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CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC'S EXCEPTIONS TO PROPOSAL FOR DECISION

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CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC'S
EXCEPTIONS TO PROPOSAL FOR DECISION

CenterPoint Energy Houston Electric, LLC ("CenterPoint Houston" or the "Company") respectfully submits these Exceptions to the Proposal for Decision ("PFD") issued on September 16, 2019.

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

In producing a PFD of nearly 500 pages, the Administrative Law Judges ("ALJs") generally provide a fair summary of the parties' positions, yet propose an overall result that threatens both CenterPoint Houston's financial health and the constructive regulatory environment that the Public Utility Commission of Texas ("Commission") has created in Texas. In fact, the PFD, in many cases, renders analysis that does not reflect the weight of credible evidence, comply with applicable law, or set good public policy. Specifically, the PFD:

- Recommends a cost of capital that jeopardizes CenterPoint Houston's financial integrity and will not allow the Company to maintain its strong credit metrics. This is because the PFD proposes a return on equity ("ROE") far below both the national average ROE for electric utilities and the ROEs most recently approved by the Commission for transmission and distribution utilities ("TDUs") in the Electric Reliability Council of Texas ("ERCOT"), as well as a capital structure that does not account for the reduced cash flow attributable to the Tax Cuts and Jobs Act of 2017 ("TCJA") or CenterPoint Houston's impending capital expenditures (*See* Sections I.B.1 and III);
- Recommends rate base disallowances totaling $352.101 million that lack evidentiary support and, in certain instances, directly conflict with Commission-required accounting practices.[1] These capital disallowances include reliability program investment[2] that has resulted in CenterPoint Houston being the most reliable electric utility in ERCOT (*See* Sections I.B.2 and II.A.1.b);
- Includes in the $352.101 million rate base disallowance a redundant disallowance of $41.2 million in URD CLEP capital costs despite the undisputed evidence showing that

[1] *See* Docket No. 49421: "49421 – Rev Req Model – ALJ Number Run – 9-9-2019.xlsx (Revenue Requirement worksheet, cell L156) PUCT Interchange Filing Search, Item No. 722); PFD at 466, Appendix B.

[2] The PFD proposes to disallow capital costs associated with the Major Underground Rehabilitation Program – $20.1 million; Underground Cable Rehabilitation Program ("URD CLEP") – $5.4 million; and Distribution Line Clearance Project – $19.4 million.

this program was not implemented until 2013 and thus, these costs were *not* previously included as expenses in the rates established by the Commission in Docket No. 38339 (*See* Sections I.B.2 and II.A.3.a);

- Recommends ring-fencing measures that go beyond those appropriate for CenterPoint Houston (*See* Sections I.B.1 and III.E); and
- Reflects number running errors that, when corrected, result in an increase of $31.495 million, not the $2.64 million increase stated in the PFD (*See* Sections I.B. and XI).

Likewise, the PFD offers recommendations that do not result in sound public policy or that contradict established law and policy. In this regard, the PFD:

- Concludes that the Commission lacks authority to approve recovery of $8.7 million in Hurricane Harvey carrying costs despite the language in the Public Utility Regulatory Act,[3] prior Commission decisions, Commission Staff's testimony recommending recovery of these carrying costs, and the Company's past practice (*See* Sections I.B.3 and II.E.4);[4]
- Concludes that ratemaking treatment does not need to be consistent with Commission-required accounting practices; and
- Disallows compensation costs that the Commission found to be reasonable in Docket No. 38339 and gives no consideration to the Texas Legislature's recent passage of House Bill ("HB") 1767 or the customer benefits realized by attracting and retaining skilled employees in an increasingly competitive job market (*See* Sections I.B.3 and IV.C.1.).[5]

Correction of the PFD on these and other issues raised in CenterPoint Houston's Exceptions is critical to preserving the Company's financial integrity and providing a regulatory environment in Texas that is predictable, consistent, reasonable, and fair. Without these corrections, the results will lead to substantial decreases in operating income, cash flows, and key financial metrics resulting in significant harm to the financial well-being of CenterPoint Houston.

A. The Commission's decision in this case is vitally important to CenterPoint Houston's financial integrity and the utility industry as a whole

CenterPoint Houston has provided electric service in the greater Houston area for nearly 140 years. During that time, the Company has powered a region that grew from a small, coastal village into one of the largest and most important economic centers in the country. The Company's service territory covers 5,000 square miles and includes Downtown Houston, the Texas Medical Center, major industrial areas such as the Ship Channel and Freeport, along with suburban communities like Pearland and Sugar Land. Since CenterPoint Houston's last rate case in 2010,

[3] Tex. Util. Code Ann. §§ 11.001-66.016 ("PURA").

[4] PFD at 76-77.

[5] *Id.* at 230-231, 238, 243-245, 248-249, 250-251.

the Company has added more than 400,000 new customers and invested over $6 billion in transmission and distribution infrastructure serving our customers, including $1 billion not yet reflected in rates through the transmission cost of service ("TCOS") and distribution cost recovery factor ("DCRF") mechanisms. Residential customer growth is expected to continue at a rate of approximately two percent per year for the next 20 years. And the Company expects to invest an average of $1 billion in additional infrastructure each year for the next five years for the benefit of its customers.

Within this context, the importance of this case—that is, the Commission's decisions in this case—for the Company, its customers and the communities it serves cannot be overstated. In this case, CenterPoint Houston has been transparent in describing its operations, documenting its expenses, and explaining the need for a credit supportive regulatory outcome.[6] The rates that the Commission sets in this case for CenterPoint Houston will determine whether the Company is positioned operationally and financially to respond to growth and continue to provide safe and reliable service. Consequently, this case provides an opportunity for the Commission to guide the course of the most reliable investor-owned electric utility in ERCOT.

This is also the first fully contested rate case for an ERCOT TDU since 2010. As such, this case offers the Commission the opportunity to affirm or revise regulatory precedent and policy that will guide future rate case decisions. In short, this case is not only critical to CenterPoint Houston's future operations and financial health, but it will send a strong signal to the investment community of whether Texas will provide balanced, constructive outcomes in utility rate proceedings that complement and support the State's economic growth.[7]

B. The PFD's recommendations jeopardize CenterPoint Houston's financial integrity and should be revised to reflect correct costs, the record evidence, and applicable Commission rules and statutes

Following the generational storm event of Hurricane Harvey and the significant investment in transmission and distribution infrastructure not yet recovered in rates and other factors impacting the Company's operations and finances, CenterPoint Houston requested a revenue requirement increase in this case of $194 million. Parties suggest that no increase is needed, or even that a decrease is warranted, because the Company was required to file this case pursuant to

[6] The Company's rate filing includes the direct testimony of 25 witnesses, over 7,000 printed pages of testimony, exhibits, schedules and work papers and over 3.5 gigabytes of electronic supporting material and data.

[7] CEHE Ex. 48a at Confidential Exh. R-EL-5 (Lapson Rebuttal).

the rate review schedule. But those arguments ignore the significant growth and capital investment since the Company's last rate case and that if this rate case had not been filed, the Company would have filed a DCRF and up to two TCOS applications to recover that capital. The $1 billion of incremental, unrecovered capital investment alone points to the need for a revenue increase of at least $100 million or more, even without considering increased expenses over the past decade or recovery of regulatory assets such as Hurricane Harvey.

As a threshold matter, the PFD's recommended increase of $2.64 million in the Company's overall revenue requirement is incorrect. In Section XI of these Exceptions, CenterPoint Houston identifies several errors with the number running calculations performed by Commission Staff. Correction of these errors results in a revenue increase of $31.495 million, not $2.64 million. Yet, even with the Company's corrected revenue requirement increase amount, the PFD would actually *decrease* the Company's operating income by nearly $30 million and require write-offs for certain disallowed rate base items.[8]

In addition, the PFD would negatively impact the Company's credit metrics and risk a downgrade by credit rating agencies. CenterPoint Houston estimates that Funds for Operations ("FFO") in 2020 resulting from the PFD would be nearly $120 million lower than that resulting from the rate case as filed by the Company.[9] As a result of this lower FFO, CenterPoint Houston estimates the 2020 credit metric ratio of FFO/Debt (S&P)[10] that results from the PFD would be 13.4% with the accelerated excess deferred income tax ("EDIT") refund and would be 14% after the conclusion of the accelerated EDIT refund.[11] These metrics are well below both CenterPoint Houston's estimate of the 2020 FFO/Debt (S&P) metric resulting from the rate case as filed by the Company of 17.3% and the Moody's Investors Service ("Moody's") downgrade threshold of

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[8] The PFD's recommendations on specific issues in the case include the following impacts: (1) disallowed rate base (capital and other costs) ($19 million revenue reduction and negative operating income impact); (2) incentive compensation ($23 million revenue reduction and negative operating income impact); (3) capital structure and return on equity ($48 million revenue reduction and negative operating income impact); (4) other expense disallowances ($17 million revenue reduction and negative operating income impact); (5) 10-year weather ($12 million revenue reduction and negative operating income impact); and (6) the related income tax impacts on revenue requirement.

[9] The PFD's recommendations on specific issues referenced in n.8 as well as the PFD's recommendation for an accelerated return of unprotected EDIT result in the decline in FFO.

[10] S&P stands for Standard & Poor's.

[11] While these percentages are slightly higher than TIEC witness Mr. Gorman's corrected percentage, the FFO/Debt resulting from the PFD is not expected to be sufficient to maintain CenterPoint Houston's current credit rating. *See* CEHE Ex. 27 at 2843:1-4 & 2844:13-2845:8, Table 6 (McRae Direct). The PFD's recommendations on specific issues referenced in footnote 8 as well as the PFD's recommendation for an accelerated return of unprotected EDIT result in the FFO/Debt metric decline.

18%.[12] Additionally, proposed rate base write-offs would reduce the Company's retained earnings and equity balance. Without additional equity infusion, this would reduce the Company's equity ratio below the allowed level.

Moreover, adoption of the PFD's recommended ROE of 9.42% for CenterPoint Houston would be the lowest Commission-approved ROE for any electric utility in the state of Texas and well below the national average authorized ROE for electric utilities.[13] This is not a sound result when viewed in light of both CenterPoint Houston's responsibility to serve customers in one of the most important economic and trade centers in the state and country and the intervening pressures and risks that the evidence shows CenterPoint Houston currently faces.[14] It is difficult to understand how the PFD reached such a result based on the record evidence in this case.

Because this proceeding contains a multitude of contested issues and is large and complex, it is easy for key evidence and policy choices to get lost in the noise. As such, CenterPoint Houston highlights three critical issues in this case: (1) cost of capital, including a record low ROE; (2) unpredictable and unsupportable capital disallowances; and (3) a series of disallowances based on flawed statutory interpretation and bad public policy. The Company thanks the Commission for its consideration of these issues and the others discussed in these Exceptions and looks forward to a Commission order allowing the Company to continue to provide safe and reliable service to customers.

1. The PFD's cost of capital recommendation jeopardizes the Company's financial integrity and is far below both the national average ROE for electric utilities and the ROEs most recently approved by the Commission for TDUs in ERCOT

The evidence demonstrates that CenterPoint Houston's proposed cost of capital, which includes a capital structure comprised of 50% equity and 50% debt and a ROE of 10.4%, is driven by two factors outside of the Company's control—growth in the Company's service territory, which has materially increased the level of capital investment required on an annual basis, and the TCJA, which has significantly reduced the Company's cash flow. Credit rating agencies have made clear that the order of a 9.42% ROE in this case will not be sufficient to sustain CenterPoint

[12] CEHE Ex. 27 at 2843:1-4 & 2844:13-2845:8, Table 6 (McRae Direct).

[13] The evidence in this proceeding establishes that the average authorized ROE for electric utilities since 2014 has been 9.68%, which is 26 basis points higher than the 9.42% ROE recommended by the PFD. *See* CEHE Ex. 42 at 16:7-8 (Hevert Rebuttal).

[14] CEHE Ex. 47 at 22-23 (Exh. R-JSM-1) (Myerson Rebuttal).

Houston's credit metrics. In a comment issued on June 17, 2019, Moody's noted that a ROE "materially below [CEHE's] current 10% . . . would be credit negative."[15] And, on June 26, 2019, during the hearing on the merits in this case, Moody's issued an updated report changing CenterPoint Houston's outlook from Stable to Negative.[16] The report further noted that the absence of a supportive rate case outcome could lead to a downgrade.[17] Thus, two very good things for customers (strong economic growth in the Houston area and tax relief) will negatively impact the Company's financial condition if the Commission acts to establish a capital structure and ROE for CenterPoint Houston that materially strays from current levels.

Remarkably, the PFD does not mention this undisputed evidence. Instead, the PFD proposes a ROE of 9.42%, which is:

- 58 basis points lower than that found reasonable by the Commission in the Company's last rate case;[18]
- 38 basis points lower than the 9.8% ROE approved in 2017 for Oncor Electric Delivery Company ("Oncor"), in Docket No. 46957;[19] and
- 23 basis points lower than any other TDU in ERCOT.[20]

Adoption of the PFD means that CenterPoint Houston would have the lowest Commission-approved ROE of any electric utility in the state of Texas.[21]

Additionally, the PFD reaches its conclusion without providing any discussion of why CenterPoint Houston should be considered dramatically less risky than other comparable utilities nor does it explain how its recommended return is commensurate with returns on investment in other enterprises having comparable risks.[22] The PFD further fails to explain how this result will allow CenterPoint Houston to attract the capital necessary to fund approximately $5.14 billion in

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[15] CEHE Ex. 43a, Confidential Exh. R-RBM-3 at 1 (McRae Rebuttal).

[16] Moody's Investor Service, *Rating Action: Moody's Affirms CenterPoint Energy Houston Electric Ratings; Outlook Changed to Negative* (Jun. 26, 2019), marked as CEHE Ex. 72 (Offer of Proof) (Declassified).

[17] *Id.*

[18] *Application of CenterPoint Electric Delivery Company, LLC, for Authority to Change Rates,* Docket No. 38339, Order on Rehearing at Findings of Fact Nos. 70A–73A (Jun. 23, 2011).

[19] *Application of Oncor Electric Delivery Company LLC for Authority to Change Rates,* Docket No. 46957, Order at Findings of Fact Nos. 32 & 35 (Oct. 13, 2017).

[20] The most recent ROE authorized by the Commission for a TDU operating in the ERCOT, is 9.65. *See* CEHE Ex. 42 at 116:18–19 & Exh. R-RBH-8 (Hevert Rebuttal).

[21] *See id.* at Exh. R-RBH-8 (Hevert Rebuttal).

[22] *Federal Power Comm'n v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1944); *Bluefield Waterworks & Improvement Co. v. Pub Serv. Comm'n of W. Va.,* 262 U.S. 679, 692-693 (1923).

capital investments over the next five years in order to connect and reliably serve customers.[23] The PFD also does not explain how its recommendation comports with long-established principles of ratemaking, which require that the return to an equity owner should be reasonably sufficient to assure confidence in the financial soundness of the utility, to maintain and support the utility's credit, and to attract the capital necessary for the proper discharge of the utility's public duties.[24] In short, the PFD's recommended ROE fails legal standards established by the Supreme Court in *Hope* and *Bluefield*.

In arriving at a recommended three-basis-point reduction in CenterPoint Houston's ROE, the PFD also wrongly concludes that CenterPoint Houston is not responsive to its customers. The record evidence proves that CenterPoint Houston takes seriously its responsibility to provide safe and reliable electric service to its customers and strives to effectively respond to customer reliability concerns. In fact, hundreds of pages of evidence describe the efforts of Company employees to fulfill this responsibility around the clock every day of the year.[25] There is no dispute that CenterPoint Houston's overall quality of service is excellent. In all but two years since 2008, CenterPoint Houston's System Average Interruption Duration Index ("SAIDI") has exceeded the Commission standard.[26] Among ERCOT investor-owned utilities, CenterPoint Houston is consistently the least penalized utility for SAIDI violations.[27] This is true despite the fact that CenterPoint Houston is located in a climate that produces above average rainfall and vegetation growth, routine thunderstorm and lightning activity, and annual exposure to tropical depressions, storms, and hurricanes.[28]

Yet, the PFD would disallow millions in return on investment based on H-E-B's alleged reliability concerns. With regard to H-E-B's specific complaint, the evidence showed that H-E-B is wrong and that the Company provides reliable service to H-E-B overall. CenterPoint Houston has also devoted significant resources to diagnose and correct issues impacting specific stores and offered to retain a third party at no expense to H-E-B to further study the issues identified by

[23] CEHE Ex. 27 at 2832:9-21 (McRae Direct).

[24] *Hope Natural Gas Co.*, 320 U.S. 591, 603; *Bluefield Waterworks & Improvement Co.* 262 U.S. 679, 692-693.

[25] CEHE Ex. 6 at 42:8–47:8 (Mercado Direct); CEHE Ex. 7 at 173:8–174:12 & 178:12–183:5 (Pryor Direct); CEHE Ex. 8 at 332:4–338:20 (Narendorf Direct); CEHE Ex. 9 at 581:1-589:12 (Bodden Direct): CEHE Ex. 10 at 665:15–669:14 & 670:15–676:21 (Sugarek Direct).

[26] CEHE Ex. 9 at 609:5-611:5 (Bodden Direct); CEHE Ex. 33 at 4:15-5:22 (Sugarek Rebuttal).

[27] CEHE Ex. 33 at 5:2-4 (Sugarek Rebuttal).

[28] *Id.* at 6:1-14.

CenterPoint Houston's analysis.[29] Thus, while the Company stands ready to continue working with H-E-B to address its concerns, the evidence in this case simply does not support the PFD's conclusion that CenterPoint Houston failed to provide reliable service to H-E-B or was unresponsive to its complaints.

The overwhelming evidence in this case also shows that the PFD's capital structure recommendation is supported by only the sparsest of analysis. The PFD states that the 50/50 capital structure proposed by CenterPoint Houston, as well as the capital structure composed of 40% equity and 60% debt proposed by Staff and most of the Intervenors "represent extremes," and it instead opts for a middle approach of 45% equity and 55% debt.[30] This is the same capital structure as adopted in CenterPoint Houston's last base rate case, in 2011.[31] It is undisputed however, that CenterPoint Houston's current capital structure does not account for the reduced cash flow attributable to the TCJA or CenterPoint Houston's impending $5.14 billion of capital investment that will be made in its system from 2019-2023.[32] The PFD fails to explain why this capital structure is appropriate in light of the evidence presented regarding changing market conditions and risk factors. The PFD also gives no weight to the evidence demonstrating that the Company's currently approved equity ratio of 45% will not produce financial metrics that are sufficient to maintain its current credit ratings.[33] Indeed, Moody's has already placed CenterPoint Houston on negative outlook based on the recommendations of the parties in the proceeding [34] and it appears to be closely watching this case to determine not only whether CenterPoint Houston's financial metrics are at risk but also whether Texas will remain a constructive regulatory climate for utility investment.[35]

Finally, setting aside the legal positions of parties on whether ring-fencing provisions may be or are appropriately applied by the Commission in the context of a base rate proceeding, the Company asks the Commission to apply its experience and judgment to evaluate whether the

[29] *Id.* at 7:1-17:18.

[30] PFD at 191.

[31] *See* Docket No. 38339, Order on Rehearing at Finding of Fact No. 67.

[32] *See* CEHE Ex. 43 at 17:1-28, 31:7-14 (McRae Rebuttal); CEHE Ex. 26 at 2680:5-12 (Hevert Direct).

[33] CEHE Ex. 27 at 2843:1-10 (McRae Direct); CEHE Ex. 48 at 42:13-21 (Lapson Rebuttal).

[34] Moody's Investor Service, *Rating Action. Moody's Affirms CenterPoint Energy Houston Electric Ratings; Outlook Changed to Negative* (Jun. 26, 2019) marked as CEHE Ex. 72 (Offer of Proof).

[35] CEHE Ex. 48 at 60:15-19 & CEHE Ex. 48a, Confidential Exh. R-EL-5 (Moody's Credit Outlook, Jun. 17, 2019) (Lapson Rebuttal).

PFD's proposed ring-fencing measures are necessary. To this end, it is undisputed that Moody's has commented that implementing formal regulatory ring-fencing commitments would be credit-neutral; that is, it would not enhance the ratings of CenterPoint Houston relative to the existing "common management practices".[36] It is further undisputed that CenterPoint Houston has been prudently managed for the past 137 years, has never been owned by a non-utility parent, and is already financially and operationally separated from its parent.[37] While these factors may have been overlooked by the PFD, they should not be discounted by the Commission as they further support a conclusion that new ring-fencing measures for CenterPoint Houston are not necessary.

If, however, the Commission desires to implement measures that maintain utility separation for affiliates, CenterPoint Houston is, without waiving the arguments raised in Sections III.E.1 through 6 of these Exceptions, willing to accept ring-fencing measures that will not damage the Company's financial integrity or harm its continued operations. These measures are discussed in Section III.E.7 of the Company's Exceptions. In all other respects, CenterPoint Houston respectfully urges the ALJs to reconsider or the Commission to reverse the ALJs' recommendation on ROE and ring-fencing.

2. The capital disallowances recommended by the PFD lack evidentiary support and, in certain instances, directly conflict with Commission-required accounting practices

This proceeding involves the review of more than $6 billion in capital investment made by CenterPoint Houston to respond to customer growth of over 400,000 customers in the past 10 years.[38] Nearly $1 billion in capital investment has yet to be reflected in the Company's rates through the DCRF or TCOS mechanisms.[39] And, residential, commercial, and industrial growth projections for the Houston area have the Company necessarily planning to spend approximately $1 billion per year over the next five years to meet the demands of that growth.[40] In this context,

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[36] CEHE Ex. 48a at Confidential Exh. R-EL-5 (Moody's Credit Outlook, Jun. 17, 2019) (Lapson Rebuttal). CenterPoint Houston hereby declassifies Exhibit R-EL-5 as confidential.

[37] CEHE Ex. 48 at 22:13-26:14 (Lapson Rebuttal); CEHE Ex. 47 at 22–23 (Exh R-JSM-1) (Myerson Rebuttal).

[38] CEHE Ex. 6 at 50:16-51:1 (Mercado Direct).

[39] *See* CEHE Ex. 7 at 307 (WP RMP-2 2018 Capital Project List Summary) (Pryor Direct) (total 2018 Distribution additions of $931,853,730 – none of which are being recovered in current rates); *See also Application of CenterPoint Energy Houston Electric, LLC to Amend its Distribution Cost Recovery Factor*, Docket No. 48226, Final Order at 2, Finding of Fact No. 6 (Aug. 30, 2018) (noting that proceeding reflected changes to invested capital between January 1, 2010 and December 31, 2017); This case presents capital investment through December 31, 2018.

[40] CEHE Ex. 6 at 51:4-17 & 86 (WP KMM-01 2017 CNP Corporate Responsibility Report) (Mercado Direct).

CenterPoint Houston needs clear instruction as to what standards the Commission will apply when determining prudence.

For instance, the evidence is undisputed that:

- All of the Company's capital investment is used and useful in providing service to the public;[41]
- No party challenged the budgetary and cost control processes that CenterPoint Houston uses on a daily, monthly and annual basis to ensure that costs remain prudent and reasonable;[42]
- CenterPoint Houston has a record of excellent reliability;[43]
- The Company follows the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts ("USOA") when determining whether a project is properly capitalized;[44] and
- The average cost variance for all transmission lines reported on its monthly construction progress reports filed between January 1, 2010 and December 31, 2018 that were not paid for by an individual customer was a *negative* 8.5%—meaning that, on average, the actual cost of the Company's ratepayer funded transmission line projects was *lower* than originally estimated.[45]

Yet, the PFD would have the Commission issue an order that disallows $117 million in capital investment, including $25.5 million invested in two essential reliability programs that the PFD explicitly finds to be imprudent simply because the ALJs feel the Company could have included more information in a discovery request—a discovery request to which no party filed a motion to compel.

The ALJs then state that they have "discounted" the Company's rebuttal testimony on this basis despite the fact that no party sought to strike this testimony.[46] In the same finding, the ALJs recognize that the 30-year capital program at issue provides "important safety and reliability benefits,"[47] yet they recommend a disallowance of 35% of the project's cost without any

[41] PFD at 410 (proposed Finding of Fact No. 44).

[42] CEHE Ex. 7 at 193:11–199:6 (Pryor Direct); CEHE Ex. 8 at 357:15–359:3 (Narendorf Direct); CEHE Ex. 9 at 589:13-607:20 (Bodden Direct); CEHE Ex. 10 at 687:10–13 (Sugarek Direct); CEHE Ex. 15 at 1090:10–1099:19 (Townsend Direct); CEHE Ex. 17 1593:10–1597:22 (James Direct); CEHE Ex. 19 at 1673:4–1678:8 (Kimzey Direct); CEHE Ex. 29 at 1703:1–1703:21 (Gauger Direct); CEHE Ex. 21 at 1716:1–1721:5 & 1736:9–1737:21 (Englet Direct).

[43] PFD at 14 & 169.

[44] CEHE Ex. 7 at 190:18-193:17 (Pryor Direct); CEHE Ex 12 at 926:19-928:7 (Colvin Direct); CEHE Ex 35 at 51:8-52:18 & 59:1-29 (Colvin Rebuttal).

[45] CEHE Ex. 32 at 18:4-18 & 81-82 (Exh. R-MWN-2) (Narendorf Rebuttal).

[46] PFD at 19 & 22.

[47] *Id.* at 22.

explanation of how the disallowance was derived. In similar fashion, the PFD completely disallows prudent land costs simply because it found those costs should have been recorded in a different FERC account (instead of simply finding that the investment should be re-classified to another account).[48] And, the PFD—while recognizing the Company must follow the FERC USOA and that the Company must classify poles, wires and conductors as capital investment when such facilities are replaced—disallows line clearance project costs because the utility's information was too voluminous to warrant a thorough review, and the ALJs disagree with the capital treatment required by the FERC USOA.[49]

Put differently, the PFD would have the Commission issue a final order in which the utility is penalized for both producing too much and too little information in discovery—without regard to the actual legal standard of whether the project at issue is prudent or whether parties were denied any discovery right. Similarly, the PFD while recognizing that the utility has and must follow the Commission's rules with respect to use of the FERC USOA when determining whether a project is capitalized or expensed, recommends a disallowance based on a finding that the word "includes" was not precise enough for purposes of describing the nature of work in a project description.[50]

These results, which apply opposite forms of logic and weigh the record evidence in a clearly inconsistent fashion, necessarily create a future prudence weighing environment where the utility has no clarity on what "contemporaneous evidence of prudence" is necessary to meet its burden of proof. If the utility produces too much evidence—costs may be disallowed. If the utility should have explained more about a program in its direct case or discovery, regardless of how thorough the final evidentiary record on rebuttal is—costs may be disallowed. Thus, the PFD creates a regulatory environment where it does not matter if the utility undisputedly acted prudently, reasonably, and followed the Commission's accounting rules because its costs are still subject to disallowance based solely on the subjective opinion of the trier of fact. Adoption of such a result is not sound public policy and will result in a regulatory environment that undermines the infrastructure investment necessary to support continued economic growth in the state of Texas.

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[48] *Id.* at 36-37; CEHE Ex. 35 at 54:10-19 (Colvin Rebuttal).

[49] PFD at 48 noting that the work orders supporting the projects were voluminous.

[50] *Id.* at 49.

3. The PFD's recommendations to disallow hurricane-related carrying costs and incentive compensation expenses and to reopen settled issues are not sound regulatory policies

The reasonableness, necessity, and prudence of the Company's system restoration costs associated with Hurricane Harvey—a storm that the Commission well knows was devastating in CenterPoint Houston's service territory—were largely unchallenged in this case. Yet, the PFD—against Staff's recommendation—finds that the Company should not recover carrying costs associated with those expenses. This reasoning is based on the ALJs' reading of the securitization statute related to storm costs and an alleged "lack of evidence supporting the carrying cost."[51] In truth, the PFD cites the evidence that fully supports the recovery of carrying costs and the appropriateness of the Company's calculation.[52] Thus, the central question for Commission consideration—as posed by Staff—is whether it will issue an order that fails to assure utilities the Commission will allow them to recover prudently incurred costs, including carrying costs, associated with hurricane restoration. With an active hurricane season currently underway, CenterPoint Houston respectfully submits that the PFD's recommendation is poor policy.

This case also presents the opportunity for the Commission to review its policy on the recoverability of incentive compensation expense in light of the Texas Legislature's passing, and the Governor's signing, HB 1767 into law.[53] These expenses, which no party suggests should be excluded from the Company's overall compensation and benefits plan, are unchallenged as to their reasonableness in this case and, with respect to STI were expressly found to be reasonable and necessary in the Company's last rate case. Rather, the Intervenors, Staff and the PFD find them to be unrecoverable based on citations to past Commission "precedent"—little of which involves CenterPoint Houston's actual incentive compensation plan. The PFD relies entirely on prior rate case decisions (but not CenterPoint Houston's prior rate case decision) to justify its incentive compensation disallowance despite unchallenged evidence produced in this case demonstrating the reasonableness of the Company's compensation philosophy and the competitive environment faced by CenterPoint Houston in attempting to recruit and retain quality employees, while dismissing out of hand the Legislature and Governor's decision to presume incentive compensation costs to be reasonable for the Company's natural gas divisions in Texas and the

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[51] *Id.* at 76.

[52] *Id.* at 73-74.

[53] *See* Tex. Util. Code § 104.060, which codifies HB 1767.

Service Company costs that are charged to those divisions by shared services employees, including customer service representatives and land and field services employees. The Company requests that the Commission evaluate the factual evidence in the record as to the reasonableness of the Company's request without the blind adherence to "precedent" underlying the PFD's reasoning.

Finally, the PFD's recommendation to establish a separate proceeding to address the treatment of securitization-related EDIT amounts represents not only an impermissible attack on prior Commission orders but is also poor policy that jeopardizes future securitization proceedings and the sanctity of settlement agreements. It is undisputed that Commission final orders are intended to be final, if they are not the subject of appeal. With regard to the settlements at issue here, PURA specifically provides that "the financing order, together with the transition charges authorized in the order, shall thereafter be *irrevocable and not subject to reduction, impairment, or adjustment* by further action of the commission, except as permitted by Section 39.307."[54] Despite this clear statutory direction, the PFD invites the Commission to commit legal error in recommending a separate proceeding to address securitization-related EDIT amounts for which a complete record exists in this case—a record that establishes that Gulf Coast Coalition of Cities' ("GCCC") and Texas Industrial Energy Consumers' ("TIEC") request to include $158 million in Rider UEDIT must be rejected. CenterPoint Houston respectfully requests that the Commission reject the recommendation of the PFD to establish a separate proceeding to consider securitization-related EDIT amounts and, in so rejecting the recommendation, avoid creating any ongoing uncertainty relating to this issue.

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

The PFD proposes a total rate base reduction of $352.101 million.[55] This reduction is primarily comprised of: (1) $106.9 million in capital investment, including $25.4 million of investment made in reliability programs that the PFD acknowledges provide "*important safety and reliability benefits*"[56] and a $51.4 million disallowance that is largely based on the PFD's incorrect finding that these costs were included in the rates established for CenterPoint Houston in Docket No. 38339; and (2) a $233.4 million regulatory asset disallowance that includes $8.7 million of Hurricane Harvey carrying costs and $176 million in pension expenses that CenterPoint Houston

[54] *Id.* § 39.303(d) (emphasis added).

[55] *See* Docket No. 49421: "49421 – Rev Req Model – ALJ Number Run – 9-9-2019.xlsx" (Revenue Requirement worksheet, cell L156) (PUCT Interchange Filing Search, Item No. 722); PFD at 479, Appendix B.

[56] PFD at 22.

has funded for the benefit of its employees and to reduce the overall pension expense paid by customers. On these issues and others discussed in this section, the PFD should be revised.

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

1. Prudence Issues

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

The Company addresses the application of these standards in specific sections below.

b. The PFD's recommended disallowance of investment in the URD CLEP Program and Major Underground Rehabilitation Program is legally flawed

Without any evidentiary support, the PFD proposes to disallow $25.5 million in capital investment ($5.4 million of investment made in the URD CLEP Program and $20.1 million of investment made in the Major Underground Rehabilitation Program). No witness supported a partial disallowance for either of these projects. Yet, the PFD proposes a disallowance of 10% of the investment in the URD CLEP Program and 35% of the investment in Major Underground Rehabilitation Program based solely on the ALJs' apparent dissatisfaction concerning a single discovery response amongst the over one thousand responses that CenterPoint Houston produced in the case. Notably, no party sought to compel the information the ALJs suggest should have been provided; in fact, no discovery dispute was ever raised regarding this RFI response. The PFD further provides no analysis or support to explain how its proposed disallowance percentages were derived. The imposition of what appears to be a discovery sanction (when there was never a motion to compel) disguised as a disallowance is reversible legal error.

