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

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

COMMISSION STAFF'S REPLIES TO EXCEPTIONS TO THE PROPOSAL FOR DECISION

Respectfully Submitted,

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

Most of the conclusions reached by the Administrative Law Judges (ALJs) in the Proposal for Decision (PFD) are correct and should be maintained over CenterPoint Energy Houston's (CEHE) objections. Staff remains grateful for the reasoned consideration of the ALJs, and Staff supports their conclusions in the PFD, with the exception of the points discussed by Staff in their exceptions to the PFD.

In addition, Staff responds to Texas Competitive Power Associates (TCPA) and Texas Industrial Energy Consumers' exceptions regarding 4 Coincident Peak (4CP) method and transmission cost recovery factor (TCRF).

Staff responds to new requests made by CEHE that should not be considered or, in the alternative, should be denied, as the record-close deadline in this proceeding was July 16, 2019 and this is not an inappropriate time to make new requests in this proceeding. CEHE attempted to introduce new evidence into the record in its exceptions.[1] Staff filed an objection and motion to strike new evidence regarding the number run in this docket.[2]

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

Despite clear precedent to the contrary, CEHE requested amounts for, and objected to the PFD's recommendations regarding, the following historically disallowed items: compensation for use of capital paid to affiliates; non-qualified pension expense to highly compensated individuals; financially based long-term incentive compensation (LTI); and, financially based

[1] CenterPoint Energy Houston Electric, LLC's Exceptions to Proposal for Decision (CEHE Exceptions) at Attachments A, C, and D (Oct. 10, 2019).

short-term incentive compensation (STI). Regarding these items, CEHE has gone to great lengths to argue why Commission precedents should not apply to it; Staff disagrees and recommends that precedents that apply to other electric utilities in Texas should also apply to CEHE.

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

1. Prudence Issues

The PFD correctly recommended the disallowance of $1,182,769 for the La Marque substation.[3] CEHE's exception regarding that amount should be rejected.[4]

2. Land Costs

The PFD correctly recommended this disallowance, because the land is not used and useful.[5] CEHE's exceptions should be rejected.[6]

3. Capital Project Accounting

Staff agrees with the PFD's recommendation to disallow $19,376,931, the amount associated with distribution line clearance project.[7] CEHE's arguments to include that amount should be rejected.[8]

Staff agrees with CEHE that the URD CLEP Program should be functionalized to distribution plant.[9]

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

1. Protected Excess Deferred Income Tax

[2] Joint Objection and Motion to Strike (Sept. 17, 2019).
[3] PFD at 30.
[4] CEHE Exceptions at 24-25.
[5] PFD at 37.
[6] CEHE Exceptions at 25-26.
[7] PFD at 50.
[8] CEHE Exceptions at 27-29.
[9] CEHE Exceptions at 30.

3. Medicare Part D Regulatory Asset

Staff supports the PFD's recommendation to use the amount provided by Mr. Kollen in his testimony, as Mr. Kollen identified five errors in CEHE's request. Mr. Kollen's calculation is based on a period of time starting in 2013 because CEHE failed to provide the necessary information on the record to execute the adjustment to correct for the five errors Mr. Kollen identified.

CEHE excepted to the PFD's calculation of the proper amount for the regulatory asset for Medicare Part D. Specifically, CEHE excepts to the PFD's calculation of the amount for the regulatory period based on a period starting in 2013, rather than starting in 2004.[10]

The PFD is correct to note that CEHE has the burden of proof in this proceeding and to note that CEHE failed to provide the necessary information to correctly adjust the Medicare Part D regulatory asset; it is Staff's position that the PFD makes an appropriate adjustment based on the information on the record.

4. Texas Margin Tax Regulatory Asset

Staff supports the PFD's recommendation[11] and urges the Commission to reject CEHE's late request for this unique accounting treatment.

In its exceptions, CEHE writes,

> ...in order to reduce controversy in this proceeding, it [CEHE] will not file an exception to the PFD on this issue [disallowance of the requested regulatory asset relating to Texas Margin Tax]. If the PFD is adopted on this issue, CEHE Houston should be allowed to revert to its former, uncontested methodology with respect to its TMT expense. CEHE Houston's former methodology would result in its 2018 payment of TMT expense of $19,627,578 being reflected in CEHE's cost of service and the $20,027,048 TMT actual expense for the 2018 test year (that will be paid in 2019) being recorded as a regulatory asset that CEHE Houston does not seek to recover in this case.[12]

Fundamentally, if CEHE continues its unique accounting treatment for Texas Margin Tax, it would not reduce controversy but would ensure that controversy would exist surrounding this issue in CEHE's next base-rate proceeding. CEHE's request attempts to continue to book a

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[10] CEHE Exceptions at 39-42.
[11] PFD at 100.
[12] CEHE Exceptions at 41.

regulatory asset for Texas Margin Tax after CEHE alleges that it is not filing an exception to the PFD's denial of its regulatory asset.

CEHE incorrectly states that its methodology was not disputed; at the very heart of the issue surrounding CEHE's request in this case is that Staff, and other intervening parties, do not support CEHE's accounting methodology for its Texas Margin Tax. No other regulated electric utility records its Texas Margin Tax expense as a regulatory asset (even though each and every utility incurs its expense and then pays its tax in the following year). In its application in this docket, CEHE requested a regulatory asset that the Commission never ordered CEHE to record as a regulatory asset in the first place.[13] Now CEHE asks for permission to continue incorrectly recording (as it has done for a decade now) this unauthorized regulatory asset—a request that would result in this issue persisting years into the future.[14] Staff believes the controversy surrounding CEHE's unauthorized accounting treatment is appropriate for consideration in this proceeding. Finally, CEHE did not request this alternate treatment in its testimony, rebuttal testimony, or briefs in this proceeding, and it should not be allowed to make a new request in its exceptions. CEHE's request should be rejected, and CEHE should start to account for its Texas Margin Tax expense in the same manner as other regulated electric utilities in Texas to avoid unnecessary future controversy.

6. REP Bad Debt Regulatory Asset

Staff supports the PFD's recommendation for CEHE's REP bad debt regulatory asset.[15]

However, CEHE excepted to the PFD's limiting its bad debt regulatory asset to an amount of $511,290, when CEHE argues it should be approximately $1.6 million.[16]

Staff believes that the PFD correctly denied CEHE's proposed upward adjustment of a little over $1 million that was the result of CEHE including in its request for rates an amount of approximately negative $1 million for REP bad debt.[17]

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[13] Staff's Reply Brief at 10.

[14] CEHE Exceptions at 41-42.

[15] PFD at 104.

[16] CEHE Exceptions at 42.

[17] PFD at 104.

F. Capitalized Incentive Compensation

Staff supports the recommendation in the PFD to remove capitalized incentive compensation.[18]

CEHE excepted to the PFD's removal of capitalized incentive compensation for the same reasons it objects to the PFD's recommended removal of incentive compensation in Section IV.C.1.[19] CEHE objected to the amount used to calculate the removal of capitalized incentive compensation.

Staff replies to CEHE's numerous exceptions regarding incentive compensation in Section IV.C.1. Regarding CEHE's exception to the amount of capitalized incentive compensation included in CEHE's request for rates in this docket, Staff believes that the PFD correctly pulls this amount from Staff Exhibit 15A in which CEHE provides updated amounts for capitalized incentive compensation.[20]

G. Capitalized Non-Qualified Pension Expense

Staff agrees with the PFD's recommendations regarding both non-qualified pension expense and capitalized amounts relating to non-qualified pension.

