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

APPLICATION OF CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC FOR AUTHORITY TO CHANGE RATES	§ § §	BEFORE THE PUBLIC UTILITY COMMISSION OF TEXAS

TEXAS COAST UTILITIES COALITION'S

REPLY TO EXCEPTIONS TO THE PROPOSAL FOR DECISION

Alfred R. Herrera
Brennan J. Foley
Sergio E. Herrera
HERRERA LAW & ASSOCIATES, PLLC
P.O. Box 302799
4400 Medical Parkway
Austin, Texas 78703

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INTRODUCTION

The Texas Coast Utilities Coalition[1] ("TCUC") of cities limits its Reply to Exceptions to the Proposal for Decision ("Reply Exceptions") to the issues of cost of capital, including the appropriate capital structure for CenterPoint Energy Houston Electric, LLC ("CEHE").

TCUC joins in and supports the positions presented by the Gulf Coast Coalition of Cities ("GCCC"), and the City of Houston and the Houston Coalition of Cities (collectively, the "COH/HCC") on issues addressed in their replies to exceptions.

For convenience and the sake of brevity, TCUC includes in its Reply Exceptions, only those sections of the Administrative Law Judges' ("ALJs") Proposal for Decision to which TCUC presents a reply to CEHE's exceptions.

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

TCUC limited its exceptions to the Administrative Law Judges' ("ALJs") Proposal for Decision ("PFD") to the ALJs' proposed return on equity of 9.45%[2] and the ALJs' proposed capital structure of 55% long-term debt and 45% common equity.[3] TCUC respectfully urges the Public Utility Commission of Texas ("Commission") to reject not only CEHE's exceptions to the PFD with regard to return on equity, capital structure, and overall cost of capital, but to also decline to adopt the PFD's recommendations on those same issues. TCUC instead urges the

1 The Texas Coast Utilities Coalition of cities is comprised of the Cities of Baytown, Clute, Freeport, League City, Pasadena, Pearland, Shoreacres, West Columbia, and Wharton.

2 *Application of CenterPoint Energy Houston Electric, LLC for Authority to Change Rates*, Docket No. 49421, Proposal for Decision at 117 (Sept. 16, 2019) ("PFD").

3 *See generally,* TCUC's Exceptions to the Proposal for Decision ("TCUC Exceptions") at 1-11.

Commission to adopt the following return on equity and long-term debt, capital structure, and overall cost of capital:

Primary Recommendation Regarding Capital Structure,
Return on Equity, and Rate of Return[4]

COMPONENT	CAPITAL STRUCTURE	COST OF CAPITAL	WEIGHTED AVERAGE COST OF CAPITAL
LONG-TERM DEBT	60%	4.38%	2.63%
COMMON EQUITY	40%	8.97%	3.59%
TOTAL	100.00%		6.22%

Alternatively, TCUC urges the Commission to adopt an overall rate of return of 6.21% as shown in the table below:

Alternative Recommendation Regarding Capital Structure,
Return on Equity, and Rate of Return

COMPONENT	CAPITAL STRUCTURE	COST OF CAPITAL	WEIGHTED AVERAGE COST OF CAPITAL
SHORT-TERM DEBT	0.90%	2.27%	0.02%
LONG-TERM DEBT	55.48%	4.38%	2.43%
COMMON EQUITY	43.62%	8.62%[5]	3.76%
TOTAL	100.00%		6.21%

A. Return on Equity [PO Issue 8]

1. The evidence establishes that CEHE is less risky than the average of the proxy groups of utilities to which CEHE compares.

CEHE contends that the "evidence indicates" that CEHE is "more risky than other similarly situated utilities;" and that the "PFD provides no indication of why it believes [CEHE's] risks … do not warrant an upward adjustment;" and that the "PFD fails to address … why [CEHE] should be considered dramatically less risky than other comparable utilities."[6]

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4 TCUC's primary recommendation includes a return on equity of 9.00%. Taking into account the ALJs' proposed adjustment to CEHE's return on equity produces a return on equity of 8.97%, which results in an overall rate of return of 6.22%.