Under the law, CenterPoint Houston meets its burden of proving investment prudence when it demonstrates that its costs, decisions, and/or actions fall within a reasonable range of costs or options available to a prudent operator.[57] The Commission has consistently used the following definition of prudence:

> The exercise of that judgment and the choosing of one of that select range of options which a reasonable utility manager would exercise or choose in the same or similar circumstances given the information or alternatives available at the point in time such judgment is exercised or option is chosen.[58]

[57] *See Joint Petition of CenterPoint Energy Entex and the City of Tyler for Review of Charges for Gas Sales*, GUD No. 9364, Final Order at Finding of Fact No. 61 (May 24, 2005).

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

The Commission has also long recognized that a utility's investments are presumed prudent until reasonably challenged.[59] Importantly, no party offered no specific challenge to any specific expenditure incurred for either the URD CLEP Program or Major Underground Rehabilitation Program. Rather, the entirety of City of Houston's ("COH") proposal is premised upon a flawed contention that the programs themselves were not "reasonable, necessary and cost-beneficial to customers."[60] Thus, based on the record in this case, the sole issue in dispute is whether CenterPoint Houston's decision to implement these programs was prudent—not whether a portion of those programs' costs should be disallowed.

In this regard, the PFD details the evidence supporting the prudence and need for both the URD CLEP and Major Underground Rehabilitation Program[61] and correctly rejects COH's argument finding that CenterPoint Houston provided "*significant evidence* to support the prudence of the URD CLEP."[62] The PFD also reasonably concludes that "the Major Underground Rehabilitation Program has been in place for 30 years and *provides important safety and reliability benefits*."[63] The PFD, however, then inexplicably strays from its analysis and conclusion when it posits that CenterPoint Houston failed to prove the prudence of the entire costs of these programs and proposes capital investment disallowances despite the absence of a specific challenge to any of the investment made in these programs.[64] Stated differently, the PFD manufactures investment disallowances sponsored by no party.

Agency decisions that are not supported by substantial evidence are deemed arbitrary and capricious.[65] To avoid this legal error, the Commission should reject the PFD's proposed capital disallowance of URD CLEP and Major Underground Rehabilitation Program investment.

In addition to the absence of supporting record evidence for its recommended capital disallowances, the PFD's discussion of the burden of proof regarding cost recovery is fundamentally flawed. The governing standard for cost recovery provides that a utility "may meet its burden without proving the reasonableness and necessity of every individual dollar paid on a

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

[60] COH/HCC Ex. 1 at 15:15-17 (Norwood Direct).

[61] PFD at 17-21.

[62] *Id.* at 19. Emphasis added.

[63] *Id.* at 22.

[64] COH/HCC Ex. 1 at 14:5-18:16 (Norwood Direct).

[65] *Texas Health Facilities Comm'n v. Charter Medical-Dallas, Inc.*, 665 S.W.2d 446, 454 (Tex. 1984).

granular level, but may present evidence that is comprehensive [in nature]."[66] The Commission has also long recognized that a utility's investments are presumed prudent until reasonably challenged.[67] Thus, it is incumbent on the challenging party to produce *credible* evidence that its proposal is more reasonable.[68] If specific evidence is offered, CenterPoint Houston then bears the burden to offer additional testimony and data establishing the prudence of that cost and practice. The analysis offered by the PFD ignores this standard.

As noted above, COH did not challenge any specific expenditure incurred for either the URD CLEP Program or Major Underground Rehabilitation Program. Instead, COH offered only the conclusory statement of its expert witness who opined that the cost of the programs was not justified by "the limited information provided by CEHE."[69] The PFD suggests that this conclusory statement imposed a burden of proof on CenterPoint Houston to "prove that each dollar of cost was reasonably and prudently invested."[70] This is not the legal standard nor is it sound regulatory policy.

First, the law is clear that mere speculation and allegation is not evidence.[71] Second, there is no burden of proof failure when no party has offered specific evidence to support an allegation that a specific project investment was imprudently incurred. Moreover, the PFD errs when it suggests that CenterPoint Houston must fully meet its cost recovery burden of proof in its direct case or in response to discovery.[72] Again, this is not the legal standard. Rather, as the party with the burden of proof, CenterPoint Houston is entitled to present rebuttal testimony and evidence responsive to arguments made by intervenors and Staff. That is exactly what CenterPoint Houston did—CenterPoint Houston presented evidence further supporting the prudence of the URD CLEP and Major Underground Rehabilitation Programs in response to the arguments raised by COH.

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66 PFD at 10 n.14.

67 Docket No. 9300, 17 Tex. P.U.C. Bull. 2057, 2147.

68 *Entergy Gulf States, Inc. v. Pub. Util. Com*m'n, 112 S.W.3d 208, 214-215 (Tex. App. – Austin, 2003, pet. denied).

69 COH/HCC Ex. 1 at 18:1 (Norwood Direct).

70 PFD at 10. The PFD also asserts that CEHE's evidence did not ". . . provide contemporaneous documentation or otherwise show what options CEHE considered and why it was prudent to use these programs (including details thereof) instead of other options during the time periods of issue." *Id.* at 15. This statement is disproven by the PFD's own discussion of the evidence at pages 17-18, 21.

71 Tex. R. of Evid. 401, which explains that evidence is that which makes the existence of a fact more or less probable than what it would be without evidence. Speculation and allegations cannot satisfy this standard.

72 PURA § 36.006 ("In the *proceeding* involving a proposed rate change, the electric utility has the burden. . . .") (emphasis added). Thus, it is the entire proceeding and not limited to direct and discovery.

From a policy perspective, the heightened burden imposed by the PFD of "proving each dollar of cost" will increase rate case expenses and related resource requirements exponentially as evidenced by the more than $6 billion of investment that has been made in CenterPoint Houston's transmission and distribution system since its last base rate case.[73] The record reflects that CenterPoint Houston introduced both comprehensive and specific evidence regarding the reasonableness and necessity of the investment made in both the URD CLEP and Major Underground Rehabilitation Program.[74] CenterPoint Houston's Application and rate filing package ("RFP") included the direct testimony of four witnesses, who each testified in support of the transmission and distribution system capital investment, which includes investment made in the URD CLEP and Major Underground Rehabilitation Programs. CenterPoint Houston also produced hundreds of itemized work orders supporting this investment. In short, the abundance of evidence supporting the prudence of not only the URD CLEP Program and the Major Underground Rehabilitation Program, but *all* of CenterPoint Houston's capital investment between January 1, 2010 and December 31, 2018, is staggering.

The PFD also does little to disguise the fact that its proposed disallowance of $25.5 million of investment in the URD CLEP and Major Underground Rehabilitation Programs is really an ALJ-imposed discovery sanction over a dispute that never occurred and has no record support. An entire section of the PFD is devoted to COH's post-hearing complaint that CenterPoint Houston waited until rebuttal testimony to support the prudence of the URD CLEP and Major Underground Rehabilitation Programs.[75] The PFD explains that the ALJs "discounted" CenterPoint Houston's rebuttal testimony on this basis.[76] This is arbitrary, capricious, and a due process violation.

The record reveals that there was no discovery dispute involving the vaguely worded RFIs referenced in the PFD, no discovery sanctions were sought, and no party sought to strike CenterPoint Houston's rebuttal testimony on grounds that the information requested in discovery was not fully produced. It is undisputed that the specific discovery requests were answered. If COH believed that CenterPoint Houston's response was inadequate, COH had the right and obligation under SOAH Order Nos. 2 and 4 to pursue a motion to compel a response to its

[73] CEHE Ex. 6 at 39:3-5 (Mercado Direct).

[74] CEHE Reply Brief at 11-14.

[75] PFD at 12-22.

[76] *Id.* at 22.

discovery request or to move to strike CenterPoint Houston's rebuttal testimony.[77] COH took no such action. Instead, COH waited to complain in post-hearing briefing that CenterPoint Houston should have provided more information in its responses well after the time when CenterPoint Houston had the ability to present evidence to dispute COH's claims. The ALJs then rendered a punitive recommendation based, at least in part, on this late and unsupported discovery complaint.[78] Due process at a minimum requires that CenterPoint Houston receive notice and an opportunity to be heard at a meaningful time and in a meaningful manner.[79] Here, the ALJs have based their decision on a finding that CenterPoint Houston failed to fully respond to discovery or belatedly presented additional information as part of its rebuttal case despite the fact that COH did not avail itself of the procedural remedies expressly provided for under SOAH Order Nos. 2 and 4.[80] In rendering this determination without notice or opportunity for hearing, the ALJs denied CenterPoint Houston its right to due process guaranteed by the Texas and U.S. Constitutions.[81]

In sum, CenterPoint Houston satisfied its burden to prove its investment in the URD CLEP and Major Underground Rehabilitation Programs was prudently incurred. The PFD's proposed disallowance of 10% of the investment in the URD CLEP Program and 35% of the investment in the Major Underground Rehabilitation Program has no record support and should be rejected. Similarly, the burden of proof standard that the PFD seeks to impose in this case is not the standard under the law and should be rejected. The PFD further errs in "discounting" CenterPoint Houston's rebuttal testimony based on a perceived discovery dispute that never occurred. To remedy these errors, the Commission should reject the PFD's recommended disallowance of investment made in the URD CLEP and Major Underground Rehabilitation Programs and approve recovery of the $111.5 million capital investment made in these necessary reliability programs between January 1, 2010 and December 31, 2018.[82]

c. Foundation Replacements—Project HLP/00/0801

The Company has no Exceptions to this section of the PFD.

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[77] SOAH Order Nos. 2 and 4 set forth express deadlines for filing motions to compel discovery and party testimony, including CenterPoint Houston's rebuttal testimony.

[78] *See* PFD at 17-22 describing the RFI responses.

[79] *See, e.g., Flores v. Emps, Ret. Sys. of Tex.*, 74 S.W.3d 532, 545 (Tex. App.-Austin 2002, pet. denied); *see also Texas Workers' Comp. Comm'n v Patient Advocates*, 136 S.W.3d 643, 658 (Tex. 2004) ("Due process at a minimum requires notice and an opportunity to be heard at a meaningful time and in a meaningful manner.").

[80] PFD at 16-22.

[81] U.S. Const. Amend. XIV; Texas Const. art. I, § 19.

[82] PFD at 12.

d. Capital Project Oversight and Budget Estimation

(1) The PFD's recommendation regarding the Company's La Marque Substation discourages utilities from making prudent changes to a project's scope once an estimate has been prepared

While the Company does not agree with the PFD's findings regarding all of the substation projects at issue, CenterPoint Houston, in an effort to reduce controversy, only excepts to the PFD's findings as they relate to the Company's La Marque Substation. Specifically, the PFD proposes to disallow $1,182,769 in capital costs related to the La Marque Substation[83] despite the fact that there is no dispute that the La Marque Substation was necessary to meet growing demand, is in service, and is used and useful. As acknowledged by the PFD, the total construction cost associated with this project was $2,773,369. The estimated cost for this project was $1,446,000 and based on this difference alone, the PFD recommends a disallowance of the difference between the actual costs and estimated cost resulting in a nearly 43% disallowance of the costs associated with this project.

This difference between the estimate and actual costs does not evidence imprudence by the Company. Rather, the evidence is undisputed that the cost differential was driven by the scope of the project, which changed after the initial estimate. In particular, the estimate reflects the cost of construction for four structures, but the substation project ultimately required the construction of seven structures.[84] Thus, in terms of the number of structures required, the scope of the project grew by 75%. No one disputed that the additional structures were necessary to meet demand or that the structures are used and useful. Nevertheless, the PFD does not allow recovery of *any* expenditures associated with those additional structures simply because the Company moved one of the structures to avoid underground utilities and rebuilt one foundation.[85] This result is simply not reasonable and suggests that a utility is prohibited from prudently changing the scope of a project if such a scope change would exceed its original estimate—no matter how prudent the scope change may be.

The Commission's prudence standard does not require perfection or an unreasonable adherence to an initial budget or estimate, nor does it require a project's cost to be less than its

[83] *Id.* at 28-30.

[84] CEHE Ex. 32 at 17:21-23, 71-72 (Exh. R-MWN-1, CenterPoint Response to Staff RFI 6-24) (Bates Pages) (Narendorf Rebuttal).

[85] *Id.* at 17:21-18:2.

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original estimate.[86] The PFD, however, would impose such a standard. In doing so, the PFD recommends a poor policy choice for electric utilities and their customers in this state because it discourages utilities from making prudent changes to project scope or design after the utility prepares an initial cost estimate. The PFD's punitive recommendation should be rejected, and all of the capital costs incurred to construct the La Marque substation facilities should be recovered.

2. Land Costs

a. The PFD improperly recommends a disallowance of land costs that are routinely recovered in rates based solely on an ALJ expressed preference that these costs be booked to a different FERC account

The PFD's error with respect to this issue is threefold. First, the PFD incorrectly concludes that $6.8 million in land costs for three distribution substation facilities that are not yet energized should be excluded from rate base on the basis that the land is not "used and useful."[87] This is not correct. The evidence is uncontroverted that substation projects are currently under construction on the three tracts of land and thus, are used and useful because a defined plan exists for these assets.[88] Put differently, the land is currently being used for its intended purpose—to support a substation. Thus, the land costs were appropriately recorded as plant in service.

Second, the PFD's discussion of the FERC Accounts used to record these assets is misleading. The issue here is whether the land costs were properly recorded in FERC Account 3600 "Land and Land Rights," which is an electric plant account includable in both FERC balance sheet accounts 1010 "Plant in Service" *and* FERC Account 1050 "Plant Held for Future Use." The PFD offers no explanation as to why land costs should not have been recorded in this "subaccount." The PFD simply suggests that land costs should have been recorded in the more "general" FERC Account 1050. This, however, is a distinction without a difference because under either FERC Account 1010, FERC Account 1050, or FERC Account 3600, the land costs are properly included in rate base and recoverable in rates.[89] Thus, no disallowance should occur—the assets should simply be moved to FERC Account 1050 if the PFD's FERC Account analysis is retained.

Finally, there is no merit to the PFD's statement that CenterPoint Houston's discussion of this issue in its rebuttal case "denied Staff the ability to conduct discovery" on this issue.[90] All

[86] PFD at 11, citing *Nucor Steel v. Pub. Util. Comm'n*, 26 S.W.3d 742, 748-749 (Tex. App.—Austin 2000, pet. denied).
[87] *Id.* at 36-37.
[88] CEHE Ex. 35 at 54:16-17 (Colvin Rebuttal).
[89] *Id.* at 54:17-19.
[90] PFD at 37.

parties had the opportunity to conduct discovery on CenterPoint Houston's rebuttal case as evidenced by SOAH Order No. 2, which expressly includes provisions for discovery on the Company's rebuttal case.[91] The fact that no party chose to propound discovery on this issue is not something that CenterPoint Houston should be faulted for. The evidence also does not support the PFD's suggestion that CenterPoint Houston failed to comply with the Commission's RFP instructions. The RFP instructions do not, as the PFD implies, require that the utility "provide detailed descriptions (acreage, what specific substations, etc.) for these lands."[92] Rather, both Schedule II-B-6 (Plant Held for Future Use) and Schedule II-B-1 (Plant in Service) require the *functionalization* of amounts included in these schedules. This information was provided in the Company's Rate Filing Package Voluminous Workpapers "WP II-F-Plant Functionalization.xlsx" along with the name of the applicable substation associated with the land cost.[93]

The PFD and proposed Finding of Fact No. 89 should be revised to authorize the inclusion of these used and useful land costs in CenterPoint Houston's rate base.

3. Capital Project Accounting

a. The PFD should be revised to provide for the recovery of the capital costs in Capital Project S/101318/CG/Tools as this issue is no longer contested

The PFD improperly recommends the disallowance of $2.1 million in capital investment in Capital Project S/101318/Tools even though this issue is no longer in dispute. The record is clear that while the Office of Public Utility Counsel ("OPUC") initially challenged CenterPoint Houston's capitalization of this capital project, OPUC withdrew this challenge in its post-hearing brief stating:

> OPUC witness Mr. Nalepa also initially recommended that certain substation tools be expensed, rather than capitalized, but based on additional information provided by the Company in its rebuttal testimony, *OPUC is no longer recommending this change*.[94]

As such, the PFD, including proposed Finding of Fact No. 99, should be revised to allow recovery of this properly capitalized investment because this issue is no longer contested. Revision of the PFD is also supported by the substantial record evidence. Pursuant to the FERC USOA, the cost

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[91] SOAH Order No. 2 at 6 (May 1, 2019).

[92] PFD at 37.

[93] CEHE Ex. 1 at 6377, WP/II-F-Plant Functionalization – Functionalization Factors (Voluminous).

[94] OPUC Initial Brief at 6 n.28 citing OPUC Ex. 5 at 37:14-38:9 (Nalepa Direct); CEHE Ex. 35 at 52:19-53:6 (Colvin Rebuttal). (Emphasis added).

of tools and equipment used in construction and/or repair work is eligible for capitalization to FERC Account 3940.[95] CenterPoint Houston demonstrated that the tools included in this account are not simple hand tools and OPUC agreed. Each item has a value of more than $500 per tool and is anticipated to provide multiple years of benefit.[96] Consequently, it is appropriate to capitalize the tools and allocate the costs over the period that the tools are expected to provide benefits, which is what the Company has done.[97]

b. The PFD suggests that the Commission ignore FERC USOA accounting requirements in recommending the disallowance of Distribution Line Clearance Project costs

With respect to the distribution line clearance project costs at issue in this case, the PFD proposes to redefine work that the FERC USOA and 16 Texas Administrative Code ("TAC") § 25.72 requires CenterPoint Houston to capitalize. Put differently, the PFD would have the Commission issue an order that conflicts with the FERC USOA requirements. This should not occur. The PFD is further flawed by the fact that it fails to reconcile its disparate and unexplained treatment of these project costs. Specifically, the PFD proposes to disallow $19,376,931 in project costs for the years 2014-2017 on the basis that these costs should have been treated as operating and maintenance ("O&M") expense. However, the PFD recommends no disallowance of 2018 capitalized costs recorded to this project. The PFD offers no analysis or explanation for the disparate treatment of capital costs recorded in this project between 2014-2017 and those recorded in 2018 other than to suggest that the supporting documentation provided by CenterPoint Houston for 2014-2017 was too vast and voluminous, yet apparently still insufficient to "prove all of these costs were properly capitalized."[98]

In rendering this recommendation, the PFD creates an inherent and unreconcilable conflict between the Commission's requirement that CenterPoint Houston keep its books and records in compliance with the FERC USOA for public utilities and the method used to establish utility rates. No party to this case disputes that CenterPoint Houston maintains its books and records in accordance with the FERC USOA as required by 16 TAC § 25.72. There is also no dispute that facility replacement work is charged to the Distribution Line Clearance Project. In fact, the PFD

[95] *See* CEHE Ex. 35 at 121-130 (Exh. R-KLC-07) (Colvin Rebuttal).

[96] *Id.* at 52:2-6.

[97] *See* CEHE Ex. 25 at 2455:4, 2456, Figure 1 (Watson Direct).

[98] PFD at 48, 50.

acknowledges the evidence establishing that the remediation activities recorded in this project include the replacement of poles, conductors, and other capital assets that are recovered as part of the Company's rate base.[99]

The PFD also finds that "[r]eplacements of defined retirement units are required to be capitalized. When a defined retirement unit is added to or retired from electric plant, FERC requires that the cost of that activity be applied to the appropriate capital account."[100] Thus, it does not matter whether the replacement of the pole or conductor is performed in connection with an existing transmission or distribution line or it is being installed as part of new construction. It also makes no difference when the associated transmission or distribution lines were placed into service as the PFD implies.[101] What matters is that the facility at issue was modified in a manner that "*included* the replacement of poles, pole hardware, conductors, and other capital facilities."[102]

Per the FERC USOA,[103] all property is considered to be either a discrete retirement unit or a minor item of property and replacements of retirement units are required to be capitalized.[104] Yet, despite this FERC USOA accounting requirement, the PFD arbitrarily concludes that these costs are "more appropriately categorized as O&M expenses."[105] If the Commission is going to require utilities such as CenterPoint Houston to maintain their books and records in accordance with the FERC USOA, it is only appropriate—and consistent with good public policy—for the Commission to follow FERC USOA guidance when determining how those costs should be treated for ratemaking purposes. No party argues otherwise. The ALJs should not have discretion to deviate from the FERC USOA requirements in determining whether costs should be capitalized or expensed for ratemaking purposes. To conclude otherwise introduces an impossibly subjective and undefined standard into the ratemaking process.

Equally concerning is the mincing of words that the PFD leans upon in an effort to defend its arbitrary recommendation. Specifically, the PFD concludes that CenterPoint Houston's "repeated references in its discovery response and testimony to this project *including* modifications

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[99] *Id. at* 50 & 517 (proposed Finding of Fact No. 102).

[100] *Id.* at 42.

[101] *Id.* at 47-48.

[102] *Id.* at 48.

[103] *See* CEHE Ex. 35 at 55:19-21 & 121-130 (Exh. R-KLC-07) (Colvin Rebuttal).

[104] *Id.* at 51:17-19.

[105] PFD at 48.

or replacements are insufficient to meet its burden to prove all of these costs were properly capitalized."[106] Here again, the PFD's conclusion inherently conflicts with its own analysis. First, the PFD acknowledges that CenterPoint Houston produced "hundreds of itemized work orders that CenterPoint broke down annually and further, biannually, in detailed project lists for 2014-2017" to support the classification of these capital costs.[107] Not a single work order of the hundreds of itemized work orders produced was challenged on grounds that the specific project costs were more appropriately treated as O&M. Stated differently, no party identified a single project that did not include the modification or replacement of facilities sufficient to support the capitalization of these costs.

Second, a plain reading of the RFI referenced by the PFD reveals that the information the PFD claims was not provided was never actually requested.[108] To further compound its error, the PFD also offers no analysis of the excerpt from *Accounting for Public Utilities* nor does it address the fact that the excerpt actually supports the opposite conclusion reached by the PFD—that costs incurred for Project 1055 should be capitalized.[109] In fact, the cited excerpt makes clear that a "pole is a unit of property, including the pole itself, the crossarm, down guys, anchor, and other minor hardware. When a work order is closed, *the total cost is unitized*, creating assets that represent the various units of property that were installed on the work order."[110] Thus, the entirety of work is properly classified as capital when it *includes* the replacement of retirement units such as poles, towers, conductors and other capital facilities.

CenterPoint Houston's testimony and supporting work order documentation is unrefuted that the work recorded in Project 1055 involved the replacement of facilities. The PFD's recommendation, including Findings of Fact Nos. 101-102, on this issue should be revised.

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[106] *Id* at 50.

[107] *Id.* at 48.

[108] *Id.* at 47-48, 50. The PFD recites CenterPoint Texas's response to Staff RFI 6-22. Contrary to the statements in the PFD, this RFI did not request (1) the exact amounts assigned to distribution as opposed to transmission; and (2) the exact amounts charged to specific distribution and transmission FERC accounts. *See* CEHE Ex. 32 at bates pages 69-70, Exh. R-MWN-1 (CenterPoint Houston's Response to Staff RFI 6-22), included as Attachment B to these Exceptions.

[109] PFD at 50.

[110] *See* Staff Initial Brief at Attachment (Robert L. Hahne & Gregory E. Aliff, Accounting for Public Utilities, § 16.7 Continuing Property Records System (pp. 512-513), Release 33 (2016)).

4. The PFD's recommended disallowance related to changes in capitalization policies incorrectly includes the URD CLEP Program, which did not exist at the time of the Company's last rate case, and its analysis results in an unsound policy

The PFD recommends a disallowance of $51.4 million in Capitalization Policy-related investment by concluding that costs for six categories of capital investment that it claims were previously expensed and recovered through rates set in Docket No. 38339.[111]

As a threshold matter, the PFD number run model overstates the proposed disallowance related to this issue. Specifically, the PFD's number run model incorrectly disallows not only 10% of the Company's URD CLEP investment as discussed in Section II.A.3 of the Exceptions, but then also removes $41.2 million of URD CLEP investment from the rate base calculation.[112] As a result, the PFD calculates an erroneous cost of service that disallows the URD CLEP Program investment twice. The PFD number run model also fails to properly functionalize the URD CLEP Program to distribution plant despite the undisputed evidence demonstrating that this is a distribution facility replacement program.[113] At a minimum, these computational errors in the PFD number run model should be corrected.

Regarding CenterPoint Houston's URD CLEP investment, the evidentiary record also does not support the PFD's conclusion that CenterPoint Houston "changed" its capitalization policy regarding the URD CLEP Program between rate cases. The evidence is undisputed that the URD CLEP Program did not exist at the time of Docket No. 38339. The test year for the last rate case ended on December 31, 2009. *Four years later in 2013*, CenterPoint Houston implemented its URD CLEP as a one-time major rehabilitation project involving replacements and changes to facilities that would enhance the useful life and service provided by the electrical system.[114] Because this program began after the Company's last rate case, it is *impossible* for the rates approved in Docket No. 38339 to include costs related to this activity. Thus, the record evidence directly refutes the PFD on this issue and the PFD should be revised accordingly.

There is also no record evidence to support the PFD's recommendation that CenterPoint

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[111] PFD at 51-52. The PFD states, "[OPUC witness] Mr. Nalepa recommended disallowing $51,417,754 *for items previously expensed* that CenterPoint began capitalizing at some point after its last rate case . . . ." (emphasis added).

[112] *See* Docket No. 49421: "49421 – Rev Req Model – ALJ Number Run – 9-9-2019.xlsx" (Revenue Requirement worksheet, cell L200 and cell L228) (PUCT Interchange Filing Search, Item No. 722).

[113] Docket No. 49421: "49421 – Model of CEHE's CCOSS – PFD.xlsm," (I-A.1 to II-F worksheet, cells N182 through T182) (PUCT Interchange Filing Search, Item No. 722).

[114] CEHE Ex. 12 at 939:20-940:3 (Colvin Direct).

Houston be required to refund capital investment included in its DCRF as part of any Capitalization Policy changes.[115] To be clear, there is no evidence in the record that capitalized amounts included in the Company's DCRF filings as a result of Capitalization Policy changes were actually recovered through the DCRF. In fact, the record establishes that each of the Company's DCRF filings was resolved through settlement, some of which were black-box agreements, and that CenterPoint Houston agreed to a reduction to its requested DCRF rates. Thus, the record in this case lacks the evidentiary support necessary to link the capitalized amounts that the PFD proposes to refund to the costs that were actually recovered by the Company under the DCRF.

The PFD's position to disallow all capital costs incurred since Docket No. 38339 related to Capitalization Policy changes should also be rejected because it is based on the flawed premise that CenterPoint Houston will "over-recover" for these capital costs if its request is approved. As a threshold matter, if there were any concerns with over-recovery or over-earning as a result of changes in the Capitalization Policy, the Company's annual Earnings Monitoring Report ("EMR") gave the Commission information necessary to assess CenterPoint Houston's financial position.[116] In this regard, the remedy is for the regulator to require CenterPoint Houston to file a rate case, or, conversely CenterPoint Houston could have filed a rate case if it had been underearning. In fact, the EMR appropriately considers those issues from an overall perspective in which aggregate changes in revenues, expenses and capital investment are analyzed rather than the granular, item-by-item approach reflected in the PFD. For these reasons, any concerns about "over-recovery" are unfounded.

Finally, the PFD reflects a misguided policy approach. Historical costs, including expenses for various items used to calculate base rates in a rate case, are examined to determine whether they are representative of a utility's cost of providing service going forward. There is no requirement—nor should there be—that a utility must reconcile its base rates with actual expenses, investment or revenues on an annual basis. Within that context, since CenterPoint Houston's last rate case nearly ten years ago, the Company has made necessary changes to its capitalization policy in response to changes in technology or accounting requirements. Changes to the Capitalization Policy occur more frequently than rate cases. Yet, the PFD sets up a framework in which the timing of Capitalization Policy changes must be tied to approval of the related costs in a rate case.

[115] *See* PFD at 458 (proposed Ordering Paragraph 15).

[116] *See* 16 TAC § 25.73 and CEHE Ex. 35 at 62:17-63:3 (Colvin Rebuttal).

Otherwise, a utility risks meaningful capital disallowances and related write-offs on its books. The Commission should not endorse that type of policy. Instead, when changes to the Capitalization Policy are appropriate—which CenterPoint Houston's undisputedly are—the utility should be allowed to record the related costs as capital or expense and present the costs for consideration in a subsequent rate case. This has been the Commission's policy in the past and this policy should be reaffirmed in this case.

In sum, at a minimum, the PFD's recommendation should be adjusted by $41.2 million to remove from the incorrect disallowance of costs associated with the URD CLEP Program since the program did not exist when rates were established in Docket No. 38339. The remainder of the PFD's proposed disallowance should be rejected based on the Company's prior DCRF settlements and in furtherance of sound regulatory policy.

B. Indirect Corporate Costs

CenterPoint Houston has no Exceptions to this portion of the PFD.

C. Prepaid Pension Asset

The PFD incorrectly recommends rejection of the Company's request to include a Prepaid Pension Asset in rate base, despite Commission precedent supporting the request.[117] To arrive at this recommendation, the PFD reveals a fundamental misunderstanding of the source of funds that have created the prepaid balance. The Prepaid Pension Asset exists because cumulative cash contributions to the pension plan have exceeded the cumulative actuarially determined pension expense over the same period.[118] In addition, these contributions are federally mandated by the Employee Retirement Income Security Act.[119] As of December 31, 2018, the actuarially calculated Prepaid Pension Asset balance was $170.4 million.[120]

The PFD incorrectly embraces GCCC's claim regarding a purported "double-counting" of the return on unrealized or unrecognized losses, which CenterPoint Energy, Inc. ("CNP") records

[117] PFD at 54, 59-63. *See Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile Fuel Costs, and Obtain Deferred Accounting Treatment,* Docket No. 39896, Order on Rehearing at Finding of Fact No. 28 (Nov. 2, 2012); *Application of AEP Texas Central Company for Authority to Change Rates,* Docket No. 33309, Order on Rehearing at Finding of Fact No. 25 (Mar. 4, 2008).

[118] CEHE Ex. 12 at 902:5-12, 965 (Exh. KLC-09) (Colvin Direct); CEHE Ex. 46 at 5:14-16 (Sanger Rebuttal).

[119] CEHE Ex. 46 at 8:16-18 (Sanger Rebuttal).

[120] There is a separate issue related to removing an amount for CWIP from that year-end balance, which the PFD correctly decides results in a balance of $103.4 million. PFD at 67.

as Accumulated Other Comprehensive Income ("AOCI").[121] This claim was soundly refuted by CenterPoint Houston witness George C. Sanger, who is the enrolled actuary for the plan itself. Mr. Sanger testified that the asset *does not* include unrealized losses and is simply the accumulation of past plan contributions minus the accumulation of pension expense recorded over the same period.[122]

In dismissing that testimony, the PFD opines that "a portion of the $370.442 million [in] unrealized losses, recorded as AOCI by CNP, *is the funding source for CenterPoint's proposed PPA*."[123] That is not accurate. The December 31, 2018 actuarial report CenterPoint Houston provided with the rate filing package confirms Mr. Sanger's description of the calculation of the Prepaid Pension Asset balance of $170.4 million.[124] This calculation shows that AOCI is not the source of funding for the asset:

Development of Prepaid (Accrued) Cost, December 31, 2018 (000s)*

Division		(Accrued)/Prepaid Benefit Cost, 1/1/2018	Net Periodic Pension Cost	Contributions	Special Adjustments	(Accrued)/Prepaid Benefit Cost, 12/31/2018	Benefit Payments
003A	CE Houston Electric	$ 167,705	$ (24,190)	$ 26,855	$ 0	$ 170,369	$ 93,897

The calculation begins with the prior year's cumulative Prepaid Pension Asset balance of $167.7 million. Next, Net Periodic Pension Cost of $24.19 million is subtracted, and Contributions of $26.855 million are added. This combination of the starting prepaid balance from the prior year *minus* Pension Cost *plus* Contributions to the plan results in a total Prepaid Pension Asset balance of $170.4 million at December 31, 2018. The above excerpt from the 2018 actuarial report illustrates the fallacy of the PFD's conclusion that AOCI is a funding source for the Prepaid Pension Asset.

Instead of this simple calculation and Mr. Sanger's related rebuttal testimony, the discussion in the PFD focuses largely on an exhibit to CenterPoint Houston witness Kristie L.

[121] *Id.* at 54. 59-63. "Unrecognized losses" are losses resulting from plan experience that differs from actuarial assumptions as well as assumption changes are not immediately recognized in Pension Expense. Instead, only a portion of accumulated Unrecognized Loss is included in the Pension Expense during the fiscal year based on amortization periods specified by the accounting standard. A plan may experience gains as well as losses. If a plan has accumulated more gains than losses, then this component is a reduction to expense. CEHE Ex. 46 at 16-17 (Sanger Rebuttal).