CEHE refers to its exceptions regarding this particular issue in Section IV.C.4 below, and Staff responds in the same section in this pleading. CEHE notes that its exceptions to the PFD's recommendation on non-qualified pension expenses also apply to capitalized amounts for non-qualified pension expense.[21]

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

A. Return on Equity [PO Issue 8]

Staff agrees with the ALJs' Return on Equity (ROE) recommendation of 9.42%. However, CEHE excepts to this recommendation.[22]

The ALJs Recommended ROE of 9.42% is based on sound and reasoned analysis from Staff and Intervenors

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[18] PFD at 112.
[19] CEHE Exceptions at 44.
[20] PFD at 124.
[21] CEHE Exceptions at 45.
[22] *Id.*

CEHE states that the PFD's recommended ROE is the product of flawed analysis by Staff and Intervenors.[23] According to CEHE, Staff's and Intervenors' ROE recommendation in the range of 9.0% to 9.45% is a result of Staff and Intervenors providing greater weight to their Discounted Cash Flow result.[24] However, as explained in Staff's testimony, Staff used four approaches to estimate the cost of equity for CEHE.[25] Staff used two discounted cash (DCF) approaches and two risk premium approaches.[26] Staff explained that use of the DCF and risk premium methods is well established by the Commission and that the results of the various methods should be close to each other or their estimates should have overlapping ranges[27], which is true of Staff's analysis as shown below:[28]

Methodology	Point Estimate	Range
Single Stage DCF Analysis	8.38%	6.09 – 10.95%
Multistage DCF Analysis	8.31%	7.51 – 10.22%
Risk premium	9.79%	N/A
CAPM Analysis	6.50%	N/A
Return on Equity (ROE)	**9.45%** (excluding CAPM)	**8.34 – 9.79%**

While CEHE contends that Staff's and Intervenors' analysis is flawed, as Staff explained in its reply brief, CEHE's ROE recommendation of 10.4% is an outlier that should be disregarded.[29] As explained in Staff's reply brief, CEHE's witness Robert Hevert's uses an unrealistically inflated growth rate in his constant growth DCF model.[30] Also, Mr. Hevert bases his CAPM analysis on inflated market risk premiums.[31] This practice of using inflated growth rate rates and risk premiums is consistently used by Mr. Hevert and has been called into question by other Commissions.[32] In fact, "Mr. Hevert has only recommended a ROE less than 10.0% in

[23] CenterPoint Energy Houston Electric, LLC's Exceptions to Proposal for Decision (CEHE Exceptions), at 45 (Oct. 10, 2019).
[24] *Id.*
[25] Direct Testimony of Jorge Ordonez (Ordonez Direct), Staff Ex. 3A at 12.
[26] *Id.*
[27] *Id.* at 12-13.
[28] Staff Ex. 3A at 28, 49 (Attachment JO-9).
[29] Staff Reply Brief at 14; TIEC Initial Brief at 9.
[30] Staff Reply Brief at 15-16.
[31] *Id.* at 16.
[32] *Id.* at 16-17; TIEC Initial Brief at 25-26; TIEC Ex. 24 at 86-87; TIEC Ex. 25 at 66, Finding of Fact 15; TIEC Ex. 26 at 19-20, Finding of Fact 33; TIEC Ex. 28.

three out of 143 cases over the last five years, and during that time period, his recommended ROE [was] never adopted by a regulator."[33] Overall, Mr. Hevert's analysis is unreliable and based on unrealistic assumptions.

CEHE also states that the ALJs failed to take into account CEHE's specific business and financial risks.[34] Without a comparison to other utilities, CEHE states that the evidence indicates that CEHE is more risky than other similarly situated utilities.[35] Staff addressed CEHE's risk profile in its reply brief; the evidence does not demonstrate that CEHE is more risky than other similarly situated utilities. The Texas regulatory environment is characterized by Moody's and S&P as "constructive" or "credit-positive."[36] As explained in Staff witness Jorge Ordonez's testimony, CEHE's risk factors reflect the relatively low risk environment for TDUs operating in ERCOT.[37] CEHE has the ability to use existing streamlined recovery methods, without going through an entire ratemaking proceeding, through the Interim TCOS mechanism and DCRF mechanism.[38] Furthermore, while CEHE is affected by hurricane risk, Texas law allows utilities that suffer hurricane damage to recover storm restoration costs including carrying charges.[39] Also, while CEHE notes the effects of the TCJA as another risk[40], the TCJA affects all utilities and the risks posed by the TCJA have already been accounted for in Mr. Ordonez estimation of CEHE's cost of equity through the comparable CEHE analysis.[41] Lastly, while CEHE characterizes itself as having greater risk, CEHE has less risk than other electric utilities because it is a TDU (wires-only utility) that does not purchase or sell electricity, and therefore does not experience commodity risk.[42]

The Recommended ROE of 9.42% for CEHE is Commensurate with Electric Utilities with Similar Risk Profiles

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[33] Staff Reply Brief at 17; TIEC Initial Brief at 24.
[34] CEHE Exceptions at 47.
[35] *Id.*
[36] Staff Ex. 3A at 37.
[37] *Id.*
[38] Staff Initial Brief at 31-32; Staff Ex. 3A at 32.
[39] Staff Initial Brief at 31; Staff Ex. 3A at 32.
[40] CEHE Exceptions at 44, fn. 200.
[41] Staff Initial Brief at 31; Staff Ex. 3A at 31.
[42] Staff 3A at 35.

Throughout its exceptions, CEHE emphasizes that the ALJs' recommended ROE of 9.42% is not commensurate with the authorized ROEs of other electric utilities.[43] In reaching this conclusion, CEHE states the following:[44]

- CEHE states that the average authorized ROE for electric utilities since 2014 has been 9.68%;
- The most recent ROE authorized by the Commission which was for a TDU operating in ERCOT is 9.65%
- Oncor has an approved ROE of 9.8%

CEHE uses examples that are not comparable. The most recent authorized Commission ROE of 9.65% as well Oncor's approved ROE were the result of settled cases.[45] As CEHE opined during the hearing, settled cases have no precedential value.[46] In the last five rate cases for investor-owned electric utility companies, the Commission has authorized a ROE between 9.50% - 9.65%.[47] Furthermore, the national average authorized ROE for delivery only electric utilities is 9.42%[48], exactly the same as the ALJs recommendation. More importantly, CEHE is a wires-only utility with no commodities risk and the average awarded ROE for wires-only utilities was 9.18% in the first half of 2018.[49] CEHE attempts to use the average authorize ROE for electric utilities of 9.68% to argue that its awarded ROE should be higher.[50] However, "authorized ROEs for companies like CenterPoint, a 'wires-only' CEHE, have consistently been 30 to 50 basis points below those of vertically integrated utilities because of the lesser risk

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[43] CEHE Exceptions at 11, 47-48.

[44] *Id.*

[45] Texas-New Mexico Power Company to Change Rates, Docket No. 48401, Order, Conclusion of Law No. 30 (Dec. 20, 2018); Application of Oncor Electric Delivery Company LLC for Authority to Change Rates, Docket No. 46957, Order, Conclusion of Law No. 18 (Oct. 13, 2017).

[46] *Id.*

[47] Staff Reply Brief at 14; Application of El Paso Electric CEHE to Change Rates, Docket No. 46831, Order, Finding of Fact No. 30 (Dec. 18, 2017); Application of Southwestern Electric Power CEHE for Authority to Change Rates, Docket No. 46449, Order on Rehearing, Finding of Facts No. 158 through 160 (Mar. 19, 2018); Entergy Texas, Inc.'s Statement of Intent and Application for Authority to Change Rates, Docket No. 48371, Order, Finding of Facts No. 47 through 51 (Dec. 20, 2018); Application of Southwestern Public Service CEHE for Authority to Change Rates, Docket No. 47527, Order, Finding of Fact 58 (Dec. 10, 2018); and Application of Texas-New Mexico Power CEHE to Change Rates, Docket No. 48401, Order, Finding of Fact No. 48 (Dec. 20, 2018).

[48] Staff Reply Brief at 14; Staff Ex. 3A at 29.

[49] Staff Reply Brief at 14; Staff Ex. 3A at 29; TIEC Initial Brief at 11.

[50] CEHE Exceptions at 47-48.

'wires-only' companies face."[51] CEHE's 9.42% awarded ROE is commensurate with the average awarded ROEs for utilities with a similar risk profile.

