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

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

TEXAS INDUSTRIAL ENERGY CONSUMERS' REPLY TO EXCEPTIONS TO PROPOSAL FOR DECISION

REDACTED

October 24, 2019

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

Over the past decade, CenterPoint Energy Houston Electric (CEHE) has been able to add approximately $5 billion in transmission and distribution investment to its rates while avoiding a full rate case by taking full advantage of the comprehensive set of rate riders available to ERCOT TDSPs, including interim Transmission Cost of Service (TCOS) updates and Distribution Cost Recovery Factor (DCRF) updates.[1] These interim riders were ***never*** meant to be a long-term substitute for a full rate case, and as a result, they do not account for important items such as Accumulated Deferred Federal Income Taxes (ADFIT), which is credited to rate base and reduces costs for customers in a full rate case. Nor do they require updates to CEHE's cost of debt or return on equity to reflect prevailing market conditions, allowing excessive rates when market conditions change, as they have over the past ten years. While these riders have allowed CEHE to recover its ***own*** investment with minimal risk, CEHE has also been over-recovering wholesale transmission costs it pays to ***other*** TSPs in ERCOT through its Transmission Cost Recovery Factor (TCRF). While the TCRF ensures exact dollar-for-dollar recovery of all incremental wholesale transmission charges between rate cases, CEHE was able to retain any over-earning in base rates from load growth. In the test year alone, CEHE over-recovered its wholesale transmission charges (which are essentially a pass-through cost) by approximately $51.9 million.[2]

These are the ***exact issues*** the legislature sought to remedy in passing Senate Bill 735 in 2017, requiring all ERCOT utilities to file a full rate review on a regular schedule: to remedy the impacts of outdated rate case outcomes that, although reasonable at the time, have now become unjust and unreasonable. Perhaps unsurprisingly, CEHE has tried to avoid the inevitable

[1] *See* CEHE Exceptions at 7-8 ("Since CenterPoint Houston's last rate case in 2010, 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.").

[2] TIEC Ex. 1 (Pollock Dir.) at 27.

consequences of its first involuntary rate filing by pushing for a rate of return and capital structure that strain credulity and are facially excessive compared to the regulated returns awarded to other ERCOT TDSPs or utilities across the country. If granted, CEHE's requested 10.4% return on equity (ROE), with a 50% equity component in its capital structure, would make it the most generously compensated TDU in Texas by a wide margin, and would cost ratepayers ***$104.1 million per year*** compared to TIEC witness Mr. Gorman's more reasonable 9.25% ROE and 40% equity ratio.[3] Contrary to CEHE's exceptions, the evidence shows that the average awarded ROE for delivery-only utilities nationwide in 2018 was just 9.38%,[4] which is lower than the PFD's recommended 9.42%. CEHE's request is wildly disproportionate to the minimal risk CEHE faces as a "wires-only" ERCOT TDU that can recover up to 95% of its capital investment through interim rate riders between rate cases.[5]

CEHE's overall risk has declined considerably since its last filing in 2010 with the proliferation of rate riders for ERCOT TDUs, and the evidence does not support CEHE's claim that it is somehow "more risky than other similarly situated utilities."[6] Indeed, CEHE as a stand-alone utility has extremely low risk and remarkable credit quality—it is CEHE's exposure to the financial risk of its upstream parent, CenterPoint Energy, Inc. (CNP) that is driving its current credit metrics. When evaluated independently of CNP, CEHE has an exemplary "a+" credit rating from S&P that places it in the top 3% of utilities in the country.[7] Similarly, CEHE does not face "unique"[8] challenges that justify its proposed rate of return. While CEHE is forecasting significant capital expenditures over the next few years, the record demonstrates that CEHE's capital

[3] TIEC Ex. 5 (Gorman Dir.) at 37, Ex. MPG-6; *see also* TIEC Reply Br. at 2.

[4] *See* CEHE Ex. 69 (Woolridge Exhibit Book) at Tab 8 (S&P Global, RRA Regulatory Focus "Major Rate Case Decisions – January – December 2018" (Jan. 31, 2019)) at 1 (average authorized return on equity for "Delivery cases" was 9.43% in 2017 and 9.38% in 2018).

[5] *See* TIEC Ex. 5 (Gorman Dir.) at 24-25.

[6] *See* CEHE Exceptions at 47 (emphasis removed); *see also id.* ("considering ***CenterPoint Houston's specific risk factors***, the evidence leans in favor of adjusting CenterPoint Houston's ROE upward, not downward.") (emphasis added).

[7] *See* TIEC Ex. 5 (Gorman Dir.) at 11, Table 1 (only 3% of electric utilities were rated A or higher by S&P in 2018).

[8] *See* CEHE Exceptions at 48 ("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.") (emphasis added); *see also id.* at 60 (discussing CEHE's "specific business and regulatory risks").

investments are on pace with its overall growth.[9] The Tax Cuts and Jobs Act (TCJA) is likewise not an issue. Contrary to CEHE's assertions, its parent CNP has admitted to investors that the TCJA's impact on cash flow is entirely manageable.[10] CEHE continues to claim that the PFD's ROE and capital structure recommendations would be "credit negative" and risk a potential downgrade.[11] Yet, CEHE witnesses Mr. McRae[12] and Ms. Lapson[13] both independently determined that CEHE will maintain solid investment grade credit ratings from all three ratings agencies if the Commission adopts TIEC witness Mr. Gorman's recommended 9.25% ROE and 40% equity ratio.

In making the hyperbolic claim that the PFD "threatens [CEHE's] financial health and the constructive regulatory environment" in ERCOT,[14] CEHE ignores the primary driver to its current credit metrics—its exposure to the financial risk of its corporate parent, CNP, which recently took on substantial additional debt to fund the acquisition of Vectren Corp. As long as this credit linkage remains, increasing CEHE's rate of return and enriching its capital structure will not measurably improve its cost of capital, but will only provide a revenue stream that will enable CNP to take on additional leverage and risk. As the PFD found, "***CenterPoint is financially stronger than its affiliates and has a lower credit rating because of them***."[15] In fact, S&P rates CEHE's debt ***three notches lower*** than its stand-alone a+ rating due to its association with its riskier parent company.[16] Granting CEHE's requested 10.4% ROE and a 50% equity ratio in an effort to influence CEHE's credit quality would do nothing except provide funds for CNP's higher-risk transactions and various unregulated business activities ***that do not benefit CEHE's ratepayers***. As discussed below, instead of increasing CNP's access to funds from CEHE, the Commission should adopt the reasonable ring fencing measures recommended by the PFD to

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[9] Tr. (Mercado Cr.) at 100:8–102:8, 104:8–10, 106:4-17 (June 24, 2019); TIEC Ex. 16 (Texas Public Utility Commission Order on Rehearing in Docket No. 38339 at 19, FoF 54 (June 23, 2011)); CEHE Ex 6 (Mercado Dir.) at WP KMM-10 (09 to 18 10K CEHE CapEx); TIEC Ex. 17 (Schedule II-B); *see also* TIEC Initial Br. at 36-38.

[10] *See* TIEC Ex. 4 (Griffey Dir.) at 28 (quoting CEHE Response to TCUC 1-02 in attachment SP 2018 CenterPoint Energy at 2-3. (HSPM)) (The TCJA is a [redacted]" and [redacted] (emphasis added).

[11] CEHE Exceptions at 9, 49.

[12] CEHE Ex. 43 (McRae Reb.) at 24-25.

[13] CEHE Ex. 48 (Lapson Reb.) at Ex. R-EL-6, p. 4.

[14] CEHE Exceptions at 1.

[15] PFD at 202 (emphasis added).

[16] TIEC Ex. 5 (Gorman Dir.) at 24-25.

ensure that CEHE and its customers are protected from the risky business activities of its parent. The reasonable ring fence recommended by the PFD will ensure that CEHE's ratepayers are no longer paying to maintain CEHE's extraordinary credit quality, only to have its parent company siphon off the benefits of CEHE's stand-alone financial strength. With these protections in place, the PFD's awarded ROE and capital structure exceed what CEHE needs to maintain access to capital at reasonable rates.

These and other issues raised in parties Exceptions to the PFD are discussed in further detail below.

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

A. Return on Equity [PO Issue 8]

1. CEHE's proposed 10.4% ROE far exceeds recent awards for comparable utilities.

a. Contrary to CEHE's misleading claims, the PFD's awarded ROE is actually *above* the national average for comparable utilities.

CEHE's repeated claim that a 9.42% ROE would be "below the national average authorized ROE for electric utilities"[17] since 2014[18] is disingenuous and misleading. First, the 9.68% average awarded ROE CEHE references is for ***all*** electric utilities—including vertically integrated utilities[19] that are not reasonably comparable to a low-risk, wires-only utility like CEHE.[20] Additionally, ROEs have been trending steadily downward over the past decade to reflect market changing conditions,[21] so comparing the PFD's awarded ROE against average awards ***going back to 2014*** gives undue weight to outdated ROEs that fail to capture today's actual

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[17] *See, e.g.*, CEHE Exceptions at 6, 10, 45, 47, 48, 59.

[18] *See* CEHE Exceptions at pg. 10, fn. 13 and pg. 47.

[19] The referenced exhibit includes the awarded ROE for Entergy Texas, Inc. *See* CEHE Ex. 42 (Hevert Reb.) at R-RBH-8. This is significant because, for example, in 2018, the average awarded ROE for delivery-only utilities (9.38%) was ***thirty basis points lower*** than the average for vertically-integrated utilities (9.68%). *See* CEHE Ex. 69 (Woolridge Exhibit Book) at Tab 8 (2019 S&P Global Market Intelligence RRA Report) at 9, Chart titled "Vertically integrated cases versus delivery-only cases".

[20] *See* Tr. (Gorman Cr.) at 562:18-563:1 (June 26, 2019) ("[C]redit rating agencies distinguish the credit metric targets for utilities with no commodity risk. And they establish a level of financial risk credit metric targets that are more lenient; that is, the utility can finance with greater amounts of financial risk or financial leverage and still maintain their bond rating because of the existence of the favorable regulatory treatment in Texas and importantly because Texas TDUs do not have commodity risk."); *see also* TIEC Ex. 4 (Griffey Dir.) at 27 (citing Moody's Credit Opinion (June 19, 2018), included in Schedule II-C-2.10 of the rate filing package) (Confidential) (Fitch notes that providing T&D service in Texas is a [redacted]," and CEHE has [redacted]

[21] TIEC Ex. 5 (Gorman Dir.) at 8, Figure 1.

cost of equity.[22] A more appropriate comparison is the average awarded ROE for delivery-only utilities like CEHE in 2018, which was ***9.38%***,[23] but even that number is too high. As Staff witness Mr. Ordonez explained, 14 of the 16 utilities included in that average are significantly riskier than CEHE because they buy and sell electricity, while CEHE is "wires-only," and does not have any commodity risk.[24] Accordingly, the PFD's recommended ROE is "commensurate with returns on investment in other enterprises having comparable risks."[25] In fact, as explained in TIEC's Exceptions,[26] the PFD's recommendation is still higher than necessary for CEHE to attract capital given the downward trend in ROE awards and the backward-looking nature of most regulated ROE analyses, which consider historical awards to proxy groups that often do not reflect the most recent market conditions.[27]

b. ROEs approved for Oncor and TNMP in prior comprehensive settlements are not instructive.