[122] CEHE Ex. 46 at 5:17-22 (Sanger Rebuttal).

[123] PFD at 60 (emphasis added).

[124] CEHE Ex. 1a at Confidential Schedule II-D-3.8.1.

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Colvin's direct testimony that provides a broader accounting view of prepaid pension matters.[125] Below is an excerpt from the exhibit that illustrates the amounts referenced above for 2017 and 2018. These amounts are supported by the actuarial report excerpt provided above:

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

		2017	2018
ACTUARIAL EXPENSE (INCOME)	[1]	41,372	24,190
PENSION EXPENSE AS INCLUDED IN RATES		20,255	20,255
CONTRIBUTIONS TO TRUST/PLAN	[2]	17,712	26,854
NET FUNDED (UNFUNDED) STATUS	[3]	(164,084)	(200,073)
LESS ACCUMULATED UNRECOGNIZED GAINS/LOSSES OR ASSET AMOUNT	[4]	331,789	370,442
PREPAID (ACCRUED) PENSION COST	[5]	167,705	170,369

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

Even though the Prepaid Pension Asset balance of $170.4 million is calculated without consideration of the "Net Funded (Unfunded) Status" and "Less: Accumulated Unrecognized Gains/Losses or Asset Amount" rows, the PFD focuses primarily on those rows and amounts. Specifically, the PFD focuses on the fact that the Prepaid Pension Asset balance can also be calculated as follows:

$(200,073,000) (Net Unfunded Status)
- $370,442,000 (Accumulated Unrecognized Gains/Losses or Asset Amount)
$170,369,000 Prepaid Pension Asset as of 12/31/2018

As the PFD notes, Mr. Sanger confirmed this is another, albeit more complicated, way to derive the Prepaid Pension Asset balance.[126]

What the PFD ignores is the fact that the Unfunded Status or Net Pension Liability, as explained in Note [3], is ultimately what CenterPoint Houston still owes for its pension plan obligation as of the December 31 measurement date each year. Regarding Note [4], AOCI is a balance sheet financial statement line item, expressed as an adjustment to shareholder equity, that

[125] PFD at 60-61, citing CEHE Ex. 12 at 965 (Exh. KLC-09) (Colvin Direct).
[126] *Id.* at 56 n.163, 58.

is equal to the pension plan's accumulated *unrecognized* loss plus the accumulated unrecognized prior service cost.[127]

As Mr. Sanger explained, the unrecognized loss for the pension plan is the same, regardless of the contributions made to the pension plan, because those losses do not immediately impact pension expense—instead, those losses are deferred, i.e., "unrecognized," and amortized into future pension expense over several years.[128] Relatedly, Note [4] explains that the $370.4 million balance in AOCI or unrecognized losses is an amount that CenterPoint Houston is required to treat "as a regulatory asset since the adoption of FAS 158 in 2006." And, CNP's annual actuarial report contains a reconciliation of the Company's net pension liability with amounts in AOCI and Accrued Pension Cost:[129]

Amounts Recognized in AOCI and Reconciliation of Pension Liability with
Accrued Pension Cost, December 31, 2018 (000s)*

		Amounts Recognized in AOCI				Reconciliation with Accrued Cost		
Division		Prior Service Cost	Net Loss/ (Gain)	Transition Obligation/ (Asset)	Total	Net Pension (Liability)	Amounts Recognized in AOCI	(Accrued) Pension Cost
003A	CE Houston Electric	$ 4,167	$ 366,275	$ 0	$ 370,442	$ (200,073)	$ 370,442	$ 170,369

The actuaries provide this schedule in order to confirm to CNP and CenterPoint Houston that increases or decreases resulting from the annual actuarial re-measurement of the Pension Plan are recognized in AOCI and Net Pension (Liability) on the balance sheet as required by FAS 158 and properly reconcile (i.e., net to zero). This allows CNP and CenterPoint Houston to confirm that both sides of the balance sheet remain *balanced*. In other words, this schedule is provided to validate that the AOCI and Net Pension Liability amounts do not impact the Prepaid Pension Asset in any way. That reconciliation and the presence of AOCI or unrecognized losses in the actuarial reports *does not* mean AOCI is the funding source for the Prepaid Pension Asset balance.

Finally, 16 TAC § 25.231(c)(2)(B)(i-ii) allows utilities to include in rate base items the utility itself funds before it recovers the corresponding expenses through rates, including items such as prepayments for materials, supplies or operating expenses. In addition, customers benefit from the Prepaid Pension Asset, because the asset's earnings help reduce pension expense that

[127] CEHE Ex. 46 at 15:2-7 (Sanger Rebuttal).

[128] *Id.* at 7:17-21.

[129] CEHE Ex. 1a at Confidential Schedule II-D-3.8.1.

would otherwise need to be paid by customers. Thus, without a corresponding ability to include the Prepaid Pension Asset in rate base, the Company is unfairly denied a return on cash paid into the pension plan while giving customers the benefit that results from including the Prepaid Pension Asset in rate base.[130] For these reasons, the Commission should reject the PFD and authorize the inclusion of the Prepaid Pension Asset in rate base.[131] The PFD should further be revised to include a Finding of Fact stating:

> The Total Prepaid Pension Asset should be reduced by the capital component identified as Construction Work in Progress (CWIP). The Company is authorized to apply and recover an amount for AFUDC on the net CWIP portion, $72.9 million. The remaining balance of the Prepaid Pension Asset, of $84.0 million, should be included in rate base and earn a return at the weighted average cost of capital (WACC).

D. Other Prepayments

The Commission should adopt the PFD's recommendation on this issue.

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

1. Protected Excess Deferred Income Tax

Although the PFD correctly analyzes this issue, any capital disallowances prior to 2018 will have an impact on the amount of EDIT that is reflected in the PFD's number run model.

2. Hurricane Harvey Regulatory Asset

CenterPoint Houston witnesses Kenny M. Mercado, Randal M. Pryor, Martin W. Narendorf Jr., and Ms. Colvin testified regarding the significant impacts of Hurricane Harvey on the Company's service territory and the associated costs incurred in responding to and recovering from that generational storm event.[132] In this case, the Company seeks recovery of $64.3 million for deferred system restoration costs related to Hurricane Harvey and the recovery of $8.7 million in associated carrying costs.[133]

The PFD correctly analyzes the evidence to recommend approval of the deferred costs in CenterPoint Houston's requested Hurricane Harvey regulatory asset as well as including that asset

[130] CEHE Ex. 46 at 9:7-18 (Sanger Rebuttal).

[131] There is a separate issue related to removing an amount for CWIP from that year-end balance, which the PFD correctly decides results in a balance of $103.4 million. PFD at 54.

[132] CEHE Ex. 6 at 46-47, 50 & WP KMM-01, bates pages 77-96 (2017 CNP Corporate Responsibility Report) (Mercado Direct); CEHE Ex. 7 at 217-218 (Pryor Direct); CEHE Ex. 8 at 353-355 (Narendorf Direct); CEHE Ex. 12 at 869 (Colvin Direct).

[133] CEHE Ex. 12 at 870 (Colvin Direct); CEHE Ex. 35 at 35 (Colvin Rebuttal); CEHE Ex. 2 at 59-60, Schedule II-B-12.

in rate base to be recovered over a three-year period.[134] The PFD, however, incorrectly states the amount of the regulatory asset because it identifies the amount included in the Company's initial rate filing package. The correct amount for the Hurricane Harvey regulatory asset is $64,309,000 as identified in the Company's errata filing.[135]

The PFD also incorrectly recommends that the Commission disallow recovery of related carrying costs due to an alleged lack of evidence and jurisdictional authority.[136] As to the evidence, it is undisputed that the record contains the calculation of carrying charges, and Ms. Colvin addressed the issue in her testimony.[137]

Regarding the authority that supports the Company's request, the PFD takes a position that is inconsistent with PURA. Contrary to the plain language of PURA §§ 35.405(a) and 36.402(b), the PFD concludes that carrying costs do not fall within the definition of "system restoration costs" and thus should not be recovered.[138] PURA § 36.405(a), however, expressly provides for recovery of system restoration costs as part of a base rate proceeding such as this one:

> An electric utility is entitled to recover system restoration costs consistent with the provisions of this subchapter and is entitled to seek recovery of amounts not recovered under this subchapter, including system restoration costs not yet incurred at the time an application is filed [for a Commission financing order], *in its next base rate proceeding* or through any other proceeding authorized by Subchapter C or D.[139]

In addition, PURA § 36.402(b) provides:

> *System restoration costs shall include carrying costs* at the electric utility's weighted average cost of capital as last approved by the commission in a general rate proceeding from the date on which the system restoration costs were incurred until the date that transition bonds are issued or *until system restoration costs are otherwise recovered pursuant to the provisions of this subchapter.*[140]

The PFD's position is thus contrary to PURA. It is also contrary to the position taken by Commission Staff. Specifically, Staff witness Jorge Ordonez testified that "PURA § 36.402

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[134] PFD at 76-77.

[135] The PFD number run model erroneously adjusted the entire amount of the known and measurable adjustment ($8.758 million) instead of the $8.742 million related to carrying costs.

[136] PFD at 76.

[137] CEHE Ex. 2 at 1150, WP/II-B-12 Errata 1; GCCC Ex. 1 at Att. B, Bates Page 99, Staff RFI No. 08-14 (Kollen Direct); CEHE Ex. 35 at 7:20-8:2, 8:8-11; 34:13-38:11 (Colvin Direct).

[138] PFD at 76.

[139] Emphasis added by CenterPoint.

[140] *Id.*

expressly provides for such recovery."[141] In addition, he also emphasized an important policy point that is unaddressed by the PFD: "[I]t is important to assure utilities that the Commission will allow them to recover prudently incurred costs, including carrying costs, associated with hurricane restoration."[142]

Despite this evidentiary and statutory support, the PFD concludes these statutes are not applicable to the Hurricane Harvey costs because the provision is located in a subchapter of PURA titled, "Securitization of System Restoration Costs," and securitized bonds have not been issued for the restoration costs, which do not exceed $100 million.[143] However, the Code Construction Act provides that "the heading of a title, subtitle, chapter, subchapter, or section does not limit or expand the meaning of a statute,"[144] and as italicized above, this statute plainly applies to methods of recovery other than a securitization proceeding. Thus, the plain statutory language—not the simple title of the subchapter—supports CenterPoint Houston's recovery of carrying costs related to Hurricane Harvey restoration efforts.

Finally, carrying costs will continue to be recorded until new base rates are implemented.[145] Likewise, the monthly compounding method used by the Company reflects the Company's actual carrying costs,[146] is supported by Staff,[147] and is consistent with Commission practice.[148] For these reasons, the Commission's order on this important issue should authorize CenterPoint Houston to recover carrying costs on its Hurricane Harvey regulatory asset. Recovery is required by PURA and, as recognized by Commission Staff, allowing such recovery is good regulatory policy.

3. Medicare Part D Regulatory Asset

The relevant facts and the applicable accounting, tax, and regulatory rules necessary to properly understand the Medicare Part D Subsidy issue are extensive and are fully addressed in CenterPoint Houston's briefing and in the testimonies of CenterPoint Houston witness Charles W.

[141] Staff Ex. 3A at 39:18 (Ordonez Direct).

[142] *Id.* at 39:18-20.

[143] PFD at 76.

[144] Tex. Gov't Code § 311.024.

[145] CEHE Ex. 35 at 38:1-11 (Colvin Rebuttal).

[146] *Id.*

[147] Staff Ex. 3A at 39:14-20 (Ordonez Direct).

[148] *Application of Texas-New Mexico Power Company for Authority to Change Rates*, Docket No. 48401, Testimony of Stacy R. Whitehurst in Support of Stipulation at Exh. SRW-S-2 at 2 of 12 (Nov. 12, 2018).

Pringle.[149] The issue is, however, fundamentally straightforward as it involves how and when CenterPoint Houston should recover an allowable expense.

In Docket No. 38339, the Commission recognized that CenterPoint Houston would incur a reasonable expense in the future and directed CenterPoint Houston to account for that expense in a regulatory asset so that it could request full recovery of the expense in a future case. CenterPoint Houston's request in this proceeding does exactly that.

The evidence demonstrates that, *since 2004*, GAAP has required Medicare Part D accruals to be made for the subsidy.[150] Until 2010, these GAAP accruals assumed that the subsidy would *always* be tax free.[151] Consequently, a customer-favorable permanent difference was established for all future subsidies expected to be received in future years.

New legislation in 2010 upended these expectations by making the subsidy taxable in 2013.[152] This, in turn, rendered the "always tax free" assumptions and accruals that had reduced rates erroneous.[153]

As a result of the 2010 legislation, the Commission was required to determine in Docket No. 38339 how to address both (1) the erroneous accruals from 2004-2009 and (2) the portion of rates from 2010 through 2012 that would, if left unadjusted, continue to assume erroneous tax-free subsidies to be received after 2013. In Docket No. 38339, CenterPoint Houston requested (1) a regulatory asset to recover erroneous accruals since 2004 and (2) an adjustment to income tax expense to prevent any further erroneous flow-throughs.[154] While recognizing that this issue dated back to 2004,[155] the Commission decided that the time was not yet ripe to make CenterPoint Houston's proposed adjustments because the subsidy would not become taxable until 2013, which would be three years after the Commission's decision in Docket No. 38339.[156] In arriving at this

[149] CEHE Initial Brief at 36-43; CEHE Reply Brief at 42-47; CEHE Ex. 13 at 1027:6-1033:12, 1038-1047 (WP CWP-01) (Pringle Direct); CEHE Ex. 36 at 9:3-12:18 (Pringle Rebuttal).

[150] CEHE Ex. 13 at 1028:3-1030:9 (Pringle Direct).

[151] *Id.*

[152] CEHE Ex. 13 at 1029:10-1030:9 (Pringle Direct).

[153] *Id.*

[154] Docket No. 38339, Order on Rehearing at 9-10.

[155] *Id.* at Finding of Fact No. 150 ("The Medicare Part D subsidy created a permanent difference of $28.6 million from 2004 through 2009, as calculated pursuant to FASB Statement No. 109."); *id.* at Finding of Fact No. 151 ("Only $5.4 million of the $28.6 million Medicare Part D subsidy was actually received from 2004 through 2009 while the $23.2 million of the permanent difference related to amounts that were anticipated to be received in 2010 and afterwards but nevertheless was required to be accrued under FASB Statement No. 106.").

[156] *Id* at 9-10; CEHE Ex. 13 at 1030:10-17 (Pringle Direct).

decision, the Commission, however, made clear that all required adjustments would be addressed in the Company's next rate case stating:

> The [2010] health care legislation underlying CenterPoint's proposal to amortize this regulatory asset will not be effective until January 1, 2013, a change too far into the future to be included in the rates set in this proceeding. However, the Commission *authorizes* CenterPoint *to continue to monitor and accrue* the difference between what their rates assume the Medicare Part B [sic] subsidy tax expense would be and the reality of what CenterPoint is required to pay as a regulatory asset to be addressed in CenterPoint's next rate case.[157]

CenterPoint Houston has fully complied with the Commission's Order in Docket No. 38839 and now requests recovery of the regulatory asset authorized in that case. In this respect, the PFD correctly finds that: (1) CenterPoint Houston is entitled to recover its Medicare Part D regulatory asset[158] and (2) CenterPoint Houston should recover its Medicare Part D regulatory asset in rate base with a return over three years.[159] CenterPoint Houston further agrees with the PFD's rejection of almost all of GCCC's assertions on this issue.[160]

CenterPoint Houston disagrees, however, with the PFD's computation of the Medicare Part D regulatory asset and its recommendation that the regulatory asset calculation should be based on a beginning period of 2013 rather than 2004 because this finding ignores the fact that accruals for the period 2004-2012 reflect the incorrect "always tax free" subsidy assumption. The PFD's finding also disregards the plain language of the Commission's order in Docket 38339.[161] For these reasons, CenterPoint Houston requests that the PFD be revised to provide for the recovery of the Medicare Part D regulatory asset in the amount of $33.204 million. Alternatively, if the PFD's recommendation is adopted, the authorized regulatory asset amount must be revised to correct the PFD's adoption of GCCC's flawed $5.572 million regulatory asset calculation. The PFD acknowledges the suspect nature of this amount and invites CenterPoint Houston to provide a correct calculation based on the PFD's recommendation that the Medicare Part D regulatory asset

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

[158] PFD at 81.

[159] *Id.* at 94.

[160] *Id.* at 89 ("Mr. Kollen provided insufficient information to understand his second alleged error. . . ."); *id.* at 90 ("Mr. Kollen did not explain why they were necessary."); *id.* at 91 ("Mr. Kollen provided insufficient information to understand his fourth alleged error."); *id.* at 92 ("Without citing evidence, GCCC asserts . . . .").

[161] CEHE Initial Brief at 37-38, 40-41; CEHE Reply Brief at 43-45.

be calculated based on a starting period of January 1, 2013.[162] CenterPoint Houston has performed this calculation and it results in a Medicare Part D regulatory asset in the amount of $16.176 million, or $5.392 million amortization for three years. The $16.176 million regulatory asset for the period 2013 through 2018 is computed as follows:

- The $6.5 million permanent adjustment included in current rates is used as the starting point. This permanent tax benefit was included in rates in Docket No. 38339 and continues today.[163] The total permanent adjustment for 2013 through 2018 is, therefore, $39.120 million;
- Each permanent adjustment included in rates is then tax effected at the applicable federal income tax rate. For tax years 2013 through 2017, the rate was 35%; and for 2018, the rate was 21%.[164] The resulting calculation is a regulatory asset before tax gross-up of $12.779 million from 2013 through 2018;
- Finally, the regulatory asset must be grossed-up using the current federal income tax rate of 21% (calculated as 1/(1-21%)).[165] After gross-up, the regulatory asset from 2013 through 2018 is $16.176 million.

4. Texas Margin Tax Regulatory Asset

While CenterPoint Houston disagrees with the PFD's proposal to disallow the Company's requested $19.6 million Texas Margin Tax ("TMT") regulatory asset, in order to reduce controversy in this proceeding, it will not file an exception to the PFD on this issue. If the PFD is adopted on this issue, CenterPoint Houston should be allowed to revert to its former, uncontested methodology with respect to its TMT expense. CenterPoint Houston's former methodology would result in its 2018 payment of TMT expense of $19,627,578 being reflected in CenterPoint Houston's cost of service and the $20,027,048 TMT actual expense for the 2018 test year (that will be paid in 2019) being recorded as a regulatory asset that CenterPoint Houston does not seek to recover in this case.[166] This would reduce the Company's overall cost of service and return CenterPoint Houston to the prior Commission-approved accounting treatment. CenterPoint Houston, therefore, requests that the Commission adopt the following alternative findings of fact to reflect the Company's agreement to return to its former TMT methodology:

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[162] PFD at 92 n.264.

[163] PFD at 81; CEHE Ex. 13 at 1031:13-1033:21 (Pringle Direct).

[164] PFD at 82; CEHE Ex. 13 at 1031:13-1033:21 (Pringle Direct).

[165] *Id*

[166] CEHE has outlined the steps that would be necessary to reflect its former methodology in Exhibit R-KLC-5. *See* CEHE Ex. 35 at 119, Exh. R-KLC-5 (CenterPoint Houston's Response to PUC RFI No. 08-01) (Colvin Rebuttal).

- As a result of the one-year lag, it is reasonable to include CenterPoint Houston's 2018 TMT payment totaling $19.6 million in the cost of service.
- Due to the one-year lag associated with TMT, the FASB ASC 980 and GAAP standards require a utility to capitalize incurred costs that will be recovered in the future.
- CenterPoint Houston's current method and related accounting treatment of recovering TMT expense is consistent with ASC 980 and GAAP standards and is reasonable.
- CenterPoint Houston's current method of accounting for TMT does not require that a regulatory asset be included in rate base for purposes of setting rates in this case.
- CenterPoint Houston's TMT in the amount of $19.6 million is reasonable and necessary.

5. Smart Meter Texas Regulatory Asset

The Commission should adopt the PFD's recommendation on this issue.

6. REP Bad Debt Regulatory Asset

16 TAC § 25.107(f)(3)(B) authorizes a utility to establish a regulatory asset for bad debt expenses resulting from a REP's default on its obligation to pay delivery charges to the utility net of collateral and bad debt currently included in rates and to request recovery of those costs through rates.[167] Accordingly, CenterPoint Houston requested inclusion in rate base of a REP bad debt regulatory asset of $1.6 million to be recovered based on a three-year amortization period.[168] The PFD correctly concludes that the REP bad debt regulatory asset should be included in rate base, earn a return, and be amortized over three years.[169] The Company takes exception, however, to the PFD's recommendation that the regulatory asset be limited to $511,290 rather than also including "bad debt already included in rates" per the requirements in 16 TAC § 25.107(f)(3)(B).[170]

The bad debt already included in CenterPoint Houston's rates is a negative number because it is a credit of just over $1 million. The PFD disputes CenterPoint Houston's interpretation of the plain language of the rule. However, when that negative number is subtracted in the simple formula required by the rule, it becomes a positive number and results in an overall REP Bad Debt regulatory asset balance of $1.6 million.[171] As Ms. Colvin explained, the rule does not state that

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[167] *See* CEHE Ex. 2 at 1243-1248, WP/II-D-1 Adj 3 for the Bad Debt adjustment.

[168] CEHE Ex. 12 at 11:18-13:4 (Colvin Direct).

[169] PFD at 108.

[170] *Id.* at 104-107.

[171] This calculation is shown at CEHE Ex. 2 at 1334, WP/II-D-2.2a.1. *See* also CEHE Ex. 35 at 39:21-40:13 (Colvin Rebuttal).

the "bad debt already included in rates" has to be a debit amount,[172] and CenterPoint Houston has no control over the fact that the REP bad debt currently in rates is a credit. The Company is simply using the numbers from its books and records.

Finally, the PFD expresses support for the Texas Energy Association for Marketers' ("TEAM") claim that including the existing credit in the regulatory asset calculation amounts to retroactive ratemaking "by attempting to reverse this O&M adjustment and reclaim it in a regulatory asset . . . ."[173] Case law makes clear that the rule against retroactive ratemaking "prohibits a utility commission from making a retrospective inquiry to determine whether a prior rate was reasonable and imposing a surcharge when rates were too low or a refund when rates were too high."[174] Generally stated, utility rates must have only prospective effect and the Commission is prohibited from setting rates that would allow a utility to recoup past losses or refund excess profits to consumers.[175] The Company is not attempting to recoup a past loss or otherwise reach back in time to calculate the REP Bad Debt regulatory asset in an impermissible way. Here, CenterPoint Houston is simply following the calculation required by 16 TAC § 25.107(f)(3)(B). The PFD should be rejected on this issue, and CenterPoint Houston's requested amount of $1.6 million should be approved.

7. BRP Pension Liability

Although the PFD correctly recommends the approval of CenterPoint Houston's Benefit Restoration Plan ("BRP") Pension Liability, the PFD's recommendation is fundamentally inconsistent with its related recommendation to disallow the Company's proposed Prepaid Pension Asset *in its entirety*. Both the BRP Pension Liability and the Prepaid Pension Asset are appropriately included as components of rate base.[176] The PFD, however, without explanation treats these items differently by including the BRP Pension Liability as a component of rate base, while rejecting the inclusion of the Prepaid Pension Asset in rate base. The PFD should be revised to correct this inconsistency. Otherwise, a fundamental mismatch between the BRP Pension liability and the Prepaid Pension Asset will be inadvertently created.

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[172] CEHE Ex. 35 at 40:9-12 (Colvin Rebuttal).

[173] TEAM Initial Brief at 3; PFD at 107.

[174] *See State v. Pub. Util. Comm'n of Tex.*, 883 S.W.2d 190, 199 (Tex. 1994).

[175] *Office of Pub. Util. Counsel v. Pub. Util. Comm'n of Tex.*, 888 S.W.2d 804, 808 (Tex. 1994); *State v. Pub. Util. Comm'n*, 833 S.W.2d 190, 199 (Tex. 1994); *Cent. Power & Light Co./Cities of Alice v. Pub. Util. Comm'n of Tex.*, 36 S.W.3d 547, 554 (Tex. App.—Austin 2000, pet. denied).

[176] CEHE Ex. 12 at 903:5-6, 906:1-6 (Colvin Direct).

The PFD continues this fundamental mismatch by *including* the BRP Pension Liability in rate base, while *excluding* the associated BRP Pension expense of $1,783,000 and capital cost of $294,923 from CenterPoint Houston's cost of service.[177] The PFD should be revised to correct this error.

8. Other Regulatory Assets and Liabilities

The PFD correctly analyzes these issues and its recommendations should be approved.

F. Capitalized Incentive Compensation

The PFD's recommendation on this issue should be rejected for the same reasons addressed in Section IV.C of these Exceptions. In addition, the PFD reflects a misunderstanding of the amounts of capitalized incentive compensation that are tied to the PFD's position. Specifically, the PFD finds that it is appropriate to base a recommended disallowance for financially-based capitalized incentive compensation on the specific amounts CenterPoint Houston acknowledges are included in Staff Exhibit 15A.[178] Adoption of the PFD methodology addressed in Section IV.C requires the revision of the capitalized incentive compensation amounts referenced in the PFD as follows:

- Union – Total capitalized union short-term incentive compensation ("STI") costs in the amount of $1,089,128 should be approved.
- Operational STI Goal – CNP O&M Expenditures is an operational goal.[179] Thus, CenterPoint Houston should be authorized to collect $1,454,719 in total capitalized STI costs through rates.
- Funding Trigger – Customers are the direct beneficiaries of operational and safety goals, regardless of a "funding trigger."[180] The Commission should reject the PFD's recommendation to disallow $918,231 in total capitalized STI costs.

Finally, even if the Commission adopts the PFD's positions on incentive compensation, the maximum total disallowance for financially-based capitalized incentive compensation should be $9,680,350, or 91.34% of the total test year capitalized incentive cost of $10,598,581 as shown in Staff Exhibit 15A.[181]

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[177] *See* PFD at 258 for BRP Pension Expense and PFD at 114-115 for BRP capital costs.

[178] *Id* at 114.

[179] Tr. at 307:14-21 (Harkel-Rumford Cross) (Jun. 25, 2019).

[180] CEHE Ex. 39 at 19:13-15 (Harkel-Rumford Rebuttal).

[181] The PFD's reliance on a 92% total STI disallowance for financially-based incentive compensation overstates the amount of financially-based STI requested by the Company. The metric weightings shown on page 238 of the PFD total 91.34%, not 92%.

G. Capitalized Non-Qualified Pension Expense

Please refer to CenterPoint Houston's Exceptions in Section IV.C.4 addressing BRP expense, which also apply to the PFD's recommendation to reject capitalized non-qualified pension costs, i.e., BRP costs.

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

A. Return on Equity [PO Issue 8]

CenterPoint Houston excepts to the PFD's recommendation that the Commission authorize CenterPoint Houston to earn a 9.42% ROE on its invested capital.[182] Long-established principles of ratemaking require that the return to an equity owner should be reasonably sufficient to assure confidence in the financial soundness of the utility, to maintain and support the utility's credit, and to attract the capital necessary for the proper discharge of the utility's public duties.[183] The return must also be commensurate with returns on investment in other enterprises having comparable risks.[184] The ROE recommended in the PFD is none of those things. Instead, the PFD takes the midpoint of a range skewed by the flawed analyses of Staff and Intervenor witnesses, and then makes arbitrary reductions to arrive at an insupportably low ROE that would be the lowest Commission-approved ROE for any electric utility in the state of Texas.[185] It also falls well below the national average authorized ROE for electric utilities.[186] Moreover, the PFD's recommended ROE is fundamentally at odds with its recommendation that the Commission impose certain ring-fencing measures on CenterPoint Houston in this case.[187] For example, it is irreconcilable to lower CenterPoint Houston's ROE by 58 basis points from its current authorized level, while

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[182] PFD at 170.

[183] *Hope Natural Gas Co.*, 320 U.S. at 603; *Bluefield Waterworks & Improvement Co.*, 262 U.S. at 692-693.

[184] *Id.*

[185] PFD at 170; *Application of Sharyland Utilities, L.P. to Establish Retail Delivery Rates, Approve Tariff for Retail Delivery Service and Adjust Wholesale Transmission Rate*, Docket No. 41474, Final Order at Finding of Fact 35b (Jan. 3, 2014); *Application of Southwestern Public Service Company for Authority to Change Rates*, Docket No. 43695, Order on Rehearing at Finding of Fact No. 69 (Feb. 23, 2016); *Application of Southwestern Public Service Company for Authority to Change Rates*, Docket No. 45524, Order at Finding of Fact No. 40 (Jan. 26, 2017); *Application of Oncor Electric Delivery Company LLC for Authority to Change Rates*, Docket No. 46957, Finding of Fact No. 32 (Oct. 13, 2017); *Application of El Paso Electric Company to Change Rates*, Docket No. 46831, Order at Finding of Fact No. 30 (Dec. 18, 2017); *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449, Order on Rehearing at Findings of Fact Nos. 158-159 (Mar. 19, 2018), *Application of Texas-New Mexico Power Company for Authority to Change Rates,* Docket No. 48401, Order at Finding of Fact No. 48 (Dec. 20, 2018).

[186] *See* CEHE Ex. 42 at 16:7-8 (Hevert Rebuttal).

[187] *See* PFD at 216-219.

simultaneously requiring it to "work to ensure that its credit ratings at all three major rating agencies . . . remain at or above [its] current credit ratings."[188]

1. The PFD's recommended ROE is the product of two arbitrary and unsupported adjustments

The PFD's discussion of its ROE recommendation begins with a summary of the competing evidence submitted by the parties.[189] The PFD observes that Staff and Intervenor recommendations resulted in a relatively tight grouping in the range of 9.0% to 9.45%,[190] while CenterPoint Houston recommends a 10.4% ROE. Contrary to the PFD's statement,[191] this close grouping of Staff and Intervenor recommendations is not "surprising." Rather, it is attributable to the fact that Staff and Intervenor witnesses have given considerable weight to their Discounted Cash Flow ("DCF")-based results [192] which also explains why Staff and Intervenor recommendations fall well below currently authorized returns.[193] As CenterPoint Houston witness Robert B. Hevert's testimony explains, since 2014, the Constant Growth DCF model has produced ROE estimates notably below the returns authorized by regulatory commissions, [194] and accordingly, the DCF results should be weighed with caution.

The PFD then determines what it deems to be a reasonable ROE range for CenterPoint Houston, but it is inconsistent, or at least unclear, as to what that range is. First, the PFD states that "taking all of the analyses into consideration, a reasonable range would be from 9.2% on the low end to 10.0% on the high end."[195] Then, a few sentences later and without intervening explanation, the PFD states that "[t]he mathematical analyses demonstrate that a reasonable range for CenterPoint Houston's ROE is between 9.0% and 10.0%."[196] The PFD then takes its midpoint from the 9.0%-10% range, which is 9.5%.[197] However, it is unclear why the PFD offers two

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[188] *Id.* at 217; *see* CEHE Ex. 48 at 32:21-33:9 (Lapson Rebuttal).

[189] CEHE notes that the PFD errs when it states that Mr. Hevert did not criticize Mr. Gorman's adjustment to remove one of Mr. Hevert's selected companies from Mr. Gorman's proxy group. PFD at 118 (*citing* CEHE Ex. 42 (Hevert Rebuttal)). As CEHE noted in its reply brief, Mr. Hevert did oppose this adjustment in his rebuttal testimony. CEHE Reply Brief at 64 (citing CEHE Ex. 42 at 91-92 (Hevert Rebuttal)).

[190] PFD at 170.

[191] *Id.*

[192] CEHE Ex. 42 at 9:2-5 (Hevert Rebuttal).

[193] *Id.* at 8:7-11.

[194] CEHE Ex. 26 at 2667 (Chart 1) (Hevert Direct); CEHE Ex. 42 at 9, Figure 2 (Hevert Rebuttal).

[195] PFD at 170.

[196] *Id.*

[197] *Id.*

ranges, or why the 9.0%-10% range was used to determine a midpoint. If the PFD had used the other range of 9.2%-10%, the midpoint would be ten basis points higher, or 9.6%.

From its derived midpoint of 9.5%, the PFD then recommends reducing the ROE to 9.45% in part to match Staff's recommendation, and in part to account for the "slight reduction" the PFD found was indicated by unspecified "economic, subjective factors."[198] However, nothing in the PFD explains why the ROE should be reduced simply to move closer to Staff's recommendation, which is far below the 9.68% average authorized ROE for electric utilities.[199] And to the extent that the PFD's adjustment is attributable to "economic, subjective factors," the PFD errs in failing to appropriately account for CenterPoint Houston's specific business and financial risks. Given that the ROE derived from the midpoint of the range was already 18 basis points below the national average, and considering CenterPoint Houston's specific-risk factors,[200] the evidence leans in favor of adjusting CenterPoint Houston's ROE upward, not downward. The evidence indicates that CenterPoint Houston is *more* risky than other similarly situated utilities, and the PFD provides no indication of why it believes that CenterPoint Houston's risks not only do not warrant an upward adjustment, but actually support a ROE reduction.