CEHE's Ability to Attract Capital is Not Harmed by the ALJs Recommended ROE

CEHE also argues that a ROE of 9.42% will negatively affect its ability to attract the capital it needs to support its large capital expansion program.[52] To support its argument, CEHE states "the PFD cites to no evidence showing that a 9.42% ROE, which is well below the national average authorized ROE for electric utilities, will allow CenterPoint Houston to attract capital. It is axiomatic that if two companies are equally risky, a rational investor will invest in the one with a higher ROE."[53] As shown in the above discussion, CEHE was awarded a ROE that is similar if not higher than the ROEs of electric utilities with similar risk profiles.[54]

Staff has previously addressed CEHE's increased capital expenditures. As Mr. Ordonez previously noted, the utility industry is capital intensive and he selected a proxy group of companies with a similar risk profile to CEHE in determining CEHE's cost of equity.[55] Therefore, CEHE's increased capital expenditures were accounted for through his selected proxy group.[56] Additionally, while CEHE may have increased capital expenditures, CEHE has the opportunity through regular Interim TCOS and DCRF proceedings that significantly reduce regulatory lag to earn timely returns on capital investment.[57]

It is Not the Regulator's Role to Support CEHE's Need for an A- Issuer Rating and Attachment D is Not Evidence for Consideration in the Record

Lastly, CEHE states that an ROE of 9.42% will not support its credit metrics.[58] In making this argument, CEHE relies on a June 26, 2019 Moody's report (Attachment D).[59] As Staff and Intervenors explained in their Joint Objection and Motion to Strike, Staff objected to the

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[51] Texas Coast Utilities Coalition's Post-Hearing Initial Brief (TCUC Initial Brief) at 10 (July 9, 2019).
[52] CEHE Exceptions at 48-49.
[53] *Id.* at 48.
[54] *Supra* at 12-13.
[55] Staff Reply Brief at 20; Tr. at 668: 7-12 (Ordonez Cross) (June 26, 2019).
[56] *Id.*
[57] Staff Reply Brief at 20.
[58] CEHE Exceptions at 49-50.
[59] CEHE Exceptions at 49, fn. 212-213.

admission of Attachment D during the cross-examination of Staff witness Mr. Tietjen and the ALJ sustained the objection.[60] While CEHE made an offer of proof, CEHE waited for several months and did not request the admission of Attachment D into the record until it filed its exceptions.[61] Therefore, this document is not in evidence and any reference to the document should including its outlook for CEHE should not be considered. Regarding CEHE's request for admission of Attachment D, Staff renews the arguments made in its Joint Objection and Motion to Strike. Also, it is not the role of the regulator to serve as a guarantor of a utility's targeted credit rating or particular level of creditworthiness.[62] CEHE's A- issuer rating is already high, four notches above the highest non-investment grade rating, and while investors must be given an opportunity to recover their reasonable capital costs, customers must also be fairly treated.[63]

Overall, it is clear that the ALJs' recommended ROE of 9.42% for CEHE allows a sufficient return on investment and balances the needs of customers.

B. Capital Structure [PO Issue 7]

As Staff noted in its exceptions, Staff recommends a 60% long-term debt and 40% equity capital structure for CEHE.[64] CEHE excepts to the ALJs recommendation of 55% long-term debt and 45% equity capital structure for CEHE.[65]

Increasing CEHE's Equity Ratio Harms Customers and Places the Responsibility of Efficient Company Management to Maintain Creditworthiness onto the Role of the Regulator

CEHE argues that, as a result of the ALJs' recommendation of 55% long-term debt and 45% equity capital structure, it will face a potential downgrade resulting in harm to customers.[66] Staff emphasizes that weakening credit metrics is not the same as a credit downgrade.[67] Furthermore, in discussing the potential downgrade, CEHE references Attachment D, Moody's

[60] Joint Objection and Motion to Strike at 2-4 (Oct. 17, 2019).
[61] *Id.* at 3-4.
[62] Staff Initial Brief at 32; Staff Ex. 3A at 33.
[63] Staff Reply Brief at 21; Staff Ex. 3A at 9.
[64] Commission Staff's Exceptions to Proposal for Decision (Staff Exceptions) at 5 (Oct. 10, 2019).
[65] CEHE Exceptions at 59.
[66] *Id.* at 60-61.
[67] Staff Reply Brief at 20.

report from June 26, 2019.[68] Staff renews its objection to this reference because it is not evidence in this proceeding.

Also, as Staff has mentioned in the Return on Equity Section, CEHE already has a high A- issuer rating, which is four notches above the highest non-investment grade rating.[69] Furthermore, while CEHE claims a credit downgrade would harm customers, the reality is the opposite. As discussed by Texas Industrial Energy Consumers in their exceptions, "Debt yields are less than 5% for bonds rated Baa by Moody's while prevailing returns on equity are between 9% and 10% in Texas."[70] Also, unlike debt, customers are required to pay a multiplier on the equity component in rates because equity returns are grossed-up to reflect income tax expense; therefore, each dollar of additional equity in CenterPoint Houston's capital structure actually increases costs to ratepayers.[71]

Additionally, as Staff has previously discussed, it is not the role of the regulator to serve as a guarantor of a utility's targeted credit rating or particular level of creditworthiness.[72] As stated in *Bluefield*, "the return . . . should be adequate, under efficient and economical management, to maintain [the] [utility's] credit and enable it to raise the money necessary for the proper discharge of its public duties."[73] The long-standing, precedential framework for electric utility regulation assumes that, ultimately, it is the utility's duty to manage its operations and finances economically and efficiently to maintain its creditworthiness.[74] Additionally, PURA § 11.002(b) confirms that the role of regulation is to serve "as a substitute for competition," and in the competitive marketplace it is the responsibility of a company to maintain and effectively manage its own creditworthiness.[75]

Staff's Recommended 60/40 Capital Structure Appropriately Considered the Market Conditions and Capital Expenditures of CEHE

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[68] CEHE Exceptions at 60, fn. 287.
[69] Staff Ex 3A at 9.
[70] Texas Industrial Energy Consumers Exceptions to Proposal for Decision (TIEC Exceptions) at 11 (Oct 10, 2019); TIEC Ex. 4 (Griffey Direct) at 7.
[71] TIEC Exceptions at 11; TIEC Ex. 4 at 9.
[72] Staff Ex. 3A at 33.
[73] Staff Ex. 3A at 33-34; *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 693 (1923).
[74] Staff Ex. 3A at 34.
[75] *Id.*

In CEHE's exceptions to the PFD, CEHE represented that "[i]t is undisputed however, that CEHE current capital structure does not account for the reduced cash flow attributable to the TCJA or CEHE's impending capital expenditures."[76]

Regarding the TCJA, the companies chosen by Staff's witness, Mr. Ordonez, in his proxy group have all been subjected to the TCJA since its passage in 2017, and therefore, his analysis recommending a 60% long term debt and 40% equity capital structure considered the impacts of the TCJA.[77] Additionally, as TIEC stated in its initial brief, CEHE's parent company CenterPoint Energy, Inc., stated in a presentation to S&P that the TCJA is "[redacted]"[78] CenterPoint also noted that tax reform [redacted][79]

Regarding CEHE's statement that the ALJs' recommendation for capital structure does not account for CEHE's impending capital expenditures, Mr. Ordonez noted that the utility industry is capital intensive, and he selected a proxy group of companies with a similar risk profile to CEHE.[80] Therefore, CEHE's increased capital expenditures were accounted for through his selected proxy group.[81] Additionally, while CEHE may have increased capital expenditures, CEHE has the opportunity through regular Interim TCOS and DCRF proceedings that significantly reduce regulatory lag to earn timely returns on capital investment.[82] Additionally, CEHE does not need additional equity in its capital structure as a result of increased capital expenditures, because as Mr. Mercado acknowledged, CEHE's ratio of capital expenditures to net electric plant in service has been nearly flat since its last base rate case.[83] In fact, CEHE "maintained its credit rating with an equity ratio of between 38 and 45 percent over the last three years."[84]

Staff's Recommended 60/40 Capital Structure Properly Accounts for CEHE's Risk Profile

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[76] CEHE Exceptions at 61.
[77] Staff Reply Brief at 15; Staff Ex. 3A at 31.
[78] TIEC Initial Brief at 38; *see also* TIEC Ex. 4 at 28 (June 6, 2019) (quoting CEHE Response to TCUC 1-02 in attachment SP 2018 CenterPoint Energy at 2-3. (HSPM)).
[79] *Id.*
[80] Staff Reply Brief at 20; Tr. at 668: 7-12 (Ordonez Cross) (June 26, 2019).
[81] *Id.*
[82] Staff Reply Brief at 20.
[83] *Id.*; TIEC Initial Brief at 37-38.
[84] Tr. at 536 (Dr. Woolridge Cross) (June 26, 2019).