CEHE also complains that a 9.42% ROE would be lower than any other utility in Texas, but that should be expected given that awarded ROEs have been trending downward to reflect favorable economic conditions and reduced risks for electric utilities.[28] As such, it makes sense that CEHE's more recent ROE would be lower than the ROEs approved for Oncor in late 2017 (9.8%)[29] and TNMP in late 2018 (9.65%).[30] In addition, both of these ROEs were approved as part of comprehensive settlements, where customers received other benefits that made the total package

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[22] The average awarded ROE for all electric utilities in 2014 was 9.91%, which is ***thirty-two basis points*** higher than the average awarded ROE for all electric utilities in 2018. . *See* CEHE Ex. 69 (Woolridge Exhibit Book) at Tab 8 (2019 S&P Global Market Intelligence RRA Report) at 8, chart titled "Electric utilities – summary table".

[23] *See* CEHE Ex. 69 (Woolridge Exhibit Book) at Tab 8 (2019 S&P Global Market Intelligence RRA Report) at 9, Chart titled "Vertically integrated cases versus delivery-only cases." If, as CEHE asserts, it is appropriate to remove the two Illinois utilities from this calculation, the average increases to just 9.48%. *See id.* at 11-14 ("D" denotes "delivery-only" utilities).

[24] PFD at 190.

[25] CEHE Exceptions at 11 (paraphrasing Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944) and Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W. Va., 262 U.S. 679, 692-93 (1923)).

[26] TIEC Exceptions at 5-8; *see also* TIEC Initial Br. at 12-15.

[27] *See* TIEC Ex. 4 (Griffey Dir.) at 27 and Ex. CSG-3 (Griffey, Charles, Whitepaper: "When 'What Goes Up' Does Not Come Down: Recent Trends in Utility Returns." (Feb. 15, 2017)).

[28] TIEC Ex. 5 (Gorman Dir.) at 8, Figure 1.

[29] *Application of Oncor Electric Delivery Company LLC for Authority to Change Rates*, Docket No. 46957, Final Order at, FoF 35 (Oct. 13, 2017).

[30] *Application of Texas-New Mexico Power Company for Authority to Change Rates*, Docket No. 48401, Final Order at 6, FoF 47 (Dec. 20, 2018).

reasonable. Accordingly, the outcome of these cases is not instructive in setting CEHE's ROE, which must be based on the evidence in this case and the prevailing economic conditions that exist today.

2. CEHE faces no unique risks that justify a higher ROE.

CEHE's exceptions to the PFD's recommended ROE primarily rest on CEHE's claim that it is somehow "***more*** risky than other similarly situated utilities."[31] The record does not support that argument. While CEHE claims that it faces risks related to large capital expenditures and the Tax Cuts and Jobs Act (TCJA),[32] the record shows that neither of those risks are unexpected or unique, and that CEHE's actual business risks justify a lower, not higher, ROE. CEHE inaccurately claims that "the PFD cites to no evidence showing that a 9.42% ROE . . . will allow CenterPoint Houston to attract capital,"[33] but the PFD's recommended ROE is well within the ranges supported by expert witnesses in this case, and exceeds Mr. Gorman's reasonable and well-supported recommended ROE of 9.25%. As such, the PFD's recommendation is fully supported by the record and substantial evidence.

a. CEHE's growth and capital expenditures are consistent with historical experience.

Contrary to CEHE's arguments, its ROE request is not justified by growth in its service territory.[34] Importantly, the only "risk" that load growth creates for a wires-only utility is the need for additional capital investments to serve load. However CEHE's capital expenditure plans are in line with past experience, and do not create any unique risk. This is particularly true given that CEHE can quickly recover its investments through the interim TCOS and DCRF riders.

Load growth is nothing new for CEHE; in previous cases, the Commission has recognized that CEHE's industrial and residential load has been growing rapidly for many years.[35] In fact, in

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[31] *See* CEHE Exceptions at 47 (emphasis in original); *see also id.* ("[C]onsidering ***CenterPoint Houston's specific risk factors***, the evidence leans in favor of adjusting CenterPoint Houston's ROE upward, not downward.") (emphasis added).

[32] In prior briefing, CEHE also argued that it faces "hurricane risk" and "regulatory risk," but only mentions those factors in passing in its Exceptions. *See* CEHE Exceptions at 47, fn. 200. For a full response to CEHE's arguments on those issues please refer to TIEC's Initial Brief at 40-41.

[33] CEHE Exceptions at 48; *see also* CEHE Exceptions at 11-12 (asserting that the PFD "fails to explain" how its decision satisfies *Hope* and *Bluefield* standards).

[34] *Id.* at 10.

[35] Tr. (Mercado Cr.) at 51:6–52:7 (June 24, 2019); Application of Cross Texas Transmission, LLC to Amend a Certificate of Convenience and Necessity for the Limestone to Gibbons Creek 345-KV Transmission Line in Brazos,

a May 2019 Earnings Call with investors, CEHE's parent bragged that CEHE has experienced consistent customer growth over the last ***30 years***.[36] This consistent growth represents an ***opportunity*** for CEHE rather than a risk.[37] As TIEC witness Mr. Griffey explained, "[i]f additional capital expenditures were a burden and not an opportunity, management would be seeking to *limit* capital expenditures, not grow them."[38] However, in that same May 2019 investor presentation, CNP emphasized its prospects for additional growth and capital investment (in particular, the Bailey to Jones Creek transmission line), and even listed "Customer Growth" as a ***positive driver*** for 2019.[39] That is because load growth means additional revenue and capital investment, which in turn increases earnings.[40]

CEHE's investment projections are similarly consistent with past periods. CEHE expects to invest just over $5 billion in its electric system over the next five years.[41] In 2018, CEHE had $952 million in capital expenditures,[42] and in 2019, it planned to spend $979 million, a minor ***2.8%*** increase.[43] CEHE witness Mr. Mercado admitted that CEHE's ratio of new capital expenditures to net electric plant in service (which is the source of CEHE's revenues and returns) has been nearly flat since its last rate case.[44] CEHE has never responded to this argument.[45] So while CEHE may have more capital expenditures in absolute terms, it is a much larger utility now and it is clear that ***CEHE's growth and capital expenditures are commensurate with its size and***

Freestone, Grimes, Leon, Limestone, Madison, and Robertson Counties, Docket No. 44649, Final Order at 16–17, FoF 137 & 139 (Jan. 13, 2016).

[36] Tr. (Mercado Cr.) at 87:25–88:8 (June 24, 2019); TIEC Ex. 13 (1st Quarter 2019 Earnings Transcript on May 9, 2019) at 6.

[37] *See* TIEC Ex. 4 (Griffey Dir.) at 24 ("Given current prevailing utility returns on equity, including those awarded in Texas, capital expenditures are more of a business opportunity than a business risk.").

[38] *See id.* at 25.

[39] Tr. (Mercado Cr.) at 84:9–16 (June 24, 2019); TIEC Ex. 12 (1st Quarter 2019 Earnings Presentation on May 9, 2019) at 5.

[40] Tr. (Mercado Cr.) at 62:12–19 (June 24, 2019); TIEC Ex. 8 (Investor & Analyst Day Presentation in June 2014) at 2.

[41] *See* CEHE Ex. 27 (McRae Dir.) at 12.

[42] Tr. (Mercado Cr.) at 106:4–5 (June 24, 2019); CEHE Ex 6 (Mercado Dir.) at WP KMM-10 (09 to 18 10K CEHE CapEx).

[43] CEHE Ex. 27 (McRae Dir.) at 16.

[44] CEHE's 2010 capital expenditures were about 11% of its net plant in service. CEHE's capital expenditures now represent approximately 12.3% of its net plant in service. This is not a material increase. *See* Tr. (Mercado Cr.) at 100:8–102:8, 104:8–10, 106:4-17 (June 24, 2019); TIEC Ex. 16 (Texas Public Utility Commission Order on Rehearing in Docket No. 38339 at 19, FoF 54 (June 23, 2011)); CEHE Ex 6 (Mercado Dir.) at WP KMM-10 (09 to 18 10K CEHE CapEx); TIEC Ex. 17 (Schedule II-B); *see also* TIEC Initial Br. at 36-38.

[45] *See generally*, CEHE Reply Br.; CEHE Exceptions.

revenue. Therefore, CEHE's alleged need for a higher ROE is not supported by the very modest increase in its capital requirements,[46] which essentially reflects the utility's overall growth.

b. The TCJA does not justify a higher ROE.

CEHE's own witness agree that the Company will maintain strong investment-grade credit ratings under TIEC witness Mr. Gorman's recommended 9.25% ROE and 40% equity ratio, ***even accounting for the impacts of the TCJA***.[47] CEHE does not explain how it is uniquely impacted by the TCJA, or why its ROE should be dramatically higher than the ***9.38%*** average awarded ROE for delivery-only utilities in ***2018***[48]—the year ***after*** the TCJA went into effect, when regulatory commissions had an opportunity to take the financial implications of that law into account.[49]

While CEHE claims that the TCJA adversely impacts one of its credit metrics—Funds from Operations to Debt (FFO/Debt)—by reducing revenues attributable to federal income tax liability,[50] its parent has acknowledged that the impact is trivial. CNP told investors that for the first quarter of 2019, the TCJA decreased CEHE's revenues by just $6 million (on a $2.1 billion revenue requirement), and that decrease was offset by a corresponding reduction in federal income tax payments.[51] By way of comparison, in that same quarter, CNP allocated CEHE $10 million in "Merger related expenses" attributable to CNP's acquisition of Vectren Corp.[52] The TCJA's cash flow impacts are trivial and in no way justify CEHE's ROE request.

In fact, when presenting to ratings agencies, CNP has described the TCJA is an overall ***positive*** factor for its credit quality. For instance, CNP told S&P its [redacted]

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[46] *See* Tr. (Mercado Cr.) at 106:1–107:17 (June 24, 2019).

[47] *See* CEHE Ex. 43 (McRae Reb.) at 23-25; CEHE Ex. 48 (Lapson Reb.) at Ex. R-EL-6, p. 3-4.

[48] *See* CEHE Ex. 69 (Woolridge Exhibit Book) at Tab 8 (S&P Global, RRA Regulatory Focus "Major Rate Case Decisions – January – December 2018" (Jan. 31, 2019)) at 1 (average authorized return on equity for "Delivery cases" was 9.43% in 2017 and 9.38% in 2018).

[49] Only one of the 16 delivery-only utility rate cases decided in 2018 was decided in the first quarter, and the order in that case did not come out until mid-March, so regulators had sufficient time to consider the impacts of the TCJA on their decisions. *See* CEHE Ex. 69 (Woolridge Exhibit Book) at Tab 8 (S&P Global, RRA Regulatory Focus "Major Rate Case Decisions – January – December 2018" (Jan. 31, 2019)) at 11 ("D" denotes "delivery-only" utilities).