Finally, the PFD further reduces its recommended ROE by three basis points as a result of service quality complaints by CenterPoint Houston customer, H-E-B.[201] As further discussed below, that adjustment is arbitrary and leads to a poor policy outcome.

2. A ROE of 9.42% is not commensurate with the authorized ROEs of other electric utilities

One of the constitutional touchstones for analyzing the reasonableness of a ROE is whether it is commensurate with the returns on investments of other enterprises having comparable risk.[202] The evidence in this proceeding establishes that the average authorized ROE for electric utilities since 2014 has been 9.68%,[203] which is 26 basis points higher than the 9.42% ROE recommended by the PFD. To be clear, CenterPoint Houston is not suggesting that the Commission is bound to

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[198] *Id.*

[199] CEHE Ex. 42 at 16:7-8 (Hevert Rebuttal).

[200] *See* CEHE Ex. 26 at 2703:10-2713:4 (Hevert Direct) (identifying customer concentration, geographic and weather-related risks, regulatory mechanisms, and capital spending as specific-risk factors for CenterPoint Houston); CEHE Ex. 27 at 2835:8-17 (McRae Direct) (identifying elevated capital expenditures over the next five years, risk caused by the TCJA, hurricane risk, and regulatory risk as business and regulatory risks faced by CenterPoint Houston).

[201] PFD at 170.

[202] *Hope Natural Gas Co.,* 320 U.S. at 603; *Bluefield Waterworks & Improvement Co*, 262 U.S. at 692-693.

[203] CEHE Ex. 42 at 16:7-8 (Hevert Rebuttal).

award a ROE based simply on the average of what this and other state regulatory commissions have approved. However, it is indisputable that CenterPoint Houston competes with those other utilities for capital,[204] and there should be some reason given for recommending a ROE so far below the national average authorized ROE, which there is not. The PFD's recommendation is also unreasonably low when compared to authorized ROEs in Texas. For example, the most recent ROE authorized by the Commission, which was also for a TDU operating in ERCOT is 9.65%,[205] which is 23 basis points higher than the PFD's recommended ROE. The most comparable utility in Texas to CenterPoint Houston—Oncor—has an approved ROE of 9.8%.[206] The PFD fails to address at all why CenterPoint Houston should be considered dramatically less risky than other comparable utilities.

3. A ROE of 9.42% will negatively affect CenterPoint Houston's ability to attract the capital it needs to support its large capital expansion program

As discussed by CenterPoint Houston witness Robert B. McRae, the ability to attract capital on reasonable terms is critically important to CenterPoint Houston because the Company expects to expend approximately $5.14 billion for capital investments in the next five years in order to connect and reliably serve customers.[207] In recommending a ROE, the PFD pays only lip service to the significant evidence in the record regarding CenterPoint Houston's unique business and financial risk factors.[208] The ALJs note that the parties raised "economic metrics," and without any further explanation conclude that "there is no clearly dispositive factor on the subjective side of the analysis," but claim to the extent there is any bias, it supports lowering CenterPoint Houston's ROE.[209] However, the PFD cites to no evidence showing that a 9.42% ROE, which is well below the national average authorized ROE for electric utilities, will allow CenterPoint Houston to attract capital. It is axiomatic that if two companies are equally risky, a rational investor will invest in the one with a higher ROE. Therefore, compared with the utilities in the proxy group and considering CenterPoint Houston's unique risk factors, CenterPoint Houston should be awarded a ROE in the higher half of the range, not the lower half. This is all more

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[204] *See* CEHE Ex. 43 at 38:6-9 (McRae Rebuttal).

[205] Docket No. 48401, Final Order at Finding of Fact No. 47 (Dec. 20, 2018).

[206] CEHE Ex. 43a, Confidential Exh. R-RBM-3 at 1 (McRae Rebuttal).

[207] CEHE Ex. 27 at 2832:9-11 (McRae Direct).

[208] *See* PFD at 170.

[209] *Id.*

important given the current intensive capital spending cycle that CenterPoint Houston finds itself in due to the need to modify or build new infrastructure to serve its growing customer base. Thus, it is important to both CenterPoint Houston and its customers that the Commission reject the PFD's recommendation and provide CenterPoint Houston with a return that is adequate to attract equity capital at reasonable rates.[210]

4. A ROE of 9.42% will not maintain and support CenterPoint Houston's credit metrics

The parties and the ALJs also fail to consider the effects of their ROE and capital structure recommendations on CenterPoint Houston's financial soundness. The evidence establishes that the award of a 9.42% ROE will not be sufficient to sustain CenterPoint Houston's credit metrics. Specifically, a June 17, 2019 comment issued by Moody's noted that a ROE "materially below [CenterPoint Houston's] current 10% .would be credit negative."[211]

In fact, on June 26, 2019, during the hearing on the merits in this case, Moody's issued an updated report, changing CenterPoint Houston's outlook from Stable to Negative.[212] The report further noted that the absence of a supportive rate case outcome could lead to a downgrade.[213] This very recent development makes clear that simply ignoring the effects of the TCJA and CenterPoint Houston's capital expenditures on CenterPoint Houston's credit metrics will not make them go away, and it supports the testimony presented by CenterPoint Houston witnesses Mr. Hevert, Mr. McRae, and Ellen Lapson on the need to mitigate CenterPoint Houston's lost cash flow.[214] As detailed below, the ALJs improperly excluded the June 26, 2019 Moody's report from evidence, but the Commission need not let that error result in the turning of a blind eye to these issues.[215] CenterPoint Houston respectfully urges the Commission to reverse the ALJs' decision and include the Moody's June 26th report, which is included as Attachment D to these Exceptions, as part of the record.[216]

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[210] CEHE Initial Brief at 70.

[211] CEHE Ex. 43a, Confidential Exh. R-RBM-3 at 1 (McRae Rebuttal).

[212] Moody's Investor Service, *Rating Action: Moody's Affirms CenterPoint Energy Houston Electric Ratings; Outlook Changed to Negative* (Jun. 26, 2019), marked as CEHE Ex. 72 (Offer of Proof).

[213] *Id.*

[214] *See* CEHE Ex. 27 at 2856:6-22 (McRae Direct); CEHE Ex. 26 at 2679:10-2680:19 (Hevert Direct); CEHE Ex. 48 at 60:3-19 (Lapson Rebuttal).

[215] Tr. at 816:6-7, 818:25-819:1 (Judge Bailey) (Jun. 26, 2019); Tr. at 963:20-21 (Judge Bailey) (Jun. 27, 2019).

[216] CEHE preserved this issue for appeal to the Commission by making an offer of proof at the hearing on the merits. Tr. at 964:6-10 (Stover); Tr. at 966:6-7 (Judge Bailey) (Jun. 27, 2019).

As discussed above, the starting point for the PFD's ROE recommendation is what it determined to be the midpoint in the reasonable range of ROE estimates for CenterPoint Houston.[217] However, as demonstrated in CenterPoint Houston's initial and reply briefs, the analyses set forth by Staff and Intervenors suffer from significant flaws and do not represent reliable estimates of CenterPoint Houston's cost of equity or its ability to maintain its credit metrics under those estimates.[218] For example, TIEC witness Michael P. Gorman initially presented a calculation of CenterPoint Houston's S&P credit metrics under his recommended ROE that actually assumed a 10.0% ROE, not the 9.25% ROE recommended by Mr. Gorman.[219] CenterPoint Houston pointed out Mr. Gorman's error and explained that remedying it would result in credit metrics below the level needed to maintain the standalone credit rating assigned by S&P for CenterPoint Houston.[220] While Mr. Gorman admitted that he had made the error and that it would reduce the Cash from Operations to Debt ("CFO/Debt") ratio below 13.0%,[221] the level needed to maintain CenterPoint Houston's standalone credit rating, he did not change his recommendation or his testimony alleging that his recommendation would support CenterPoint Houston's credit rating. Mr. Gorman's analysis was further problematic in that he refused to consider CenterPoint Houston's credit metrics under the criteria of two of the rating agencies, Moody's and Fitch Ratings ("Fitch").[222] The PFD does not appear to have taken into account the demonstrated flaws in the various recommendations that it relies upon to determine its recommended ROE.

5. By refusing to admit CenterPoint Houston's most recent credit ratings outlook published by Moody's, the ALJs erroneously excluded relevant and admissible evidence that the ROE and capital structure proposed by Intervenors and Commission Staff increase the risk of a downgrade for the Company's credit rating

In her rebuttal testimony filed on June 19, 2019, Ms. Lapson testified about CenterPoint Houston's credit ratings and credit outlooks, relying on information that was up-to-date at the time of filing.[223] At the time, the Company's credit rating outlook as determined by Moody's was

[217] *See* PFD at 170.

[218] *See* CEHE Initial Brief at 54-60; CEHE Reply Brief at 56-67.

[219] CEHE Ex. 43 at 21:20-22:14 (McRae Rebuttal).

[220] *Id.* at 22:18-23:18 (McRae Rebuttal).

[221] Tr. at 574:4-10 (Gorman Cross) (Jun. 26, 2019).

[222] CEHE Reply Brief at 62.

[223] CEHE Ex. 48 at 17, Table 1 and 55:1-12 (Lapson Rebuttal).

Stable, although in light of the position of Staff and Intervenors in this case, Moody's issued a credit outlook indicating that an outcome that lowered the Company's equity layer or its ROE would be credit negative.[224] On June 26, 2019, while the hearing on the merits in this case was ongoing and the record was still open, Moody's took action to change the Company's ratings outlook from Stable to Negative and published a report to explain its rationale for the action.[225] Specifically, Moody's determined that the ROE and capital structure proposed by Staff and Intervenors through testimony in this case, "may further pressure credit measures."[226] Given the impact of credit ratings on a utility company's cost of debt, CenterPoint Houston took diligent action to admit the June 26th Moody's report and ensure that the record before the Commission would be accurate and up-to-date. As detailed below, each attempt was erroneously denied by the ALJs.

On the same day that Moody's published the report, counsel for CenterPoint Houston attempted to use the report as the basis for cross-examination of a Staff expert witness, Mr. Tietjen.[227] Such use of the report was proper under Texas Rule of Evidence 803(18) because the report was called to Mr. Tietjen's attention on cross examination[228] and Mr. Tietjen admitted the report was a reliable authority.[229] Staff, however, objected to the use of the June 26th Moody's report on the grounds that the report was outside the scope of Mr. Tietjen's testimony.[230] But this objection was without merit because Mr. Tietjen's pre-filed testimony explicitly addresses ratings agency reports and states that, "when the Commission reviews a utility's financial risk as part of its fundamental task of establishing just and reasonable rates," pre-emptive actions such as financial protections or ring-fencing may be appropriate.[231] Because Mr. Tietjen took such a position in his testimony, it would have been fair to ask him on cross-examination whether he still believed ring-fencing was necessary given that, as the June 26th Moody's report stated, positions taken by Staff on other issues in the case increased the financial risk to the Company. The ALJs,

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[224] *Id.*

[225] Moody's Investor Service, *Rating Action· Moody's Affirms CenterPoint Energy Houston Electric Ratings; Outlook Changed to Negative* (Jun. 26, 2019), marked as CEHE Ex. 72 (Offer of Proof).

[226] *Id.* at 1.

[227] Tr. at 814:19-816:7 (Tietjen Cross) (Jun. 26, 2019).

[228] Tex. R. of Evid. 803 (18)(A); Tr. 814:22-23 (Tietjen Cross) (Jun. 26, 2019).

[229] Tex. R. of Evid. 803 (18)(B); Tr. 814:14-18 (Tietjen Cross) (Jun. 26, 2019).

[230] Tr. at 815:9-13 (Tietjen Cross) (Jun. 26, 2019).

[231] Staff Ex. 1A at 13:6-8 (Tietjen Direct).

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however, erroneously sustained Staff's objection,[232] so CenterPoint Houston was not able to present this line of questioning into the record.

In addition to Staff's objection, TIEC objected to the use of the June 26th Moody's report on cross-examination on the grounds that it was hearsay.[233] But this objection was misplaced because Texas Rule of Evidence 803(18) is an exception to hearsay. And, again, Texas Rule of Evidence 803(18) applies because an expert witness can be cross-examined on a publication such as the June 26th Moody's report if the publication is established as a reliable authority,[234] which was the case here.[235] This objection should have been overruled.

Counsel for CenterPoint Houston next moved to enter the report into evidence as an exhibit.[236] Although Staff objected, it did not state any basis for the objection.[237] Rather, when the ALJ asked if, "[t]he objection stands?," counsel for Staff confirmed that it did.[238] Presumably, then, Staff was relying on its previous objection to use of the June 26th Moody's report in the cross examination of Mr. Tietjen, which was based on the argument the report was outside the scope of Mr. Tietjen's testimony. However, whether the June 26th Moody's report could be used in cross-examination is a separate question than whether it could be admitted into evidence. At that point, Staff's arguments should have been directed at questions of relevance or admissibility. Nevertheless, the ALJs sustained Staff's objection.[239]

On the next day of the hearing, CenterPoint Houston tried to enter the June 26th Moody's report into the record by supplementing the pre-filed rebuttal testimony of Ms. Lapson.[240] TIEC objected on the grounds that the June 26th Moody's Report was improper supplemental rebuttal testimony, and the objection was joined by COH, Staff, and the Texas Coast Utilities Coalition.[241] But, as the Company argued at the hearing, supplemental testimony is expressly allowed under

[232] Tr. at 816:6-7, 818:6-7 (Tietjen Cross) (Jun. 26, 2019).

[233] Tr. at 817:1-6 (Tietjen Cross) (Jun. 26, 2019).

[234] Tex. R. of Evid. 803(18)(B).

[235] Tr. at 814:14-18 (Tietjen Cross) (Jun. 26, 2019).

[236] Tex. R. of Evid. 803(18).

[237] "Mr. Mack: (Moving head up and down.)" Tr. at 818:22-24 (Tietjen Cross) (Jun. 26, 2019).

[238] *Id.* at 818:24.

[239] *Id.* at 818:25-819:1 (Tietjen Cross) (Jun. 26, 2019).

[240] Tr. at 955:7-12 (Lapson Cross) (Jun. 27, 2019).

[241] *Id.* at 956:20-957:15, 956:22-25, 958:11-12, 959:24-25 (Lapson Cross) (Jun. 27, 2019).

16 TAC § 22.225(c) as long as Ms. Lapson was available for cross-examination, which she was in this case.[242]

Under that rule, the ALJs may exclude the supplemental testimony "*if* there is a showing that the supplemental testimony raises new issues or unreasonably deprives opposing parties of the opportunity to respond to supplemental testimony."[243] No such showing was made in this case. Specifically, the supplemental testimony did not raise new issues because Ms. Lapson had already testified about the Company's credit outlook as of June 17, 2019, and even stated that Moody's would soon release an updated report.[244] Moody's June 26, 2019 ratings action was released as anticipated. The parties were not unreasonably deprived of the opportunity to respond because CenterPoint Houston notified the parties of the updated report at the earliest possible moment prior to Ms. Lapson taking the stand, the parties had the opportunity to cross-examine Ms. Lapson, and the Company stated that it would not object to other parties submitting supplemental testimony in response to the new information.[245] For these reasons, the ALJs should have allowed for an accurate record for the Commission by allowing CenterPoint Houston to supplement Ms. Lapson's testimony, consistent with 16 TAC § 22.225(c).

6. H-E-B Service Quality Issue

The PFD's findings regarding the H-E-B service quality issue and the PFD's related further reduction in the ROE recommended for CenterPoint Houston are not supported by substantial evidence and should be reversed. There can be no reasonable dispute that CenterPoint Houston takes seriously its responsibility to provide safe and reliable electric service to its customers. Messrs. Mercado, Narendorf, Pryor, and Company witnesses Dale Bodden and Julienne P. Sugarek submitted hundreds of pages of testimony describing the efforts of Company employees to fulfill this responsibility around the clock every day of the year.[246] CenterPoint Houston's overall quality of service is excellent as evidenced by the fact that in all but two years since 2008, CenterPoint Houston's SAIDI has exceeded the Commission standard.[247] Moreover, among ERCOT investor-

[242] *Id.* at 956:1-3 (Lapson Cross) (Jun. 27, 2019).

[243] 16 TAC § 22.225(c) (emphasis added).

[244] CEHE Ex. 48 at 17, Table 1, 57:14-58:5 (Lapson Rebuttal).

[245] Tr. at 959:4-7 (Lapson Cross) (Jun. 27, 2019).

[246] CEHE Ex. 6 at 42:8–47:8 (Mercado Direct); CEHE Ex. 7 at 173:8–174:12 & 178:12–183:5 (Pryor Direct); CEHE Ex. 8 at 332:4–338:20 (Narendorf Direct); CEHE Ex. 9 at 581:1-589:12 (Bodden Direct): CEHE Ex. 10 at 665:15–669:14 & 670:15–676:21 (Sugarek Direct).

[247] CEHE Ex. 9 at 609:11-611:19 (Bodden Direct); CEHE Ex. 33 at 4:15-5:13 (Sugarek Rebuttal).

owned utilities, CenterPoint Houston is consistently the least penalized utility for SAIDI violations.[248] And, CenterPoint Houston has achieved this excellent service reliability despite the fact that its transmission and distribution system is located in a climate that produces above average rainfall and vegetation growth, routine thunderstorm and lightning activity, and annual exposure to tropical depressions, storms, and hurricanes, such as Ike and Harvey.[249]

Despite these facts, CenterPoint Houston understands that the reliability experience of individual customers can vary, and the Company strives to respond effectively to customer reliability concerns. One such customer intervened in this rate case and called into question the reliability of the service it receives from CenterPoint Houston. The evidence provided by Ms. Sugarek establishes that the Company provides reliable service to H-E-B overall, devoted significant resources to diagnose and correct issues impacting specific stores, and offered to retain a third party at no expense to H-E-B to further study the issues identified by CenterPoint Houston's analysis.[250] While the Company stands ready to continue working with H-E-B to address its concerns, the evidence in this case simply does not support the PFD's conclusion that CenterPoint Houston failed to provide reliable service to H-E-B or was unresponsive to its complaints.

The PFD's error in this regard is further compounded by the punitive three-basis-point reduction it proposes to its already unreasonable low ROE recommendation. While the PFD cites PURA § 36.052 as authority for its proposal, the PFD mischaracterizes CenterPoint Houston's position in the case with respect to issues raised by H-E-B and ignores the substantial evidence presented by the Company detailing its efforts to aid H-E-B in remedying its reliability issues. The recommendation of the PFD is disappointing because the undisputed record demonstrates that CenterPoint Houston's overall quality of service is excellent and that it has gone to great lengths to work with H-E-B to resolve its issues.

Further, the PFD's penalization of CenterPoint Houston for simply noting its overall record on reliability and rebutting H-E-B's specific claims is disturbing. The overwhelming evidence demonstrates that CenterPoint Houston does have "an 'unwavering commitment' to its customers."[251] CenterPoint Houston never suggested that it was not concerned about H-E-B's outage experience. In fact, Ms. Sugarek testified to just the opposite. The evidence is undisputed

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[248] CEHE Ex. 33 at 5:2-13 (Sugarek Rebuttal).

[249] *Id.* at 6:1-14 (Sugarek Rebuttal); CEHE Ex. 31 at 24:12-14 (Pryor Rebuttal).

[250] CEHE Ex. 33 at 7:1-17:18 (Sugarek Rebuttal).

[251] PFD at 169.

that when H-E-B initially raised certain concerns in 2015, CenterPoint Houston met with H-E-B, performed studies, presented the results of its analysis, and spent over $250,000 improving service to H-E-B locations.[252] Upon learning that H-E-B had more recently expressed reliability concerns to the Commission, CenterPoint Houston quickly contacted H-E-B again in January 2019,[253] obtained additional data from H-E-B in February 2019,[254] analyzed that data,[255] and proposed to meet with H-E-B to review the data.[256] CenterPoint Houston even offered on two separate occasions to engage a third party, *at CenterPoint Houston's own expense*, to assist in further analyzing H-E-B's issues.[257] Yet, the PFD cites none of these facts and accuses CenterPoint Houston of an "unwillingness to accept even a modicum of responsibility for the reliability issues faced by H-E-B."[258] Such rhetoric suggests that the ALJs failed to review the Company's rebuttal testimony on the issue.

The undisputed facts demonstrate that CenterPoint Houston has been responsive to, and taken considerable responsibility for, H-E-B's outage experiences, including $250,000 in specific remedial action in 2015 (not counting the Company's ongoing maintenance and system hardening expenditures) and an offer to fund a third-party study in 2019. CenterPoint Houston has never suggested that H-E-B's concerns are not important. CenterPoint Houston simply pointed out that one customer's complaint, in the context of undisputed excellent system-wide reliability should not justify a quality of service adjustment to ROE. This is especially true here, where the customer in question operates a business that is unusually sensitive to electric disruptions.

This is not the first time the Commission has been faced with a similar issue. In Docket No. 8928, the Commission considered whether to adjust the return of Texas-New Mexico Power ("TNP") based on quality of service concerns expressed by one large customer.[259] The ALJs noted that the customer's electrical requirements were "exceptional," because they sought 100%

[252] CEHE Ex. 33 at 9:6-11:8 (Sugarek Rebuttal).

[253] *Id.* at 11:11-13.

[254] *Id.*

[255] *Id.* at 11:11-15:8.

[256] *Id.* at 15:11-13.

[257] *Id.* at 15:11-13, 16:6-11.

[258] PFD at 169.

[259] *Application of Texas-New Mexico Power Co. for Authority to Change Rates*, Docket No 8928, Examiners' Report at 63-66 (Feb. 1, 1990).

reliability.[260] They further noted that the customer's decision to expend its own funds on improved reliability was evidence "that its electric requirements are exceptional."[261] The ALJs concluded that "[t]he additional expenses and investment incurred by TNP to provide [the customer] with exceptional service would subsequently be charged to all of TNP's ratepayers,"[262] and refused to make a quality of service adjustment to TNP's rate of return.[263] In the Final Order, the Commission deleted a single sentence suggesting that the customer's large size was an independent reason to require it to bear the burden of its exceptional electric needs, but otherwise adopted the Examiners' Report without changes.[264] Like TNP's customer, H-E-B claims to be extraordinarily sensitive to electrical interruptions such that "[o]utages of less than one minute may cause H-E-B's equipment to malfunction."[265] As with TNP's customer, H-E-B's decision to install on-site generation is evidence of its exceptional electric requirements.

Perhaps recognizing the fallacy of basing a quality of service adjustment on H-E-B's alleged experience, the PFD attempts to make a case that CenterPoint Houston has provided poor service to other customers as well. But here the PFD engages in wholly unsupported and illogical speculation. The PFD points to a small amount of complaint emails produced by CenterPoint Houston in discovery from a small number of other customers and simply *speculates* that there may have been "exponentially higher" numbers of complaints.[266] Nothing in the record evidence supports this speculation. Rather, the complaint emails actually evidence the Company's efforts to respond to complaints and the ALJs ignore that they often demonstrate the resolution of customer complaints. And, when viewed against the Company's overall record with its 2.5 million customers (not just the few in the emails), the number of complaints related to CenterPoint Houston's quality of service is astoundingly low.

The PFD's lack of logic is further exacerbated by its apparent misunderstanding of SAIDI and System Average Interruption Frequency Index ("SAIFI") statistics. Over nearly a decade, a small number of customers have expressed frustration with what they believe to be poor quality

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[260] *Id.* at 65.

[261] *Id.*

[262] *Id.*

[263] *Id.* at 122 (Finding of Fact No. 69).

[264] Docket No. 8928, Final Order at 5 (adopting Examiner's Report as amended) (February 24, 1990) and Order on Rehearing at 3 (incorporating Final Order as amended) (Apr. 12, 1990).

[265] PFD at 162 (citing H-E-B Ex. 1 at 11).

[266] *Id.* at 166-167.

service; therefore the PFD concludes that "customer experiences are not accurately captured or accounted for in aggregate measurements like SAIDI and SAIFI,"[267] and that the "frequency and duration of outages that H-E-B has experienced are not reflected in the data."[268] The PFD's analysis incorrectly assumes that SAIDI and SAIFI statistics rely on voluntary customer complaints filed at the Commission, rather than on comprehensive utility data regarding its system.[269] Moreover, the PFD's logic is completely backward. The PFD concludes that because the *subjective* opinions of a few customers do not align with the *objective* SAIDI and SAIFI data collected by the Commission, the *objective* data must be incorrect. In fact, logic dictates the opposite conclusion, because H-E-B's experience *is* included in the aggregate data, as are the experiences of the relatively small number of other customers who have complained over the past several years. COH's witness testified that over the past three years, that objective, aggregate data "translates to average customer service reliability of approximately 99.98%, which is very good."[270] The appropriate conclusion from these facts is that the subjective experiences of a small number of dissatisfied customers is unrepresentative, not that the objective, aggregate data should be disregarded.

To justify the proposed quality of service adjustment, the PFD rejects traditional Commission measures of service quality in favor of evidence that is incomplete at best and misleading at worst. H-E-B's data comes only from its facilities that have on-site generation installed, and only since such generators were installed.[271] Yet, Mr. Presses admitted that "H-E-B does not have any engineering documentation regarding reliability studies at our own facilities."[272] On the other hand, Ms. Sugarek provided detailed information with respect to *all* H-E-B locations.[273] Ms. Sugarek's data shows a less serious outage problem than the information put forth by H-E-B.[274] The PFD arbitrarily and capriciously ignores Ms. Sugarek's data covering

[267] *Id.* at 166.

[268] *Id.*

[269] *Id.* (incorrectly suggesting that SAIDI and SAIFI statistics are "captured" through complaints filed at the Commission).

[270] COH/HCC Ex. 1 at 9:4-5 (Norwood Direct).

[271] H-E-B Ex. 1 at 10:15-20 (Presses Direct).

[272] Tr. at 401:17-19 (Presses Cross) (Jun. 25, 2019).

[273] CEHE Ex. 33 at 7:3-6 (Sugarek Rebuttal).

[274] *Id.* at 8:7-15.

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all H-E-B facilities and relies instead on H-E-B data that H-E-B's own witness acknowledges is *incomplete*.

H-E-B's analysis is also flawed because it does not account for problems caused by H-E-B's own equipment. Mr. Presses testified that none of the H-E-B outages resulted from problems with H-E-B's equipment.[275] He stated that H-E-B only recorded outages when its on-site generation came on and that the on-site generation only comes on in response to a CenterPoint Houston outage.[276] Mr. Presses' testimony rests on this fundamental assertion. Yet on cross examination, Mr. Presses acknowledged a June 2018 event in which H-E-B "was left without power during a failed transition from generator power to CenterPoint power," and all of the corrective actions "involved work on H-E-B's side of the meter, not on CenterPoint's side of the meter."[277] Mr. Presses likewise acknowledged a July 2018 event involving a "malfunction with equipment owned by [H-E-B] or [its] on-site generation provider [that] prevented this facility from being connected to CenterPoint's power, even though CenterPoint was ready and able to provide power."[278] These instances undermine the fundamental premise of Mr. Presses' testimony—that all of the outages he describes are the fault of CenterPoint Houston, not H-E-B's own equipment. Yet, the PFD adopts Mr. Presses' assertion without question.

The PFD uncritically cuts and pastes from H-E-B's briefing statements that mischaracterize CenterPoint Houston's testimony. For example, the PFD quotes H-E-B's statement that "CenterPoint acknowledged that H-E-B has on-site generation at locations within the service territories of other utilities in ERCOT and operates them without issues related to melted fuses."[279] Here is the actual exchange with Ms. Sugarek, which H-E-B cites:

> Q. Are you aware that H-E-B has the same type of facilities behind its locations in every other electric utility in ERCOT?
>
> A. I have—I have heard that. *I do not have direct knowledge.*
>
> Q. Are you aware that there's been no issue with fuses with any of those on-site generators?
>
> A. *I do not know* the nature of the operations in the other territories.[280]

[275] Tr. at 414:5-9 (Presses Redirect) (Jun. 25, 2019) (Declassified).

[276] *Id.* at 413:7-414:4.

[277] Tr. at 407-408 (Presses Cross) (Jun. 25, 2019).

[278] *Id.* at 408:5-8-409.

[279] PFD at 168, quoting verbatim from H-E-B's Reply Brief at 24.

[280] Tr. at 1220:25-1221:8 (Sugarek Cross) (Jun. 27, 2019) (emphasis added).

To *both* questions from H-E-B's counsel, Ms. Sugarek answered that she did not know. Even a cursory review of the transcript reveals that H-E-B's briefing mischaracterizes CenterPoint Houston's testimony as "acknowledgment."

In sum, the Commission should reject the PFD's findings of fact regarding CenterPoint Houston's quality of service, adopt new findings of fact recognizing CenterPoint Houston's above-average quality of service as recognized by COH and borne out by CenterPoint Houston's SAIDI and SAIFI statistics, and reject the quality of service adjustment recommended by the PFD.

7. Conclusion

Based on the foregoing, it is clear that a 9.42% ROE is not commensurate with returns on investment in other enterprises having comparable risks, is not sufficient to attract capital under CenterPoint Houston's particular circumstances, and does not adequately reflect the significant capital investment CenterPoint Houston is making and will be making to serve customers. Furthermore, it reflects an unwarranted quality of service adjustment that should be rejected. Accordingly, the Commission should reject the ROE recommended in the PFD and instead should authorize a ROE that, at a minimum, is consistent with recent ROEs authorized by the Commission for TDUs operating in ERCOT and the national average.

B. Cost of Debt [PO Issue 8]

CenterPoint Houston does not except to this portion of the PFD.

C. Capital Structure [PO Issue 7]

CenterPoint Houston also takes exception to the PFD's recommendation that the Commission authorize a capital structure composed of 45% equity and 55% long-term debt.[281] The evidence demonstrates that the Company's currently approved equity ratio of 45% will not produce financial metrics that are sufficient to maintain its current credit ratings.[282] As noted above and discussed in CenterPoint Houston's initial brief, the Company is experiencing significant declines in cash flows and credit quality due to the effects of the TCJA,[283] as well as its capital expenditure forecast.[284] CenterPoint Houston's witnesses Mr. McRae and Ms. Lapson, who was a Managing Director at Fitch for more than a decade,[285] each performed a quantitative

[281] PFD at 191.

[282] CEHE Ex. 27 at 2843:1-10 (McRae Direct); CEHE Ex. 48 at 42:13-21 (Lapson Rebuttal).

[283] CEHE Initial Brief at 67; CEHE Ex. 43a, Confidential Exh. R-RBM-3 at 1 (McRae Rebuttal).

[284] CEHE Initial Brief at 70; CEHE Ex. 43a, Confidential Exh. R-RBM-3 at 1 (McRae Rebuttal).

[285] CEHE Ex. 48 at 62 (Exh. R-EL-1 at 1) (Lapson Rebuttal).

analysis showing how an equity ratio of 45% would affect CenterPoint Houston's credit ratings. Both Mr. McRae and Ms. Lapson concluded that without an increase in equity ratio, a weakening in the cash flow metrics would expose CenterPoint Houston to a downgrade of at least one notch in its credit ratings from Moody's and Fitch.[286] Indeed, as discussed above, Moody's has already placed CenterPoint Houston on negative outlook based on the recommendations of the parties in the proceeding [287] and it appears to be closely watching this case to determine not only whether CenterPoint Houston's financial metrics are at risk but also whether Texas will remain a constructive regulatory climate for utility investment.[288]

1. Increasing CenterPoint Houston's equity ratio is the most beneficial method to customers for preserving CenterPoint Houston's financial metrics

The overwhelming evidence in this case shows that if the Company's financial metrics as established in this case are not sufficient to mitigate the effects of the TCJA on CenterPoint Houston's cash flow, as well as to account for its other specific business and regulatory risks, CenterPoint Houston will face a potential credit downgrade. A downgrade in CenterPoint Houston's credit rating would raise the cost of long-term debt at a time when CenterPoint Houston will be incurring a significant amount of additional long-term debt. As discussed above, CenterPoint Houston expects to expend approximately $5.14 billion for capital investments from 2019-2023.[289] If CenterPoint Houston is downgraded as a result of this case, its Texas retail customers will be paying higher interest rates on that debt for as long as the newly issued bonds are outstanding,[290] which may be decades. Moreover, the evidence demonstrates that the impact of a downgrade would not be temporary in nature. Due to the requirements of the ratings agencies, it may be years before the rating is restored to its current level, even if the Commission were to take action in CenterPoint Houston's next rate case to restore the level of cash flows.[291] On the other hand, if CenterPoint Houston's equity ratio is increased in this case to avoid a downgrade,

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[286] Id. at 42:17-44:13 (Lapson Rebuttal); *see* CEHE Ex. 27 at 2842:19-2843:10 (McRae Direct).