5 TCUC's alternative recommendation includes short-term debt in CEHE's capital structure and is premised on a return on equity of 8.65%. Taking into account the ALJs' proposed adjustment to CEHE's return on equity produces a return on equity of 8.62%, which results in an overall rate of return of 6.21%.

6 CEHE Exceptions at 47-48.

CEHE cites to no evidence to support its contention that it is more risky than other similarly situated utilities; nor could it – the evidence establishes the opposite. Dr. J. Randall Woolridge, TCUC's expert witness on cost-of-capital issues, testified that based on analysis of his proxy group (the "Electric Proxy Group") and Mr. Robert Hevert's Proxy Group, CEHE is less risky than the average of the two proxy groups of utilities.[7]

Further, it is not the ALJs' duty to explain why CEHE does not "warrant an upward adjustment" to its return on equity ("ROE"). Instead, the burden is on CEHE to establish the merits of its proposed rates, including its proposed return on equity.[8]

2. CEHE ignores the fact that from 2000 through 2018, utility regulatory commissions have approved lower ROEs.

CEHE asserts that the "evidence in this proceeding establishes that the average authorized ROE for electric utilities since 2014 has been 9.68%;" that the "PFD's recommendation is … unreasonably low when compared with authorized ROEs in Texas;" and that the "PFD fails to address … why [CEHE] should be considered dramatically less risky than other comparable utilities."[9]

With regard to the average ROE of 9.42% that CEHE notes, that ROE is the average for *all* electric utilities, not just delivery companies. Dr. Woolridge's testimony established that ROEs for delivery companies are consistently below ROEs for fully-integrated utilities:

> One consistent factor in electric utility authorized ROEs is that the ROEs for delivery or distribution companies have consistently been below those of vertically integrated utilities. This is shown in Figure 4, below. The lower authorized ROEs are usually attributed to the fact that delivery or distribution companies do not own and operate electric generation which is perceived to be the riskier part of electric utility operations. I believe that commissions in states who have deregulated the electric-utility industry recognize the lesser risk of "wires-only" companies like CenterPoint Houston and award lower ROEs. The authorized ROEs for electric delivery companies have been 30-50 basis points below those of vertically-integrated electric utilities in recent years. In 2018, the average authorized ROE for electric delivery companies was 9.38%.[10]

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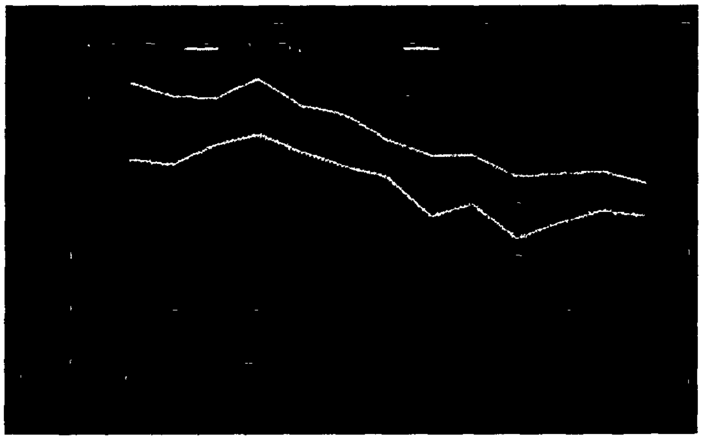
7 Direct Testimony of J. Randall Woolridge, TCUC Exh. 1 at 16; *see also* TCUC Initial Post-Hearing Brief ("TCUC Initial Brief") at 14-15 (July 9, 2019).

8 *See* Public Utility Regulatory Act ("PURA") § 36.006(1).

9 CEHE Exceptions at 47-48.

10 *See* TCUC Exh. 1 at 13-14. Indeed, the 9.42% ROE to which CEHE cites is in fact higher than the national average ROE of 9.38% for 2018. *Id.*

Figure 4
Authorized ROEs for Vertically Integrated versus
Delivery Only Electric Utilities
2006-2019



Thus, CEHE's reliance on an average ROE of 9.42% is misplaced.