[50] *E.g.*, CEHE Exceptions at 6, 7, 10, 13, 49, 59, 60, 61, 62, and 63.

[51] TIEC Ex. 13 (1st Quarter 2019 Earnings Transcript on May 9, 2019) at 10; TIEC Ex. 12 (1st Quarter 2019 Earnings Presentation on May 9, 2019) at 13.

[52] *Id.*

[redacted][53] CNP also claimed that [redacted] in its consolidated FFO/Debt ratio,[54] and that "[redacted][55] The record confirms that any negative impacts of the TCJA will be minor and short-lived. For example, Staff witness Mr. Tietjen explained that the TCJA can be expected to increase regulated utilities' rate base because the tax change eliminated bonus depreciation and its associated ADFIT, which is treated as an offset to rate base.[56] Accordingly, under the TCJA, regulated utilities can expect their rate base and, by extension, their earnings, to grow, which will offset any long-term cash flow impacts.[57] The credit effects of the TCJA benefit utilities in other respects as well. For instance, as TIEC witness Mr. Gorman described in his direct testimony, the TCJA actually ***reduces*** a utility's cost of equity capital in the long run because it decreases the income tax cost of a utility dividend.[58] Accordingly, the TCJA does not justify CEHE's unreasonable ROE request.

3. Mr. Gorman's recommended 9.25% ROE will give CEHE reasonable access to capital while reducing costs for customers.

In addition to providing a return commensurate with investments of comparable risk, as discussed above, the relevant standard for a just and reasonable rate of return developed by the Supreme Court in *Hope* and *Bluefield* balances customer interests against (1) the utility's financial integrity and (2) its access to capital.[59] CEHE cannot reasonably demonstrate that it would lose access to capital (much less suffer financial instability) under either the PFD's or Mr. Gorman's recommended ROE. Instead, CEHE makes the empty claim that these lower ROEs would be "credit negative,"[60] which means nothing more than they would provide CEHE with less money. PURA requires the Commission to set a rate of return that will allow CEHE sufficient access to

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[53] TIEC Ex. 4 (Griffey Dir.) at Ex. CSG-2 (Griffey HSPM Workpapers) at Bates 277 of 361 (CEHE Response to TCUC01-02, SP 2018 CenterPoint Energy Annual Presentation at p. 12 of 96) (HSPM) (emphasis added).

[54] *Id.* (emphasis added).

[55] *Id.* at Bates 295 of 361 (CEHE Response to TCUC01-02, SP 2018 CenterPoint Energy Annual Presentation at p. 29 of 96) (HSPM) (emphasis added).

[56] Tr. (Tietjen Cr.) at 786:25-787:10 (June 26, 2019); *see also* TIEC Ex. 4 (Griffey Dir.) at Ex. CSG-3, p. 7.

[57] Tr. (Mercado Cr.) at 62:12-19 (June 24, 2019); *see also* TIEC Ex. 4 (Griffey Dir.) at 24-25.

[58] TIEC Ex. 5 (Gorman Dir.) at 10.

[59] *Id.* at 38-39.

[60] *E.g.*, CEHE Exceptions at 11, 49, 51, 61.

capital ***at the lowest cost to customers***[61]—not to avoid any and all actions that would be "credit negative." The Commission should see through CEHE's transparent scare tactics. For instance, CEHE states that adopting the PFD's ROE would cause CEHE to "not maintain"[62] its credit metrics, and that it would "negatively affect" CEHE's ability to attract capital.[63] But the same is true of any reduction to CEHE's revenues, and it fails to answer the question of whether "maintaining" a certain credit metric or avoiding a certain "negative impact" is necessary to meet PURA's legal requirements. Nor are these questions answered by the June 26, 2019 Moody's report that the ALJs kept out of evidence at the hearing (and which should not be considered[64]). Despite the many pages that CEHE spends arguing about this credit report, it says essentially the same thing as the others: that decreasing CEHE's current ROE or equity ratio would put downward pressure on its credit metrics.[65] But that does not meaningfully inform the issue the Commission must consider in setting CEHE's capital structure and return. To the contrary, the Commission must set just and reasonable rates and it must decide what return and capital structure will allow CEHE a reasonable opportunity to earn a reasonable return in that context.

Contrary to CEHE's assertions, it cannot reasonably claim that it will become unstable or lose access to capital because ***its own witnesses agree*** that CEHE will maintain investment-grade credit ratings under Mr. Gorman's recommended 9.25% ROE and 40% equity ratio.[66] Additionally, it is indisputable that similar ratings have allowed CEHE's regulated affiliate CERC to borrow on reasonable terms.[67] So contrary to CEHE's claims, there is ample evidence in the record that adopting Mr. Gorman's ROE and capital structure proposal (or the PFD's more generous position) will allow CEHE to attract necessary capital on reasonable terms.

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[61] PURA § 31.001(a) ("The purpose of this subtitle is to establish a comprehensive and adequate regulatory system for electric utilities to assure rates, operations, and services that are just and reasonable to the consumers and to the electric utilities.").

[62] CEHE Exceptions at 49.

[63] *Id.* at 48.

[64] *See* Docket No. 49421, Joint Objection and Motion to Strike (Oct. 17, 2019).

[65] *See* CEHE Exceptions, Attachment D at 1 ("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 metrics.").

[66] *See* CEHE Ex. 43 (McRae Reb.) at 23-25; CEHE Ex. 48 (Lapson Reb.) at Ex. R-EL-6, p. 3-4; *see also* TIEC Reply Br. at 18; TIEC Exceptions at 14-15.

[67] CNP's 2018 Form 10K filing states that CERC issued $300 million in "unsecured senior notes" in August of 2017, and also lists CERC's credit ratings as Baa2 (Moody's), A- (S&P), and BBB (Fitch). *See* CEHE Ex. 88 (Optional Completeness to TCUC Ex. 31: CNP 2018 Form 10K) at 64, 116.

In addition to allowing CEHE to access sufficient capital, adopting Mr. Gorman's recommended 9.25% ROE and 40% equity ratio will also reduce customers' rates by ***$104.1 million per year*** compared to CEHE's request.[68] Accordingly, the Commission should adopt Mr. Gorman's proposed ROE and capital structure because it results in a return that is more than sufficient and results in rates that are just and reasonable to both CEHE and its customers.[69]

4. CEHE witness Mr. Hevert's ROE presentation is flawed and biased and should be disregarded.

The Commission should give almost no weight to CEHE witness Mr. Hevert's recommended 10.4% ROE. Mr. Hevert's proposal patently exceeds prevailing ROEs for low-risk wires-only TDUs like CEHE, and the evidence shows that Mr. Hevert consistently recommends excessive ROEs for the utilities he represents.

At the hearing, Mr. Hevert admitted that he has only recommended an ROE lower than 10.0%[70] in ***three out of 143 cases*** over the last five years,[71] and during that same period, his recommended ROE has ***never*** been adopted by a regulator.[72] Further, utility commissions throughout the country have deemed Mr. Hevert's analysis unreliable because he ***overestimates*** long-term growth rates and uses ***excessive*** risk premiums,[73] just as he has done here. For instance,

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[68] TIEC Ex. 5 (Gorman Dir.) at 37, Ex. MPG-6.

[69] PURA § 31.001(a) ("The purpose of this subtitle is to establish a comprehensive and adequate regulatory system for electric utilities to assure rates, operations, and services that are just and reasonable to the consumers and to the electric utilities."); PURA § 36.003(a) ("The regulatory authority shall ensure that each rate an electric utility or two or more electric utilities jointly make, demand, or receive is just and reasonable.").

[70] For context, since February of 2018, ***no electric utility in the country has been awarded an ROE of greater than 10.0%***. CEHE Ex. 42 (Hevert Reb.) at 73; Tr. (Hevert Cr.) at 741:3-17 (June 26, 2019).

[71] Tr. (Hevert Cr.) at 724:5-24 (June 26, 2019); TIEC Ex. 22 (Entergy New Orleans RFI Response from Docket No. UD-18-07 RE: Hevert Prior Testimony).

[72] Tr. (Hevert Cr.) at 723:13-724:4 (June 26, 2019); TIEC Ex. 22 (Entergy New Orleans RFI Response from Docket No. UD-18-07 RE: Hevert Prior Testimony).

[73] *See e.g.* TIEC Ex. No. 27 (Oklahoma Corporation Commission Final Order in Docket No. PUD 201500273 (Feb. 2, 2017)) at 5 (emphasis added)

Hevert's return on equity estimate is high because 1) his constant growth DCF results are based on ***excessive and unsustainable long-term growth rates***, 2) his multi-stage DCF is based on a ***flawed accelerated dividend cash flow timing and an inflated gross domestic product growth estimate as a proxy for long-term sustainable growth***, 3) his CAPM is based on ***inflated market risk premiums***, and 4) his bond yield plus risk premium is based on ***inflated utility equity risk premiums***.;

TIEC Ex. No. 24 (Maryland Public Service Commission Order in Docket No. 9336 (July 2, 2014)) at 86–87 (emphasis added)

Pepco witness Hevert has relied on growth rates and risk premiums that are too high to be consistent with actual current or predicted versions of those indicators. We also have reservations about Mr. Hevert's asymmetric elimination of mean and median low DCF results. Mr. Hevert also appears to have overestimated other numbers that biased his ROE to too high a level);

in his Constant Growth Discounted Cash Flow (DCF) analysis, Mr. Hevert relied primarily on what he called the "Mean High" result, which used the ***maximum earnings-per-share growth rate estimate***[74] for each of his proxy companies to unnaturally inflate his recommended ROE.[75] Similarly, when performing his Capital Asset Pricing Model (CAPM) analysis, Mr. Hevert assumed that the market will grow between ***11.63% to 14.82% every year***,[76] which is two to three times a reasonable long-term sustainable growth rate, and far out of line with the actual capital appreciation of the S&P 500 between 1926 and 2018, which is between 5.8% to 7.7%.[77] These and the many other issues that plagued Mr. Hevert's analysis are discussed in detail in TIEC's prior briefing.[78]

Mr. Hevert also refused to revise his 10.4% ROE recommendation downward in response to new information, further demonstrating his lack of credibility. As shown during cross-examination, Mr. Hevert substantially adjusted the results of his various models between his direct and rebuttal testimony to reflect the most recent economic data.[79] Based on this updated data, every result from his Constant Growth DCF model fell by around 0.5%,[80] all of his CAPM results fell by between 0.27% and 1.34%,[81] and his Bond Yield Plus Risk Premium results also dropped.[82] Nonetheless, Mr. Hevert maintained his original 10.4% ROE recommendation.[83] According to Mr. Hevert, such dramatic changes to the results of his model (to reflect the most recent economic data) meant they had to be disregarded.[84] This is simply not credible. Either Mr. Hevert's models are unreliable and should be disregarded in their entirety, or the new information should have

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see also TIEC Initial Br. at 24-26 (quoting orders from various state regulatory commissions that presented similar criticisms of Mr. Hevert's methodology and conclusions).

