFFICE OF PUBLIC UTILITY COUNSEL
1701 N. Congress Avenue, Suite 9-180
P.O. Box 12397
Austin, Texas 78711-2397
512-936-7500 (Telephone)
512-936-7525 (Facsimile)
cassandra.quinn@opuc.texas.gov
opuc_eservice@opuc.texas.gov (Service)

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing document was served on all parties of record in this proceeding on this 10th day of October 2019 by facsimile, electronic mail, and/or first class, U.S. Mail.

Cassandra Quinn