The Commission does not establish a utility's ROE based on an average of ROEs that regulatory agencies have approved for other utilities.[11] While such data may inform the Commission's decision, the basis for setting CEHE's ROE is based on data specific to CEHE. In this proceeding, the evidence establishes that compared to Dr. Woolridge's Electric Group of proxy utilities, and Mr. Hevert's Proxy Group, CEHE is less risky.[12]

Also, the evidence establishes that from 2000 through 2018, regulatory commissions across the Nation have been approving lower ROEs; the uncontroverted evidence establishes that from 2000 to 2018, authorized ROEs for electric utilities have declined from an average of 10.01% in 2012, 9.8% in 2013, 9.76% in 2014, 9.58% in 2015, 9.60% in 2016, 9.68% in 2017, 9.56% in 2018, and 9.57% in the first quarter of 2019.[13] In 2018, the average authorized ROE for electric delivery companies was 9.38%.[14]

Additionally, the only Texas utilities to which CEHE points in support of its statement that the PFD's recommended ROE is "unreasonably low when compared to authorized ROEs in

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[11] CEHE repeats its mantra that the PFD's recommended ROE is below the national average. *See* CEHE Exceptions at 48.

[12] TCUC Exh. 1 at 16; *see also* TCUC Initial Brief at 14-15.

[13] CEHE Initial Brief at 52.

[14] TCUC Exh. 1 – Woolridge Dir. at 13-14. Tellingly, CEHE ignores that in a recent South Dakota case the South Dakota commission set the ROE at 8.75%. *See* TCUC's Reply Post-Hearing Brief at 7 ("TCUC Reply Brief").

Texas,"[15] are the Texas-New Mexico Power Company ("TNMP") and the Oncor Electric Delivery Company, LLC ("Oncor"). Each of the rate cases in which the Commission approved the ROEs for TNMP and for Oncor were settled rate cases;[16] as CEHE is well aware, settled cases provide no precedent upon which to base a decision in a fully contested case.

Moreover, CEHE cites to no evidence to support its contention that the utility in Texas most comparable to CEHE is Oncor.

Finally, and as noted above, with regard to CEHE's complaint that the PFD fails to address why CEHE should be considered less risky than comparable utilities, the burden is not on the ALJs or any other party besides CEHE, to establish that CEHE is less risky than comparable utilities. That burden is on CEHE, a burden CEHE failed to carry.

3. Moody's June 26th report is not in evidence and the ALJs correctly excluded it from the record.

CEHE relies on non-record data – the Moody's June 26, 2017 report – to support its contention that absent a ROE "materially below" 10.0% would be "credit negative." TCUC will not repeat the arguments presented in the "Joint Objection and Motion to Strike" filed by the Commission Staff and joined in by TCUC, Texas Industrial Energy Consumers ("TIEC"), the Gulf Coast Coalition of Cities ("GCCC"), and the Office of Public Utility Counsel ("OPUC"). Suffice it to note that Moody's June 26th report is not in evidence and the ALJs were correct to exclude it from the record.

Moreover, a "negative" credit report does not comprise a downgrade of a utility's credit rating. CEHE itself implies as much, noting that "absence of a supportive rate case outcome *could* lead to a downgrade."[17] Crucially, nothing in the record supports the notion that CEHE cannot access the capital markets at a reasonable cost.[18]

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15 CEHE Exceptions at 48.

16 *See*, *Application of Oncor Electric Delivery Company LLC for Authority to Change Rates*, Docket No. 46957, Final Order at 1 and 13-14 (Conclusions of Law Nos. 62-65) (December 13, 2017) ("*Docket No. 46957*"); and *Application of Texas-New Mexico Power Company LLC to Change Rates*, Docket No. 48401, Final Order at 1 and 16 (Conclusions of Law Nos. 16-19) and at 19 (Ordering Paragraph 30).

17 *See* CEHE Exceptions at 49.

18 *See* TCUC Initial Brief at 30-38; *see also* TCUC Reply Brief at 14-15. CEHE attempts to draw a link between the Staff and Intervenors' proposed ROEs and Moody's credit outlook citing to CEHE witness Ellen Lapson's testimony, but the cite CEHE notes provides no such support. *See* CEHE Exceptions at 50-51.

Thus, Moody's June 26th report cannot serve as a basis for concluding that an ROE below 10.0% will somehow lead to a downgrade of CEHE securities.