74 CEHE Ex. 26 (Hevert Dir.) at 61 ("I calculated the high DCF result by combining the ***maximum EPS growth rate estimate*** as reported by Value Line, Zacks, and First Call with the subject company's dividend yield.") (emphasis added); *see also* TIEC Initial Br. at 26-27.

75 Even with the most favorable possible assumptions, this DCF analysis resulted in a ROE range of 9.53% to 9.73%, which is still well below Mr. Hevert's requested ROE of 10.4%. *See* CEHE Ex. 42 (Hevert Reb.) at 177.

76 *Id.* at 81.

77 *Id* (citing Duff & Phelps, *2019 SSBI Yearbook* at 6-17).

78 *See* TIEC Initial Br. at 24-34; TIEC Reply Br. at 9-16.

79 *Cf.* CEHE Ex. 26 (Hevert Dir.) at 7 (Table 1A) *with* CEHE Ex. 42 (Hevert Reb.) at 177 (Figure 53).

80 *Id.*; *see also* Tr. (Hevert Cr.) at 742:10-745:10 (June 26, 2019).

81 *Cf.* CEHE Ex. 26 (Hevert Dir.) at 7 (Table 1A) *with* CEHE Ex. 42 (Hevert Reb.) at 177 (Figure 53); *see also* Tr. (Hevert Cr.) at 742:10-745:10 (June 26, 2019).

82 *Cf.* CEHE Ex. 26 (Hevert Dir.) at 7 (Table 1A) *with* CEHE Ex. 42 (Hevert Reb.) at 177 (Figure 53).

83 CEHE Ex. 42 (Hevert Reb.) at 7.

84 Tr. (Hevert Re-Dir.) at 767:5-25 (June 26, 2019).

resulted in a revised, lower recommendation. Mr. Hevert's analysis has been proven unreliable and result-oriented, and should not inform the Commission's ROE recommendation.

5. The Discounted Cash Flow (DCF) model provides reasonable results that should be used to establish CEHE's ROE.

CEHE's only substantive critique of the intervenor and Staff witnesses' ROE recommendations, which informed the PFD's recommendation, is that they relied on the results of Discounted Cash Flow (DCF) models.[85] However, contrary to CEHE's assertion, the DCF model is providing valid results in the current economic environment, and CEHE witness Mr. Hevert's criticisms of the DCF model are based almost entirely on the demonstrably false assumption that interest rates will rise in the near future.[86] Additionally, as the PFD recognized, the Staff and intervenor witnesses all developed their recommendations by weighing the results of multiple models and coming to an overall conclusion on a reasonable ROE range,[87] and none of them were focused entirely on the DCF model, as CEHE implies.

Mr. Hevert's claim that the Constant-Growth DCF model has generated results that are below the returns actually authorized by regulatory commissions in the recent past is misleading and irrelevant.[88] First, as TIEC witness Mr. Griffey explained, the ROEs awarded by regulatory bodies are "sticky" in the sense that they generally lag behind the economic factors that drive utilities' required returns,[89] and because economic conditions have become more favorable for utilities in recent years, it is to be expected that ROE awards would remain slightly above the results of valid economic models like the DCF. Additionally, Mr. Hevert's testimony shows that since 2017, the "Mean DCF Estimate"[90] he calculated has only been about 0.3-0.4% below actual awarded ROEs.[91] So even if Mr. Hevert's criticism were valid, which it is not, correcting for this supposed "bias" in Mr. Hevert's own "Mean" DCF analysis produces a recommended ROE of

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[85] CEHE Exceptions at 46.

[86] *See* TIEC Ex. 20 (March 20, 2019 Federal Reserve Board Press Release) (revising December projections downward); TIEC Ex. 21 (June 19, 2019 Federal Reserve Board Press Release) (revising March projections further downward); Tr. (Hevert Cr.) at 718:17-721:23 (June 26, 2019).

[87] *See* PFD at 115-170.

[88] *Id.*

[89] TIEC Ex. 4 (Griffey Dir.) at 26-27.

[90] Mr. Hevert's DCF result that does not apply unreasonably inflated growth rates. *See* CEHE Ex. 42 (Hevert Reb.) at 177 (this approach produced a suggested ROE range of 8.71% to 8.9%).

[91] CEHE Ex. 26 (Hevert Dir.) at 6, Chart 1; CEHE Ex. 42 (Hevert Reb.) at 9, Figure 2; *see also* TIEC Initial Br. at 26-27.

between 9.11% and 9.3%.[92] This is ***directly in line*** with the intervenors' and Staff's recommended ranges, and slightly below the ROE selected by the PFD,[93] which is yet another indication that those ROE recommendations are valid and should be adopted.

C. Capital Structure [PO Issue 7]

1. The costs of CEHE's proposed capital structure significantly exceed the alleged interest rate savings, even over the long term.

CEHE is asking the Commission to require ratepayers to fund an equity component at 50%, with an additional cost of ***$45.9 million per year***,[94] to avoid a speculative credit downgrade and slight increase in borrowing costs. This proposal should be rejected because it significantly favors the interests of CEHE's shareholders over those of its ratepayers. Even if CEHE received a credit downgrade as it claims, Mr. Gorman has demonstrated that the incremental borrowing cost would only be approximately $6.7 million per year,[95] which pales in comparison to the equity costs CEHE claims are necessary to avoid this potential outcome. On a net basis, ratepayers would be better off by $39.2 million per year if the Commission adopted a 40% equity ratio, even if it resulted in a one-notch credit downgrade.[96] Further, without the robust ring-fencing protections approved in the PFD, CEHE would only continue to export the benefits of its strong credit rating to its parent company to the detriment of its customers, making it even more unreasonable to require ratepayers to fund any additional equity.

CEHE's only response to TIEC's analysis of this cost tradeoff for customers is to claim that ratepayers will continue to pay for higher interest debt over the life of a loan,[97] while equity components can be adjusted in the future. However, CEHE has never attempted to quantify the impact of these borrowing costs over time, and the record shows that ratepayers are better off today with a lower equity percentage, even if that means paying higher interest rates. CEHE witness Mr. McRae states that a one-notch credit downgrade would increase the cost of a 30-year, $700

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[92] Mr. Hevert's "Mean" DCF analysis produced an ROE range of 8.71% to 8.9%, and adding a conservative 0.4% onto that result yields a recommended ROE range of 9.11% to 9.3%. *See* CEHE Ex. 42 (Hevert Reb.) at 177 ("Mean" DCF approach produced a suggested ROE range of 8.71% to 8.9%).

[93] *Id* at 177 (Mr. Hevert's Mean DCF results ranged from 8.71% to 8.9%); CEHE Ex. 42 (Hevert Reb.) at 9, Figure 2.

[94] TIEC Ex. 5 (Gorman Dir.) at 31.

[95] *Id.*

[96] *Id.*

[97] CEHE Exceptions at 60.

million[98] loan offering by 22.9 basis points, and Mr. Gorman calculated that such an increase would cause ratepayers to pay an additional $48.1 million of nominal interest over the life of that 30-year bond, or just $1.6 million per year.[99] However, it is undisputed that providing CEHE with additional equity would increase customers' rates by $45.9 million ***every year***, which will be paid in the near term rather than spread out into the distant future.[100] Therefore, under any reasonable set of assumptions, the tradeoff between interest savings on debt and increase in equity percentage is not even close. The Commission should reject CEHE's position and adopt a 40% equity ratio.

2. CEHE's requested 50% equity ratio is excessive compared to its risk factors.

CEHE's requested 50% equity ratio is excessive compared to its risk level, which is extremely low as a "wires-only" utility for the reasons discussed above. CEHE has substantially lower risk than vertically integrated utilities, which face increased environmental risk and commodity risk when building and operating generation facilities, as well as when selling energy to retail customers. Yet, CEHE's requested 50% equity component would be higher than the 48.46% equity ratio that this Commission awarded to SWEPCO last year as a vertically integrated utility.[101] Further, the evidence shows that CEHE operates in an extremely favorable regulatory environment in Texas,[102] and that its risks have been ***decreasing*** in recent years. Not only have

[98] It is worth noting that CEHE does not issue $700 million in debt each year. In fact, many years it issues less than half of that amount. According to CNP's SEC 10k statements, CEHE has made the following long term debt issuances in recent years:

Date	Debt Issued
January 2019	$700 million
February 2018	$400 million
January 2017	$300 million
August 2016	$300 million
May 2016	$300 million

See CEHE Ex. 84 (Optional Completeness to TCUC 27) at 147; CEHE Ex. 88 (Optional Completeness to TCUC 31) at 116; CEHE Ex. 92 (Optional Completeness to TCUC 35) at 110.

[99] TIEC Ex. 5 (Gorman Dir.) 30.

- $700 M x 0.229% = $1,603 M per year.
- $1.603 M per year x 30 years = $48.09 M.

[100] Due to the time value of money, upfront payments are substantially more expensive than payments over time.

[101] *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449, Order on Rehearing at 31 (Mar. 19, 2018).

[102] *See e.g.* TIEC Ex. 4 (Griffey Dir.) at 27-28; TIEC Ex. 4 (Griffey Dir.) (citing Moody's Credit Opinion (June 19, 2018), included in Schedule II-C-2.10 of the rate filing package) (Confidential) (Moody's has indicated that CEHE enjoys [redacted]

economic conditions improved for regulated utilities generally,[103] but due to the implementation of various rate riders for ERCOT TDUs, CEHE can very quickly put up to 95% of its investments into rates without the need to file a rate case.[104] This is simply not the profile of a utility that merits a 50% equity ratio.

Additionally, CEHE has not shown that it is uniquely risky or merits a higher capital structure than other low-risk wires-only ERCOT TDUs. CEHE's proposed capital structure would have the highest equity component of any ERCOT TDU by 5-10%. Oncor, the state's largest TDU, is able to attract sufficient capital on reasonable terms with 42.5% equity.[105] In its Exceptions, CEHE argues that its anticipated capital expenditures and the TCJA justify its position, but as addressed above, the record shows that CEHE's projected capital spend is in line with its historical experience and its revenue growth trajectory,[106] and the TCJA presents, at most, a temporary and manageable impact to CEHE's cash flows.[107] And while CEHE repeatedly references the 49.91% average equity ratio awarded to delivery-only utilities nationwide in 2018,[108] Staff witness Mr. Ordonez demonstrated that 14 of those 16 utilities are actually much more risky than CEHE because they absorb commodity risk through buying and selling electricity.[109] Further, the evidence shows that CEHE will be able to maintain strong investment grade credit ratings and access to capital at Mr. Gorman's recommended 9.25% ROE and 40% equity ratio,[110] demonstrating that CEHE's proposed 50% equity structure far exceeds what it needs to reasonably attract capital.

[redacted] and has "[redacted].