[287] Moody's Investor Service, *Rating Action: Moody's Affirms CenterPoint Energy Houston Electric Ratings; Outlook Changed to Negative* (Jun. 26, 2019) marked as CEHE Ex. 72 (Offer of Proof).

[288] CEHE Ex. 48 at 60:15-19 & CEHE Ex. 48a Confidential Exh. R-EL-5 (Lapson Rebuttal).

[289] *See* CEHE Ex. 26 at 2680:5-12 (Hevert Direct).

[290] CEHE Ex. 43 at 30:10-16 (McRae Rebuttal).

[291] *See id.*

the Commission will have the opportunity to revisit the equity ratio in a future rate case filed pursuant to the rate review schedule.[292]

2. The capital structure recommended by the PFD does not account for changing market conditions and risk factors

Like the ROE recommendation, the PFD's capital structure recommendation is supported by only the sparsest of analysis. The PFD states that the 50/50 capital structure proposed by CenterPoint Houston, as well as the capital structure composed of 40% equity and 60% debt proposed by Staff and most of the Intervenors "represent extremes," and it instead opts for a middle approach of 45% equity and 55% debt.[293] This is the same capital structure as adopted in CenterPoint Houston's last base rate case, in 2011.[294] It is undisputed however, that CenterPoint Houston's current capital structure does not account for the reduced cash flow attributable to the TCJA or CenterPoint Houston's impending capital expenditures.[295] The PFD does not explain why this capital structure is appropriate in light of the evidence presented regarding changing market conditions and risk factors.

The PFD states that parties do not "reject a capital structure approaching the current capital structure out of hand."[296] In support of this contention, the PFD points to the June 17, 2019 Moody's report, stating that CenterPoint Houston itself "has presented evidence that rating agencies consider an equity ratio of 45% a credit positive event."[297] However, this statement mischaracterizes the evidence. CenterPoint Houston has in fact presented evidence that a 45% equity ratio will result in a downgrade.[298] Moreover, the June 17, 2019 Moody's report to which the PFD points states that an equity layer below 45% is *credit negative*, but does not explicitly say that the award of an equity ratio of 45% is positive.[299] Furthermore, a utility's financial metrics depend on both its ROE and its capital structure—they do not exist in a vacuum.[300] To this end, CenterPoint Houston's evidence showed that in conjunction with a 50% equity ratio to combat

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[292] CenterPoint Houston, which is subject to the requirements of PURA § 36.157 and 16 TAC § 25.247(c)(2)(B), is now on a regular rate review schedule.

[293] PFD at 191.

[294] *See* Docket No. 38339, Order on Rehearing at Finding of Fact No. 67.

[295] *See* CEHE Ex. 43 at 17:1-28, 31:7-14 (McRae Rebuttal).

[296] PFD at 190-191.

[297] *Id.* at 191.

[298] CEHE Ex. 48 at 42:17-44:8 (Lapson Rebuttal); *see* CEHE Ex. 27 at 2842:19-2843:11 & Table 5 (McRae Direct).

[299] CEHE Ex. 43a, Confidential Exh. R-RBM-3 at 1 (McRae Rebuttal) (emphasis added).

[300] *See* CEHE Ex. 26 at 2713:18-2714:15 (Hevert Direct).

reduced cash flows, CenterPoint Houston *also* needs a 10.4% ROE.[301] Yet, the PFD proposes that the Commission authorize an ROE that is 98 basis points lower than CenterPoint Houston's requested ROE and 58 basis points below its current authorized ROE, while also failing to increase the amount of equity in its capital structure. It is difficult to see how rating agencies will see this as a credit positive outcome.

3. A 50/50 capital structure properly accounts for CenterPoint Houston's business and regulatory risks, and is consistent with the equity levels recently established for comparable utilities in other jurisdictions

A 50/50 capital structure properly accounts for the level of business and regulatory risks that CenterPoint Houston faces, including elevated capital expenditures required to reliably serve customers, risk caused by the TCJA, hurricane risk, and regulatory risk.[302] Moreover, a 50/50 capital structure is consistent with the level of equity authorized for comparable utilities in other jurisdictions.[303] For the last eight calendar quarters, the average equity ratio was 53.28% for the holding companies in Mr. Hevert's proxy group, and 53.13% for the utility operating companies encompassed within those holding companies.[304] The average equity ratio of electric delivery-only utilities for calendar year 2018 was 49.91%,[305] and it has been trending upward in recent years.[306] CenterPoint Houston competes with those utilities for scarce capital. Consequently, if CenterPoint Houston's capital structure reflects a lower level of equity than the companies with which it competes for capital, CenterPoint Houston will have more trouble attracting capital because lenders and investors will perceive the Company as having greater risk.[307]

4. Conclusion

The combined impacts of the TCJA and CenterPoint Houston's capital expansion program will not allow CenterPoint Houston to maintain its current credit rating, absent support from the Commission in this rate case.[308] The evidence in this case demonstrates that an equity ratio of

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[301] *Id.*

[302] CEHE Ex. 27 at 2835:12-17 (McRae Direct).

[303] *Id.* at 2834:6-18.

[304] *Id.* at 2854:4-8.

[305] CEHE Ex. 43 at 38:9-11 (McRae Rebuttal).

[306] Staff Ex. 3A at 36:1-2, Chart (Ordonez Direct); CEHE Ex. 43 at 38:9-11 (McRae Rebuttal); CEHE Ex. 48 at 50:9-12 (Lapson Rebuttal).

[307] *See* CEHE 48 at 52:17-20 (Lapson Rebuttal) ("If the Commission orders a capital structure that is excessively leveraged and may result in low credit ratings, utilities in Texas would have a harder time to access sources of funding and to fulfill the needs of customers.").

[308] *See* CEHE Initial Brief at 52.

45% will not be sufficient to provide that necessary support. Accordingly, the Commission should reject the PFD's capital structure recommendation and instead approve a capital structure composed of 50% equity and 50% long-term debt. However, if the Commission is not inclined to approve a 50% equity ratio in this case, CenterPoint Houston respectfully requests that the Commission adopt an equity ratio midway between 45% and 50%, in order to help CenterPoint Houston mitigate its reduced cash flow and preserve its financial integrity so that it may continue to provide safe and reliable service to its customers.

D. Overall Rate of Return [PO Issue 8]

For the reasons described in CenterPoint Houston's briefing and these Exceptions, above, CenterPoint Houston's ROE should be set at a level that fairly allows the Company to compete for and attract capital and its capital structure should be composed of 50% equity and 50% debt. Based on the 50/50 capital structure supported by Mr. McRae and Ms. Lapson,[309] the 10.4% ROE supported by Mr. Hevert,[310] and the 4.38% cost of debt supported by Mr. McRae and adopted in the PFD,[311] CenterPoint Houston's overall rate of return should be 7.39%.[312]

E. Financial Integrity [PO Issue 9]

The Company appreciates the concern that the Commission and certain intervenors have shown with respect to protecting CenterPoint Houston through the imposition of certain ring-fencing measures. The evidence demonstrates that CNP has a record of protecting the financial integrity of CenterPoint Houston and thus shares that interest. However, the record shows that the PFD incorrectly analyzed the issue of whether financial protections are appropriate in the context of a rate case, and whether they are needed "to protect CenterPoint [Houston's] ability to provide reliable service at just and reasonable rates."[313] First, although PURA may provide authority for the Commission to impose financial protections in certain other circumstances, the PFD incorrectly finds that it is appropriate for these issues to be addressed in a Chapter 36 rate proceeding. The Legislature amended PURA to provide the Commission ring-fencing authority within the context of the review and approval of a utility sale, transfer, merger ("STM"). Given the nature of the specific provisions granting that authority, the Legislature did not intend for that authority to be

[309] CEHE Ex. 27 at 2834:8-20 (McRae Direct); *see* CEHE Ex. 48 at 60:3-19 (Lapson Rebuttal).

[310] CEHE Ex. 26 at 2664:19-22 (Hevert Direct).

[311] CEHE Ex. 27 at 2857:9 (McRae Direct); PFD at 173.

[312] CEHE Ex. 43 at 4:18-21 (McRae Rebuttal).

[313] PFD at 192.

used outside of an STM proceeding. Furthermore, imposition of ring-fencing measures by a utility commission within the context of a rate case would be very unusual if not unprecedented.[314] To the extent that the Commission is seeking to impose ring-fencing measures generally on Texas utilities, this should be done through the rulemaking process and not piecemeal through individually litigated cases.

Second, if the Commission is authorized to impose ring-fencing measures, the PFD employs the wrong standard. Instead of finding that Staff and TIEC presented sufficient evidence to support the finding that the Commission must impose ring-fencing measures so that CenterPoint Houston can provide reliable service at just and reasonable rates, the PFD determines that there is "no convincing reason not" to order ring-fencing measures thereby, improperly shifting the burden of proof.[315] In this regard, the PFD improperly places the burden of proof on CenterPoint Houston when, in fact, Staff and TIEC have the burden of proving that ring-fencing measures are necessary for CenterPoint Houston to provide reliable service at just and reasonable rates. A review of the record in this case demonstrates that Staff and TIEC failed to meet this burden. TIEC and Staff did not present adequate evidence to support the imposition of their recommended financial protections. CenterPoint Houston established that it has robust ring-fencing measures in place today and that no formal or new ring-fencing measures are needed for it to maintain its financial integrity,[316] but the PFD wrongly dismissed without justification the evidence presented by the Company. There is also no merit to the PFD's suggestion that the Commission should act to mandate the existing ring-fencing measures that CenterPoint Houston has in place.[317] The evidence in the case established CenterPoint Houston and CNP have no intention of changing the existing ring-fencing measures.[318] In fact, some of the cited protection measures address affiliate relationships and are already at least partly addressed in PURA.[319] Therefore no further action by the Commission is required, particularly where there are no claimed violations of PURA or the Commission's rules.

[314] CEHE Ex. 48 at 40:18-20 (Lapson Rebuttal).

[315] PFD at 215.

[316] *See, e.g.,* CEHE Ex. 48 at 25:14-26:14 (Lapson Rebuttal).

[317] PFD at 215-216.

[318] CEHE Ex. 48 at 22:13-19, 26:8-14, 31:15-32:10 (Lapson Rebuttal).

[319] *See* PURA § 39.157(d).

However, in an effort to address any lingering concerns the Commission may have regarding this issue, CenterPoint is willing to accept certain ring-fencing measures that will not damage the Company's financial integrity or harm its continued operations. The remaining ring-fencing measures recommended by the PFD will financially harm the Company, are otherwise irreconcilable with other recommendations in the PFD, and/or are overly vague. The measures to which CenterPoint Houston can agree are set forth in Section III.E.7 below.[320]

Finally, CenterPoint Houston respectfully requests that to the extent that any ring-fencing measures are imposed, the PFD be revised to provide the Company with a reasonable amount of time, no shorter than 120 days, to implement any new measures and if ordered, another 30 days to obtain a non-consolidation opinion. The Company also requests that it be allowed to seek an extension of the ring-fencing implementation deadlines for good cause if the need should arise given that the time period to implement such measures may be inadequate and not commercially reasonable.

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

The question at issue in this proceeding is not whether the Commission has any authority under PURA to impose ring-fencing protections, but whether the Commission is authorized to impose such protections within the context of a Chapter 36 rate case. As the PFD noted, PURA provides broad authority to the Commission to establish a comprehensive and adequate regulatory system.[321] The PFD particularly cites the authority in PURA §§ 11.002 and 14.001. These provisions establish the general construct of the regulatory scheme that is spelled out in the remaining portions of the statute. PURA § 11.002 defines the purpose of PURA and is not a specific grant of authority, and PURA § 14.001 establishes that the Commission has the express and implied powers it needs to implement the specific provisions of PURA. While broadly worded, these provisions do not grant unenumerated powers to the Commission and do not in themselves provide the Commission authority to impose ring-fencing measures in a rate case.

[320] CenterPoint Houston's willingness to accept the measures set forth in Section III.E.7 should not be construed as a waiver of CenterPoint's legal arguments regarding the Commission's jurisdictional authority or the evidence demonstrating that additional ring-fencing measures are not necessary to protect CenterPoint Houston's financial integrity or the other arguments raised in Sections III.E.1 through 6 of these Exceptions. Rather, the Company's willingness to accept certain additional measures evidences the Company's commitment to achieving a constructive regulatory outcome in this case that balances the concerns raised by the Company and stakeholders on this issue.

[321] Tex. Util. Code § 11.002(a).

The Legislature made specific grants of authority in PURA §§ 39.262(l-o) and 39.915 to the Commission to address whether certain transactions are structured to protect the public interest.[322] These proceedings have resulted in the imposition of ring-fencing measures to ensure a utility is sufficiently protected as a result of the transaction. This authority is logically connected to the consideration of utility transactions, particularly mergers or acquisitions of utilities. In the context of a newly formed or reorganized utility, if the Commission concludes that ring-fencing measures are necessary, those measures can be adopted prior to the consummation of the transaction and the formation of the new entity or entities. In contrast, in the context of a rate case, the proceeding is to set the rates of an existing utility that is not involved in a sale or merger. Therefore, no new corporation is being formed and ring-fencing measures that are not already in place at a utility could be costly and disruptive to a utility's operations. There is no explicit grant of authority to the Commission to impose ring-fencing in a rate case and ring-fencing measures are not logically connected to the setting of rates, and so there is no legitimate reason to believe that the Legislature intended for the Commission to have authority to impose such measures in a rate case. Indeed, imposition of ring-fencing measures by a utility commission within the context of a rate case would be very unusual if not unprecedented.[323]

The Commission has previously found that its jurisdiction to set rates does not extend to proceedings under PURA §§ 39.262(l-o) and 39.915. For example, in a proceeding where the Commission had to determine whether a transaction was in the public interest under PURA §§ 39.262 and 39.915, the Commission found that it would not conduct a prudence review of invested capital but leave that question to be addressed in a rate proceeding.[324] Likewise, the Commission does not address Chapter 36 rate questions within proceedings to consider applications to amend certificates of convenience and necessity under Chapter 37 of PURA.[325] Therefore, the PFD's conclusions are in conflict with the intent of the Legislature and the

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[322] *See* CEHE Initial Brief at 71.

[323] CEHE Ex. 48 at 40:18-20 (Lapson Rebuttal).

[324] *Joint Report and Application of Oncor Electric Delivery Company LLC, Sharyland Distribution & Transmission Services L.L.C., Sharyland Utilities LP., and Sempra Energy for Regulatory Approvals Under PURA §§ 14.101, 37.154, 39262 and 39.915,* Docket No. 48929, Amended Preliminary Order at 20 (Mar. 1, 2019).

[325] *Application of Trinity Valley Electric Cooperative, Inc. for an Amendment to a Certificate of Convenience and Necessity for a Proposed 138kv Transmission Line for the North Texas Municipal Water District (NTMWD) on Lake Tawakoni in Van Zandt County, Texas,* Docket No. 33525, Order No. 11 at 2 (May 4, 2007).

Commission's own interpretation of its authority regarding the exercise of the separate and distinct grant of regulatory power to the Commission.

The PFD also relies on certain specific grants of authority that allow the Commission to carry out its purpose and responsibilities.[326] However, the cited provisions do not contemplate the imposition of ring-fencing within a rate case, and there is no evidence to suggest that the Legislature intended the Commission to have an implied power to impose ring-fencing in fulfilling its ratemaking responsibilities.[327] Notably, only one of the cited provisions is from PURA Chapter 36, and it is the provision that requires the Commission to find that a utility's rates are just and reasonable.[328] This section of PURA has no explicit grant of authority to impose ring-fencing measures, and no credible argument or case was made that the Commission cannot set just and reasonable rates without the power to impose ring-fencing measures. In fact, the Commission has fulfilled its responsibility to set utility rates for decades but has never before imposed ring-fencing measures in doing so. The PFD also cites to PURA § 14.201, but the operative phrases in that section ("may inquire into" and "shall keep itself informed") make clear that it allows the Commission to monitor a utility's management and affairs but does not authorize the imposition of ring-fencing measures.

Further, at least one of the PFD's cited provisions addresses the requirements for utility and affiliate relationships and the adoption of rules implementing those.[329] The relevant rules adopted by the Commission address a utility's required reporting of affiliate transactions, and the code of conduct for utilities and their affiliates.[330] Neither the statute nor the rules are implicated in this case and are not otherwise relevant to rate questions generally except to the extent a utility may have violated the rules and is seeking to recover inappropriate costs. No party has claimed that CenterPoint Houston is violating PURA or the affiliate rules as part of its relationship with CNP or seeking to recover inappropriate costs associated with this issue. Therefore, to the extent that the proposed ring-fencing measures contemplate any of the requirements found in these

[326] PFD at 197-198.

[327] These provisions involve reporting of affiliate transactions; access to records of affiliate transactions; inquiry into the management of a utility; a utility's rates are just and reasonable; subsidization of affiliates; requiring the maintenance of separate books and records; standards for affiliate transactions; and a prohibition of an affiliate of a utility to pledge the utility's assets or cash to obtain credit. PURA §§ 14.003; 14.154(a); 14.201; 36.003(a); 39.157(d) (11), (13), (14), (17).

[328] PFD at 197 (PURA § 36.003(a)).

[329] *Id.* at 197-198 (PURA § 39.157(d) (11), (13), (14), (17)).

[330] *See* 16 TAC §§ 25.84 and 25.272.

statutory provisions, it is not a justification for the Commission to impose the ring-fencing measures, particularly because no party has claimed CenterPoint Houston is in violation of the law.

The Legislature's intent should be determined from the words of the statutes it passes.[331] The language in the cited provisions of PURA is clear, and none of the relevant provisions provide the Commission the authority to impose ring-fencing within the context of a rate case.

Finally, to the extent the Commission seeks to impose ring-fencing measures on utilities as a matter of course, such measures must be established through a rulemaking proceeding pursuant to the Administrative Procedure Act rather than through individually litigated contested cases.[332] The Commission's preliminary order in the pending AEP Texas rate case included the same issue to be addressed regarding financial integrity as the Commission's preliminary order in this case.[333] And Commission Staff has proposed similar ring-fencing measures in both cases.[334] This suggests that the Commission may intend to impose ring-fencing measures on utilities as a matter of course, and as such, any decisions made by the Commission in these two cases could have wide ranging implications. Rather than making such decisions in contested cases on an ad hoc basis, the Commission should use the rulemaking process, which would offer several advantages in informing the Commission's decisions. First, a rulemaking would allow all utilities and other stakeholders—not just parties with standing to intervene in individual rate cases—the opportunity to participate in the process and offer comments. Second, a rulemaking would allow stakeholders to provide the Commissioners feedback directly, without ex parte restrictions, regarding the impacts of specific ring-fencing measures, including potential unintended consequences and financial costs that would be imposed on utilities and their customers. For these reasons, if the Commission concludes that ring-fencing measures may be appropriate for

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[331] *See Robinson v Budget Rent-A-Car Systems, Inc.*, 51 S.W.3d 425, 430 (Tex. App. - Houston [1st Dist.] – 2001, pet. denied) (finding that courts construe unambiguous statutes "in accordance with their plain meaning.").

[332] Tex. Gov't Code § 2001.001-.038 (describing the procedure that a state agency must follow when adopting rules); *see Rodriguez v. Service Lloyds Ins. Co*, 997 S.W.2d 248 (Tex. 1999) (finding that "ad hoc" rulemaking can only occur "when using [the notice and comment] rulemaking procedures would frustrate the effective accomplishment of the agency's functions.").

[333] *Compare Application of CenterPoint Energy Houston Electric, LLC for Authority to Change Rates*, Docket No. 49421, Preliminary Order at Issue 9 (May 9, 2019) *with Application of AEP Texas Inc. for Authority to Change Rates*, Docket No. 49494, Preliminary Order at Issue 13 (May 24, 2019).

[334] *See Application of AEP Texas Inc. for Authority to Change Rates*, Docket No. 49494, Direct Testimony of Darryl Tietjen at 15-18 (Aug. 1, 2019).

CenterPoint Houston, the Commission should initiate a rulemaking and provide interested stakeholders with notice and opportunity to comment.

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

No recommendations were made under this heading, and CenterPoint Houston has no Exceptions to this section of the PFD.

3. Affiliates' Financial Impacts on CenterPoint

The evidence in this case establishes that CenterPoint Houston has robust ring-fencing measures in place today.[335] The claim by Staff and TIEC that CenterPoint Houston's relationship with CNP is causing imminent negative financial impacts to CenterPoint Houston is not supported by the evidence. The PFD cites the misleading data point used by Staff and TIEC about the makeup of CNP's net income from CenterPoint Houston.[336] Income from CenterPoint Houston has made up approximately half to three-quarters of CNP's net income in the last two years (not over 90%), but most importantly that percentage will be much smaller now with the acquisition of Vectren.[337] And regardless of how much of CNP's income is derived from CenterPoint Houston, Staff and TIEC did not present evidence that this alone created any negative financial implications for CenterPoint Houston. Staff and TIEC merely made speculative statements about the possibility that if CNP is in financial distress that there could be negative impacts to CenterPoint Houston, but neither Staff nor TIEC (nor any other party) claims that CNP is in current financial distress or that such distress is even imminent. As to this issue, CenterPoint Houston understands that the Vectren transaction may have raised an initial concern that the debt taken on at CNP to close the transaction would have some impact on the financial health of CenterPoint Houston. The evidence, however, showed that this is not the case. The Vectren transaction was primarily equity financed and has not impaired CenterPoint Houston's ability to access credit markets nor affected its credit rating at two of the three agencies.[338] Additionally, the Vectren transaction is not comparable to the Energy Future Holdings Corp. ("EFH") transaction for the reasons outlined in Ms. Lapson's rebuttal testimony. To the contrary, Vectren has diversified CNP's other holdings and increased the number of regulated subsidiaries, which is likely a stabilizing effect on CNP.[339]

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[335] CEHE Ex. 48 at 21-22, 25-26 (Lapson Rebuttal).

[336] PFD at 202.

[337] CEHE Reply Brief at 81.

[338] CEHE Ex. 48 at 12:9-17–13:1-4 (Lapson Rebuttal).

[339] *Id.* at 13:5-26–14:1-6.

In short, the Vectren transaction does not support the need for imposing ring-fencing measures for CenterPoint Houston.

The PFD also incorrectly states that all three major rating agencies indicate that CenterPoint Houston has a lower credit rating because of its affiliates.[340] As the examples provided in the PFD make clear, only one rating agency (S&P) lowered the credit rating of CenterPoint Houston based on the ratings of its parent CNP.[341] The PFD discussion of the other two ratings agencies, Moody's and Fitch, only addresses those agencies' evaluations of CNP's rating, not CenterPoint Houston's. And while Moody's lowered its rating of CNP after the Vectren transaction (Fitch did not), importantly Moody's did not change its rating of CenterPoint Houston.[342]

Although the PFD alleges that "multiple ratings agency reports have commented on the risk that CNP's other subsidiaries impose on CNP,"[343] the risks to CNP associated with CNP's subsidiaries as discussed in those reports do not impute those risks to CenterPoint Houston. Put differently, the PFD misreads the agency reports. The evidence demonstrates that neither the Vectren transaction, nor any other affiliate transaction, have ever impacted CenterPoint Houston's credit quality. The ratings agencies treat CenterPoint Houston on a stand-alone basis, as should the Commission.

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

No PFD recommendations were made under this heading.

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

Staff and TIEC witnesses suggest a variety of supposed reasons for a stronger ring fence, however in each instance the evidence presented in the case does not support those justifications.[344] Ms. Lapson presented substantial evidence to refute Staff's and TIEC's claims, and tellingly no party objected to her testimony nor cross-examined her as to the substance of her testimony at the hearing.[345] Yet, the PFD largely ignores Ms. Lapson's testimony.

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340 PFD at 202.

341 *Id.*

342 CEHE Ex. 48 at 14:7-12 (Lapson Rebuttal).

343 PFD at 203-204.

344 *Id.* at 210-211. See CEHE Initial Brief at 72-74; and CEHE Reply Brief at 77-84; see generally CEHE Ex. 48 at 20:3-41:5 (Lapson Rebuttal).

345 Tr. 967:2-971:8 (Lapson Cross) (Jun. 27, 2019).

In particular, the PFD ignored key distinctions between the funding methodologies employed by the private equity purchasers of Oncor's parent and CNP's current financial strength. The PFD incorrectly ignores the significant differences in the percentage of debt used to fund the acquisition of Oncor's parent compared to the acquisition by CNP of Vectren [346] and also incorrectly concludes that the financial community does not disregard S&P's downgrade of CenterPoint Houston when in fact there has been no impact on CenterPoint Houston's financing.[347]

The PFD found that "[w]hen the acquisition of Oncor's parent occurred, bankruptcy was not expected and did not occur until seven years later."[348] However, the PFD seemingly disregards the real and apparent risk of default understood by the rating agencies—as noted by Ms. Lapson in her testimony that Moody's rated the senior bonds used to fund the Oncor 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. In contrast, Moody's rated the debt issued by CNP to finance its acquisition of Vectren was rated at Baa1, and CNP's issuer rating after its acquisition of Vectren was solidly investment grade at Baa2. These facts demonstrate that the PFD's reliance on the Oncor history to support the imposition of a stronger ring fence for CenterPoint Houston is misplaced because the acquisition financing debt for Oncor's parent was deeply speculative and indicated a high likelihood of default as compared to the solid investment grade ratings given to both the acquisition financing debt used by CNP as well as CNP after its acquisition of Vectren and Moody's and Fitch's unchanged credit ratings of CenterPoint Houston following the acquisition financings.

Alternatively, without pointing to any contrary evidence or other support, the PFD finds the evidence "unconvincing" that the financial community disregards S&P's expressions of concern and the downgrade of CNP and CenterPoint Houston.[349] This is a mischaracterization of Ms. Lapson's testimony regarding a split in ratings among the rating agencies. Ms. Lapson testified that when a company has a "split rating" among the ratings agencies, as CenterPoint Houston currently does, investors typically use a method to reconcile the differences.[350] They can

[346] CEHE Ex. 48 at 12:9-17–13:1-4 (Lapson Rebuttal).

[347] PFD at 214.

[348] *Id.* at 215.

[349] *Id* at 214.

[350] CEHE Ex. 48 at 17:1-18:15 (Lapson Rebuttal).

consider the preponderance of two out of three ratings or the middle of three ratings.[351] This means that the market would look to the ratings of Moody's and Fitch because they are the same and effectively establish the median.[352] The PFD gives no reason to discount the reliable testimony from Ms. Lapson, an expert witness whose qualifications were not questioned by any party, with decades of experience at rating agencies evaluating the risks of the utility industry.[353] Her testimony is not refuted by any other witness or other evidence, and there is no legitimate reason to discount it.

The PFD also discounts the fact that Staff and TIEC did not consider financial impacts to CenterPoint Houston of the proposed ring-fencing measures and instead placed the burden to prove up costs on CenterPoint Houston.[354] Staff and TIEC had the burden of proof to show that the ring-fencing measures were necessary to protect CenterPoint Houston's ability to provide reliable service at just and reasonable rates. Staff and TIEC make unsupported claims that CenterPoint Houston will experience cost savings from the ring-fencing measures, but TIEC in particular assumes that even new ring-fencing measures can be adopted without costs.[355] On the other hand, while the exact costs that would be incurred are not yet known, CenterPoint Houston provided testimony that to comply with the proposed ring-fencing measures would logically have some costs, including costs associated with renegotiating credit agreements and obtaining a non-consolidation opinion.[356] So the PFD erroneously places weight on claimed cost savings that were not supported by evidence, but discounts without justification the undisputed evidence that there will be costs to comply with the measures.

6. ALJs' Analysis and Recommendation about Specific Proposals

The PFD applies the wrong burden of proof standard in finding that there is "*no persuasive reason not* to order those [ring-fencing] measures and shows significant benefits if the Commission does order them."[357] The parties were required to show that the measures *were needed* for CenterPoint Houston's *ability to provide reliable service at reasonable costs*—not that there is

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[351] *Id* at 18:1-15.

[352] CEHE Ex. 48. at 18:1-15 (Lapson Rebuttal).

[353] *Id.* at 5:6-8:9 & 62 (Exh. R-EL-1).

[354] PFD at 215.

[355] TIEC Ex. 4 at 9:9-12 (Griffey Direct).

[356] CEHE Reply Brief at 80.

[357] PFD at 216 (emphasis added).

nothing to stop the Commission from imposing them, or that there may be some perceived benefits to the measures. The PFD first lists the ring-fencing measures that CenterPoint Houston already has in place as requiring formal adoption to prevent CenterPoint Houston from changing these measures.[358] The PFD acknowledges that the basis for imposing these measures is future uncertainty, not evidence that such measures are necessary to address existing risks.[359] In fact, in some cases, the ring-fencing measures CenterPoint Houston has in place are required under PURA or by CenterPoint Houston's existing credit agreements.[360]

The PFD also acknowledges that even though CNP has recently been downgraded by two of the ratings agencies, it still maintains an investment grade rating of BBB+ and no evidence suggests that it is at risk of bankruptcy now or in the near future.[361] So there was no evidence to suggest that CenterPoint Houston would be pulled into a bankruptcy proceeding of CNP—nor was there evidence to suggest that if CNP was in financial distress that CenterPoint Houston's existing ring-fencing measures were not sufficient to ensure it would not be pulled into a CNP bankruptcy.

To address the unsubstantiated risks, the PFD recommends adoption of additional ring-fencing measures proposed by Staff and TIEC. These additional measures are not necessary, potentially detrimental to CenterPoint Houston and its customers, or cannot be implemented because the measures as proposed are inscrutable:[362]

- **CenterPoint shall not commingle its assets with those of other CNP affiliates**[363] – As a general matter, CenterPoint Houston does not commingle its assets with that of its affiliates. However, CenterPoint Houston participates in a money pool with its affiliates, which is advantageous to CenterPoint Houston.[364] While CenterPoint Houston maintains title to the funds it places in the money pool, this could be considered to be commingling of assets. CenterPoint Houston should be allowed to continue to participate in the money pool and receive the benefits from its participation. If the Company is precluded from participating in the money pool, it could lose the associated financial benefits and be forced

[358] *Id.* at 216-217. CenterPoint Houston maintains current practices or policies that it believes are consistent with these proposed measures. *See* CEHE Ex. 48 at 31:15-32:10 (Lapson Rebuttal). However, CenterPoint Houston participates in a revolving credit facility that is also used by CNP and other affiliates. CEHE Ex. 48 at 97 (Exh R-L-4) (Lapson Rebuttal).

[359] PFD at 214- 215. *See also* CEHE Ex. 48 at 31:12-32:10 (Lapson Rebuttal).

[360] CEHE Ex. 48 at 94 (Exh. R-EL-4) (Lapson Rebuttal) (describing separateness factors of CenterPoint Houston and the reasons for the existing policies or practices, including PURA, the Commission's affiliate rules, and credit agreements.).

[361] PFD at 202 & 214.

[362] CEHE Reply Brief at 79-84.

[363] PFD at 217.

[364] CEHE Ex. 48 at 96 (Exh. EL-R-4) (Lapson Rebuttal).

to incur additional expenses to move its funds to other accounts. The Company will accept a revised commitment, however, as discussed in section III.E.7 below.

- **CenterPoint shall not lend money to or borrow money from CNP affiliates**[365] – As a general matter, CenterPoint Houston does not lend to or borrow from its affiliates. However, CenterPoint Houston participates in a money pool with its affiliates, which is advantageous to CenterPoint Houston.[366] While CenterPoint Houston itself is not lending to or borrowing from affiliates directly, the funds in the money pool are periodically loaned to CenterPoint Houston affiliates or to CenterPoint Houston. The Commission should not prevent CenterPoint Houston from continuing to participate in the money pool and receiving the benefits from its participation. The Company will accept a revised commitment, however, as discussed in section III.E.7 below.

- **Dividend restrictions based on net income**[367] – It is CenterPoint Houston's current practice to issue quarterly dividends that are less than net income in the previous quarter. In addition, CenterPoint Houston has a practice of annually truing up its capital structure by issuing dividend payments or making an equity infusion to maintain CenterPoint Houston's capital structure. Under a covenant in its revolving credit agreement, CenterPoint Houston must maintain a debt to capital ratio of 65% at the end of each quarter. Because issuing dividends causes CenterPoint Houston to increase its debt to capital ratio, the covenant in its revolving credit agreement effectively constrains the amount of dividends that CenterPoint Houston can issue to CNP.[368] As such, the proposed measure is not needed, and as written could cause CenterPoint Houston to not be able to comply with other proposed measures. For example, CenterPoint Houston may need to issue a dividend to ensure it is within its authorized capital structure. Because CenterPoint Houston would issue that dividend prior to having finalized financials for either the fourth quarter or the full year, it would not know whether such dividends would exceed fourth quarter net income or cause the aggregation of all dividends issued in that year to exceed that year's annual net income. This could cause CenterPoint Houston to choose between risking not complying with the requirement of limiting dividends to net income (since it needed to true up its capital structure) or risking the possibility of exceeding its permitted equity ratio in its authorized capital structure (which another ring-fencing measure requires) due to the held back dividends.