CEHE's overall risk profile is relatively low compared to other electric utilities. As Staff has previously discussed, both S&P and Moody's characterize the Texas regulatory environment as "constructive" or "credit-positive."[85] This is partly due to the availability of the Interim TCOS and DCRF mechanisms that allow recovery of transmission and distribution costs.[86] Particularly, the Interim TCOS mechanism allows CEHE to adjust its transmission rates twice per year to account for increases in transmission investment and transmission investment expenses.[87] Also, the DCRF mechanism permits CEHE to adjust its distribution-related rates once per year to account for increases in distribution investment and distribution investment related expenses.[88] Furthermore, although CEHE faces hurricane risk, Texas law allows CEHE to recover storm restoration costs including carrying costs.[89]

CEHE contends that a 55/45 capital structure is not comparable to the capital structure established for other electric utilities. CEHE states, "For the last eight calendar quarters, the average equity ratio was 53.28% for the holding companies in Mr. Hevert's proxy group, and 53.13% for the utility operating companies encompassed within those holding companies."[90] Mr. Hevert's proxy group is not an appropriate comparison to CEHE because it includes vertically integrated utilities that do not have a similar risk profile to CEHE.[91]

CEHE also states that a 55/45 capital structure is not appropriate for CEHE because "[t]he average equity ratio of electric delivery-only utilities for calendar year 2018 was 49.91%, and it has been trending upward in recent years."[92] However, as Mr. Ordonez explained in his direct testimony, 14 out of 16 delivery-only electric utilities analyzed in the 2018 S&P Global Market Intelligence RRA Report purchase and sell electricity, and therefore these 14 "delivery-only" electric utilities are not a good proxy for CEHE, which is a wires-only utility that does not face this commodity risk.[93] Mr. Gorman explained during the hearing that "there are very few other utilities, very few other utilities around the country that do not have commodity risks."[94]

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[85] Staff Reply Brief at 17-18; Staff Ex. 3A at 31.
[86] Staff Reply Brief at 19.
[87] Staff Reply Brief at 19; Staff Ex. 3A at 31.
[88] *Id.*
[89] Staff Reply Brief at 19; Staff Ex. 3A at 32, 39.
[90] CEHE Exceptions at 62.
[91] Staff Reply Brief at 32.
[92] CEHE Exceptions at 62.
[93] Staff Initial Brief at 33; Staff Ex. 3A at 35.
[94] Tr. at 619: 1-3 (Gorman Redirect) (June 26, 2019).

CenterPoint Energy, Inc., the parent company of CEHE, is one of the utilities that experiences commodity risk.[95] Therefore, as discussed during the hearing and addressed in Staff's briefing and Exceptions, if ring-fencing protections are imposed, it would likely be a credit positive event for CEHE that would improve the credit metrics of CEHE.[96]

Overall, because of the ring-fencing protections recommended by the ALJs as well as the credit-positive regulatory environment for utilities operating in Texas, a 60/40 capital structure is appropriate for CEHE.

D. Overall Rate of Return [PO Issue 8]

As noted in Staff's exceptions, Staff recommends that the Commission authorize a 60/40 capital structure. When CEHE's cost of debt of 4.38% and the ALJs recommended Return on Equity of 9.42% are taken into account, the rate of return is 6.40%.

E. Financial Integrity [PO Issue 9]

The PFD correctly concluded that PURA grants the Commission authority to order the ring-fencing provisions recommended in the PFD, with the exception of certain additional provisions recommended by Staff.[97]

In its exceptions, CEHE repeats its arguments from briefing that the Commission lacks the authority in the context of a rate proceeding to impose ring fencing protections, and that the relevant statutes do not explicitly mention ring fencing.[98]

The ALJs provide a comprehensive review of the statutory framework to conclude that the Commission has "the authority to, in an electric utility rate case, with or without the utility's agreement, to impose on the utility ring fencing",[99] and Staff will not belabor that particular point here.

CEHE conceded that the Commission has imposed ring-fencing measures in the context of sale, transfer, and merger transactions, as these allow the Commission to determine whether

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[95] Tr. at 619: 5-7 (Gorman Redirect) (June 26, 2019).
[96] Tr. at 635: 16-17 (Griffey Cross) (June 26, 2019); Tr. at 639: 17-24 (Griffey Redirect) (June 26, 2019).
[97] PFD at 192.
[98] *Id.* at 194.
[99] *Id.* At 198

the structure of a transaction is in the public interest.[100] CEHE argues that imposing ring-fencing provisions should be limited to that context, and that it is not appropriate in a rate proceeding.[101]

However, as stated above, the statutes provide the Commission a broad grant of authority in the context of rate proceedings, if the Commission determinations on issues involve the implementation of mechanisms that serve to maintain a utility's financial stability.[102]

Here, two circumstances warrant the imposition of ring-fencing measures: (1) CNP's acquisition of Vectren, increasing its financial and operational risks with respect to CEHE; and (2) the risks inherent in CNP's business and its subsidiaries even prior to the Vectren acquisition.[103]

With respect to the Vectren acquisition, CEHE's argument regarding how financial insulation provisions should only be limited to sale, transfer, and merger transactions, and are not appropriate in rate proceedings, only furthers Staff's argument in this particular case. CNP, CEHE's parent CEHE, purchased Vectren.[104] Two credit rating agencies downgraded CNP's credit rating as a result of the Vectren acquisition.[105] The Vectren acquisition did not require Commission approval, since it was in another jurisdiction, and, thus, a sale, transfer, and merger application was not filed with the Commission. The Commission did not have the ability to vet the transaction and analyze its effects on Texas ratepayers.

Transactions, business, operations, and leveraging activities of a parent CEHE and its subsidiaries can affect the credit profile and financial exposure of the parent as well as the regulated utility affiliates.[106] These factors can, in turn, affect the rate proceeding-related elements such as cost of capital and capital structure.[107] If these conditions cause the utility to incur higher costs to provide its services, it is possible that the utility will request that ratepayers bear the burden of the higher costs in its next rate proceeding.[108] This, in conjunction with the foregoing, justifies the imposition of financial protection measures in this proceeding.

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[100] CEHE Exceptions at 66.
[101] *Id.*
[102] Direct Testimony of Darryl Tietjen (Tietjen Direct), Staff Ex. 1A at 8.
[103] Staff Initial at 35.
[104] Staff Ex. 1A at 6.
[105] *Id.* at 10-11.
[106] *Id.* 11-12.
[107] *Id.* at 12.
[108] *Id.*

PURA grants the Commission broad authority to ensure just and reasonable rates for Texas ratepayers. Further, the ramifications of CNP's Vectren acquisition justify the Commission's imposition of financial protections to ensure the protection of Texas ratepayers from potential downstream costs and the effects of potential financial instability. Thus, Staff respectfully requests that the Commission adopt Staff's proposed ring-fencing measures in their entirety, and reject CEHE's arguments that they are not necessary to ensure just and reasonable rates for Texas ratepayers, including CEHE's proposed modifications of Staff's financial protection language.

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

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

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

CEHE does not except to the PFD's recommendation to adjust federal income tax expense for flow-through changes but does note that CEHE believes the number run contains errors for which there are attendant impacts.[109] Staff disagrees with CEHE's assertions and addresses this issue in Section XI below.

2. Effect of TCJA [Issue 29]

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

1. Ad Valorem (Property) Taxes

CEHE supports the PFD's analysis of flow-through impacts to *ad valorem* tax expense but notes that CEHE believes that the number run incorrectly calculates *ad valorem* expense.[110]

Staff addresses CEHE's assertions about the number run in Section XI below. However, CEHE's exceptions do not address *ad valorem* tax expense specifically in Section XI.

2. Texas Margin Tax

In its exceptions, CEHE notes that it believes the PFD handled this issue correctly but notes that it is affected by the issue in Section II.E.4 above.[111]

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[109] CEHE Exceptions at 78.

[110] *Id.*

[111] *Id.* at 94.

Staff disagrees with CEHE's assertions about the accounting treatment for Texas Margin Tax, which can be found in Section II.E.4 above.

3. Payroll Taxes

In its exceptions, CEHE supports the PFD's treatment of flow-through impacts to payroll taxes, but alleges that the number run erred in its calculation of the amount of disallowance for incentive compensation, which has a flow-through impact to FICA and payroll taxes.[112]

Staff addresses this issue both in its exceptions[113] and in Section XI below.