[103] TIEC Ex. 5 (Gorman Dir.) at 8-11.

[104] *See* TIEC Initial Br. at 15; Tr. (Mercado Cr.) at 65:15–25 (June 24, 2019); TIEC Ex. 8 (Investor & Analyst Day Presentation in June 2014) at 7.

[105] Docket No. 46957, Final Order at 7, FoF 32 (Oct. 13, 2017).

[106] Tr. (Mercado Cr.) at 100:8–102:8, 104:8–10, 106:4-17 (June 24, 2019); TIEC Ex. 16 (Texas Public Utility Commission Order on Rehearing in Docket No. 38339 at 19, FoF 54 (June 23, 2011)); CEHE Ex 6 (Mercado Dir.) at WP KMM-10 (09 to 18 10K CEHE CapEx); TIEC Ex. 17 (Schedule II-B); *see also* TIEC Initial Br. at 36-38.

[107] *See* TIEC Ex. 4 (Griffey Dir.) at 28 (quoting CEHE Response to TCUC 1-02 in attachment SP 2018 CenterPoint Energy at 2-3. (HSPM)) (The TCJA is a [redacted] and [redacted]) (emphasis added).

[108] *E.g.*, CEHE Exceptions at 62.

[109] PFD at 190.

[110] CEHE Ex. 43 (McRae Reb.) at 23-25; CEHE Ex. 48 (Lapson Reb.) at Ex. R-EL-6.

E. Financial Integrity [PO Issue 9]

1. Ring-fencing will ensure that CEHE can continue to provide safe and reliable electric service at just and reasonable rates.

The evidence shows that increasing CEHE's ROE and enriching its capital structure has very little impact on CEHE's credit rating due to its affiliation with its parent, CNP. The PFD appropriately recognized, in light of this evidence, that the best way to support CEHE's financial integrity while ensuring that its rates are just and reasonable is to adopt ring-fence protections to insulate CEHE from the financial risks created by its parent. This targeted approach is best for both CEHE and its ratepayers because it limits CEHE's responsibility for its upstream corporate parent's riskier acquisitions and business activities.

The evidence clearly demonstrates the adverse impact of CEHE's credit linkage with CNP, and supports the ring-fence recommendations in the PFD. As the PFD appropriately determined, "***CenterPoint is financially stronger than its affiliates and has a lower credit rating because of them***."[111] On a stand-alone basis, CEHE's customers have funded an exemplary a+ credit rating from S&P, which would place CEHE in the ***top 3%*** of utilities nationwide in terms of credit quality.[112] However, because CEHE's credit is linked to CNP's, S&P rates CEHE's debt ***three notches lower*** at BBB+. S&P explains that [redacted][113] Critically, as mentioned above and in prior briefing, CEHE's own testimony demonstrates that even if the Commission adopted Mr. Gorman's capital structure and ROE proposals, CEHE's stand-alone credit rating from S&P would still be ***significantly higher*** than the BBB+ group rating it is currently assigned.[114] In other words, if CEHE's credit rating were not dragged down by its association with CNP, its borrowing costs would be equal to or lower than they are today, but with significantly lower overall rates for its customers. Similarly, even if the ratings agencies rate CEHE separately from its parent, they often "notch" corporate subsidiaries' credit ratings in light of their parent companies' risks.[115] As a

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[111] PFD at 202 (emphasis added).

[112] *See* TIEC Ex. 5 (Gorman Dir.) at 11, Table 1 (only 3% of electric utilities were rated A or higher by S&P in 2018).

[113] CEHE Ex. 43 (McRae Reb.) at Ex. R-RBM-4, p. 5 (S&P Global Ratings – CenterPoint Energy Houston Electric LLC, March 22, 2019) (Confidential) (emphasis added).

[114] CEHE Ex. 43 (McRae Reb.) at 23-25.

[115] TIEC Ex. 4 (Griffey Dir.) at 12; *id.* Ex. CSG-2 (Griffey HSPM Workpapers) at Bates 1 of 361 (response to TCUC 1-4 at 1 of 196, Fitch Full Rating Report for CenterPoint Energy Houston Electric , LLC at 1) [redacted]

recent Fitch report stated, for CEHE, [redacted]"[116] Moody's also takes CEHE's financial linkage with its parent into account when determining its credit rating, and stated early this year that "[redacted]."[117] Accordingly, strong ring fencing protections are necessary to ensure that CEHE's customers are no longer paying to maintain CEHE's financial strength, just to see the associated benefits siphoned off to CNP and its shareholders.

Further, CNP uses CEHE's regulated returns[118] to finance risky acquisitions and support various unregulated businesses,[119] which significantly increases CEHE's financial risk without any corresponding benefit to its customers. For example, CNP's recent $6 billion leveraged acquisition of Vectren Corp. caused both CNP ***and CEHE*** to be downgraded one notch by S&P.[120] CEHE responds to this by arguing that Moody's and Fitch rate CEHE separately from CNP, and have not downgraded it in the wake of the Vectren merger.[121] However, as the PFD found, all three ratings agencies have expressed concern about the Vectren merger, and it is "[not] credible that the financial community simply disregards S&P's expressions of concern and downgrade of CNP and CenterPoint."[122] CEHE's arguments to support its proposed capital structure and ROE depend heavily on the ***possibility*** of a one-notch credit downgrade,[123] but CEHE is cavalier in disregarding the credit downgrade that ***actually happened*** due to the Vectren acquisition. And unlike the Vectren acquisition, reducing CEHE's rate of return in conjunction with a ring-fence

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[redacted] (HSPM) (emphasis added).

116 *Id.* at Ex. CSG-2 (Griffey HSPM Workpapers) at Bates 1 of 361 (response to TCUC 1-4 at 1 of 196, Fitch Full Rating Report for CenterPoint Energy Houston Electric, LLC at 1) (HSPM).

117 TIEC Ex. 4 (Griffey Dir.) at 18, ftn. 21 (HSPM) (emphasis added).

118 For example, when analyzing CEHE, S&P assumes that it will pay [redacted] per year in dividends to CNP. CEHE Ex. 43 (McRae Reb.) at Exhibit R-RBM-4, p. 3 (S&P Global Ratings – CenterPoint Energy Houston Electric LLC, March 22, 2019) (Confidential).

119 For example, about 25% of Vectren Corp.'s earnings come from unregulated businesses. TIEC Ex. 4 (Griffey Dir.) at 10.

120 *Id.* at 10.

121 CEHE Exceptions at 70.

122 PFD at 214.

123 *See e.g.*, CEHE Exceptions at 9, 49, 50, 60, 61, 71.

would actually provide savings for CEHE's customers.[124] In sum, this Commission and CEHE had absolutely no involvement in, and received no benefit from, the Vectren merger, yet CEHE's customers are being asked to pay for its consequences. The Commission should reject this outcome.

CEHE's attempt to downplay the impact of ring fencing measures by claiming that they will be "credit neutral" misses the point entirely.[125] First, as discussed above, eliminating the credit linkage between CEHE and its parent will result in an immediate improvement in CEHE's credit profile, which is currently being dragged down three notches by its parent's activities under S&P's analysis. Ring fencing will also improve CEHE's credit strength by eliminating CEHE's linkage with its much riskier parent company, allowing it to borrow based on the strength of its own credit metrics, without factoring in the financial risk of its parent or affiliates.[126] So while CEHE may be correct that ring fencing does not directly change CEHE's credit metrics (FFO to debt etc.), it ***would*** change the benchmarks that ratings agencies use to evaluate risk in relation to those ratios,[127] and it will insulate CEHE and its customers from the actual financial risks created by CEHE's parent. Thus, a reasonable ring fence ensures that CEHE's customers actually receive the benefits of the credit quality they are funding through regulated rates, and protects them from the adverse consequences of parent-level financial distress.

2. It is not enough for CEHE to maintain voluntary financial separations between itself and CNP.

CEHE argues that should not be required to maintain a ring-fence because it can maintain voluntary financial separations from its parent; however, those existing policies have not stopped CNP from using CEHE's cash flows to fund risky business ventures to CEHE's detriment, as shown above. Additionally, CEHE's voluntary financial protections are just that: voluntary. As the PFD noted,[128] in a recent SEC 10K filing, which must be sworn to, CEHE admitted that it faces substantial risks due to its lack of real financial separation from its parent and affiliates. Among other statements, it admitted that:

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124 As discussed above, the record shows that those benefits would likely outweigh the additional debt costs if the Commission were to adopt TIEC witness Mr. Gorman's recommended ROE and capital structure.

125 CEHE Exceptions at 14.

126 TIEC Ex. 4 (Griffey Dir.) at 13-24.

127 *Id.*

128 PFD at 213-214.

- ***"The creditworthiness and liquidity of our parent company and our affiliates could affect our creditworthiness and liquidity."***[129]
- ***"CenterPoint Energy can exercise substantial control over our dividend policy and business and operations and could do so in a manner that is adverse to our interests."***[130]
- ***"Our management could decide to increase our dividends to CenterPoint Energy to support its cash needs. This could adversely affect our liquidity."***[131]

In light of these risks, even S&P recognizes that [redacted][132] This could pose a serious problem in the event that CNP becomes financially distressed.[133]

The Commission should not leave CEHE exposed to financial risks created by its parent company when the utility and its customers can be protected by reasonable, proven ring-fence protections that have been adopted by the Commission in other cases. While current management has voluntarily maintained certain financial separations, without real ring-fencing, there is no guarantee that those protections will continue, especially if CNP encounters significant financial difficulty and puts pressure on the utility to change those practices. Under that scenario, CEHE's ratepayers would pay an even heavier price for CNP's risky business activities, despite receiving no benefits. Over the past few years, the Oncor bankruptcy has demonstrated that ring fencing measures can be invaluable when there is financial distress at a utility's parent company. Recognizing this risk and the current impacts to CEHE's credit ratings, it would be unreasonable to wait until CNP actually becomes financially distressed to address these issues. Accordingly, the Commission should take action in this case to create a reasonable ring fence that separates CEHE from the risks created by its parent.

3. The Commission should adopt the ring fencing provisions recommended by Mr. Griffey and adopted by the PFD.

In its Exceptions, CEHE offers to agree to some of TIEC and Staff's ring-fencing proposals.[134] The Commission should adopt the ring fencing protections that CEHE is willing to

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[129] TIEC Ex. 6 (2017 10-K) at 8 (emphasis in original).

[130] *Id.* at 7 (emphasis in original).

[131] *Id.* (emphasis added).

[132] CEHE Ex. 43 (McRae Reb.) at Ex. R-RBM-4, p. 5 (S&P Global Ratings – CenterPoint Energy Houston Electric LLC, March 22, 2019) (Confidential) (emphasis added).

[133] TIEC Ex. 4 (Griffey Dir.) at 13-24.