CEHE's exceptions regarding the proper ROE miss the mark. To the extent the ALJs' recommended ROE is in error, it is because it is too high. Therefore, TCUC respectfully urges the Commission to adopt a return on equity of 9.00% with a corresponding capital structure of 60% debt and 40% equity.[19]

B. Cost of Debt [PO Issue 8]

CEHE presented no argument in this section of its exceptions.

C. Capital Structure [PO Issue 7]

1. The preponderance of the evidence and Commission precedent support a capital structure comprised of 60% debt and 40% equity.

CEHE states that the evidence demonstrates that the "Company's currently approved equity ratio of 45% will not produce financial metrics that are sufficient to maintain its current credit ratings."[20] For its proposition, CEHE cites to the testimonies of its witnesses, Mr. Robert B. McRae and Ms. Ellen Lapson.[21] However, the passages in Mr. McRae's and Ms. Lapson's respective testimonies do not support the conclusion CEHE wants the Commission to reach, mainly that absent achieving the financial metrics it aspires too, its credit ratings will go down. Neither Mr. McRae's nor Ms. Lapson's testimony combined or individually, establish that CEHE's credit rating will be downgraded if the Commission adopts TCUC's proposed capital structure, or for that matter the ALJs' proposed capital structure.

Instead, the evidence establishes that CEHE's average common equity ratios for CenterPoint Energy, Inc. and CEHE are 33.4% and 42.9%, respectively, [22] and that CEHE's common equity ratio has been in the 38% to 45% range over the three-year time period from

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19 *See* TCUC Initial Brief at 9-13.

20 *See* CEHE Exceptions at 59.

21 *See Id.*

22 *See* TCUC Initial Brief at 34.

January, 2016 through December 31, 2018.[23] Crucially, at this level of equity, CEHE has not only raised capital at reasonable costs, but maintained its credit ratings.[24]

Additionally, these ratios ignore CEHE's use of short-term debt. Including short-term debt in determining the overall debt CEHE uses to fund its operations, its total use of debt for the 13-quarter period January 1, 2016 through March 31, 2019, ranged from a low of 54.2% to a high of 61.3%. Over this same 13-quarter period, including short-term debt, CEHE had an average of 56.9% total debt in its capital structure.[25]

2. CEHE presented no evidence linking higher credit ratings to lower electric rates and the evidence establishes that with materially lower *actual* equity-capital ratios, CEHE has accessed the capital markets.

CEHE claims that a downgrade in CEHE's credit rating would lead to higher interest rates, implying that a higher credit rating automatically produces lower electric rates.[26] In isolation, and in the oft-used caveat, "All Else Being Equal," higher interest rates would seem to mean higher electric rates.

However, there is no evidence in the record to establish that higher interest rates alone result in higher electric rates. Nor is there any evidence in the record that a higher credit rating of itself produces lower electric rates. Additionally, to the extent that a higher ROE would lead to higher credit ratings, there is no evidence in the record that a higher ROE and a higher credit rating, produces lower electric rates.

The more crucial evidence in the record, and as noted above, is that at equity-capital ratios in the 38% to 45% range over the three-year time period from January, 2016 through December 31, 2018, CEHE has not only raised capital at reasonable costs, but maintained its credit ratings.[27]

Thus, CEHE's exceptions regarding its capital structure are unsupported by the record. Further, the ALJs erred in recommending a capital structure of 55% long-term debt and 45%

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[23] *See Id.* at 31.

[24] *See Id.*

[25] *See Id.* at 34.

[26] *See* CEHE's Reply Exceptions at 60.

[27] *See* TCUC Exceptions at 7-8.

equity. Instead the preponderance of the evidence and Commission precedent support a capital structure comprised of 60% debt and 40% equity.[28]

D. Overall Rate of Return [PO Issue 8]

For the reasons noted above, TCUC excepts to the ALJs' proposed overall rate of return of 6.65% and urges the Commission reject CEHE's exceptions regarding its overall rate of return. TCUC further urges the Commission to adopt an overall rate of return of 6.22% as shown in the table below:

Primary Recommendation Regarding Capital Structure, Return on Equity, and Rate of Return[29]