C. Labor Expenses

1. Incentive Compensation

The PFD correctly recommended removal of amounts of short-term incentive compensation (STI) and long-term incentive compensation (LTI).[114]

However, CEHE argues that its request should be approved in full.[115] CEHE further objects to the PFD's use of Commission precedent in disallowing amounts of STI and LTI, mostly because CEHE does not think that the precedent should apply to it because it was not party to those individual dockets.[116] CEHE further refers to recent legislation affecting *gas* utilities in support of its request.[117] CEHE further excepts because it believes that its union STI costs are reasonable; because it believes its CNP O&M Expenditure goal is an operational goal, not a financial goal; and because it believes that the funding trigger for the operational goals does not warrant a partial disallowance despite precedent to the contrary.[118] Finally, CEHE discusses the total amount of incentive compensation and provides evidence proving that CEHE previously responded with erroneous information to a crucial request for information (RFI) regarding incentive compensation in this docket.[119]

CEHE's main arguments here do not support the reversal of nearly a decade of unambiguous Commission precedent. CEHE's arguments and the facts on the record do not

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[112] *Id.* at 79.
[113] Staff's Exceptions at 4.
[114] PFD at 243.
[115] CEHE Exceptions at 83.
[116] *Id.* at 81.
[117] *Id.*
[118] *Id.* at 83-84.
[119] *Id.* at 84-85.

show that CEHE is any different from any other regulated electric utility in Texas with respect to incentive compensation. The long-standing Commission precedent has been set and reaffirmed for many regulated electric utilities based on similar arguments and circumstances, and it should not be overturned in this case.[120] Staff's position is that the PFD is correct to follow the almost decade of unambiguous precedent.[121] However, as noted in Staff's exceptions, the PFD did not fully follow precedent and it is Staff's position that the PFD should be modified to disallow all LTI that CEHE has admitted on the record is financially based, in order to fully conform to the numerous precedents on LTI.[122]

Staff disagrees with CEHE's assertions that its union STI costs should be deemed reasonable merely because they are based on a negotiation.[123] The precedent that the PFD followed and that Staff's and intervenors' positions relied upon applies to union STI.[124] CEHE further thinks that Staff's and intervenors' positions are inherently wrong for not recommending different treatments for union and non-union STI amounts.[125] Staff notes that its position considered union and non-union amounts, and, based on precedent, made its recommendation accordingly.[126]

CEHE repeats its argument that its goal relating to CNP O&M Expenditures is an operational, and not a financial, metric.[127] The PFD correctly followed precedent and evidence to categorize a goal for minimizing expenses as a financial metric.[128] Financial metrics are those calculated using inputs from a balance sheet or income statement, and, in this case, the metric pulls from income statement amounts.[129]

CEHE again faults the PFD for following precedent and removing half of the amount of two operational metrics whose payment is based on a financial trigger.[130] Staff supports the PFD on this, and Staff does not believe CEHE has put on any evidence that "shows the usefulness of

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[120] PFD at 231.
[121] *Id.*
[122] Staff Exceptions at 9-10.
[123] CEHE Exceptions at 83.
[124] PFD at 113.
[125] *Id.* at 83.
[126] *Id.* at 230-231.
[127] CEHE Exceptions at 83-84.
[128] PFD at 240.
[129] Operational metrics, conversely, are calculated from non-financial data; common examples of operational metrics include those based on number of outages, number of customer complaints, or number of safety violations.
[130] CEHE Exceptions at 84.

threshold"[131], as CEHE asserts, that would justify disregarding long-standing and unambiguous precedent on operational payments based on financial triggers.

Lastly and importantly, CEHE has finally delivered proof that it had previously provided incorrect information in response to a crucial RFI in this docket.

In its exceptions, CEHE writes:

> The PFD finds that the total STI expense CEHE Houston requested to recover through rates in this proceeding is $16,879,888. The calculation of this total amount can be found in the record on WP R-KLC-02. This should be the starting point of any STI disallowance calculation. The PFD's [*sic*] calculation, however, relies on an incorrect starting point, using RFI PUC03-01 for Direct STI and V-K-6.1 for Affiliate STI. Importantly, RFI PUC03-01 includes both capital and O&M book amounts for the test year. This is not the amount requested in the case.[132]

RFI No. Staff 03-01 specifically requested the amount of incentive compensation included in CEHE's request for rates in this docket.[133] CEHE, in its rebuttal testimony and briefs, claimed that Staff and intervenors used the wrong amounts for STI compensation, when CEHE was responsible for providing said information.[134] Now, in its exceptions, CEHE finally explains the discrepancy without acknowledging its error.[135] The issue remains: RFI No. Staff 03-01 asked for the amount of STI CEHE included in its request for rates in this docket; CEHE now asserts that, instead of providing the amount of STI it was requesting for rates in this docket, it instead provided both capital and book amounts for the test year in its response.[136] As noted in Staff's exceptions, it is Staff's position that any benefit resulting from the discrepancy arising from CEHE's contradictory evidence in this case should accrue to the benefit of ratepayers and not the CEHE, and that the PFD should be modified to reflect this.

2. Executive Employee Related Expenses

Staff supports the PFD's recommended adjustment to remove these executive employee-related expenses.

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[131] *Id.*

[132] CEHE Exceptions at 84-85.

[133] Workpapers to the Direct Testimony of Mark Filarowicz (Filarowicz Direct), Staff Ex. 4A at 57-68 (Attachment MF-11).

[134] CEHE Reply Brief at 83.

[135] CEHE Exceptions at 84-85.

[136] RFI No. Staff 03-01 does not use the terms "test year" or "book amount."

In its exceptions, CEHE believes that the PFD errs in recommending removal of approximately $1.14 million of executive employee-related expenses. These expenses are not tax deductible because they are amounts paid to employees in excess of $1 million dollars annually. CEHE instead suggests that the Commission look to market studies to determine appropriate compensation.

Staff here, as elsewhere, disagrees with CEHE that market studies should be the main factor in determining what is reasonable and necessary expenses for the provision of public electric service. Commission precedent on reasonable and necessary expenses has correctly deemed that market studies alone are not sufficient for making an expense reasonable and necessary.[137] The same basic tenets of ratemaking principles that support the removal of non-qualified pension expense also support the PFD's recommendation on removing these executive employee-related expenses.

3. Payroll Adjustments

Staff supports the PFD's recommendation on this issue.

CEHE excepted to the PFD's recommendation to remove approximately $1.65 million of employee expenses relating to 32 full-time employees that CEHE identified as being terminated after the acquisition of Vectren.[138] CEHE also excepts to the PFD because it did not allow for severance expenses associated with the termination of those 32 employees to go into rates.[139] CEHE's logic on both exceptions is inherently flawed, as base rates should only reflect ongoing, recurring annual costs.

The annual costs associated with 32 employees that CEHE identified as no longer employed by CEHE after the Vectren acquisition are appropriately removed from base rates because CEHE admits it will not incur costs relating to those 32 employees going forward. Similarly, because the severance expenses were a one-time expense, it would also be inappropriate to include any of these costs in future annual rates as if they were recurring. The PFD correctly analyzes this issue and recommends an appropriate and necessary adjustment.[140]

[137] Staff Reply Brief at 33-34.
[138] CEHE Exceptions at 87
[139] *Id.*
[140] PFD at 255.

4. Benefit Restoration Plan Expenses

Staff agrees with the PFD's recommendation to remove $1.78 million relating to benefit restoration plan expenses.[141]

However, CEHE excepted to this recommendation, arguing that it has put on evidence to show why this payment for non-qualified pension expense (for highly compensated executive employees) should be included in rates, despite Commission precedent to the contrary.[142] CEHE further disputes an assumption that these payments to executives would more closely align with shareholder interests than customer interests.[143]

Staff disagrees, as CEHE has failed to put on evidence to demonstrate why Commission precedent that applies to other regulated electric utilities in Texas should not apply to CEHE here. Commission precedent disallowing non-qualified pension expense acknowledges that many utilities may pay non-qualified pension expense, but that it is not a reasonable and necessary expense for providing public electric service.[144] Finally, Staff disagrees with CEHE's assertion about the payment of non-qualified pension expense being in customers interest; general ratemaking theory and Commission precedent also disagree with CEHE's unsupported assertion here.

D. Depreciation [PO Issue 25]

In its exceptions, CEHE does not lodge an official objection to the PFD's treatment of depreciation. However, it claims that the number run failed to apply the proper FERC accounts to the recommended adjustments.[145]

Staff replies to this issue fully in Section XI below, but here notes that the number run used the FERC accounts provided on the record where FERC accounts were provided; in many instances the information is not available on the record by FERC account. It is important to note that CEHE possesses the information in its accounting records and that CEHE failed to identify the locations on the record to make the adjustments by FERC account that it asserts the number run should have used.

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[141] PFD at 258.
[142] CEHE Exceptions at 89.
[143] *Id.*
[144] Staff Reply Brief at 34.
[145] CEHE Exceptions at 89.