[134] CEHE Exceptions at 76-77.

adopt, which include many of the provisions TIEC witness Mr. Griffey proposed in his testimony.[135] However, the provisions CEHE is willing to accept are not sufficient to protect CEHE's ratepayers, so the Commission should adopt the full suite of ring-fence protections recommended by the PFD, which will create financial separation between CEHE and CNP. In particular, CEHE did not agree to the two most important protections in TIEC witness Mr. Griffey's ring fencing proposal: a "dividend stopper" and a non-consolidation opinion.

a. A dividend stopper will ensure that CEHE can make necessary capital investments and provide safe and reliable service.

A dividend stopper is the cornerstone in any ring fence because it ensures that the utility's cash flow is protected when it is most needed to provide safe, adequate, and reliable utility service.[136] Dividend stoppers prevent the utility's parent (or its creditors) from starving the utility for cash to fund upstream shareholder or creditor payments.[137] As noted above, CEHE currently faces exactly this risk because CNP controls its dividend policy.[138] If CNP needs additional cash to support its financial stability or business activities, it can pull dividends from CEHE without regard to CEHE's financial condition.[139] CEHE argues that CEHE's credit agreement prevents it from issuing additional dividends if its debt/capitalization ratio goes above 65%, or, in other words, if CEHE's actual capital structure goes beyond 65% debt/35% equity.[140] But this protection is insufficient. Not only is CEHE's credit agreement subject to renegotiation, but the limitation on

[135] CEHE is willing to agree to the following ring fencing provisions proposed by Mr. Griffey:

- CEHE shall not include in its debt or credit agreements any financial covenants or rating-agency triggers related to any other entity.
- CEHE shall not guarantee the debt of or pledge any assets for entities other than CEHE. (CEHE limits this provision to its affiliates, but gives no reason for that limitation, so the Commission should expand it to cover all other entities.)
- CEHE shall not share credit facilities with CNP or any affiliate.
- CEHE shall maintain its registrations with all three major credit rating agencies.
- CEHE shall maintain a stand-alone credit rating.

Cf. CEHE Exceptions at 76-77 *with* TIEC Ex. 4 (Griffey Dir.) at 19-20 (Figure 2).

[136] TIEC Ex. 4 (Griffey Dir.) at 15.

[137] *Id.*

[138] As CEHE admitted to investors in a recent SEC 10K, "CenterPoint Energy can exercise substantial control over our dividend policy and business and operations and could do so in a manner that is adverse to our interests." TIEC Ex. 6 (2017 10-K) at 7 (emphasis in original).

[139] As noted above, Moody's has explained that if CNP relies on more dividends from CEHE, that could result in credit downgrades for CEHE. TIEC Ex. 4 (Griffey Dir.) at 21.

[140] CEHE Exceptions at 74; *see also* TIEC Ex. 4 (Griffey Dir.) at 20.

dividends is not directly tied to whether CEHE's financial condition will allow it to issue additional dividends while still providing safe and reliable electric service.

As TIEC witness Mr. Griffey testified, the Commission should require CEHE to adopt a dividend stopper similar to the one in Oncor's ring fence.[141] Specifically, CEHE should be required to suspend dividend payments if its credit rating with any of the three major ratings agencies falls to BBB-/Baa3 (the lowest end of investment-grade), and prevent further dividends until otherwise authorized by the Commission.[142] This would allow CEHE to recover its financial health without the weight of upstream dividends dragging its finances down. Unlike the capitalization provisions in CEHE's credit agreement, this dividend stopper is tied directly to CEHE's financial health, and would require CEHE to retain cash if it gets close to losing an investment-grade credit rating. Retaining the cash that would otherwise flow to CNP as dividends will restore CEHE's financial condition, and CEHE would be required to continue retaining cash until the Commission is satisfied that dividends are once again appropriate. This is a rational and effective failsafe that removes much of the risk that CNP could compromise CEHE's financial ability to reliably serve its customers. The Commission should follow the PFD in adopting Mr. Griffey's recommended dividend stopper, and also require CNP to remove inconsistent provisions from its credit arrangements, such as those that allow CNP to have unrestricted access to CEHE's cash flow.[143]

b. A non-consolidation opinion will provide assurance of CEHE's financial separation from its affiliates.

CEHE should also be required to obtain a non-consolidation opinion stating that it would not be dragged into a bankruptcy proceeding for its parent or non-subsidiary affiliates,[144] as recommended by TIEC and Staff and adopted by the PFD. While CEHE asserts that a non-consolidation opinion is unnecessary and not binding, such an opinion provides assurance of CEHE's financial separation and places CNP's creditors on notice that they will not be able to

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[141] TIEC Ex. 4 (Griffey Dir.) at 20 ("If the credit rating by any one of the three major ratings agencies (Standard & Poor's, Moody's Investor Service, or Fitch Ratings) falls below BBB (Baa2) for Oncor senior secured debt, then Oncor will suspend payment of dividends or other distributions, except for contractual tax payments, until otherwise allowed by the Commission.").

[142] *Id.*

[143] *Id.* at 22

[144] *Id.*

access CEHE's assets.[145] Once bankruptcy is imminent, it may already be too late to obtain such an opinion, creating significant uncertainty for CEHE and its customers. Accordingly, it is reasonable and prudent for the Commission to require CEHE to obtain a non-consolidation opinion now to ensure CEHE's financial security and ability to provide safe and reliable electric service.

4. The Commission has authority to require CEHE to adopt ring fencing measures.

The PFD provides a detailed explanation of the Commission's authority to adopt ring fencing provisions in the context of this case,[146] contrary to CEHE's arguments. As the PFD explains, the Commission always has general regulatory authority over a utility's operations and business, even in a rate proceeding under PURA Chapter 36. The legislature's stated purpose in enacting PURA was "to protect the public interest inherent in the rates and services of public utilities" and to "establish a ***comprehensive*** and adequate regulatory system for public utilities to assure ***rates, operations, and services*** that are just and reasonable to the consumers and to the utilities."[147] Consistent with this broad purpose, PURA § 14.001 gives the Commission the "general power to ***regulate and supervise the business*** of each public utility within its jurisdiction and to do ***anything specifically designated or implied*** ... that is necessary and convenient to the exercise of that power and jurisdiction."[148] These general powers to regulate and supervise a utility's business apply regardless of the type of proceeding a utility files, and are not diminished in the context of a Chapter 36 rate case. Additionally, in a rate case, the Commission may select the most effective means to ensure that a utility can provide reliable service at a reasonable cost—whether that is setting a rate or ordering the utility to take affirmative actions under the Commission's broader authority to supervise and regulate utility operations. In other words, the Commission is not required to address all issues that arise in a rate case solely through rate adjustments.

In addition, Mr. Griffey's ring fencing recommendations are directly relevant to Chapter 36 ratemaking requirements. PURA § 36.003 tasks the Commission with ensuring that each utility

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[145] *Id.*

[146] PFD at 193-199.

[147] PURA § 11.002 (emphasis added); *see also* PURA § 31.001(a) (restating this intent for electric utilities specifically).

[148] Emphasis added.

rate is just and reasonable,[149] and that every rate is "sufficient, equitable, and consistent."[150] Specific to CEHE's requested rate of return, Chapter 36 states that the Commission must "permit the utility a reasonable opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public in excess of the utility's reasonable and necessary operating expenses."[151] As to the factors the Commission must consider in establishing a reasonable rate of return, PURA provides the following, non-exhaustive list: "(1) the efforts and achievements of the utility in conserving resources; (2) the quality of the utility's services; (3) the efficiency of the utility's operations; and (4) the quality of the utility's management."[152] Chapter 36 does not restrict the Commission to adjusting the utility's rate of return as the ***sole*** means of addressing these factors. Rather, the Commission's authority under both Chapter 36 and PURA generally supports its ability to adopt financial and operational requirements, such as those proposed by Mr. Griffey and referenced by Mr. Gorman.

Finally, as the PFD explains, CEHE's claim that the Commission lacks authority to require ring fencing measures outside of a sale-transfer-merger (STM) proceeding proves too much.[153] If the Commission were so limited, it would be left powerless to stop a utility's parent company from compromising the utility's ability to provide safe and reliable electric service, unless the utility was engaged in a reviewable STM transaction.[154] The Legislature cannot have intended such a result, as it would interfere with the Commission's mandate to protect the public interest in the rates and services provided by public utilities.[155] Accordingly, the Commission has authority to adopt ring fencing provisions in the context of this proceeding, and should adopt the protections recommended by the PFD.

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[149] PURA § 36.003(a).

[150] PURA § 36.003(b).

[151] PURA § 36.051.

[152] PURA § 36.052.

[153] PFD at 195-96.

[154] *Id.*

[155] *See* PURA § 11.002 (stating that the purpose of PURA is "to protect the public interest inherent in the rates and services of public utilities" and to "establish a ***comprehensive*** and adequate regulatory system for public utilities to assure ***rates, operations, and services*** that are just and reasonable to the consumers and to the utilities.") (emphases added); PURA § 11.008 ("***This title shall be construed liberally to promote the effectiveness and efficiency of regulation of public utilities*** to the extent that this construction preserves the validity of this title and its provisions.") (emphasis added).

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

B. Labor Expenses

1. Incentive Compensation

a. Short-Term Incentive Compensation

i. The PFD is in line with well-established Commission policy.

The Commission should uphold its "well-established and unambiguous"[156] precedent on disallowing financially based incentive compensation by adopting the PFD's recommended disallowances. As the PFD correctly concludes, "(1) those costs are not considered to be reasonable and necessary to provide service to the public, and (2) they provide more immediate benefits to shareholders, rather than ratepayers."[157] As CEHE notes, the one exception to this established policy occurred when the Commission approved CEHE's short-term incentive compensation (STI) plan in Docket No. 38339.[158] However, CEHE fails to mention that unlike in this case, no party filed testimony to support disallowing its STI plan in Docket No. 38339, so that case was decided based on lack of dispute from the parties—not a policy decision. As such, the PFD appropriately reasoned that the outcome in Docket No. 38339 should not be interpreted as precedential on this issue.

ii. CEHE's claims about the Houston job market do not justify allowing financially based incentive compensation in rates.

CEHE contends that it must offer competitive incentive compensation packages to attract employees in a tight job market,[159] but this does not justify (1) tying incentive compensation packages to the company's earnings and then (2) requiring CEHE's customers to pay for the incentive compensation costs. As noted in TIEC's Exceptions,[160] the relevant issue in determining whether a particular incentive compensation package belongs in regulated rates is whether the performance metrics align the interests of the utility's employees with those of its customers—or whether they benefit only the utility's shareholders. It may be reasonable for CEHE to offer

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[156] PFD at 243.

[157] PFD at 243-244; *see also* TIEC Initial Br. at 52-53; Staff Initial Br. at 39-40.

[158] CEHE Exceptions at 81-82.

[159] CEHE Exceptions at 79-80.