- **Dividend restrictions based on credit rating**[369] – This measure prohibits CenterPoint Houston from issuing dividends if it falls below its current credit rating of BBB+ (which is its current credit rating from only one agency) and is still well above investment grade. There is no justification given for limiting CenterPoint Houston's dividends while it maintains an investment grade credit rating (which is the case unless CenterPoint Houston's ratings falls below BBB-, not BBB+). Additionally, the restriction is overly vague in that it does not state whether the corporate credit rating/issuer default rating (in the cases of S&P, Moody's, and Fitch respectively) or the senior secured debt credit rating

[365] PFD at 217.

[366] CEHE Ex. 48 at 96 (Exh. EL-R-4) (Lapson Rebuttal).

[367] PFD at 217.

[368] CEHE Ex. 48 at 96 (Exh. R-EL-4) (Lapson Rebuttal).

[369] PFD at 217.

must remain investment grade, and does not specify whether a breach of the restriction occurs when CenterPoint Houston's credit rating falls below the relevant threshold rating for one, two or all three rating agencies. Finally, language requiring CenterPoint Houston to "work to ensure" the maintenance of its credit ratings is vague and cannot be reconciled with a cost of capital result that does not allow the Company to maintain and support its credit metrics.[370] Thus, this language should not be included.

- **Debt Limitation**[371] – CenterPoint Houston currently is party to covenants that require it to maintain no more than 65% of its capital as debt, and it actively manages its capital to maintain its approved capital structure as closely as possible.[372] However, it is not feasible to expect on a day-to-day, or even on a weekly or monthly, basis that CenterPoint Houston will always be able to maintain its exact approved capital structure given ongoing operations and the need to borrow or raise funds to maintain its system.
- **Debt unavailable to affiliates**[373] – The evidence is undisputed that CenterPoint Houston does not secure debts for its affiliates.[374] Therefore, there is no need to adopt a ring-fencing measure to address this issue.
- **Non-consolidation opinion**[375] – As described in detail, this is not relevant or necessary for CenterPoint Houston, which has issued billions of dollars in bonds in its own name for years without the need of a non-consolidation opinion.[376] Non-consolidation opinions are not binding. In addition, although CenterPoint Houston has sufficient measures in place that separate it from CNP, it is CenterPoint Houston's understanding that its participation in the money pool along with CNP and other affiliates may be an obstacle to obtaining a non-consolidation opinion. As described above, at a minimum, the Company's inability to participate in the money pool could have direct negative financial impacts for the Company. The Company could experience additional costs or restrictions in its ability to attract capital depending on the type of measures adopted.

Further, while CenterPoint Houston does not agree that the measure addressing the transfer of material assets or facilities to affiliates is necessary, it agrees that the language the PFD proposes to strike from the measure is reasonable.[377] Finally, CenterPoint Houston agrees with the PFD to the extent that it does not recommend adopting the remaining ring-fencing measures.[378]

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[370] *See* Sections III.A.4 and III.C.1 of CenterPoint Houston's Exceptions.

[371] PFD at 217.

[372] CEHE Ex. 48 at 97 (Exh. R-EL-4) (Lapson Rebuttal).

[373] PFD at 218.

[374] CEHE Ex. 48 at 97 (Exh. R-EL-4) (Lapson Rebuttal).

[375] PFD at 218.

[376] CEHE Ex. 48 at 37:18-38:2 (Lapson Rebuttal).

[377] PFD at 218.

[378] *Id.* at 218-219.

7. Certain new ring-fence measures that will not damage the Company's financial integrity or harm its continued operations are acceptable to CenterPoint Houston

As noted above, CenterPoint Houston understands the Commission's desire to maintain utility separation given the history of EFH bankruptcy and the ring-fencing provisions that protected Oncor. In light of those concerns, and without waiving the arguments raised in Sections III.E.1-6 of these Exceptions, CenterPoint Houston is willing to accept the following ring-fencing measures as proposed:

- CenterPoint Houston'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 Houston;
- The financial covenant in CenterPoint Houston's credit agreement shall not be related to any entity other than CenterPoint Houston. CenterPoint Houston shall not include in its debt or credit agreements any financial covenants or rating-rating agency triggers related to any entity other than CenterPoint Houston.
- CenterPoint Houston shall not pledge its assets in respect of or guaranty any debt or obligation of any of its affiliates. CenterPoint Houston shall not pledge, mortgage, hypothecate, or grant a lien upon the property of CenterPoint Houston except pursuant to an exception in effect in CenterPoint Houston's current credit agreement, such as the first mortgage and general mortgage.
- CenterPoint Houston shall maintain its own stand-alone credit facility, and CenterPoint Houston shall not share its credit facility with any regulated or unregulated affiliate.
- CenterPoint Houston shall maintain registrations with all three ratings agencies.
- CenterPoint Houston shall maintain a stand-alone credit rating.
- CenterPoint Houston's first mortgage bonds and general mortgage bonds shall be secured only with CenterPoint Houston's assets.
- No CenterPoint Houston assets may be used to secure the debt of CNP or its non-CenterPoint Houston affiliates.
- CenterPoint Houston shall not hold out its credit as being available to pay the debt of any affiliates (provided that, for the avoidance of doubt, CenterPoint Houston is not considered to be holding its credit out to pay the debt of affiliates, or in breach of any other ring-fencing measure, with respect to the $68 million of CenterPoint Houston general mortgage bonds that currently serve as collateral for certain outstanding CNP pollution control bonds).
- Without prior approval of the Commission, neither CNP nor any affiliate of CNP (excluding CenterPoint Houston) may incur, guaranty, or pledge assets in respect of any incremental new debt that is dependent on: (1) the revenues of CenterPoint Houston in more than a proportionate degree than the other revenues of CenterPoint Houston; or (2) the stock of CenterPoint Houston.

- CenterPoint Houston 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 Houston.

Additionally, although CenterPoint Houston maintains its objections to the remaining ring-fencing measures, CenterPoint Houston could also accept the adoption of the following measures as modified:

- **Commingling assets with affiliates and lending or borrowing money from affiliates.** Except for its participation in a money pool with its affiliates, which has concrete advantages to the Company, and its customers through lower cost of borrowing, CenterPoint Houston does not commingle assets with affiliate assets, nor does it lend to or borrow from its affiliate. Therefore, CenterPoint Houston would accept the following revised measures (assuming CenterPoint Houston is not otherwise required to obtain a non-consolidation opinion):
  - Except for its participation in an affiliate money pool, CenterPoint Houston shall not commingle its assets with those of other CNP affiliates.
  - Except for its participation in an affiliate money pool, CenterPoint Houston shall not lend money to or borrow money from CNP affiliates.
- **Credit rating requirements**. CenterPoint Houston has presented arguments and evidence regarding why this measure as written is unworkable and maintains its objection to that language. However, CenterPoint Houston can accept a requirement to report to the Commission if it falls below the investment grade threshold. Therefore, CenterPoint Houston accepts the following:
  - CenterPoint Houston 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 Houston believes that the above measures adequately address any concerns the Commission may have with CenterPoint Houston's status as a separate entity from its affiliates and is willing to accept these provisions to achieve a constructive regulatory outcome in this case that balances the concerns raised by the Company and stakeholders on this issue.

8. The PFD should be revised to provide sufficient time for the implementation of any new ring-fence measures and provide for a good cause extension of the implementation deadlines, if necessary

If the Commission decides to impose new ring-fence measures, the PFD's proposed 30-day timeline is insufficient to implement these measures.[379] In some instances, CenterPoint Houston will have to renegotiate credit facilities and make other changes that will likely require more than 30 days as these changes will require the cooperation and consent of third parties.

[379] PFD at 457 (proposed Ordering Paragraph 9).

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Therefore, CenterPoint Houston requests at least 120 days (or as reasonably needed if 120 days is insufficient) to implement these changes. CenterPoint Houston also requests an additional 30 days after the initial implementation to obtain a non-consolidation legal opinion if one is required. This additional time is necessary because a non-consolidation legal opinion must be obtained *after* the Company' makes the other structural changes so that the opinion can be given considering CenterPoint Houston's current structure and arrangements. The Company also requests that it be allowed to seek an extension of the ring-fencing implementation deadlines for good cause if the need should arise. Certain of the measures will require actions by third parties not subject to CenterPoint Houston's control or otherwise require significant time to implement.[380]

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

A. Federal Income Tax Expense [PO Issues 28, 29]

1. Amount of Federal Income Tax Expense [Issue 28]

Although the PFD correctly analyzes this issue, the PFD's number run contains a number of errors for which there are attendant impacts. CenterPoint Houston addresses these computation errors in Section XI of its Exceptions.

2. Effect of TCJA [Issue 29]

Although the PFD correctly analyzes this issue, any capital disallowances prior to 2018 will have an impact on the amount of EDIT that is reflected in the PFD's number run model.

B. Taxes Other Than Income Tax [PO Issue 26]

1. Ad Valorem (Property) Taxes

Although the PFD correctly analyzes this issue, the PFD's number run model incorrectly calculates ad valorem expense. CenterPoint Houston addresses these computation errors in Section XI of its Exceptions.

2. Texas Margin Tax

With the clarifications described in Section II.E.3, the PFD correctly analyzes this issue, and the Commission should adopt its recommendations.

[380] For example, if it is determined that CenterPoint Houston must obtain separate insurance lines to obtain a non-consolidation opinion, doing so could take 4-6 months.

3. Payroll Taxes

Although the PFD correctly analyzes this issue, the PFD's number run contains an error related to calculation of incentive compensation for which there are attendant impacts, including FICA. CenterPoint Houston addresses these computation errors in Section XI of its Exceptions.

C. Labor Expenses

1. Incentive Compensation

The PFD proposes to slash CenterPoint Houston's recovery of reasonable and necessary incentive compensation costs by $24.5 million based on an unwavering adherence to prior Commission decisions in dockets that did not involve CenterPoint Houston. The PFD's proposed disallowance of financially-based STI is both overstated and unsupported by the record evidence. First, the amount of financially-based STI expense at issue in this case is $15.4 million,[381] not $24.5 million[382] included in the PFD's number run model. Second, the PFD inexplicably dismisses the Commission's order approving recovery of STI in CenterPoint Houston's last rate case and ignores evidence that refutes the shareholder-versus-customer benefit test that has been applied in those prior decisions. The PFD also relies on Commission precedent for other utilities to reach its recommendations on incentive compensation recovery, yet ignores the fact that "agencies are not bound to follow their decisions in contested cases in the same way that courts must follow controlling precedent."[383] Instead, when an agency departs from a prior position, it must simply explain its reasoning.[384] Thus, CenterPoint Houston provided ample record evidence that shows why continuing to adhere to prior decisions leads to the denial of reasonable and necessary incentive compensation costs.

Broadly speaking, the evidence is undisputed that CNP must offer incentive compensation to employees at all levels and to award that reasonable compensation based on the achievement of a combination of operational, safety and financial goals.[385] Specifically, CenterPoint Houston presented unrefuted evidence related to the Houston-area and Texas employment market and other factors that are putting increasing pressure on the Company's ability to attract and keep employees.

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[381] *See* Attachment A to these Exceptions & CEHE Ex. 35 at 23 (WP R-KLC-02 ($16,879,888 x 91.34%)) (Colvin Rebuttal).

[382] *See* Docket No. 49421: "49421 – Rev Req Model – ALJ Number Run – 9-9-2019.xlsx" (O&M Adjustments Tab, cells F70 and H70) PUCT Interchange Filing Search, Item No. 722).

[383] *Oncor Elec. Delivery Co. LLC v. Pub. Util Comm'n*, 406 S.W.3d 253, 267 (Tex. App.—Austin, 2013, no pet.).

[384] *Id*

[385] CEHE Ex. 22 at 1849:21-1842:6, 1851:4-13, 1854:12-18 (Harkel-Rumford Direct).

That evidence gives this Commission the opportunity to determine what policy and approach is reasonable regarding incentive compensation based on the facts and circumstances that exist in CenterPoint Houston's service territory today. The undisputed evidence shows:

- **Increasing Competition for Utility Workers**: There is a growing shortage of electric utility line skills because of an aging work force and increased electric utility work in Texas and throughout the country, including increasingly aggressive recruitment of skilled labor from California utilities that are offering compensation packages above the local and national market.[386] Due to these factors, CenterPoint Houston has lost approximately 100 line skills from its internal and contractor resources during the first half of 2019.[387]
- **Low Unemployment Rates**: CNP competes on a national level for executive, managerial and professional positions, and from 2013 through 2018, the national unemployment rate declined from 8.0% to 3.9%.[388] The market for most hourly or non-exempt positions is regional,[389] and the unemployment rate in Texas also declined between 2013 and 2018 from 6.5% to 3.7%.[390]
- **Major Competition in the Houston area**: According to the United States Bureau of Labor Statistics, among the 12 largest metropolitan areas in the country, Houston ranked first in both the number of jobs added in the twelve-month period ending October 2018, which coincides with most of the test year, and the annual rate of job growth.[391] In the trade, transportation, and utilities sector, which includes Houston's largest employers, local employment increased by 2.6%, which is more than double the 1.1% nationwide increase.[392] CNP must also compete with other Houston-based companies that offer a higher level of compensation and benefits, including upstream and midstream energy companies who also need engineers, financial analysts, accountants, and skills that are necessary for CNP to operate safely and reliably.[393]
- **Looming Retirement-Eligible Employees**: Healthy and robust job growth at the national and local levels is occurring at the same time that CNP must cope with a growing number of its employees becoming eligible for retirement. Approximately 29% of CNP employees were eligible to retire in 2018, and 38% will be eligible to retire by 2022.[394]

In its post-hearing briefs, CenterPoint Houston provided a detailed recitation of the evidence on these issues, yet the PFD dismisses this evidence in a single sentence in the long-term incentive

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[386] CEHE Ex. 31 at 16:18-17:8 (Pryor Rebuttal).

[387] *Id.* at 17:4-6.

[388] CEHE Ex. 22 at 1841:7-16 (Harkel-Rumford Direct).

[389] *Id.* at 1842:18-1843:9 & CEHE Ex. 22a (Confidential Exh. LHR-3) (Harkel-Rumford Direct).

[390] *Id.* at 1841:9-11, 1876 (Exh. LHR-1) (Harkel-Rumford Direct).

[391] CEHE Ex. 23 at 1903:14-22 & 1904 (Chart 1) (Reed Direct).

[392] *Id.* at 1905:13-17.

[393] CEHE Ex. 39 at 11:13-17 (Harkel-Rumford Rebuttal).

[394] CEHE Initial Brief at 76-78; CEHE Reply Brief at 89-92; CEHE Ex. 22 at 1840:20-21 (Harkel-Rumford Direct).

compensation ("LTI") analysis, and the evidence is not even mentioned in the STI analysis.[395] Instead, the PFD returns time and again to prior Commission decisions for other utilities while rejecting the importance of the Commission's decision in Docket No. 38339 in which CenterPoint Houston was authorized to collect all STI costs through rates.[396] In that case, the Commission found that STI was a reasonable and necessary component of a total compensation package required to recruit, retain, and motivate employees.[397] That continues to be true today.

The Commission should not be beholden to prior decisions in other cases when the evidence supports a different outcome here. That is particularly true given the recent policy pronouncement from the Legislature and the Governor by the adoption of HB 1767, which creates a statutory 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.[398] As the PFD notes, CenterPoint Houston does not take the position that the statute applies to electric utilities as a matter of law.[399] But that the statute does represent a significant public policy development regarding utility recovery of incentive compensation costs—particularly for a utility such as CenterPoint Houston because CNP operates both gas and electric utilities in Texas, and Human Resources administers compensation and benefits the exact same way for all employees across CNP.[400] In fact, the evidence shows that there are over 1,500 non-union CNP positions who provide services to both CenterPoint Houston and CNP's gas divisions.[401] These include customer service representatives, operations supervisors, land and field services employees and regulatory personnel.[402] When challenged during the hearing on the merits, Company witness John Reed explained that "the conclusion I drew from [HB 1767] was, in this case, this relates to costs incurred under the same programs for

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[395] PFD at 240.

[396] *Id.* at 248, 258-259.

[397] Docket No. 38339, Order on Rehearing at Finding of Fact No. 81 stating "The evidence demonstrates that CenterPoint's short-term incentive compensation plan (STI) is a reasonable and necessary component of a total compensation package required to recruit, retain, and motivate employees."

[398] CEHE Ex. 39 at 8:10-9:4 (Harkel-Rumford Rebuttal); CEHE Ex. 40 at 24:17-25:13 (Reed Direct). Financially-based incentive pay for certain executive officers is excluded from that presumption. CEHE Ex. 40 at 29-31, Exh. R-JJR-1 (Reed Rebuttal).

[399] PFD at 230.

[400] CEHE Ex. 39 at 8:20-23 (Harkel-Rumford Rebuttal).

[401] *Id.* at 9 & 32-45 (Exh R-LHR-1).

[402] *Id.*

the same company and in some cases even the same employees as at issue in this docket for CenterPoint Houston."[403]

The PFD, however, recommends the Commission reject this clear policy signal from the Legislature and Governor and instead proceed down the typical path of focusing only on whether shareholders or customers are the purported beneficiaries of a given incentive compensation goal, despite the fact that this is the first contested case proceeding since the new law was enacted.[404] That approach should not be adopted. As Mr. Reed testified, "a different standard should not apply as a matter of regulatory policy" for CenterPoint Houston regarding the recovery of compensation and benefits costs for the gas utility and the electric utility when both rely on market studies to determine compensation for employees and those employees are offering the same services to both types of utilities.[405]

Even if the Commission continues to focus on whether customers benefit from incentive compensation tied to financial goals, the evidence in this case establishes that customers do benefit when Company employees achieve these goals. Specifically:

- Eighty-five percent of 2018-2019 WorldatWork survey respondents, including 96 utilities, use STI, and CNP's 2018 STI Plan goals were shown to be consistent with goals used by most of CNP's peer utilities.[406]
- The combination of operational, safety and financial goals in the STI and LTI plans encourage employee behavior that aligns the interests of employees, customers, and shareholders.[407] A properly designed incentive compensation plan must include a combination of goals that lead to success for all interested stakeholders.[408]
- All actions the Company and its employees take affect customers *and* shareholders and CenterPoint Houston's employees know this.[409] Likewise, shareholders appropriately expect the Company's primary focus to be on its customers because if the Company does not provide safe, reliable service at a reasonable cost, neither its customers nor shareholders will be satisfied.

[403] Tr. at 1354:14-18 (Reed Cross) (Jun. 28, 2019).

[404] PFD at 230.

[405] Tr. at 1356:7-8 (Reed Cross) (Jun. 28, 2019).

[406] CEHE Ex. 22 at 1851:4-6, 1853:20-1854:9 & CEHE Ex. 22a Confidential Exhs. LHR-5 and LHR-6 (Harkel-Rumford Direct).

[407] CEHE Ex. 22 at 1854:3-1855:18, 1860:20-1861:9 (Harkel-Rumford Direct).

[408] CEHE Ex. 39 at 7-8, 15, 20 (Harkel-Rumford Rebuttal).

[409] CEHE Ex. 40 at 14:4-15:6 (Reed Rebuttal).

- Company witness Lynne Harkel-Rumford explained during the hearing that investment from shareholders gives the Company the opportunity to install infrastructure, make capital expenditures, and manage rates charged to customers by lowering borrowing costs.[410]

This evidence supports CenterPoint Houston's recovery of financially-based STI expenses in the amount of $15.4 million and LTI expenses in the amount of $7.5 million and the PFD should be revised accordingly to both correct its error regarding the amount of financially-based STI expenses included in the Company's RFP and to provide for recovery of the above-reference amounts in rates.

As to the specifics of the PFD's positions on STI:

- **Union STI Costs Are Deemed Reasonable**: The PFD erroneously recommends a disallowance of union-related STI by concluding that Commission precedent is sufficient evidence to trump the presumption of reasonableness for an employee wage that is the product of a collective bargaining agreement under PURA § 14.006.[411] A presumption is a rule of law requiring the trier of fact to reach a particular conclusion in the absence of evidence to the contrary.[412] Yet, some parties were unaware of the presumption until it was raised during the hearing. For example, TIEC witness Billie S. LaConte admitted she did not review PURA § 14.006. And after it was brought to her attention, Ms. LaConte confirmed that her position to disallow union STI costs was contrary to Texas law.[413] Yet, the PFD summarily concludes that even though Staff, COH, OPUC and TIEC did not specifically address financially-based union STI costs, the arguments they presented apply to all financially-based incentive compensation costs.[414] No party, however, specifically addressed union STI costs or presented evidence contrary to the presumption that the applicable collective bargaining agreements and their related compensation amounts were reasonable. Thus, union STI expenses in the amount of $1,490,322 should be approved.[415]

- **CNP O&M Expenditures is an Operational STI Goal**: Contrary to the PFD's position that this goal be considered financial, simply because a goal is measured in dollars does not make it a financial goal. In fact, CNP explains this goal is an operational one in communications with employees,[416] and the goal motivates employees to find operational efficiencies that benefit customers through

[410] Tr. at 1344:16-22 (Harkel-Rumford Cross) (Jun. 28, 2019).

[411] PFD at 230-231; PURA § 14.006 states, "[t]he commission *may not* interfere with employee wages and benefits, working conditions, or other terms or conditions of employment that are the product of a collective bargaining agreement recognized under federal law. An employee wage rate or benefit that is the product of the collective bargaining is presumed to be reasonable." (emphasis added).

[412] *Temple Independent School Dist v English*, 896 S.W.2d 167, 169 (Tex. 1995).

[413] Tr. at 438, 446, 437-438 (LaConte Cross) (Jun. 25, 2019).

[414] PFD at 244.

[415] *See* CEHE Ex. 35 at 17:1-10 (Colvin Rebuttal); PFD at 231 n.894. These amounts exclude FICA and Savings Match.

[416] Tr. at 307:12-21 (Harkel-Rumford Cross) (Jun. 25, 2019).

reasonable rates, safe and reliable operations and enhanced customer service.[417] In addition, this goal is calculated by starting with total O&M that is adjusted to remove items that have revenue offsets or are outside of employees' control.[418] When employee efforts help the Company successfully manage O&M expenses, those efforts help limit the growth in the overall revenue requirement and therefore reduce customer rates. Yet, the PFD's position highlights the flaw that is inherent in the customer-versus-shareholder benefit concept that is revealed in the PFD's reference to there being no way to know if the cost savings achieved due to this goal are used for a purpose that benefits customers.[419] All of the Company's investment and cost savings benefit customers and shareholders.[420] Because CNP O&M Expenditures is an operational goal, the Commission should reject the PFD's recommendation to disallow $2,317,609 in STI costs.[421]

- **A "funding trigger" for STI operational and safety goals does not warrant a disallowance**: CNP maintains a funding trigger for STI related to achievement of core operating income that is in place to ensure that CNP is financially healthy and able to fund existing operations before providing employees with incentive pay. Rather than encourage this type of responsible financial decision-making, the PFD adopts the Intervenor and Staff positions that half of the STI related to operational and safety goals should be disallowed due to this "trigger."[422] The position in the PFD is also tied to prior Commission decisions on this concept, while disregarding evidence that shows the usefulness of the threshold. For these reasons, and because customers are the direct beneficiaries of operational and safety goals, regardless of a "funding trigger," the Commission should reject the PFD's recommendation to disallow $1,461,798 in STI costs.[423]

Finally, even if the Commission adopts the PFD's positions on incentive compensation, a double-counting error in the STI calculation must be fixed. The PFD finds that the total STI expense CenterPoint Houston requested to recover through rates in this proceeding is $16,879,888.[424] The calculation of this total amount can be found in the record on WP R-KLC-02.[425] This should be the starting point of any STI disallowance calculation. The PFD's calculation, however, relies on an incorrect starting point, using RFI PUC03-01 for Direct

[417] CEHE Ex. 39 at 15:5-22 (Harkel-Rumford Rebuttal).

[418] *Id.*

[419] PFD at 240, 253.

[420] CEHE Ex. 39 at 15:5-22 (Harkel-Rumford Rebuttal).

[421] *See* CEHE Ex. 35 at 17:1-9 (Colvin Rebuttal); disallowance calculated using total requested STI expense of $16,879,888 (PFD at 231) multiplied by O&M Expenditures goal weighting of 13.74% (PFD at 238).

[422] PFD at 244-245.

[423] *See* CEHE Ex. 35 at 17:1-9 (Colvin Rebuttal); disallowance calculated using total requested STI expense of $16,879,888 (PFD at 231) multiplied by half of the sum of the customer satisfaction (7.09%) and safety goal weighting (10.22%), which is 8.66% (PFD at 238).

[424] PFD at 231.

[425] *See* CEHE Ex. 35 at 17:1-9 & 23 (WP R-KLC-02 - STI Expense Calculation Summary) (Colvin Rebuttal).

STI and V-K-6.1 for Affiliate STI.[426] Importantly, RFI PUC03-01 includes both capital and O&M book amounts for the test year. This is not the amount requested in the case. The PFD further compounds this error by failing to remove the capital portion of STI to derive the O&M STI. Therefore, even if the Commission adopts the PFD's position, by using WP-R-KLC-02, the maximum disallowance of STI costs should be $15,418,090, or 91.34% of $16,879,888.

2. Executive Employee Related Expenses

The PFD also errs by disallowing payroll expense in the amount of $1.14 million based on an unprecedented and arbitrary new standard for assessing the reasonableness of executive base pay. The ALJs rely, without explanation, on a theory advanced by COH witness Mark Garrett that executive compensation should be based on what is tax-deductible under the TCJA. In short, Mr. Garrett rationalizes that anything in excess of the $1 million tax-deductibility threshold in the TCJA is discretionary and only necessary to incentivize executive employees to increase the Company's stock price. In fact, the $1 million cap on deductible executive compensation in the TCJA has nothing to do with setting competitive levels, the reasonableness and necessity of that compensation, or ratemaking in general at this Commission.[427] Neither Mr. Garrett nor the PFD explain why the TCJA should be used as a threshold for reasonability or why compensation exceeding this threshold signifies a deference to financial performance over the interests of customers.[428] Nor do they point to any instance where the Commission has relied on this standard in prior cases.

A more appropriate metric for the reasonableness of executive compensation are market studies providing a comparison to other utilities, as provided by the Company, because they reflect the amount of compensation necessary to acquire and retain executive-level employees.[429] COH did not even contest that CNP uses a market-based approach, that such approach ensures salaries for executive positions target the median of the market, or that its Board retained a third-party consultant to ensure the compensation offered to senior executives remains competitive.[430] Texas legislators and the Governor have, in fact, codified this approach for analyzing executive

[426] *See* Docket No. 49421: "49421 – Rev Req Model – ALJ Number Run – 9-9-2019.xlsx" (Incentive Compensation Tab) (PUCT Interchange Filing Search, Item No. 722).

[427] CEHE Ex. 39 at 28:1-29 (Harkel-Rumford Rebuttal).

[428] As Ms. Harkel-Rumford testified, she has observed the behavior of CNP officers that demonstrates a balanced loyalty to all stakeholders, including customers. CEHE Ex. 39 at 26:20-21 (Harkel-Rumford Rebuttal).

[429] *Id.* at 28:11-14; CEHE Ex. 40 at 25:11–13 (Reed Rebuttal).

[430] PFD at 249 n.947 (citing CenterPoint Ex. 22 at 1844).

compensation in setting gas utility rates through their adoption of HB 1767. The ALJs, however, completely ignore this evidence, without explanation, and disallow *all* executive base pay in excess of the $1 million tax-deductibility threshold in the TCJA that was allocated to CenterPoint Houston.[431]

To that end, if the Commission elects to adopt the TCJA tax-deductibility threshold recommended by Mr. Garrett, the evidence shows that Mr. Garrett grossly miscalculated—by almost ten-fold—CenterPoint Houston's senior executive salaries that exceed the $1 million threshold.[432] Additionally, if the total compensation amount allocated to the Company of $1.14 million (which includes base salary, STI, LTI, and BRP) is disallowed, it will result in an improper double disallowance of STI, LTI, and BRP amounts because the PFD separately recommends disallowing 92% of STI, 66% of LTI, and 100% of BRP.[433] As to the first point, the evidence established the $1.14 million disallowance recommended by Mr. Garrett represents the *total* amount of senior executive base pay compensation allocated to the Company.[434] This is evidenced on Page 41 of the Company's 2019 Proxy Statement,[435] which identifies the salaries of five executives, only one of which exceeds the $1 million TCJA threshold, by $245,000, as shown below:[436]

Name and Principal Position	Year	Salary ($)
Scott M. Prochazka	2018	1,245,000
President and Chief Executive	2017	1,154,925
Officer	2016	996,525
William D. Rogers	**2018**	**588,750**
Executive Vice President and	**2017**	**555,000**
Chief Financial Officer	**2016**	**485,000**
Tracy B. Bridge	2018	535,000
Executive Vice President and	2017	512,499
President Electric Division	2016	481,250
Milton Carroll	**2018**	**701,250**
Executive Chairman	**2017**	**662,500**
	2016	**618,750**
Dana C. O'Brien	2018	511,249
Senior Vice President and	2017	492,500
General Counsel		

431 *Id.* at 250-251.

432 CEHE Ex. 37 at 19:1-23 (Townsend Rebuttal).

433 Additionally, the PFD's reliance on a 92% total STI disallowance for financially-based incentive compensation overstates the amount of financially-based STI requested by the Company. The metric weightings shown on page 251 of the PFD total 91.34%, not 92%.

434 CEHE Ex. 37 at 19:1-23 (Townsend Rebuttal).

435 *Id.* The 2019 Proxy Statement is available at http://investors.centerpointenergy.com/static-files/69174ece-f776-41b7-bffb-98bdbe209f94.

436 *Id.* at 19:18-21.

CenterPoint Houston receives an allocated 54.20% share of this $245,000,[437] or $132,786. The PFD should be revised to reflect this fact if the Commission adopts Mr. Garrett's threshold. The PFD misconstrues this distinction and mistakenly disallows *all* senior executive base pay allocated to CenterPoint Houston.[438] For these reasons, if the Commission elects to use the tax-deductibility threshold, the Company's alternative calculation should be adopted.

3. Payroll Adjustments

The PFD reaches the right position on most payroll adjustment issues in this case.[439] The only such issue to which CenterPoint Houston excepts relates to the PFD's inconsistent conclusion to disallow base pay related to 32 employees who were terminated due to the Vectren acquisition that occurred after the end of the test year while ignoring the corresponding severance costs.[440] The PFD declares that the $1.65 million in payroll for those employees is a known and measurable adjustment to test year costs and should be removed. While the Company disagrees with that position, the reversible error occurs when the PFD also rejects inclusion of related severance expense for the 32 employees. The evidence shows the Company incurred $3.9 million in severance costs to achieve the $1.65 million reduction in payroll expense.[441] The PFD, however, recommends that the Commission ignore severance costs because, "there is no evidence to prove those costs and they are not representative of future rates."[442]

In fact, CenterPoint Houston's uncontroverted evidence established the existence and the amount of severance costs.[443] In addition, the evidence shows that providing severance pay to employees whose jobs are impacted through no fault of their own is fair, reasonable, and consistent with market practices. Indeed, CenterPoint Houston's experience confirms severance costs are a recurring expense.[444] The Company also provided evidence that, going forward, any changes or

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[437] *Id.* at 19:14-23.

[438] *Id.* at 19:1-23. While the ALJs observe that the Company did not attach the 2019 Proxy Statement to its rebuttal testimony, the statement and page number are referenced and attested to in Company witness Michelle Townsend's rebuttal testimony and are publicly available on CenterPoint Houston's website. http://investors.centerpointenergy.com/static-files/69174ece-f776-41b7-bffb-98bdbe209f94.

[439] PFD at 257.

[440] *Id.* at 255-257, 268-269.

[441] CEHE Ex. 39 at 29:6-9 (Harkel-Rumford Rebuttal); CenterPoint Ex. 35 at 20:2-4 (Colvin Rebuttal).

[442] PFD at 256.

[443] CEHE Ex. 35 at 19:23-20:6 (Colvin Rebuttal); CEHE Ex. 2 at 273-274 (Schedule II-D-3.6.1).