E. Affiliate Expenses [PO Issues 35, 36]

1. CenterPoint's Vectren Acquisition Adjustment

Staff agrees with the PFD's analysis and recommendation on this issue.[146]

However, CEHE excepted to the PFD's recommendation to remove approximately $1.6 million of expenses relating to the normalized integration planning billing by Service CEHE employees.[147] CEHE noted:

> In order to accurately capture a normal test year, an adjustment was made to normalize integration planning billings to reflect Service CEHE's employee labor that would have been billed to CEHE Houston during this time if the integration planning for the Vectren transaction had not occurred.[148]

At a fundamental level, CEHE should not be allowed to include in rates an adjustment to provide hours that might have been worked by Service CEHE employees had the Vectren acquisition not taken place. CEHE's adjustment relied upon uncertain, unmeasurable, and unsupported assumptions and the PFD correctly removed the expenses from base rates.

2. Compensation for Use of Capital/Affiliate Carrying Charges

In its exceptions, CEHE excepted to the PFD's recommendation, consistent with Staff's testimony and Commission precedent, to remove amounts paid to affiliates for carrying charges on the use of shared assets. CEHE incorrectly asserts,

> CEHE Houston has shown that Service CEHE assets are used and useful and held for the benefit of the business units, including CEHE Houston. CEHE Houston has also shown that costs Service CEHE incurs for these assets are no different than utility-owned assets for which an equity return is earned, and that the costs of these assets were prudently incurred.[149]

Staff disagrees with CEHE and supports the PFD's recommendation. There is long-standing and unambiguous Commission precedent maintaining the removal of carrying costs paid to affiliates. CEHE's payments to its affiliates for use of shared assets are no different than other utilities' and CEHE has not put on any evidence as to why Commission precedent should not apply in this case. Staff respectfully recommends adoption of the PFD's recommendation.

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[146] PFD at 282.

[147] CEHE Exceptions at 89.

[148] *Id.*

[149] *Id.* at 90.

F. Injuries and Damages

CEHE excepted to the PFD's adjustment to injuries and damages to reflect a five-year average as recommended by Staff, arguing that the amount is not representative of its current level of injuries and damages.[150]

In response, Staff asserts that the PFD correctly analyzes this issue and reflects the necessary adjustment. As noted in its testimony, Staff could have recommended a three-average (consistent with other Commission precedents), which would have resulted in a greater reduction. The fact that the three-year average would result in a greater reduction than the five-year average disproves CEHE's assertion that injuries and damages expense is steadily increasing each year; rather, the nature of the incurrence of injuries and damages is such that one would expect volatility (both upward and downward) from year to year, and thus the use of an average in a regulated rate-setting process is appropriate and reasonable.

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

In its exceptions, CEHE excepted to this item but notes that it is with the same exception to be found at Section II.E.4 above.[151]

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

CEHE states that, although it does not except to this portion of the PFD, it identified purported errors in the PFD's number run.[152] Staff responds to this contention in Section XI.

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

As discussed in Section XI, Staff rejects CEHE's argument that there are what it characterizes as errors to be addressed and corrected in the PFD's number run with respect to billing determinants.[153]

Staff specifically addresses CEHE's arguments regarding weather normalization and the energy efficiency program below.

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[150] *Id.* at 91-92.
[151] CEHE Exceptions at 92.
[152] *Id.*

A. Weather Normalization

Staff supports the PFD recommended 10-year period for weather normalization adjustments to test year sales consistent with Commission precedent.[154] CEHE argues that the Commission disregard Commission precedent and adopt a 20-year time period based on testimony endorsed by CEHE's witness J. Stuart McMenamin.[155]

The last three Commission dockets for which weather normalization was a contested issue all determined that 10-years is the appropriate time period.[156] CEHE states that according to Dr. McMenamin using shorter periods, such as a 10-year period "provides a less stable measure, that can vary significantly depending on the 10-year period that is selected."[157] This ignores the Commission findings from these dockets, where the Commission found that there can be weather trends that are reasonably captured by 10 years of data which are more sensitive to the test year.[158] The Commission again stated that 10 years of data is a reasonable means of capturing weather trends in the Order for the rulemaking adopting 16 Texas Administrative Code § 25.243.[159] Dr. McMenamin does not provide evidence regarding his studies on how 20 years of data can reasonably capture weather trends as well as a 10-year time period. Therefore a 20-year time period that is not consistent with Commission precedent should not be accepted.

B. Energy Efficiency Plan Adjustment

Staff respectfully requests the adoption of the language in the PFD, which adopts Staff's recommendation to reject CEHE's proposal.

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[153] *Id.*

[154] PFD at 319.

[155] CEHE Exceptions at 93.

[156] *Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at 44 (Mar. 6, 2014); *Application of Southwestern Public Service Company for Authority to Change Rates*, Docket No. 43695, Order on Rehearing at 44 (Dec. 18, 2015); and *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449, Order on Rehearing at 44 (Dec 16, 2016).

[157] CEHE Exceptions at 93.

[158] *Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at 44 (Mar. 6, 2014) and *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449, Order on Rehearing at 44 (Dec 16, 2016).

[159] *Rulemaking Relating to Periodic Rate Adjustments*, Project No. 39465, Order Adopting New § 25.243 as Approved at the September 15, 2011 Open Meeting (Sept. 27, 2011).

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

A. Functionalization

1. Texas Margin Tax Expense and Associated Accounts

Staff agrees with CEHE that the PFD holds the functionalization percentages constant to the CEHE's original filing,[160] and that it would be appropriate for the functionalization percentages to be updated as a flow-through impact from other adjustments.

2. Miscellaneous General Expense (FERC Account 930.2)

Staff agrees with CEHE that the PFD holds the functionalization percentages constant to the proportions shown in Staff Ex. 2A at 34-39,[161] and that it would be more appropriate for the functionalization percentages to be updated as a flow-through impact from other adjustments.

3. Unprotected Excess Deferred Income Tax

The PFD correctly recommended the adoption of Staff witness Brian Murphy's recommendation to functionalize unprotected excess deferred income tax (UEDIT) as 24.5% to wholesale transmission customers and 75.5% to retail customers.[162] Staff based its proposed functionalization of UEDIT on excess accumulated deferred income tax information adopted by the Commission in prior dockets and provided by CEHE witness Pringle in the CEHE's direct case.[163]

Additionally, CEHE's request to use a net plant functionalization factor for UEDIT amounts[164] was not presented in its direct or rebuttal cases or in CEHE's briefing on this issue, and it would be inappropriate to consider this request at this point in the proceeding.

B. Class Allocation

1. Class Allocation of Transmission Costs

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160 Number-running Communications at Bates 11 (Sept. 17, 2019): "The ALJs recommend approving CenterPoint's proposal on how to functionalize the Texas Margins Tax (TMT) expense as 14.8% to the Transmission Service Function and 85.2% to the Distribution Service Function. CenterPoint rejected its initial functionalization approach for TMT expense to adopt Staff witness Brian Murphy's recommended approach instead."

161 Number-running Communications at Bates 11 (Sept. 17, 2019): "Accordingly, the $146.2 million Account 930.2 expenses should be functionalized based on the allocation proportions illustrated below…"

162 PFD at 335.

163 Direct Testimony of Charles W. Pringle (Pringle Direct), CEHE Ex. 13 at 2.

164 CEHE Exceptions at 94-95.

The PFD correctly rejected TCPA's argument that CEHE's allocation of and rate design for transmission costs should be based on an ERCOT Four Coincident Peak (4CP) method.[165] Despite the evidence and argument in the record to the contrary, TCPA continues to maintain that the ERCOT 4CP allocation and rate design for the retail transmission costs result in cost-shifting and are inconsistent with cost-causation, and TCPA recommends finding that the non-coincident peak (NCP) allocation of retail transmission costs is reasonable and cost-based.[166] TCPA's arguments were thoroughly evaluated by the ALJs based on the evidence in the record, and properly rejected. Staff comprehensively addressed TCPA's arguments in its reply brief,[167] and briefly addresses them here.

TCPA maintains that the PFD's conclusions that an ERCOT 4CP allocation and rate design for retail transmission costs align with cost causation are "erroneous and factually unsupported," and that the ALJs "conflate the allocation of transmission costs in ERCOT with the cause of the underlying costs themselves."[168] These claims are incorrect as reference to PURA, the Commission rules, and the record clearly shows that:

1. PURA § 35.004(d) mandates a coincident peak rate design for TSPs' wholesale transmission rates in ERCOT.
2. 16 TAC § 25.192(b)(1) more specifically requires that the coincident peak rate design for TSPs' wholesale transmission rates is one based on the ERCOT 4CP.
3. 16 TAC § 25.192(d), in combination with 16 TAC § 25.192(b)(1), requires that each DSP be charged for wholesale transmission service based on the total ERCOT 4CP demand of all the customers connected to the DSP. Therefore, it is unambiguous that it is CEHE's customers' ERCOT 4CP loads that cause CEHE to incur wholesale transmission charges as a distribution service provider (DSP).
4. CEHE's retail transmission costs are effectively a "pass-through" to retail customers of the wholesale transmission charges that CEHE incurs as a DSP.[169]

[165] PFD at 336-343.
[166] TCPA Exceptions at 1.
[167] Staff Reply at 61-69.
[168] TCPA Exceptions at 2.
[169] Staff Ex. 7B at 33.