[160] TIEC Exceptions at 16-17.

incentive pay to attract employees, but there is no evidence that employees require those incentives to be based on the Company's financial performance. Accordingly, even if CEHE must offer an incentive package to attract talent, it is still entirely inappropriate to charge CEHE's captive ratepayers for the cost of incentive compensation that is based on improving the company's earnings and financial performance. Accordingly, no party has objected to CEHE recovering incentive compensation costs that are directly tied to operational and safety goals, which are designed to motivate CEHE's employees to provide superior utility service. Consistent with longstanding precedent and the PFD, the costs of financially based incentive compensation should be disallowed in total.

iii. The Legislature specifically declined to change existing law, and in turn, Commission policy, regarding financially based incentive compensation for electric utilities.

CEHE disingenuously claims that that Legislature made a "policy pronouncement" on incentive compensation for regulated utilities in adopting House Bill 1767 (HB 1767) this past session, but HB 1767 applies solely to gas utilities regulated by the Railroad Commission. Legislation that would have applied the same treatment for electric utilities under PUC regulation was specifically ***not*** adopted and, in fact, did not even receive a hearing. HB 1767 amended the Gas Utility Regulatory Act (GURA) to require the ***Railroad Commission*** to presume that ***gas utilities'*** compensation expenses are reasonable under certain circumstances.[161] The sponsor of HB 1767 filed two other bills at the same time: HB 1766, which would have applied only to electric utilities[162] and HB 1768, which would have applied to both electric and gas utilities.[163] Neither bill was adopted or heard in committee.[164] Accordingly, the Legislature had an opportunity to adopt the same "policy" for the PUC and declined to do so. As a result, there is no basis for CEHE's claim that the Legislature intended HB 1767 to influence this Commission's policies on incentive compensation expenses.

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[161] CEHE Exceptions at 81-82.

[162] TIEC Ex. 37 (HB 1766).

[163] TIEC Ex. 38 (HB 1768).

[164] PFD at 229.

Nor is it relevant that CEHE's parent company operates both gas and electric utilities in Texas, even if those companies use the same incentive compensation plan.[165] There is no legal or regulatory principle underlying CEHE's implication that its incentive compensation plan must be treated identically by the Public Utility Commission and the Railroad Commission, and it is absurd for CEHE to suggest that it deserves any kind of special treatment simply because its parent company also owns a gas utility. It is also irrelevant that certain CNP employees serve both CEHE and a Texas gas utility.[166] As established in CEHE's own testimony, when employees split their responsibilities between CEHE and other CNP subsidiaries, the related expenses are allocated to each subsidiary based on the amount of time the employee dedicated to each business.[167] This process works equally well for incentive compensation, so the existence of shared employees does not justify allowing CEHE to recover its entire incentive compensation package in rates.

iv. The Commission should not find that CEHE's union STI costs are reasonable.

CEHE also disagrees with the PFD's recommendation to disallow certain union-related STI expenses and contends that no party "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."[168] However, as the PFD correctly notes "the evidence and the arguments presented by [the opposing] parties apply to all of the requested financially-based incentive compensation costs."[169] Therefore, the parties evidence regarding Commission precedent and the reasoning behind disallowing financially based incentive compensation costs "sufficiently rebuts the presumption of reasonableness established by PURA § 14.006."[170] Additionally, as noted in TIEC's prior briefing, PURA § 14.006 requires CEHE to provide adequate evidence that the STI amounts paid to its collective bargaining employees were

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165 CEHE Exceptions at 81-82.

166 *See* CEHE Exceptions at 81.

167 *E.g.* CEHE Ex. 15 (Townsend Direct) at 23 (discussing division of employee time and expenses related to affiliate services).

168 CEHE Exceptions at 83.

169 PFD at 231.

170 *Id.*

the product of a collective bargaining agreement "recognized by federal law,"[171] and CEHE never presented any such evidence. The Commission should uphold the PFD on this point as well.

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

A. Functionalization

1. Texas Gross Margins Tax Expense (and associated accounts)

The PFD's recommendation on the appropriate functionalization of Texas Gross Margins Tax (TMT) expense is well-reasoned, supported by the evidence, and should be adopted over the City of Houston's (COH's) exceptions. TMT is levied on the revenues that CEHE collects for providing wholesale transmission service and retail delivery service.[172] The tax attributable to CEHE's retail service should be allocated to customers in CEHE's retail service area, and only the tax on CEHE's wholesale transmission service should be "uplifted" or spread to all customers on the ERCOT transmission grid through TCOS.[173] CEHE's original functionalization proposal was inconsistent with cost causation principles because it uplifted a large portion of the tax attributable to CEHE providing ***retail*** service to its customers into TCOS.[174] In particular, CEHE functionalized the contents of FERC Account 565—which contains ERCOT transmission payments that CEHE made to other TSPs for its retail customers' use of the ERCOT grid—to the ***wholesale*** transmission function, even though those costs were incurred in the course of CEHE providing ***retail*** service.[175]

In its rebuttal testimony, CEHE abandoned its original functionalization proposal and recognized that Commission Staff's approach was correct.[176] Nevertheless, COH has continued to support CEHE's original position. But contrary to the City of Houston's (COH) complaint that the PFD does not adequately justify its decision,[177] the PFD clearly aligns CEHE's "transmission function revenue requirement" with CEHE's wholesale transmission revenue requirement. As

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[171] *Id.* at 220.

[172] *Id* at 25-26.

[173] *Id.* at 31.

[174] *Id.* at 30 ("The critical flaw in CEHE's approach is equating the transmission functional revenue requirement (which is a component of its ***retail*** cost of service) with its ***wholesale*** transmission revenue requirement.") (emphasis in original); Tr. 854 (Murphy Cr.) at 854:23–855:5 (June 26, 2019).

[175] Staff Ex. 2A (Murphy Dir.) at 30-31.

[176] CEHE Ex. 35 (Colvin Reb.) at 47.

[177] COH Exceptions at 29.

Staff pointed out in testimony, and as CEHE agreed in rebuttal,[178] "[t]he critical flaw in CEHE's [original] approach is equating the transmission functional revenue requirement (which is a component of its ***retail*** cost of service) with its ***wholesale*** transmission revenue requirement."[179] The PFD agreed with Staff's reasoning[180] and explained that functionalizing the TMT expenses associated with FERC Account 565 to retail customers "accurately incorporates CenterPoint's requested wholesale transmission revenue requirement of $395.8 million and the retail revenue requirement of $2.282 million (which includes the $942.4 million for ERCOT transmission payments)."[181] Additionally, the PFD correctly noted that CEHE's initial proposal "conflict[s] with cost causation principles . . . [because it] uplift[s] a portion of the TMT expense attributable specifically to its provision of retail service to all customers on the ERCOT transmission grid through its TCOS."[182] This incorrect functionalization is significant because "for every dollar in common costs assigned to the transmission function . . . CEHE's retail customers will bear only 25 cents on the dollar in the form of ERCOT transmission payments."[183] In other words, this incorrect functionalization would force all customers in ERCOT to subsidize certain aspects of providing CEHE's retail customers' electric service. Accordingly, cost causation principles require the Commission to appropriately functionalize CEHE's entire cost of providing ***retail*** electric service to the Distribution Service function, as Commission Staff recommended and the PFD adopted.

COH also complains that the PFD does not provide adequate justification for reversing its precedent from CEHE's last rate proceeding. [184] However, the PFD recognized that Staff and TIEC "clarified that this issue was not contested in CenterPoint's last base rate case, and as such, the Commission's decision in that case should not control in this case, especially in light of the evidence presented."[185] Accordingly, the Commission should adopt the PFD's functionalization of CEHE's TMT expense.

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[178] CEHE Ex. 35 (Colvin Reb.) at 47.

[179] Staff Ex. 2A (Murphy Dir.) at 30; *see also* Tr. (Murphy Cr.) at 854:23-855:5 (June 23, 2019).

[180] PFD at 329 ("The ALJs concur with Mr. Murphy's mathematical explanation for his recommendation, as adopted by CenterPoint.").

[181] PFD at 329-330.

[182] *Id.* at 330.

[183] Staff Ex. 2A (Murphy Dir.) at 20.

[184] COH Exceptions at 30.

[185] PFD at 329; *see also* Staff Ex. 2A (Murphy Dir.) at 32.

B. Class Allocation

1. Class Allocation of Transmission Costs and Distribution Costs

a. Transmission Costs

ii. 4CP Allocation versus NCP Allocation

Texas Competitive Power Advocates (TCPA), which represents the interests of competitive generators, is inappropriately seeking to litigate the merits of the Commission's rule allocating wholesale transmission costs to distribution providers based on the ERCOT 4CP in this proceeding. This allocation decision was made decades ago when the Commission adopted PUC Subst. R. 25.192(b)(1), which mandates in relevant part that "The monthly transmission service charge to be paid by each DSP is the product of each TSP's monthly rate as specified in its tariff and the DSP's previous year's average of the 4CP demand that is coincident with the ERCOT 4CP." Under this rule, CEHE's wholesale transmission charges are a direct function of its customers' demand during the ERCOT 4CP. As a result, CEHE's wholesale transmission charges should, in turn, be passed down to it retail customers based on their contribution to the ERCOT 4CP. Any other outcome would create a mismatch in the way wholesale transmission costs are allocated to CEHE and how they are allocated to its customers, violating basic cost-causation principles.

TCPA's arguments are more appropriately directed at the allocation policy embodied in PUC Subst. R. 25.192, which is not subject to change in this proceeding. TCPA takes the erroneous position that any 4CP allocation methodology is inconsistent with cost causation principles because the cost of building the ERCOT transmission system is not driven exclusively by demand during the ERCOT 4CP intervals.[186] While there are significant factual problems with TCPA's position,[187] these arguments are irrelevant because ***CEHE's wholesale transmission charges*** are a direct product of its customers' ERCOT 4CP demand based on PUC Subst. R. 25.192. In this proceeding, the Commission has to decide how to allocate the ERCOT wholesale transmission charges that CEHE incurs in its role as a load-serving distribution service provider (DSP) among CEHE's retail customer classes. It is undisputed that pursuant to PURA[188] and the

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[186] TCPA Exceptions at 1-2.

[187] For example, Staff witness Mr. Abbott testified that "***customers' load coincident with the system peak. . . is the primary driver of transmission system costs.***" Staff Ex. 7B (Abbott Reb.) at 32 (emphasis added); *see also* TIEC Ex. 1 (Pollock Dir.) at 11; TIEC Ex. 2 (Pollock Reb.) at 7-8.

[188] PURA § 35.004(d).

Commission's rules,[189] CEHE incurs those charges based on its customers' usage at the time of the ERCOT 4CP. As a result, if CEHE's customers reduce their usage during the ERCOT 4CP, CEHE's allocated ERCOT wholesale transmission costs go down. Conversely, if CEHE's customers use more power during the ERCOT 4CP, CEHE's allocated transmission costs increase.[190] The relationship is direct and one-for-one, and should be reflected in the retail allocation of wholesale transmission costs as the PFD recommends.