[444] CEHE Ex. 39 at 29:9-17 (Harkel-Rumford Rebuttal).

savings related to the Vectren acquisition would entail costs to achieve those savings.[445] Finally, other severance costs are included in the Company's request in this case, and no party challenged those amounts.[446] Accordingly, as CenterPoint Houston established, severance costs are a recurring expense that should be recovered through rates if the base pay for the 32 severed employees is removed from rate recovery.[447]

4. Benefit Restoration Plan Expenses

Like the PFD's position on financially-based incentive compensation costs, the PFD blindly adheres to prior Commission decisions in recommending a disallowance of BRP expenses.[448] In doing so, the PFD defaults to the customer versus shareholder benefit mindset that is applied to financially-based incentive compensation and assumes that the high-level employees who are eligible for this benefit have interests that are more closely aligned with shareholders and not customers.[449] To the contrary, the evidence demonstrates that CenterPoint Houston should be authorized to recover BRP expenses because:

- Evidence addressed in Section IV.C.1 shows how competitive the Houston-area job market is currently and that over one-third of CNP employees will be retirement-eligible by 2022.
- Many utility and energy companies provide retirement plans, and the BRP is simply an extension of the Retirement Plan available to all other employees that is designed to restore a benefit for employees whose pay is over the IRS limit.[450] That limit is not related to the reasonableness of the pay or the benefit.
- CNP must offer this benefit to eligible employees as part of their total compensation package in order to *retain* those employees and provide a compensation level that is commensurate with their level of responsibility.[451] Given the reality of retirement-eligible employees, retention is critical at this time.
- Pitting the interests of shareholders and customers against one another ignores the basic principle that to be recovered costs must simply be reasonable and necessary[452] and is inconsistent with the way CNP structures benefit options for employees. Contrary to the argument that employees eligible for the BRP are more closely aligned with shareholders,

[445] CEHE Ex. 47 at 9:6-12. (Myerson Rebuttal).

[446] CEHE Ex. 39 at 29:17-19 (Harkel-Rumford Rebuttal).

[447] *Id.* at 29:16-17.

[448] PFD at 259.

[449] *Id.*

[450] CEHE Ex. 22 at 1868:9-13 (Harkel-Rumford Direct).

[451] CEHE Ex. 39 at 25:15-23 (Harkel-Rumford Rebuttal).

[452] *Id.* at 26:9-14.

the actions of CNP officers and executives demonstrate a balanced approach to customers and shareholders.[453]

- Contrary to the language cited by intervenors and referenced in the PFD, providing a competitive compensation and benefits package is not "discretionary"—it is critical to CNP's ability to attract and retain the management personnel who are necessary to operate the utility and provide strategic and management guidance.[454]

Because the evidence and facts in this case support the provision of a BRP and its related costs, CenterPoint Houston should be authorized to recover $1.783 million.

D. Depreciation [PO Issue 25]

Although the PFD correctly analyzed the issues related to depreciation expense, the PFD's number run model fails to apply the correct FERC accounts to calculate depreciation expense. CenterPoint Houston addresses these computation errors in Section XI of its Exceptions.

E. Affiliate Expenses [PO Issues 35, 36]

1. CenterPoint's Vectren Acquisition Adjustment

The PFD errs by disallowing $1.6 million in known and measurable expenses related to the normalized integration planning billing by Service Company employees. As explained in the direct and rebuttal testimonies of Ms. Townsend, during the test year, many Service Company employees worked on integration planning activities, which are not part of the normal daily activities provided by Service Company.[455] In order to accurately capture a normal test year, an adjustment was made to normalize integration planning billings to reflect Service Company's employee labor that would have been billed to CenterPoint Houston during this time if the integration planning for the Vectren transaction had not occurred. The adjustment is known and measurable because the Company knows:[456]

- the direct charges that Service Company employees billed to work on Vectren integration activities;
- the Vectren integration activities are not part of the normal daily activities provided by Service Company to CenterPoint Houston during a normal test year;
- the 2018 Service Company planned billings to CenterPoint Houston; and
- what was billed to CenterPoint Houston as a result of Service Company employees being reassigned to support the Vectren transaction.

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[453] *Id.* at 26:15-27:5.

[454] *Id.* at 27:6-15.

[455] CEHE Ex. 37 at 16:3-15 (Townsend Rebuttal).

[456] *Id.*

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The PFD, however, asserts that the Company did not satisfy the known and measurable standard because the adjustment includes "some components that were known but also estimates and assumptions."[457] This is an incorrect application of the known and measurable standard. The Commission's prior treatment of known and measurable adjustments is based on ensuring that rates are based on representative costs and "reasonable certainty," [458] not eliminating all uncertainty, estimates or assumptions.[459] Similar adjustments are regularly made for test-year end customer or employee counts.[460] And, the only assumption inherent in the calculation is that Service Company employees will perform their normal job duties after their participation in Vectren integration activities has concluded. This is no different than the reasonable assumptions made to adjust labor expense for known pay increases or newly hired employees. The adjustment is measurable based on planned billing amounts during the test year, which as Ms. Townsend testified are representative of ongoing work performed by Service Company on behalf of CenterPoint Houston.[461]

2. Compensation for Use of Capital/Affiliate Carrying Charges

The PFD errs in its disallowance of compensation for use of capital and affiliate carrying costs. CenterPoint Houston has shown that Service Company assets are used and useful and held for the benefit of the business units, including CenterPoint Houston.[462] CenterPoint Houston has also 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.[463] Therefore, just as a return is earned on the assets held by CenterPoint Houston, the assets held by Service Company for the benefit of CenterPoint Houston should earn a return, consistent with PURA § 36.051. Finally, while the PFD points to two prior Commission cases, it does not explain how or why the facts of those cases should apply to CenterPoint Houston.[464] The

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[457] PFD at 282.

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

[459] *See, e.g , Application of AEP Texas Central Company for Authority to Change Rates*, Docket No. 33309, PFD at 103-108 (Aug. 30, 2007) (approving group insurance and savings plan insurance based on annualizing last month of test year); *Application of CenterPoint Energy Application for Authority to Change Rates*, Docket No. 38339, PFD at 64-65 (Dec. 3, 2010) (approving annualization of last three months of test year).

[460] CEHE Ex. 45 at 33:7-12 (Troxle Rebuttal).

[461] CEHE Ex. 15 1111:16-1112:17 (Townsend Direct).

[462] CEHE Ex. 37 at 13:5-14:10 (Townsend Rebuttal).

[463] *Id.* at 13:11-16.

[464] PFD at 286

Company asks the Commissioners to consider the merits of its request based on the record in this proceeding and to approve the requested compensation for use of affiliate capital.

F. Injuries and Damages

The PFD also rejects the Company's reasonable request to recover $20.5 million for Injuries and Damages expense, which is supported by an actuarial report that determines the level of expense that is likely to occur in 2019.[465] The PFD's recommendation on this issue should be revised for a number of reasons. First, the PFD ignores the fact that the Company through the RFI process directed the intervenors to the detailed information needed to analyze the trend of injuries and damages claims. Second, the PFD's recommendation undermines the importance of the actuarial studies performed by Milliman, Inc., which assess the Company's obligation for funding projections and unpaid claim estimates for workers' compensation benefits, and auto and general liability claims.[466]

In recommending the use of a five-year average of injuries and damages expense, the PFD finds that the test year amount of Injuries and Damages expense is not normal or recurring.[467] The evidence, however, shows that since 2009, CenterPoint Houston's Injuries and Damages expenses have increased nearly every year—the 2009 expense was $7.3 million whereas the 2018 test-year level of expense was $22.8 million.[468] Thus, contrary to the PFD's premise, there is no evidence in the record that a five-year average of injuries and damages expense reflects the ongoing level of expense. In fact, all of the evidence in the record reflects that the PFD recommends a level of expense for injuries and damages that is not reflective of ongoing, recurring costs. The evidence shows CenterPoint Houston's actual injuries and damages expense for the twelve-month period ending in April 2019—four months after the end of the test year—was $22.8 million, which is higher than the Company's requested expense level.[469] The PFD's recommendation is contrary to this increasing trend.

Finally, utility rates are calculated based on test year amounts, adjusted for known and measurable changes—rates are not calculated based on multi-year averages.[470] Staff's proposed

[465] *Id.* at 287-289; CEHE Ex. 1 at 3967-3968 (Schedule II-D-2).

[466] CEHE Ex. 12a at Confidential Exhs. KLC-04 & KLC-05 (Colvin Direct).

[467] PFD at 289.

[468] Staff Ex. 4A at 22, Table MF-3 (Filarowicz Direct); PFD at 287.

[469] CEHE Ex. 35 at 23:21-23 & 80 (WPR-KLC-04) (Colvin Rebuttal).

[470] *Id* at 21:20-22.

five-year average amount recommended by the PFD results in a total expense of $18.2 million, which reflects a level of expense experienced by the Company five years ago.[471] In contrast, the Company's injuries and damages expense request is known and measurable and reflects the expected ongoing level of expense based upon an actuarial report. For these reasons, the Commission should not adopt the PFD on this issue.

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

The Company's Exceptions to the PFD's findings related to Hurricane Harvey Restoration costs are address in Section II.E.4. above.

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

The PFD's recommendation on this issue should be approved.

I. Vegetation Management

The PFD correctly analyzes the record evidence relating to the Company's test-year vegetation management expenses and its recommendation should be approved.

J. Smart Meter Texas Expense

While the Company does not agree with the PFD's recommendations related to Smart Meter Texas Expense, it is not filing Exceptions on this issue to reduce controversy.

K. Street Lighting Expense

The PFD's recommendation on this issue should be approved.

L. Loss on Sale of Land

The PFD correctly analyzes the record evidence relating to the Company's loss on the sale of land during the test-year and its recommendation should be approved.

V. WHOLESALE TRANSMISSION COST OF SERVICE [PO Issues 4, 5, 6, 37]

Although the Company has no Exceptions to this portion of the PFD, CenterPoint Houston has identified errors in the PFD's number run model related to this issue. These errors and the necessary corrections are discussed in Section XI of the Company's Exceptions.

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

As discussed in Section XI of its Exceptions, CenterPoint Houston has identified several items associated with the billing determinants reflected in the PFD's number run model that should be corrected.

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[471] PFD at 287, Injuries and Damages expense in 2014 was $18.5 million.

A. Weather Normalization

The PFD recommends a 10-year period for determining normal weather,[472] a result that comports with recent Commission decisions, but is not the best policy. The Commission should establish a policy of using 20-year forecasts to determine normal weather in base rate cases. CenterPoint Houston does not dispute that the Commission has used a 10-year period to determine normal weather in recent cases, but it is worth noting that a 30-year normal weather was adopted for use in CenterPoint Houston's last rate case, Docket No. 38339. However, testimony by Company witness J. Stuart McMenamin strongly supports CenterPoint Houston's position that the Commission should, as the body that sets policy, shift to a 20-year period.

First, Dr. McMenamin testified that using shorter periods, such as a 10-year normal "provides a less stable measure, that can vary significantly depending on the 10-year period that is selected."[473] Second, Dr. McMenamin presented the results of survey data, reproduced in the PFD, indicating that utilities have shifted away from using a 30-year period or 10-year period and now favor a 20-year period.[474] In rejecting Dr. McMenamin's recommendation, the PFD focuses on arguments by the contesting parties that "Dr. McMenamin failed to provide the underlying data," and that "the studies were performed by a group under Dr. McMenamin's direction."[475] Those are odd criticisms.

Dr. McMenamin produced the *results* of the survey, and the surveys themselves were readily available on Itron's website.[476] There is no suggestion that Dr. McMenamin misrepresented those results, and no party asked for the underlying data in discovery. Even more puzzling is the suggestion that Dr. McMenamin's testimony is somehow less reliable because the survey was performed under his direction—a fact that actually makes him *more* qualified to speak to the survey and its results. Rather than considering Dr. McMenamin's survey results to make an informed decision on the appropriate weather normalization period to use, the PFD defaults to recent Commission decision. Nevertheless, the Commission should also recognize that 30-year normal weather was last adopted for CenterPoint Houston and exercise its policy-making authority

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472 *Id.* at 319.

473 CEHE Ex. 44 at 27-28:1-2 (McMenamin Rebuttal).

474 *Id.* at 28:3-29:13; PFD at 317.

475 PFD at 314.

476 Tr. at 367:13-14 (McMenamin Cross) (Jun. 25, 2019).

to shift to a more moderate and stable 20-year period for determining normal weather, which is the period most often relied upon today by utilities for their own forecasting.

B. Energy Efficiency Plan Adjustment

While the Company does not agree with the PFD's recommendations related to this issue, it is not filing Exceptions on this issue to reduce controversy.

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

CenterPoint Houston has identified a number of issues or errors associated with functionalization and cost allocation that require correction in the PFD's number run model.

A. Functionalization

1. Texas Margin Tax Expense and Associated Accounts

The Company agreed in rebuttal testimony[477] to Staff witness Brian T. Murphy's theory of functionalizing the costs in FERC account 565 to retail customers. However, the PFD holds the functionalization percentages constant to the Company's original filing.[478] As flow-through impacts from the PFD will change the calculation of FERC account 565, the Company believes the TMT functionalization percentages will change accordingly.

2. Miscellaneous General Expense (FERC Account 930.2)

The Company agreed in rebuttal testimony[479] to Mr. Murphy's theory of directly assigning certain additional costs in FERC Account 930.2. However, the PFD holds the functionalization percentages constant to the Company's original filing.[480] As flow-through impacts from the PFD are considered, the Company believes the functionalization of FERC Account 930.2 is not static and the functionalization percentages will change accordingly.

3. Unprotected Excess Deferred Income Tax

The Company believes it is appropriate to apply the unprotected EDIT benefit to retail customers. However, the PFD incorrectly recommends the use of Mr. Murphy's functionalization proportion percentages to apply Rider UEDIT to both transmission and distribution.[481] If it is determined that Rider UEDIT should be functionalized to both transmission and distribution, the

[477] CEHE Ex. 35 at 47:18-20 (Colvin Rebuttal).

[478] PFD at 329-330.

[479] CEHE Ex. 35 at 48:13-16 (Colvin Rebuttal).

[480] PFD at 332.

[481] *Id.* at 335.

Company requests that the net plant functionalization factor reflect the most current flow-through impacts related to the applicable capital disallowances. The Company defers to the Commission as to the appropriate functionalization of these costs.[482]

B. Class Allocation

CenterPoint Houston has no Exceptions to this section of the PFD.

VIII. REVENUE DISTRIBUTION AND RATE DESIGN [PO Issues 4, 5, 43, 49, 50]

A. Residential Customer Charge

The PFD correctly analyzed this issue and its recommendation should be approved.

B. Customer and Meter Charges – Per Meter Basis vs. Per Customer Basis

The PFD errs in rejecting CenterPoint Houston's proposal to assess the Customer and Meter charge on a per-meter rather than the current per-customer basis. The purpose for changing the Customer Charge and Metering Charge in the transmission and distribution rate schedules from a "per Retail Customer" to a "per meter" basis is to recover the costs associated with the acquisition, operation and maintenance of additional meters serving the same retail customer premises.[483] As explained in rebuttal testimony, Retail Customers who take service through multiple meters often do so at their own request rather than by any necessity.[484] This tariff change assures that those customers pay the costs for the meters used to serve them rather than being subsidized by other customers.[485] Furthermore, CenterPoint Houston's current retail rate schedules already indicate that customers taking delivery using more than one meter will be incur an additional charge.[486] This change simply clarifies the additional charge that will be applicable and assigns the cost to the entity causing the cost to be incurred, consistent with principles of cost-causation.[487] This tariff change should be adopted.

C. Transmission Service Facility Extensions

The Company has no Exceptions to this section of the PFD.

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482 CEHE Ex. 30 at 46:3-11 (Troxle Direct).

483 CEHE Ex. 45 at 45:13-20 (Troxle Rebuttal).

484 *Id.* at 46:22-47:3.

485 *Id.* at 46:2-5.

486 *Id* at 45:22-46:2.

487 *Id* at 46:4-5.

D. Street Lighting Service

The PFD's rejections of CenterPoint Houston's proposal to adopt LED streetlights as the new standard streetlight is poor policy. The following facts—all of which are recognized in the PFD—support the adoption of LED as a new standard: (1) LED luminaires provide approximately 60% kWh energy saving for the end use customer; (2) over the life of the asset, the cost of an LED luminaire is less than the cost of an equivalent High Pressure Sodium luminaires; (3) LED luminaire installations for streets and roadways across the country increased from 0.3% in 2010 to 28.3% in 2016, which directly affect manufacturing, availability and cost of older technologies;[488] (4) to that end, GE announced in 2015 that it was discontinuing production of certain traditional lighting products in favor of LED and smart technology;[489] and (5) maintaining an inventory of all luminaire types (both LED and non-LED) will result in additional costs to be borne by the ratepayers.[490]

Additionally, while the PFD points to Staff's concerns about the "uncertain" financial impacts of this shift to LED lights, these concerns were shown to be unfounded. As explained in the Company's rebuttal testimony,[491] the Company performed an analysis of the costs of shifting to LED as the new standard and included it in its RFP.[492] It showed that the cost for a non-LED installation versus an LED installation is indistinguishable, known and measurable and easily comparable.[493] The PFD ignored this evidence entirely, deferring to the *potential* "customer choice" for an outmoded technology. Based on these record facts, CenterPoint Houston's proposal is prudent, rational and cost-effective and should be adopted.

E. Discretionary Services - Pre-Interconnection Study Costs

The PFD correctly analyzed this issue and its recommendation should be approved.

488 CEHE Ex. 33 at 20:12-23:9 (Sugarek Rebuttal).

489 *Id.* at 23:3-6; *see id.* at Exh. R-JPS-18 (stating that "luminaire manufacturers estimate that they'll be manufacturing solid-state light . . . exclusively within five years").

490 *Id.* at 23:8-9.

491 CEHE Ex. 45 at 43:8-11 (Troxle Rebuttal).

492 Errata 1 WP-Streetlight Rate Design tabs Tariff Comp, SLS Rate Design, and Schedules A thru E.

493 *Id.*

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

A. Rider UEDIT [PO Issue 51]

1. Recovery Period for Rider UEDIT

The PFD errs in recommending a one-year period to return reclassified protected EDIT to customers and a two-year period to return other unprotected EDIT to customers.[494] As an initial matter, the PFD's recommendation continues to ignore the cash flow issues and rating agency consequences of such a recommendation. Moreover, the PFD completely ignores the undisputed evidence that:

- the Company's EDIT balance may change significantly over time if a change in tax laws occurs or specific guidance from the Treasury or IRS is issued;[495]
- the three-year period for returning unprotected EDIT to customers proposed by the Company is consistent with the period requested by CenterPoint Houston for other regulatory assets and liabilities;[496] and
- a one-year return period would be much shorter than the unprotected EDIT refund periods approved in other *Texas* utility rate cases.[497]

It likewise fails to acknowledge undisputed evidence demonstrating a one -year refund period risks a potential incorrect refund to customers and treats CenterPoint Houston differently on this issue than any other utility in the state, all for the sake of a faster refund. This should not be the case. A three-year time period of Rider UEDIT allows CenterPoint Houston to appropriately track the Company's balances of protected EDIT and unprotected EDIT, take any changes into account if prompted by a change in the tax law or IRS guidance during that time period if they occur, and to record an over- or under-balance of amounts collected under the Rider UEDIT compared to the actual net liability amount.[498] It is fair to both CenterPoint Houston and its customers.[499] The Company's proposed recovery period should be approved.

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[494] PFD at 374-375.

[495] CEHE Ex. 13 at 1007:3-5 (Pringle Direct).

[496] *See also Application of Houston Lighting and Power Company*, Docket No. 8425, Order at Finding of Fact No. 245 (Jun. 20, 1990) (addressing unprotected deferred taxes when the federal income tax rate decreased in 1986 and 1987 and concluding that "[t]he evidence supports a three year amortization period for unprotected excess deferred income taxes").

[497] *See, e g., Application of Oncor Electric Delivery Company LLC for Authority to Decrease Rates*, Docket No. 48325, Order at Finding of Fact No. 31 (Apr. 4, 2019) (10-year amortization period); Docket. No. 48401, Final Order at Finding of Fact No. 18 (Dec. 20, 2018) (5-year amortization period).

[498] CEHE Ex. 12 at 909:18-910:5 (Colvin Direct).

[499] CEHE Ex. 35 at 61:14-62:10 (Colvin Rebuttal).

2. Amount to Return through Rider UEDIT

a. The establishment of a separate proceeding to address the treatment of securitization-related EDIT amounts would constitute an impermissible attack on prior Commission orders and settlement agreements, is unnecessary, and would be poor policy.

The PFD correctly concludes that GCCC's request to add $158 million in EDIT associated with Transition Bonds and System Restoration Bonds to Rider UEDIT should be denied *if* that return would be contrary to Commission orders or Commission-approved settlement agreements, yet then incorrectly finds that there was insufficient evidence to make an informed decision on the merits.[500] The PFD's finding as to the sufficiency of the evidence is in error. Likewise, the PFD's recommendation to sever this issue into a separate proceeding undermines the sanctity of settlements, which is a poor public policy result. Both of the settlement agreements associated with the $158 million are in the record, and those settlement agreements and the Commission orders in those dockets are clear.[501] All future and potential Accumulated Deferred Federal Income Tax ("ADFIT") issues related to transition costs and system restoration costs were fully settled once and for all in agreements approved by the Commission. The establishment of a separate proceeding to address the treatment of securitization-related EDIT amounts is thus not only poor policy but barred by res judicata and collateral estoppel.[502]

i. Both the Transition Bond and System Restoration Bond proceedings fully and finally addressed the future treatment of ADFIT

Under the doctrines of res judicata and collateral estoppel, claims and related matters that should have been litigated in a prior suit, are barred when a final judgment on the merits involving the same parties has been issued.[503] In this case, it is undisputed that, all potential future ADFIT benefits on Transition Bonds, as well as the need to adjust the ADFIT balance relating to Transition Charges and any related potential future benefit was identified by the Company and Staff in pre-

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[500] PFD at 394.

[501] CEHE Ex. 65 (Transition Bonds Settlement Agreement); CEHE Ex. 66 (Docket No. 37200, System Restoration Bonds Settlement Agreement).

[502] *Bar v. Resolution Trust Corp.* 837 S.W.2d 627, 628 (Tex. 1992); *Texas General Indem. Co. v Tex. Workers Compensation Comm'n*, 36 S.W.3d 635, 638 (Tex. App.—Austin 2000, no pet.).

[503] *Amstadt v. United States Brass Corp.*, 919 S.W.2d 644 652 (Tex. 1996).

filed testimony in those transition proceedings.[504] The same is true with respect to the Company's System Restoration Bonds.[505]

In fact, with respect to the Transition Bonds, the unambiguous language of the settlement agreement reads:

> WHEREAS, the Signatories wish to avoid the uncertainty, time, inconvenience and expense of further litigation by compromising, resolving and settling *forever* all differences and matters in controversy among them with respect to CenterPoint Houston's recovery of true-up balances under the Public Utility Regulatory Act.[506]

And, there is no question that the ADFIT balances and potential ratepayer benefits were "matters in controversy" in that proceeding.[507] With respect to the Company's System Restoration Bonds, the settlement agreement is similarly final and encompassing of the balances at issue in this case:

> The ADFIT Credits . . . are a full and complete settlement of all issues and *all potential issues* regarding treatment of the ADFIT associated with the system restoration costs being securitized. The Signatories agree that ADFIT benefits associated with such system restoration costs shall not be applied to reduce the securitizable balance and that the ADFIT balance shall not be used to reduce rate base in future proceedings.[508]

Both GCCC and TIEC were signatories to the settlement agreements in those proceedings.[509] Consequently, for the Company's transition charges, the issues GCCC and TIEC (for the first time in briefing) seek to relitigate in this proceeding were settled "forever" (in the language of the settlement agreement itself)[510] in a settlement agreement that fully subsumed those issues.[511] And, with respect to CenterPoint Houston's System Restoration Bonds, an adjustment provision was created to take into account any "potential" ADFIT benefit associated with system restoration costs and associated insurance recoveries.[512] Mr. Tietjen acknowledged both these facts on cross-examination and the PFD cites no evidence to the contrary.[513] Accordingly, the

[504] CEHE Ex. 62 at bates pages 30:19-33:2 (Testimony of Walter Fitzgerald in Docket No. 39504); CEHE Ex. 64 at 11-12 (Testimony of Darryl Tietjen in Docket No. 39504).

[505] *Application of CenterPoint Energy Houston, LLC for a Financing Order*, Docket No. 37200, Financing Order, Finding of Fact No. 8(B) at 19(Aug. 26, 2009).

[506] CEHE Ex. 65, Docket No. 39504, Stipulation, Attachment A at bates pages 9-10 (emphasis added).

[507] Tr. at 799:2-11 (Tietjen Cross) (Jun. 26, 2019); CEHE Ex. 35 at 69:1-71:6 (Colvin Rebuttal).

[508] *See* CEHE Ex. 66, Docket No. 37200, Settlement Agreement at 4. (emphasis added).

[509] *See id.* at bates pages 14-15; CEHE Ex. 65 Stipulation, Attachment A at bates pages 13-14.

[510] CEHE Ex. 65 Stipulation, Attachment A at bates page 9.

[511] *Id.* at bates page 10; *See also*, Tr. at 798:2-799:22, 802:20-806:3 (Tietjen Cross) (Jun. 26, 2019).

[512] Docket No. 37200, Financing Order, Finding of Fact No. 8(B) at 19.

[513] Tr. at 804:11-805:5 (Tietjen Cross) (Jun. 26, 2019).

PFD invites the Commission to commit legal error in recommending a separate proceeding to address securitization-related EDIT amounts for which a complete record exists in this case and establishes that GCCC's and TIEC's request to include $158 million in Rider UEDIT must be rejected.

ii. The record in this case demonstrates that benefits provided to ratepayers in the agreements settling CenterPoint Houston's transition bond and system restoration bond cases far exceed any additional "benefit" that might be calculated

GCCC's and TIEC's request is also one-sided, punitive, and fails to account for CenterPoint Houston's substantial concessions made in order to finally and fully settle the system restoration costs and transition costs cases. The evidence is undisputed that the black box reduction amount in Docket No. 39504 was nearly three times the additional amount of $158 million EDIT "benefit" now sought by GCCC and TIEC. In fact, in Docket No. 39504 alone the settlement agreement included:

- A *$600 million reduction* to the Company's original request;
- No additional carrying costs accruing on the true-up balance (which were accruing at over $1 million per day prior to the settlement);
- CenterPoint Houston paying COH and GCCC rate case expenses;
- CenterPoint Houston bearing the cost of its own rate case expenses; and
- CenterPoint Houston bearing the up-front qualified costs of securitizing the true-up balance (which ran into the millions also).[514]

Similarly, the ADFIT credit applied to the system restoration balance was substantial – including a return on the system restoration related ADFIT of $207,006,452, plus a return of and on a principal amount of $6,500,000 over the life of the bonds at *11.075%*.[515] In short, the ratepayer benefit of more than $800 million derived from the settlement agreements "forever" settling ADFIT issues in Docket Nos. 39504 and 37200 alone demonstrates that GCCC's and TIEC's proposal to reopen those issues is unreasonable on its face.

Put differently, in its most simple terms, the entire ADFIT balance associated with the bonds at issue is $158 million. Neither GCCC, TIEC, nor even Staff's filed testimony on this issue suggest a scenario where any re-measuring of the ADFIT benefit associated with the Transition Bonds or System Restoration Bonds could possibly *exceed* the benefit already provided to

[514] CEHE Ex. 65; Tr. at 802:20-806:3 (Tietjen Cross) (Jun. 26, 2019).

[515] CEHE Ex. 66 Docket No. 37200, Settlement Agreement at 2-3.

ratepayers through the $600 million black box reduction agreed to in Docket No. 39504 (by itself) or when combined with the $207 million ADFIT balance earning an 11.075% interest rate returned through the agreement in Docket No. 37200. Ratepayers are benefiting and will continue to benefit from the TCJA through reduced federal income tax expenses and through the return of $835 million of protected and unprotected EDIT.[516] There is no need for the Commission to further consider this issue and GCCC and TIEC should not be permitted to challenge final and comprehensive settlement agreements to which they are each a signatory.

iii. It would be poor policy to jeopardize future securitization proceedings

Finally, as Mr. Tietjen acknowledged at hearing, the statutory framework surrounding securitizations is unique.[517] Chapter 39, Subchapter G of PURA sets forth a statutory framework to "enable utilities to use securitization financing to recover" certain amounts relating to unbundling, including competition transition charges.[518] Chapter 36, Subchapter I of PURA provides a similar framework to "enable an electric utility to obtain timely recovery of system restoration costs and to use securitization financing to recover these costs."[519] Both types of bonds are issued pursuant to financing orders approved by the Commission that identify the specific amount of stranded costs and system restoration costs that can be securitized pursuant to the statutory framework.[520]

Further, it is undisputed that financing orders are intended to be final. PURA specifically provides that "the financing order, together with the transition charges authorized in the order, shall thereafter be *irrevocable and not subject to reduction, impairment, or adjustment* by further action of the commission, except as permitted by Section 39.307."[521] This provision is bolstered by a pledge of the state of Texas that provides in relevant part:

> The state pledges . . . for the benefit and protection of financing parties and the electric utility, that it will not take or permit any action that would impair the value of transition property, or, except as permitted by Section 39.307, reduce, alter, or impair the transition charges to be imposed, collected, and remitted to financing parties, until the principal, interest and premium, and any other charges incurred

[516] CEHE Ex. 35 at 75:11-13 (Colvin Rebuttal).

[517] Tr. at 801:13-802:11 (Tietjen Cross) (Jun. 26, 2019).

[518] Tex. Util. Code § 39.301.

[519] *Id.* § 36.401.

[520] *Id.* § 39.303.

[521] *Id.* § 39.303(d) (emphasis added).

and contracts to be performed in connection with the related transition bonds have been paid and performed in full.[522]

Consistent with the statutes set forth above, each financing order relevant here provides that it is final and not subject to rehearing by the Commission,[523] and each contains the pledge pursuant to Section 39.310 of PURA.[524]

As Mr. Tietjen noted, these statutory protections are essential in order for customers to realize the benefits of the securitizations,[525] because only by eliminating virtually all credit risk from the securitization bonds could the securitization bonds receive AAA credit ratings and a consequently lower cost of capital that could be enjoyed by customers. To this end, the need for this certainty is clearly ongoing, as the Commission only recently used a securitization to the benefit of customers for AEP Texas, Inc.[526] To put future securitizations at risk—which Mr. Tietjen's direct testimony and testimony at hearing confirms could result from reopening settled securitization cases[527]—is simply unnecessary and would be poor public policy, especially given the undisputed customer benefit amounts in the record. CenterPoint Houston respectfully requests that the Commission reject the recommendation of the PFD to establish a separate proceeding to consider securitization-related EDIT amounts and thereby avoid creating any ongoing uncertainty relating to this issue.

B. Merger Savings Rider

The PFD correctly analyzed this issue and its recommendation should be approved.

C. Other Riders

CenterPoint Houston has no Exceptions to this section of the PFD.

X. BASELINES FOR COST-RECOVERY FACTORS [PO Issues 4, 5, 43, 53]

CenterPoint Houston has no Exceptions to this section of the PFD.

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[522] *Id.* § 39.310.

[523] *Application of CenterPoint Energy Houston Electric, LLC for Financing Order*, Docket No. 30485, Financing Order, Conclusion of Law No. 45 at 66 (Mar. 16, 2005); *Application of CenterPoint Energy Houston Electric, LLC for Financing Order*, Docket No. 34448, Financing Order, Conclusion of Law No. 49 at 69 (Sept. 18, 2007); Docket No. 37200, Financing Order, Conclusion of Law No. 47 at 67.

[524] Docket No. 30485, Schedule TC 2 Order, Conclusion of Law No. 41 at 65; Docket No. 34448, Schedule TC 3 Order, Conclusion of Law No. 45 at 68; Docket No. 39809, Schedule TC 5 Order, Conclusion of Law No. 42 at 61; Docket No. 37200, Financing Order, Conclusion of Law No. 43 at 66.

[525] Tr. at 802:7-19 (Tietjen Cross) (Jun. 26, 2019).

[526] *Application of AEP Texas, Inc. for a Financing Order to Securitize System Restoration Costs*, Docket No. 49308, Financing Order (Jun. 17, 2019).

[527] Staff Ex. 1A at 26:11-33 (Tietjen Direct) (Bates Pages).

XI. PFD NUMBER RUN MODEL ERRORS

On September 17, 2019, the Commission's Rate Regulation Division submitted its number running communications and workpapers regarding the PFD. This filing included two Excel files.[528] CenterPoint Houston has reviewed these files and identified several issues and/or errors with the models presented. These errors result in an incorrect calculation of the cost of service. The correction of these errors results in a total base revenue increase of $31.495 million as compared to the PFD's stated $2.644 million increase. This corrected cost of service calculation is based on the adoption of the PFD in its entirety.