5. 16 TAC § 25.234 requires that rates be based on cost under cost causation principles. 16 TAC § 25.192 establishes that customer's load at the ERCOT 4CP is what causes CEHE to incur wholesale transmission charges.
6. Therefore, cost causation dictates that CEHE's retail transmission costs, which are incurred based on ERCOT 4CP load, should be allocated to classes based on ERCOT 4CP load, and that it is appropriate to charge individual customers based on their ERCOT 4CP load.

At the hearing, Staff witness William Abbott testified to the clarity of the cost-causation in this situation:

> Substantive Rule 25.192 mandates how cost causation occurs in this situation. It says wholesale transmission charges are charged to distribution service providers based upon their 4CP -- their ERCOT 4CP load. So this is the most clear-cut case of cost causation I think there is. The rules say how those costs are incurred.[170]

TCPA claims the PFD errs regarding the cause of the underlying costs, stating that "transmission costs remain fixed regardless of each Distribution Service Provider's (DSP's) rate design" immediately subsequent to claiming that "the issues with 4CP will only continue to grow as transmission costs continue to increase." The underlying costs at issue are the wholesale transmission costs charged to DSPs such as CEHE, which then allocates the costs among retail rate classes and collects them via retail rates. As an initial matter, TCPA's suggestion that wholesale transmission costs within ERCOT would remain the same if the ERCOT coincident peak load were to double or triple is entirely without support in the record.

Furthermore, TCPA's argument misses the point as to the costs at issue in this proceeding; regarding the contested retail transmission cost allocation and rate design for CEHE customers in this proceeding, these retail transmission costs are not fixed over time. As 16 TAC § 25.192(b)(1) states, a DSP such as CEHE pays to each TSP in ERCOT an amount equal to the TSP's wholesale transmission service rate multiplied by the DSP's ERCOT 4CP load:

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[170] Tr. at 924:3-9.

> 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.

With respect to CEHE's test year retail transmission costs at issue in this proceeding, those costs are not fixed – they would be lower if CEHE's aggregate customer ERCOT 4CP were lower, and they would be higher if such load were higher. As Staff witness William Abbott stated in cross-rebuttal testimony, "if a customer with a 4CP rate design reduces its 4CP load, the customer's load reduction directly results in CenterPoint being charged less for wholesale transmission service – costs are *avoided* for CenterPoint."[171] As indicated in Staff's reply brief, and demonstrated by TCPA's discussion of and reference to wholesale transmission planning at ERCOT, TCPA appears to take issue with the ERCOT 4CP rate design for wholesale transmission rates mandated under 16 TAC § 25.192, and misapplies opposition to that rule to the issue in this proceeding of the allocation and rate design of costs incurred by CEHE as a result of adhering to the requirements of that rule.

Staff respectfully requests that the Commission adopt the PFD's recommendation regarding the appropriateness of the ERCOT 4CP allocation and rate design for retail transmission costs.

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

C. Transmission Service Rate

Staff disagrees with TIEC's exceptions to the PFD's recommendation to approve CEHE's request to "zero out" its TCRF rider and move all current transmission expense into base rates.[172]

In excepting on this issue, TIEC maintains that Staff's support for CEHE's proposal is inconsistent with Staff's prior positions and is aimed at solving a different issue than the over-recovery that occurs as a result of transmission expenses being included in base rates instead of the TCRF rider.[173] The "different issue" refers to an allocation issue that arises under the TCRF rule due to the mismatch between TCRF allocation factors being fixed between base rate cases

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171 Abbott Cross-Rebuttal at 33.

172 TIEC Exceptions at 24.

173 *Id.*

while the TCRF billing units are updated semiannually, which can result in TCRF rates that drift further away from cost as load patterns change over time, and potentially produce large changes in rates when they are reset at cost in a rate case.[174] While TIEC claims that the allocation issue is irrelevant to the issue of "zeroing out" the TCRF,[175] it is the allocation issue which is the basis of Staff's support for CEHE's proposal to "zero out" the TCRF rider in this case. As pointed out in testimony and at the hearing, while it does not conflict with the TCRF rule, moving retail transmission cost recovery entirely out of base rates and into the TCRF rider, as TIEC requests, exacerbates the mismatch that exists under the TCRF rule when the allocation factors are not updated between base rate cases.[176] "Zeroing out" the TCRF as CEHE requests reduces the amount of costs recovered in the TCRF, and therefore mitigates any allocation mismatch and therefore reduces rate volatility when rates are reset to cost in a rate case.[177] However, TIEC is correct that "zeroing out" the TCRF rider increases the likelihood that CEHE will over-recover what ideally would be a straight pass-through of transmission expenses to customers.[178]

Due to the combination of these two issues, Staff agrees that the best outcome is one in which CEHE is ordered to update the TCRF allocation factors on an annual or biennial basis, and transmission cost recovery is moved entirely out of base rates and into the TCRF rider as TIEC requests.[179] However, absent such a requirement for frequent updates to the TCRF allocation factors, Staff respectfully recommends that the Commission adopt the PFD's recommendation to approve CEHE's request to zero out the TCRF rider.

D. Street Lighting Service

The PFD correctly rejected CEHE's proposal to amend provisions in its Lighting Services Tariff to mandate installation of LED lights for the 160 municipalities it serves.

CEHE failed to explain why it is necessary to strip away the lighting customer's discretion to choose a non-LED lamp type.[180] In its exceptions, CEHE again failed to explain why it necessary to eliminate the customer's choice, instead mischaracterizing the ALJs'

[174] Abbott Cross-Rebuttal at 24-25; Tr. at 922:6-10 (Abbott Cross).
[175] TIEC Exceptions at 28.
[176] Abbott Cross-Rebuttal at 27; Tr. at 921:9-922:20.
[177] *Id.*
[178] TIEC Exceptions at 24 – 26.
[179] Abbott Cross-Rebuttal at 25; Tr. at 929:4-12.

decision by re-casting it incorrectly as a rejection of LED lighting.[181] Under CEHE's existing tariff, customers may already choose the LED lighting options that CEHE is attempting to mandate as the exclusive type of lighting available.[182] No one in this proceeding has proposed taking that choice away, including the ALJs.

In the PFD, the ALJs expressed concern that the financial impacts of CEHE's LED mandate on current and future customers remains unclear.[183] In its exceptions, CEHE made no attempt to address the ALJs' concerns by clarifying the customer impacts of the proposal. The Commission should reject CEHE's arguments and adopt the PFD's decision to maintain customer choice on this issue.

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

A. Rider UEDIT [PO Issue 51]

2. Amount to Return through Rider UEDIT

The ALJs agreed with Staff's recommendations that, if the Commission concludes that this issue warrants additional review and possible action, the Commission should set a deadline for CEHE to initiate a separate Commission proceeding to address the appropriate treatment of excess accumulated deferred income tax (EDIT) amounts related to CEHE's four securitized bond issuances still outstanding. Staff further recommended that CEHE's filing include information responsive to the points Staff witness Darryl Tietjen discussed in his testimony and any other information CEHE believes, or the Commission states, may be relevant and necessary to consider.[184]

Staff witness Tietjen testified that CEHE has four issuances of securitized bonds outstanding, summarized in the table below:

Docket	Order Date	Securitized Amount (rounded)	Type of Costs Securitized	Scheduled Final Payment Dates

[180] PFD at 367: "Based on the evidence and arguments presented, the ALJs find it unreasonable to all but completely eliminate the Lighting Service customers' ability to choose the type of lamp offered to them, especially when there is uncertainty regarding the overall financial impact to the current and future customers."
[181] PFD at 94.
[182] Direct Testimony of Matthew A. Troxle (Troxle Direct), Exhibit MAT-8 at 38.
[183] PFD at 364.
[184] PFD at 394.