Finally, TIEC understands that TCPA's opposition to ERCOT 4CP allocation of wholesale transmission costs is based on potential pricing impacts on ERCOT's wholesale energy market. TIEC does not agree with these alleged impacts (due to the overlap of 4CP response and price response). But in any event, regulated utility rates and class allocations should be based solely on sound ratemaking principles—not an attempt to influence external factors that have nothing to do with regulated utility rates, such as wholesale energy prices. Rates should be designed to track cost-causation and to allow customers to manage their regulated utility costs through reasonable means, such as reducing usage during peak demand periods. Incidental impacts on wholesale energy prices have no bearing on the appropriate cost allocation for ***regulated rates***. For these reasons, TCPA's arguments are both irrelevant and misguided, and the PFD's recommendations should be adopted.

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

A. Rider UEDIT [PO Issue 51]

Utilities like CEHE regularly collect certain anticipated tax payments from customers well in advance of when it actually makes those tax payments to the government. These excess collections are referred to as accumulated deferred income taxes (ADIT), and they are essentially an interest-free loan from ratepayers to the utility. When the TCJA was enacted in late 2017, the federal corporate income tax rate fell from 35% to 21%, meaning that a portion of the ADIT that CEHE had collected from its customers will never actually become due to the government as taxes. As explained below, these excess deferred income taxes (EDIT) should be returned to customers as quickly and completely as possible.

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[189] 16 TAC § 25.192.

[190] *See* Tr. (Abbot Cr.) at 898:2 – 899:1 (June 26, 2019) ("[I]f customers are reducing their load at the time of the peak, those transmission costs are not being incurred, they are not being allocated to CenterPoint, they're not being allocated to that customers' class, and they're not being charged [to] the customer.").

1. The Commission should adopt the PFD's decision to return the amounts included in CEHE's Rider UEDIT to ratepayers more quickly than CEHE has proposed.

CEHE's EDIT balance is divided into two buckets. The TCJA deems certain EDIT related to the depreciation of poles and wires assets to be "protected EDIT," and requires that those amounts be returned to ratepayers over the remaining life of the associated assets using a method called the "average rate assumption method" (ARAM).[191] The remaining portion of CEHE's EDIT is referred to as "unprotected EDIT" (UEDIT), and can be refunded to customers over any period deemed reasonable by the Commission.[192] CEHE's proposed Rider UEDIT would refund its entire UEDIT balance, as well as the first year of protected EDIT, over the next three years.[193] However, the PFD adopted TIEC's recommendation that all unprotected EDIT be returned to customers over two years, and that the first year of protected EDIT (which has already been amortized using ARAM) be returned to customers over a single year.[194] As explained below, the Commission should adopt the PFD's decision on this issue.

a. CEHE's entire UEDIT balance should be returned to customers over two years.

As the PFD recognizes, TIEC's proposed return period of two years better comports with one of the primary objectives of the TCJA, which was to "put[] money back into customers pockets."[195] Under CEHE's proposal to return UEDIT over three years,[196] CEHE would still be refunding UEDIT amounts ***five years*** after the passage of the TCJA.[197] This is especially problematic because the longer it takes for CEHE to return its EDIT balance, the less likely it becomes that CEHE will return the money to the customers who initially paid the amounts.[198]

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[191] TIEC Ex. 3 (LaConte Dir.) at 6.

[192] *Id.* at 7.

[193] *Id.* at 6-7.

[194] PFD at 375.

[195] *Id.* at 374.

[196] CEHE Ex. 30 (Troxle Dir.) at 45.

[197] PFD at 374.

[198] With each passing year, CEHE will acquire new customers who will receive credit for EDIT amounts they had no part in funding, and some of CEHE's customers will leave and never fully recover amounts they paid to CEHE to cover tax payments that, now, will never occur. *See* PFD at 374 ("A two-year recovery period for UEDIT makes it more likely that money will be returned to the customers who paid it initially.").

The PFD also correctly rejected CEHE's baseless contention that a three-year period was needed to ensure the accuracy of the refund amount.[199] As TIEC witness Ms. LaConte noted, many other utilities have refunded their UEDIT amounts over a much shorter time period.[200] For example, Entergy Arkansas refunded $466 million of UEDIT over a period ranging from 7 to 21 months.[201] Additionally, while CEHE is correct that tax laws could change and impact the accuracy of the refund, that risk will exist regardless of the time-frame over which CEHE refunds its UEDIT.[202]

Finally, while it is true that the Commission has approved longer amortization periods for UEDIT balances in Texas, those cases were settled and therefore do not bind the Commission's hands in this proceeding.[203] Accordingly, the Commission should adopt the PFD's recommendation to return CEHE's entire UEDIT balance to customers over a two-year period.

b. The $18.7 million in protected EDIT already amortized under ARAM should be returned to customers over one year.

CEHE transferred approximately $18.7 million of protected EDIT that had already been amortized under ARAM to its UEDIT balance and proposed refunding that amount to customers through its Rider UEDIT over three years.[204] However, as CEHE's witnesses admitted on cross-examination, the protected EDIT amount that is amortized next year will be returned to customers over a one-year period.[205] There is no reason to treat the first year of amortized protected EDIT differently just because CEHE chose to characterize those funds as UEDIT. As such, the PFD correctly found that "CenterPoint did not prove the amounts at issue should be refunded over a much longer period simply because CenterPoint combined them with UEDIT to be refunded through Rider UEDIT."[206] The Commission should make the same finding, and should require CEHE to return the entire first year of amortized protected EDIT to customers over one year.

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[199] PFD at 374.

[200] TIEC Ex. 3 (LaConte Dir.) at 8; PFD at 374.

[201] TIEC Ex. 3 (LaConte Dir.) at 8; see also *In the Matter of the Application of Entergy Arkansas, Inc. for a Proposed Tariff Revision Regarding the Request for Approval of a Tax Adjustment Rider to Provide Tax Benefits to its Retail Customers*, Docket No. 10-014-TF, Order No. 2 at 3 (Mar 27, 2018).

[202] PFD at 375.

[203] *See id.*

[204] TIEC Ex. 3 (LaConte Dir.) at 6-7.

[205] Tr. (Colvin Cr.) at 1273:13–1274:4 (June 28, 2019); PFD at 375.

[206] PFD at 375.

2. **The Commission should open a new proceeding to determine the appropriate treatment of the $158 million in EDIT related to various securitization bonds.**

During discovery, it was revealed that after the TCJA was passed in late 2017, CEHE was left with approximately $158 million in EDIT balances related to securitized bonds that were issued to recover the costs of electric deregulation within ERCOT and storm restoration costs.[207] Rather than bringing these EDIT amounts to the Commission's attention, CEHE simply recorded them as income in the 2017 tax year.[208] However, to the extent that these ***excess*** deferred tax balances were originally funded with customers' regulated rates, CEHE should be required to refund them. Unfortunately, as the PFD noted, "this issue is complicated."[209] It was difficult for the parties to completely explore this issue because it did not come to light until this case was already well underway. Despite this, just summarizing the parties' arguments took the PFD ***17 pages***.[210] And even now, some of the issues left outstanding are (1) what portion (if any) of the EDIT balance related to system restoration costs were ratepayer-funded, (2) how to calculate the particular refunds (if applicable) given the different structures of the bonds associated with the different dockets, and (3) the risk of an EDIT refund being viewed negatively by capital markets and credit rating agencies.[211] Given the complexity of these issues and the magnitude of the EDIT amounts involved, the PFD reasonably concluded that it would be wise to open a subsequent proceeding to allow further discovery and testimony.[212]

CEHE disagrees with the PFD's recommendation, and argues that the Commission can make its decision on this record.[213] In particular, CEHE claims that any ADFIT issues "were fully settled once and for all in agreements approved by the Commission."[214] But this claim stretches the meaning of those settlement agreements beyond credibility because the Commission did not anticipate or address the effect of a prospective corporate tax reduction when determining the

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[207] *See* GCCC Ex. 1 (Kollen Dir.) at Attachment D (Response to GCCC RFI No. 01-05).

[208] *Id.* at 56 (citing CenterPoint Energy, Inc. 2018 10-K at 151).

[209] PFD at 394.

[210] *Id.* at 376-393.

[211] Staff Ex. 1A (Tietjen Dir.) at 24-25; PFD at 388.

[212] PFD at 394.

[213] CEHE Exceptions at 98.

[214] *Id.*

appropriate level of ADFIT related to the original securitization bonds.[215] It is undisputed that those settlement agreements contemplate $158 million in ADFIT that will ***never become due as taxes*** due to the TCJA, and allowing CEHE to treat the EDIT associated with these securitized bonds as income would be inconsistent with how the Commission has handled other EDIT amounts associated with non-securitized assets. It is worth taking the time to determine whether these amounts were originally funded by ratepayers and should be returned to them, especially because this issue received short shrift during the discovery phase of this proceeding.

Alternately, CEHE contends that the Commission should not open a new proceeding because "financing orders are intended to be final."[216] However, PURA does not prevent the Commission from ordering CEHE to refund this EDIT.[217] PURA § 39.310 only prevents the Commission from taking "any action that would impair the value of transition property, or . . . reduce, alter, or impair the ***transition charges to be imposed, collected, and remitted to financing parties.***"[218] This $158 million in newly created EDIT does not represent the value of transition property, but of anticipated taxes related to the securitization bonds. No party has proposed to modify the transition charges related to the bonds or the amounts that will be remitted to the bondholders. The only question here is whether CEHE or its ratepayers should receive the $158 million in EDIT that will no longer be paid ***to the government*** in taxes.

Given these open questions related to a substantial EDIT balance, the Commission should adopt the PFD's recommendation to open a new proceeding in order to more thoughtfully address this issue.

XII. CONCLUSION

The Commission should reject CEHE's unreasonable and unjustified rate request and revise the PFD's awarded ROE and capital structure downward, rather than upward as CEHE requests. Increasing CEHE's equity level and ROE is unnecessary and would solely benefit

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[215] Mr. Tietjen notes that the relevant securitization transactions are: *Application of CenterPoint Energy Houston Electric, LLC for a Financing Order*, Docket No. 30485 (Order, March 16, 2005); *Application of CenterPoint Energy Houston Electric, LLC for a Financing Order*, Docket No. 34448 (Order, September 18, 2007); *Application of CenterPoint Energy Houston Electric, LLC for a Financing Order*, Docket No. 37200 (Order, August 27, 2009); *Application of CenterPoint Energy Houston Electric, LLC for a Financing Order*, Docket No. 39809 (Order, October 27, 2011). Staff Ex. 1A (Tietjen Dir.) at 18

[216] CEHE Exceptions at 101.

[217] *See* PFD at 386.

[218] PURA § 39.310 (emphasis added).

CEHE's parent company, especially if the Commission were to weaken the reasonable ring fencing conditions adopted in the PFD. Additionally, the Commission should preserve the PFD's well-reasoned findings with respect to incentive compensation expenses, Texas Margins Tax functionalization, and the treatment of excess deferred income taxes.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Michael McMillin, Attorney for TIEC, hereby certify that a copy of the foregoing document was served on all parties of record in this proceeding on this 24th day of October 2019 by hand-delivery, facsimile, electronic mail and/or First Class, U.S. Mail, Postage Prepaid.

Michael McMillin