COMPONENT	CAPITAL STRUCTURE	COST OF CAPITAL	WEIGHTED AVERAGE COST OF CAPITAL
LONG-TERM DEBT	60%	4.38%	2.63%
COMMON EQUITY	40%	8.97%	3.59%
TOTAL	100.00%		6.22%

Alternatively, TCUC urges the Commission to adopt an overall rate of return of 6.21% as shown in the table below:

Alternative Recommendation Regarding Capital Structure, Return on Equity, and Rate of Return

COMPONENT	CAPITAL STRUCTURE	COST OF CAPITAL	WEIGHTED AVERAGE COST OF CAPITAL
SHORT-TERM DEBT	0.90%	2.27%	0.02%
LONG-TERM DEBT	55.48%	4.38%	2.43%
COMMON EQUITY	43.62%	8.62%[30]	3.76%
TOTAL	100.00%		6.21%

XII. Conclusion

For the reasons noted above, TCUC respectfully urges the Commission to deny CEHE's exceptions to the PFD with regard to CEHE's cost of capital. Further, TCUC urges the

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28 *See* TCUC's Reply Exceptions at 11-15.

29 TCUC's primary recommendation includes a return on equity of 9.00%. Taking into account the ALJs' proposed adjustment to CEHE's return on equity produces a return on equity of 8.97%, which results in an overall rate of return of 6.22%.

30 TCUC's alternative recommendation includes a return on equity of 8.65%. Taking into account the ALJs' proposed adjustment to CEHE's return on equity produces a return on equity of 8.62%, which results in an overall rate of return of 6.21%.

Commission to grant TCUC's Exceptions to the Proposal for Decision and to adopt a revenue requirement that employs an overall rate of return of 6.22% based on the following cost of capital and capital structure:

Primary Recommendation Regarding Capital Structure,
<u>Return on Equity, and Rate of Return</u>[31]

COMPONENT	CAPITAL STRUCTURE	COST OF CAPITAL	WEIGHTED AVERAGE COST OF CAPITAL
LONG-TERM DEBT	60%	4.38%	2.63%
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LONG-TERM DEBT	55.48%	4.38%	2.43%
COMMON EQUITY	43.62%	8.62%[32]	3.76%
TOTAL	100.00%		6.21%

Also, TCUC joins in the exceptions submitted by the City of Houston and the Gulf Coast Coalition of Cities and further urges the Commission to sustain the parties' "Joint Objection and Motion to Strike" filed by the Commission Staff and joined in by TCUC, TIEC, the Gulf Coast Coalition of Cities, and OPUC regarding admission of that Moody's June 26th report.

Lastly, TCUC joins in the City of Houston's reply to exceptions regarding CEHE's allegations regarding the "Number Running Model." CEHE's assertions and allegations of errors in the Number Running Model, are without merit and TCUC urges the Commission to reject CEHE's "exceptions" on this point.

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31 TCUC's primary recommendation includes a return on equity of 9.00%. Taking into account the ALJs' proposed adjustment to CEHE's return on equity produces a return on equity of 8.97%, which results in an overall rate of return of 6.22%.

32 TCUC's alternative recommendation includes a return on equity of 8.65%. Taking into account the ALJs' proposed adjustment to CEHE's return on equity produces a return on equity of 8.62%, which results in an overall rate of return of 6.21%.

Respectfully submitted,

HERRERA LAW & ASSOCIATES, PLLC
P.O. Box 302799
4400 Medical Parkway
Austin, Texas 78703
(512) 474-1492 (voice)
(512) 474-2507 (fax)

By: Alfred R. Herrera w/ permission Leslie Lindsey

Alfred R. Herrera
State Bar No. 09529600
aherrera@herreralawpllc.com

Brennan J. Foley
State Bar No. 24055490
bfoley@herreralawpllc.com

Sergio E. Herrera
State Bar No. 24109999
sherrera@herreralawpllc.com

service@herreralawpllc.com

ATTORNEYS FOR TEXAS COAST UTILITIES COALITION

CERTIFICATE OF SERVICE

I hereby certify that on this the 24th day of October 2019, a true and correct copy of the ***Texas Coast Utilities Coalition's Reply to Exceptions to the Proposal for Decision*** was served upon all parties via electronic mail in compliance with SOAH Order No. 2.

By: ______________________

Leslie Lindsey