The errors in the PFD's number run model are numerous. In addition to the presence of hard coded references in the models, which make it difficult to trace adjustments and associated results, the retail base revenue requirement contained in the two Excel files do not match—the "49421 – Rev Req Model – ALJ Number Run – 9-9-2019.xlsx" shows a revenue requirement of $2,120,280,000 while the "49421 – Model of CEHE's CCOSS – PFD.xlsm" shows a revenue requirement of $2,160,658,921. Thus, there is almost a $40 million disparity between the two models. CenterPoint Houston has also identified the following necessary corrections that must be made to the PFD's number run model in order to accurately reflect the PFD's recommendations:

1. The amounts requested by CenterPoint Houston should be derived from its errata filing.[529] Certain items in the PFD number run models do not tie to amounts contained in the Company's errata filing and require correction.
2. Certain proposed capital disallowances were not applied to the correct FERC accounts resulting in inaccurate adjustments to depreciation expense.
3. Certain capital disallowances are duplicative.
4. There are calculation errors due to the use of wrong inputs for the STI disallowance. First, the adjustment started with the book numbers rather than the test year requested numbers. Second, the calculation neglected to remove capitalized STI in order to calculate the O&M adjustment.
5. Bad debt amortization is missing from the PFD number run model.
6. Incorrect functionalization factors were used.
7. Flow through impacts are not complete even though the Number Running Communications memo specifically indicated these should be made as outlined in the "Global instructions" on bates page 4. For example, Accumulated Depreciation and ADFIT related to disallowed plant in service was not adjusted in the models. Attachment C provides a summary of the attendant impacts for the capital disallowances.

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[528] Docket No. 49421, PUCT Interchange Filing Search, Item No. 722.

[529] CEHE Ex. 2 Errata 1 Schedules and Schedule Workpapers.

8. The D2 allocator appears to use information for the ERCOT 4CP at the meter, rather than at the source.
9. The PFD number run does not appear to have used Dr. McMenamin's weather normalization adjustment as applied to a 10-year normalization period as directed by the PFD.

As shown in Attachment A to the Company's Exceptions, correction of these errors results in a total base revenue increase of $31.495 million as compared to the PFD's proposed $2.644 million increase and assumes that the PFD recommendations are adopted in their entirety. To be clear, Attachment A makes no adjustments to the PFD's number run model based on the Company's substantive Exceptions—the Company has only corrected errors to give accurate effect to the PFD's recommendations. To extent deemed necessary, CenterPoint Houston respectfully requests and moves for the admission into the evidentiary record of Attachment A to these Exceptions.

XII. OTHER ISSUES [including but not limited to PO Issues 13, 14, 20, 30, 31, 32, 40, 41, 42, 47, 48, 57, 58, 59]

CenterPoint Houston has no Exceptions to this section of the PFD. However, CenterPoint Houston notes a couple of typos that should be corrected in the PFD. In Finding of Fact No. 395, the word "by" is misspelled as "y." In Ordering Paragraph No. 11, the referenced docket number should be 49421 (this docket) instead of 46449 (a Southwestern Electric Power Company docket).

XIII. FINDINGS OF FACT

CenterPoint Houston excepts to the proposed Findings of Fact to the extent that they are inconsistent with the Exceptions made herein. CenterPoint Houston respectfully requests that the Commission conform the Findings of Fact as may be necessary to grant CenterPoint Houston's Exceptions.

XIV. CONCLUSIONS OF LAW

CenterPoint Houston excepts to the proposed Conclusions of Law to the extent that they are inconsistent with the Exceptions made herein. CenterPoint Houston respectfully requests that the Commission conform the Conclusions of Law as may be necessary to grant CenterPoint Houston's Exceptions.

XV. PROPOSED ORDERING PARAGRAPHS

CenterPoint Houston excepts to the proposed Ordering Paragraphs to the extent that they are inconsistent with the Exceptions made herein. CenterPoint Houston respectfully requests that

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the Commission conform the Ordering Paragraphs as may be necessary to grant CenterPoint Houston's Exceptions.

XVI. CONCLUSION

It is beyond dispute that a fiscally strong utility is in the interest of customers, regulators, and shareholders. CenterPoint Houston's application in this case supports its need to increase rates to recover its reasonable and necessary costs, to be given a reasonable opportunity to earn a fair return on its investment, and to remain financially strong so it can continue providing safe and reliable service.

As detailed in these Exceptions, the PFD should be revised to correct legal error, conflicting recommendations, and establish sound regulatory policies. Correction of the PFD on the issues raised in the Company's Exceptions is critical to providing a regulatory environment in Texas that will be predictable, consistent, reasonable, and fair. It will also provide CenterPoint Houston and other utilities with regulatory certainty, and it will provide the Company with a reasonable opportunity to earn a reasonable return on its invested capital and establish a solid foundation that maintains the Company's financial health and enables the Company to continue to run one of the most reliable TDU systems in the state.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of October 2019, a true and correct copy of the foregoing document was served on all parties of record in accordance with 16 Tex. Admin. Code § 22.74.

Patrick H. Peters III

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The following are being provided electronically in native format:

Attachment A
Attachment C
Supporting workpapers for Attachments A and C

PFD Number Running Errors (See CenterPoint Houston Electric, LLC's Exceptions to Proposal for Decision, Section XI) (dollars in thousands)

Schedule	CCOSS Cell (s)	Rev Requirement	PFD	CEHE Corrected PFD	Difference	Explanation	CEHE Schedules/WP (Cell Ref)
	O&M						
II-D-1	Multiple	O&M	$ (15,012)	$ (6,286)	$ 8,726	Capitalized STI amount should not be included in the O&M adjustment and book test year difference, see ALJ file O&M tab, columns (1)	See STI Support file
II-D-2	Multiple	O&M A&G	(9,535)	(9,129)	406	Capitalized STI amount should not be included in the O&M adjustment and book test year difference, see ALJ file O&M tab, columns (1)	See STI Support file
II-D-1	N/A	O&M	-	(353)	(353)	Bad Debt amortization should be shown in FERC 9040	II-D-1, (G91)
II-D-1		O&M		(1,203)	(1,203)	Wholesale FERC 565	II-D-1, (G26)
		Wholesale difference	-	1,855	1,855	Wholesale not updated for changes to O&M	
Total			(24,547)	(15,116)	9,431		
	Depreciation and Amortization						
II-E-1	F890	Depreciation on Adj to Remove Capital Project S/101318/CG/Tools	(67)	(118)	(51)	1 PFD Adjustments not in proper FCA of 3950 Depreciation rate per corrected FCA to be applied 2 Functionalization Factor should be E39501 instead of DIST	II-E-1, (F66)
II-E-1	F891	Depreciation on Adj for Changes to Capitalization Policy	(1,609)	(2,884)	(1,275)	1 PFD Adjustments not in proper FCAs CLEP disallowance of ($41,215) in FCA 367 01 and depreciation rate per FCA to be applied 2 Functionalization Factor should be E36701 instead of TRTBSE 3 Remaining Capital Policy adjustment of ($10,203) - apply composite depreciation rate (3 13%)	II-E-1, (F44)
II-E-1	F835-836, F847-848	Line Clearing	(618)	(618)	0		
II-E-1	F834	Substations	(30)	(30)	-		
II-E-1	F892-893	Depreciation on Adj for Incentive & Non-Qualified Benefits	(314)	-	314		
II-E-1	F849-850	Depreciation Adj 35% for Major Underground, and Depreciation Adj 10% for CLEP Prudence	(714)	-	714		
II-E-4 1	F882	Amortization - Expedited Switches	(400)	-	400	Number Run model applied Texas Margin Tax and Hurricane Harvey adjustments across all regulatory assets	No Adj needed
II-E-4 1	F883	Amortization - Hurricane Harvey	(22,270)	(2,947)	19,323	Number Run model applied Texas Margin Tax and Hurricane Harvey adjustments across all regulatory assets	II-E-4 1 1, (E14)
II-E-4 1	F884	Amortization - Ike Residual	1,394	-	(1,394)	Number Run model applied Texas Margin Tax and Hurricane Harvey adjustments across all regulatory assets	No Adj needed
II-E-4 1	F885	Amortization - PURA	20,968	-	(20,968)	Number Run model applied Texas Margin Tax and Hurricane Harvey adjustments across all regulatory assets	No Adj needed
II-E-4 1	F886	Amortization - Smart Meter Texas	(2,399)	-	2,399	Number Run model applied Texas Margin Tax and Hurricane Harvey adjustments across all regulatory assets	No Adj needed
II-E-4 1	F887	Amortization - Texas Margin Texas	(6,787)	(6,543)	244	Number Run model applied Texas Margin Tax and Hurricane Harvey adjustments across all regulatory assets	II-E-4 1 1, (E18)
		Wholesale difference	-	(2,767)	(2,767)	Flow through impact	
Total			(12,846)	(15,907)	(3,061)		

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Schedule	CCOSS Cell (s)	Rev Requirement	PFD	CEHE Corrected PFD	Difference	Explanation	CEHE Schedules/WP (Cell Ref)
	TOTI						
II-E-2	F919	Ad Valorem	(955)	(956)	(2)	Errata 1 amount not used	WP II-E-2 Adj 3, (B15)
II-E-2	F914	Payroll Related FICA	(2,655)	(1,957)	698	FICA associated with Capitalized and book test year difference STI amount should not be included in the adjustment	WP II-E-2, (D9)
II-E-2	F914	Payroll Related FICA	(118)	(118)	-	Reduction in workforce	
II-E-2	F928	Texas Gross Margin	(1,229)	(400)	829	Follows revenue, Functionalization needs to be updated with revenue changes	
		Wholesale difference	-	19	19	Flow through impact	
Total			(4,956)	(3,412)	1,544		
	Income Taxes						
II-E-3		Income Taxes	64,439	66,429	1,989	Flow through impact	II-E-3, III-E-3
	Other Revenues						
II-E-5	F1028-1033	Other Revenues	-	(816)	(816)	1 Company requested amounts for each FERC listed is different from Errata-1 2 FERC 4500 - FF changed from DA to FF#74 (FORFEIT_450) 3 FERC 4510 - FF changed from DA to FF#75(MISC_REV_451) 4 FERC 4540 - FF changed from DA to FF#76 (RENT_454) 5 FERC 4560 - FF changed from DA to FF#2 (TRAN) 6 FERC 4561 - FF changed from DA to FF#14 (PLTXGNL-N) 7 Errata 1 number not used	II-E-5, (H15-H19)
	Return on Rate Base						
II-B		Return	553,432	561,775	8,343	Flow through impact	II-B, III-B
	Total Revenue Requirement Difference				$ 17,430		
				Check	(0)		

(1) sum of the amounts on II-D-1 and II-D-2 ties to O&M tab columns F $22,220 and H $2,327 on Number Run total $24,547

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Schedule	CCOSS Cell (s)	Functionalization	PFD	CEHE Corrected PFD	Difference	Explanation
II-B-1		FF # 20 - TRTBSE	TRTBSE	DIST		Cable assessment disallowance is distribution (DIST) and should apply FF# 3
II-B-7		DIT Account 283	DIT_283	DA		Newly created factor did not apply Number Run adjustments
II-D-2		FF # 67 Injuries & Damages	INJ_DAM_925	DA		Newly created factor did not apply Number Run adjustments
II-D-2		FF # 68 Pension & Benefits	PEN_BEN_926	DA		Newly created factor did not apply Number Run adjustments
II-D-3		FERC 586 and 597	MET	MET		Updated to change from DIST to MET function
II-E-2		TMT	TOTREV_PFD	TOTREV_TMT		Created FF #66 for Texas Margin Tax functionalization. ALJ new factor used original filing instead of Number Run adjustments
II-E-2		FF # 72 - Ad Valorem	AD_VALOREM	DA		Factors used original filing instead of Number Run adjustments
II-E-4 1		FF # 73 Harvey Regulatory Asset	HARVEY	DA		Number Run applied Regulatory Asset to 100% DIST Correction should follow functionalization on II-B-12 Regulatory Assets as agreed to in Errata 3 filed June 14, Item #549 CCOSS model applied FF # 3 and not newly created #73
II-F		FF # 6 - TOTREV	TOTREV	TOTREV		Factors used original filing instead of Number Run adjustments
II-F		FF # 18 - DPLNT362	DPLNT362			Calculation linked to II-B-5 Accumulated Depreciation instead of II-B-1 Rate Base Accounts - Plant in CCOSS model
II-F		Miscellaneous General Expense FERC 930 2	PFD_9302	CEHE9302		Number Run Factors are hardcoded percentages and do not account for Number Run Adjustments to this FERC Created new FF # 79 to apply agreed upon percentages

Schedule	CCOSS Cell (s)	Rate Base	PFD	CEHE Corrected PFD	Difference	Explanation
II-B-3	F181	Gross Plant	$ (2,127)	$ (2,127)	$ -	PFD Adjustments not in proper FCA Tools should be in FERC Account 3940
II-B-3	F182	Gross Plant	(51,418)	(41,215)	(10,203)	Should be applied to FCA 36701 The Underground Cable Life Extension of $41 2M already included in ALJ adjustment I A 1 FF# 20 (TRTBSE) used instead of FF # 42 (E36701)
			-	(10,203)	10,203	AP, Property Accounting, Call Center, Microprocessor, Luminaires
II-B-5	N/A	Accumulated Depreciation	-	9,271	(9,271)	Accumulated Depreciation change needs to be calculated on disallowed plant
II-B-6	E318	Plant Held For Future Use	200	49	151	Errata-1 Company request not used
II-B-6	E320	Plant Held For Future Use	729	880	(151)	Errata-1 Company request not used
II-B-7	E341-344 E348-350	Accumulated Deferred Taxes	-	72,365	(72,365)	ADIT on disallowanced plant and regulatory assets Company requested balance for each FERC is different from Errata - 1
II-B-9		Cash Working Capital	(1,981)	(89)	(1,892)	Flow through impact, D49421 original filing used instead of Errata - 1
II-B-11	E451	Regulatory Liabilities	(60,109)	(60,642)	533	Errata-1 Company request not used
II-B-11	E452	Regulatory Liabilities	(6,848)	-	(6,848)	Errata-1 Company request not used
II-B-11	E456	Regulatory Liabilities	(712,173)	(718,489)	6,316	Errata-1 Company request not used
II-B-12	F482	Regulatory Assets	(8,856)	(8,840)	(16)	Hurricane Harvey Known & Measurable adjustment in original filing removed along with carrying costs Disallowance should include carrying cost ($8,742) and audit exception ($96)
Total			$ (842,582)	$ (759,040)	$ (83,542)	

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PFD Number Running Errors (See CenterPoint Houston Electric, LLC's Exceptions to Proposal for Decision, Section XI) (dollars in thousands)

Schedule	CCOSS Cell (s)	Allocator	PFD	CEHE Corrected PFD	Difference	Explanation
II-I-2 TRAN	J926	D2 Actual Allocator - RES	31,137	33,040	-1,903	PFD used information from the ERCOT Peak @ Meter instead of the Source
	K926	D2 Actual Allocator - Sec < 10	546	579	-33	PFD used information from the ERCOT Peak @ Meter instead of the Source
	L926	D2 Actual Allocator - Sec > 10	22,686	24,071	-1,385	PFD used information from the ERCOT Peak @ Meter instead of the Source
	M926	D2 Actual Allocator - Primary	2,276	2,366	-90	PFD used information from the ERCOT Peak @ Meter instead of the Source
	N926	D2 Actual Allocator - Transmission	9,173	9 341	-167	PFD used information from the ERCOT Peak @ Meter instead of the Source

Schedule	Class	Adjustments to IV-J-5	CEHE Corrected PFD - Adjustment to Billing Determinants	PFD	Difference	Explanation	CEHE PFD Total Billing Units	PFD Total Billing Units	Difference	Unit
IV-J-5 Billing Determinants	Residential kWh	Customer Changes	214,250,936	0	214,250,936	Did not update customer change due to weather and EEP	29,642,887,054	29,428,636 118	214 250 936	kWh
	SVS (Non-IDR) kWh	Customer Changes	6,737,830	0	6 737,830	Did not update customer change due to weather and EEP	924,195 405	917 454,734	6 740,671	kWh
	SVL (Non-IDR)	Abnormal Weather								
		Billing kVa	(678,438)	0	(678 438)	Did not update for abnormal weather				
		NCP kVa	(994,749)	0	(994 749)	Did not update for abnormal weather				
		Customer Changes								
		Billing kVa	880 095	0	880,095	Did not update for customer change				
		NCP kVa	800,871	0	800,871	Did not update for customer change				
		EEP	0			Did not update for energy efficiency				
	SVL (IDR)	Abnormal Weather								
		Billing kVa	(434,450)	0	(434,450)	Did not update for abnormal weather				
		NCP kVa	(55,905)	0	(55,905)	Did not update for abnormal weather				
		Customer Changes								
		Billing kVa	945,222	0	945,222	Did not update for customer change				
		NCP kVa	724,190	0	724,190	Did not update for customer change				
		EEP	0			Did not update for energy efficiency				
	PVS (Non-IDR)	Abnormal Weather								
		Billing kVa	(15,880)	0	(15,880)	Did not update for abnormal weather				
		NCP kVa	(15,980)	0	(15,980)	Did not update for abnormal weather				
		Customer Changes								
		Billing kVa	22,608	0	22,608	Did not update for customer change				
		NCP kVa	19,887	0	19,887	Did not update for customer change				
		EEP	0			Did not update for energy efficiency				
	PVS (IDR)	Abnormal Weather								
		Billing kVa	(74,880)	0	(74,880)	Did not update for abnormal weather				
		NCP kVa	(13,192)	0	(13,192)	Did not update for abnormal weather				
		Customer Changes								
		Billing kVa	276,834	0	276,834	Did not update for customer change				
		NCP kVa	172,102	0	172,102	Did not update for customer change				
		EEP	0			Did not update for energy efficiency				
	TVS	CEHE 4CP kVa	31,358,776	0	31 358,776	Did not update for CEHE 4CP kVa				

Schedule	Class	Item	CEHE PFD Total Billing Units	PFD Total Billing Units	Difference	Unit
IV-J-7	Residential	TRANSMISSION and DISTRIBUTION SYSTEM CHARGE	29 642,887,054	29 428,636,118	214,250,936	kWh
	SVS	TRANSMISSION and DISTRIBUTION SYSTEM CHARGE	924,195,405	917,454,734	6,740,671	kWh
	SVL	TRANSMISSION SYSTEM CHARGE				
		IDR METERED	31,267,565	31,267,565	0	4CP Kva
		NON-IDR METERED	72,100,984	71,625,494	475,490	NCP Kva
		DISTRIBUTION SYSTEM CHARGE *Does not include Ratchet for Billing Kva*				
		IDR METERED	29,513,330	29,725,495	(212,165)	Billing Kva
		NON-IDR METERED	52,591,084	52,307,808	283,276	Billing Kva
	PVS	TRANSMISSION SYSTEM CHARGE				
		IDR METERED	7,602,789	7,615,993	(13,204)	4CP Kva
		NON-IDR METERED	1,044,827	1,035,936	8,891	NCP Kva
		DISTRIBUTION SYSTEM CHARGE *Includes Ratchet for Billing Kva*				
		IDR METERED	12,247,170	12,278,206	(31,036)	Billing Kva
		NON-IDR METERED	1,185,678	1,182,769	2,909	Billing Kva
	TVS	TRANSMISSION SYSTEM CHARGE	29,796,612	29,796,612	0	4CP Kva
		DISTRIBUTION SYSTEM CHARGE	31,358,776	29,796,612	1,562,164	CEHE 4CP Kva

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PUBLIC UTILITY COMMISSION OF TEXAS DOCKET NO 49421 (CEHE base-rate case) TEST YEAR ENDING 12/31/2018 Proposal for Decision Number Run BASE REVENUE REQUIREMENTS SUMMARY (amounts in dollars)	Errata 1		CEHE Corr Number Run	PFD issued 9/16/19		
	CEHE Requested	PFD Adjustment	Corrected Adjusted	CEHE Requested	PFD Adjustment	PFD Adjusted
Retail Delivery Present Base Revenues	2,095,241,703	1,111,067	2,096,352,770	2,095,600,469	12,175,029	2,107,775,498
Retail Delivery Proposed Base Revenues	2,284,108,581	-107,652,266	2,176,456,315	2,282,203,678	-121,544,757	2,160,658,921
Retail Delivery Increase - $s	188,866,878	na	80,103,545	186,603,209	na	52,883,423
Retail Delivery Increase - %	9.01%	na	3.82%	8.90%	na	2.51%
Wholesale Transmission Present Base Revenues	388,968,021	0	388,968,021	388,968,021	0	388,968,021
Wholesale Transmission Proposed Base Revenues	392,549,119	-52,189,529	340,359,590	395,796,573	-57,067,782	338,728,791
Wholesale Transmission Increase - $s	3,581,098	na	-48,608,431	6,828,552	na	-50,239,230
Wholesale Transmission Increase - %	0.92%	na	-12.50%	1.76%	na	-12.92%
CEHE Total Present Base Revenues	2,484,209,724	1,111,067	2,485,320,791	2,484,568,490	12,175,029	2,496,743,519
CEHE Total Proposed Base Revenues	2,676,657,700	-159,841,795	2,516,815,905	2,678,000,251	-178,612,539	2,499,387,712
CEHE Total Base Revenue Increase - $s	192,447,976	na	**31,495,114**	193,431,761	na	**2,644,193**
CEHE Total Base Revenue Increase - %	7.75%	na	1.27%	7.79%	na	0.11%

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CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC
2019 CEHE RATE CASE
DOCKET 49421-SOAH DOCKET NO. 473-19-3864

PUBLIC UTILITY COMMISSION OF TEXAS
REQUEST NO.: PUC06-22

QUESTION:

For the project listed under Project Number HLP/00/1055 and described in the WP RMP-2 Capital Project List Summaries (years 2014-2017) as "'Distribution line clearance corrections between transmission and distribution facilities to meet National Electrical Safety Code (NESC) requirements" (and also found in the 'WP RMP-2 Capital Project List Detail' spreadsheets for these years).

a. When were the associated transmission and distribution lines placed into service?

b. What dollar amount, if any, was incurred during the rebuilding, reconductoring, or upgrading of existing electric facilities?

c. Please elaborate on why these corrections were necessary and explain how CenterPoint become aware of the need to correct this clearance.

d. Did a change to NESC requirements necessitate this work? Please provide supporting documentation as needed.

e. Why does CenterPoint believe this work should be capitalized instead of treated as an operation or maintenance expense?

ANSWER:

For the project listed under Project Number HLP/00/1055 and described in the WP RMP-2 Capital Project List Summaries (years 2014-2017) as "'Distribution line clearance corrections between transmission and distribution facilities to meet National Electrical Safety Code (NESC) requirements", see following responses:

a. Project 1055 represents CEHE's Lidar based Transmission Line Clearance Program. CEHE performs Lidar surveys on approximately 20% of the transmission system each year to identify and correct NESC transmission line clearance issues. During the 2014-2017 time-period, 204 transmission line clearance issues, involving 158 distribution circuits and 69 transmission circuits, were addressed by modifications to distribution facilities. In addition, 85 transmission clearance issues were resolved by modifications to 55 transmission circuits. Information on the in-service dates for the transmission lines and distribution lines is not readily available.

b. Between 2014 and 2017, a total of $19,376,931 was spent on this project.

c. CEHE's Transmission Line Clearance Program (1055) utilizes LIDAR technology to determine clearances as compared to the NESC standard at the time of survey. Approximately 20% of the transmission system is surveyed each year. Clearance corrections are addressed by modifications to transmission facilities, distribution facilities, or both.

d. No. This work is not a result of any changes to NESC requirements.

e. This work should be capitalized because the modifications included the replacement of poles, pole hardware, conductors, and other capital facilities.

SPONSOR (PREPARER):
Randal Pryor/Martin Narendorf (Randal Pryor/Martin Narendorf)

RESPONSIVE DOCUMENTS:
None

Capital Disallowance Summary
At December 31, 2018
(Thousands of Dollars)

	1	2	3 = 1+2	4	5 = 3+4	6	7	8 = 1*7	9	10	11	12 = 6+8+9+11
						6.65%			0.81968%	2.41%	26.58%	
	Gross Plant	Accumulated Depreciation	Net Plant	Accumulated Deferred Income Taxes	Net Rate Base	Return (1)	Depreciation Rate (2)	Annual Depreciation Expense	Annual Property Tax Expense (3)	Interest (4)	Income Tax on Return (5)	Total Revenue Requirement (8)
CLEP	$ (5,400)	$ 596	$ (4,804)	$ 620	$ (4,184)	$ (278)	3 34%	$ (180)	$ (44)	$ (101)	$ (47)	$ (550)
MUDG (366 01/367 01)	(20,127)	2,075	(18,053)	2,149	(15,904)	(1,058)	3 34%	(672)	(165)	(383)	(179)	(2,074)
LaMarque (354 01)	(1,183)	48	(1,135)	153	(982)	(65)	2 15%	(25)	(10)	(24)	(11)	(111)
Alexander (354 01)	(196)	13	(183)	27	(156)	(10)	2 15%	(4)	(2)	(4)	(2)	(18)
WA Parrish (354 01)	(3)	0	(2)	0	(2)	(0)	2 15%	(0)	(0)	(0)	(0)	(0)
Land not used and useful (360 01)	(6,804)	-	(6,804)	-	(6,804)	(452)	0 00%	-	(56)	(164)	(77)	(585)
Tools (395 01)	(2,127)	386	(1,741)	316	(1,425)	(95)	5 56%	(118)	(17)	(34)	(16)	(247)
Line Clearance D (364 01)	(4,844)	339	(4,505)	506	(4,000)	(266)	3 84%	(186)	(40)	(96)	(45)	(537)
Line Clearance D (365 01)	(4,844)	339	(4,505)	506	(4,000)	(266)	3 24%	(157)	(40)	(96)	(45)	(508)
Line Clearance T (355 01)	(4,844)	411	(4,433)	547	(3,886)	(258)	2 47%	(120)	(40)	(94)	(44)	(462)
Line Clearance T (356 01)	(4,844)	411	(4,433)	547	(3,886)	(258)	3 21%	(155)	(40)	(94)	(44)	(497)
Policy Changes (6)	(51,418)	4,517	(46,901)	5,919	(40,981)	(2,725)	3 34%	(1,717)	(421)	(988)	(462)	(5,326)
STI capitalized (7)	(9,751)	129	(9,622)	13	(9,609)	(639)	3 13%	(305)	(80)	(232)	(108)	(1,132)
Non-qualified Pension (7)	(295)	8	(287)	444	157	10	3 13%	(9)	(2)	4	2	1
	$ (116,680)	$ 9,271	$ (107,408)	$ 11,747	$ (95,661)	$ (6,361)		$ (3,650)	$ (956)	$ (2,305)	$ (1,078)	$ (12,047)

(1) Rate of Return per the Proposal for Decision finding of fact 209
(2) Depreciation rate from WP E-1 Adj 1 for all item except STI capitalized and Non-qualified Pension
(3) Property Tax expense rate from WP II-E-2 1 FF
(4) Interest Rate per the Proposal for Decision finding of fact 209
(5) Income Tax rate per II-E-3
(6) Applied FERC 367 to the entire balance
(7) Depreciation rate is the composite rate
(8) Updates to TCJA-related EDIT are not reflected here Estimated EDIT Regulatory Liability would be reduced by $ 7,036

MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms CenterPoint Energy Houston Electric ratings; outlook changed to negative

26 Jun 2019

Up to $4,300 Million of Debt Securities Affected

New York, June 26, 2019 – Moody's Investors Service ("Moody's") affirmed the ratings of CenterPoint Energy Houston Electric, LLC (CEHE), including its A3 senior unsecured and Issuer rating, A1 senior secured rating and changed the outlook to negative from stable.

Outlook Actions:

..Issuer: CenterPoint Energy Houston Electric, LLC

....Outlook, Changed To Negative From Stable

Affirmations:

..Issuer: CenterPoint Energy Houston Electric, LLC

.... Issuer Rating, Affirmed A3

....Senior Secured Regular Bond/Debenture, Affirmed A1

....Senior Unsecured Bank Credit Facility, Affirmed A3

....Senior Secured First Mortgage Bonds, Affirmed A1

....Underlying Senior Secured First Mortgage Bonds, Affirmed A1

RATINGS RATIONALE

"The negative cash flow implications of tax reform, along with higher debt incurred to fund its elevated capital investment plan, are expected to weaken CenterPoint Energy Houston Electric's key financial metrics more than we had projected when tax reform was passed," said Robert Petrosino, Vice President - Senior Analyst. "Going forward, we expect cash flow from operations before changes in working capital (CFO pre-WC) to debt will be in the 15% to 17% range, lower than historical levels of closer to 20% and weakly positioning CEHE from a financial metric standpoint." The outcome of the utility's pending rate case, expected by October, will be important in determining the future financial strength of the utility.

On 5 April 2019, CEHE filed its first full rate case request since 2010, seeking approval for a base rate revenue increase of approximately $161 million, including recovery on approximately $64 million in expenses related to Hurricane Harvey restoration efforts not currently reflected in rates. The filing was premised upon a 10.4% return on equity (ROE), 50% equity layer, a test year ending December 2018, and a 7.39% return on assets with a rate base valuation of $6.5 billion. In addition, CEHE also requested a prudency determination on all of its capital investments made since 2010 as well as the formation of a separate rider to refund approximately $97 million in unprotected Excess Deferred Income Tax (EDIT) to its customers over the next three years.

As of 13 June 2019, four interveners had provided testimony supporting a lower ROE and lower equity layer than CEHE is seeking. Additionally, on 12 June 2019, the PUCT staff weighed in on the matter, recommending a 9.45% ROE and a 40% equity layer, significantly lower than the company had requested. A final rate case outcome that provides CEHE with an ROE materially below its current 10% ROE and an equity layer lower than its current 45% may further pressure credit measures.

CEHE's credit profile also reflects its low business risk as a transmission and distribution (T&D) utility operating in Texas, where we view the regulatory environment governed by the Public Utility Commission of Texas (PUCT) to be generally constructive. The Texas regulatory framework provides several rate mechanisms and securitization policies for the recovery of utility expenses such as bad debt, pension expenses and weather

EXHIBIT
CEHE 118 12

related restoration costs. Importantly, the framework also allows for timely rate base recognition of investments in transmission and distribution assets between rate cases through its Transmission Cost of Service (TCOS) and Distribution Cost Recovery Factor (DCRF) mechanisms.

CEHE has low carbon transition risk within the regulated electric and gas utility sector as a transmission and distribution utility but is it is exposed to environmental risk, most notably from the increasing severity of major hurricanes in the Gulf of Mexico which can have destructive impacts on Houston and the surrounding service territory. Nevertheless, the financial risk associated with such storms is mitigated by the PUCT which allows Texas utilities to securitize prudently incurred costs to recover and restore service from storms.

Outlook

CEHE's negative outlook reflects its declining credit measures despite a financial policy that is targeting a 50% debt to capital ratio. Over the next few years, we see the ratio of CFO pre-WC to debt in the 15% to 17% range, weakly positioning CEHE from a financial metric standpoint, barring a supportive rate case outcome later this year.

Factors that could lead to an upgrade

Given the negative outlook and expected pressure on CEHE's credit measures, a ratings upgrade is unlikely over the next 12 to 18 months. However, the rating outlook could be stabilized if there is a supportive outcome of its pending rate case, or if the regulatory environment otherwise becomes more constructive leading to an improvement in CEHE's financial performance such that its CFO pre-WC to debt returns closer to historical levels. An upgrade could occur if CFO pre-W/C to debt rises above 22% on a sustainable basis.

Factors that could lead to a downgrade

CEHE's ratings could be downgraded if the utility's pending rate case or financial policies does not lead to a material improvement in projected financial metrics, including CFO pre-WC to debt below 18% on a sustained basis; there is a less supportive regulatory environment for transmission and distribution utilities in Texas overall, or there is a greater reliance on dividends from CEHE to support parent CNP's high leverage.

Profile

CenterPoint Energy Houston Electric, LLC is a rate-regulated electric transmission and distribution (T&D) utility serving approximately 2.5 million metered customers in the greater Houston, Texas area. CEHE is regulated by the Public Utility Commission of Texas (PUCT) and the cities in which it operates. CEHE is a core subsidiary of CenterPoint Energy, Inc. (CNP, Baa2 stable), a holding company that also owns regulated electric and natural gas utility subsidiaries and non-regulated businesses, primarily a joint venture interest in the Enable Midstream Partners, LP (Enable, Baa3 stable) master limited partnership (MLP).

The principal methodology used in these ratings was Regulated Electric and Gas Utilities published in June 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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