30485[185]	March 2005	$1,851,000,000	Stranded/True-up	August 2019
34448[186]	September 2007	$488,000,000	Stranded/True-up	February 2020
37200[187]	August 2009	$665,000,000	System Restoration	August 2022
39809[188]	October 2011	$1,695,000,000	Stranded/True-up	October 2024

As stated in the table above, the final payment dates for refunds to customers range from August 2019 to October 2024, with amounts ranging from $488,000,000 to $1,851,000,000. These orders were entered in March 2005, September 2007, August 2009, and October 2011.

In the intervening time period between the entry of those orders and the dates of the final payments associated with refunding the amounts associated with the securitization orders, the TCJA was passed in December 2017, changing the corporate tax rate from 35% to 21%.[189] The decrease in the corporate tax rate converted a portion of CEHE's remaining securitization-related ADFIT balances to *excess* accumulated deferred income tax, or EDIT.[190] This EDIT portion of the ADFIT balance, amounting to approximately $158 million, was previously funded at least in part by rate payers, but is now no longer due to the Internal Revenue Service.[191] As a result of the amount involved and the complexity of the issues, Staff witness Darryl Tietjen recommended that, subject to the Commission's consideration of the potential impact on the capital market's perception of securitization-related transactions by Texas utility companies, severing the issue into a separate proceeding would be the best approach to address the appropriate treatment of the EDIT amounts related to CEHE's four securitized bonds currently outstanding.[192]

CEHE argues that the language in the settlement agreements prohibit amendments to the orders, and doing so would result in poor public policy.[193] By arguing that it would be

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185 *Application of CenterPoint Energy Houston Electric, LLC for a Financing Order*, Docket No. 30485 (Order, March 16, 2005).

186 *Application of CenterPoint Energy Houston Electric, LLC for a Financing Order*, Docket No. 34448 (Order, September 18, 2007).

187 *Application of CenterPoint Energy Houston Electric, LLC for a Financing Order*, Docket No. 37200 (Order, August 27, 2009).

188 *Application of CenterPoint Energy Houston Electric, LLC for a Financing Order*, Docket No. 39809 (Order, October 27, 2011).

189 PFD at 380.

190 Staff Ex. 1A at 23.

191 *Id.*

192 *Id.*

193 CEHE Exceptions at 98.

inappropriate for the Commission to even sever the issue to thoroughly examine the issue and determine whether the orders issued by the Commission may be amended due to the intervening change in law, CEHE seeks to retain the amounts ratepayers paid in advance for corporate taxes, allowing CEHE to enjoy those amounts, as well as interest accrued.

Staff respectfully requests that, if the Commission concludes that this issue warrants additional review and possible action, the Commission adopt Staff's recommendation to open a separate docket to examine issues related to the securitized amounts in the four financing orders and whether they may be potentially amended due to an intervening law, and reject CEHE's recommendation that the Commission is barred from examining those issues.

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

XI. PFD NUMBER RUN MODEL ERRORS

On the next to last page in the substantive portion of its exceptions, CEHE lodged a general exception to the PFD, citing purported errors with the number run model performed by the Commission's Rate Regulation Division.[194] In referring to these alleged errors, CEHE failed to substantiate its claims or provide specific references to the record to support its argument that the amounts should be adjusted. CEHE's proposed "corrections" result in a total base revenue increase of $31.495 million, as opposed to the PFD's proposed increase of $2.644 million increase, a differential of $28.851 million. This exception is inappropriate for a number of reasons, as discussed in the Joint Objection and Motion to Strike submitted by Staff and other intervenors.[195]

Further, CEHE is incorrect when it asserts that its so-called "corrections" fully reflect the PFD. In fact, the PFD correctly incorporated the amounts associated with the number runs by Staff, which was performed following the instructions of the ALJs.[196] Many of CEHE's adjustments explicitly contradict numbers provided in the PFD and number-running instructions, as explained, in part, below.

CEHE argued that the hard-coded amounts in the models make it "difficult to trace adjustments and associated results".[197] However, these cells are hard-coded because the PFD

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[194] *Id.* at 103.
[195] Joint Objection and Motion to Strike (Oct. 17, 2019).
[196] CEHE Exceptions at 104.
[197] *Id.* at 103.

and the number-running instructions explicitly provided exact amounts, and to achieve those exact amounts, certain cells must be hard-coded.

Additionally, CEHE alleges that there is a disparity between the two models. However, Staff maintains that this is necessary in order to comply with the PFD and the number-running instructions. In its application in this docket, CEHE forced its two models to balance by making a sizable adjustment to FERC Account No. 565 in the revenue requirement model, based on further "downstream" considerations from the total cost of service model. The PFD and the number-running instructions do not specify that the revenue requirement should be sizably adjusted in FERC Account No. 565 as CEHE did in its application, so Staff did not implement such an adjustment in its execution of the number run. Like many of CEHE's assertions regarding the number run, here CEHE takes issue with the PFD or number-running instructions, not with the number run.

With respect to the purported $40 million disparity, CEHE presented a cost study that does not match its requested level of revenues. CEHE's lead witness, Kenny Mercado, testified, "With respect to the cost of service portion of its request, the CEHE's filed cost of service data demonstrates that CenterPoint Houston's annual cost of service totals approximately $2.3 billion."[198]

Consistent with Mr. Mercado's statement, Schedule I-A-1 to the CEHE's rate filing package indicates a "total adjusted revenue requirement" of $2.282 billion.[199] However, $2.3 billion is not CEHE's total cost of service or its total requested revenue requirement. The actual total revenue requirement of $2.678 billion requested by CEHE in this case can be found in the application.[200] The $2.3 billion amount reflects the CEHE's proposed retail cost of service. The disparity between what CEHE claimed it was asking for and its actual total request is approximately $400 million dollars, and the source of the difference between the two number-running models relates to the manner in which the CEHE presented its case.

In Staff's direct case, Staff provided an explanation that accounts for the $400 million gap between what CEHE represented as its total cost of service and what the CEHE was actually requesting:

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198 Direct Testimony of Kenny Mercado (Mercado Direct), CEHE Ex. 6 at 21.
199 Schedule I-A-1.
200 Application at 12.

> [Total requested revenue requirement] is the term CEHE uses for its retail delivery revenue requirement. The wholesale revenue requirement is overlaid within the retail cost of service's transmission function, and Account 565 is used in that function as a plug to ensure that the transmission functional 'revenue requirement' ties to the CEHE's total wholesale transmission expenses, which are costs associated with serving CEHE's retail customers that the CEHE incurs in its role as a DSP.[201]

In other words, CEHE did not properly present its total cost of service as composed of wholesale transmission cost of service plus retail cost of service, where the actual wholesale transmission cost of service (TCOS) amounts comprise the transmission function and where the transmission expenses CEHE incurs as a distribution provider for receiving wholesale transmission service (Account 565 amounts) are included as a retail distribution expense in the distribution function. Instead, the CEHE included both wholesale TCOS amounts and also retail transmission expenses in the transmission function, then adjusted downward the amounts in Account 565 below the actual level of Account 565 expenses, an adjustment that reduces the stated total CEHE cost of service amount to a level that reflects only the retail cost of service.

Consistent with the above explanation provided in Staff's direct case, which was not challenged by CEHE in its rebuttal case, and consistent with the fact that the appropriate Account 565 amounts cannot be determined until after the functional allocation process,[202] the PFD number-running communications filed in this docket contain the following notes to the ALJs:

> **Overall base revenues.** For an investor-owned transmission and distribution utility like CEHE, changes in retail base revenues, wholesale base revenues, and total base revenues cannot be determined until the functionalization process has been completed. See Attachment C 1 for a summary of present base revenues, PFD-adopted base revenues, and base revenue changes on a retail, wholesale, and CEHE total basis. Attachment Cl is analogous to the information presented by CEHE in its application, on the table at Bates 23. PFD number-running rates have been set based on these amounts.[203]

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[201] Direct Testimony of Brian Murphy (Murphy Direct), Staff Ex. 2A at 9.

[202] This fact occurs because a TDU as a TSP provides wholesale transmission service in part to itself as DSP. Therefore, in calculating rates the TDU's wholesale transmission rate (derived from its TCOS) is an input into its retail distribution rates as a transmission expense incurred as a DSP under Account 565.

[203] Number-running communications at Bates 35 (Sep 17, 2019).

In the context of the above discussion, the "49421 – Rev Req Model – ALJ Number Run – 9-9-2019.xlsx" file does not reflect the post-functionalization flow-through effects on Account 565 and does not correct for CEHE's misleading downward adjustment to Account 565, but rather reflects various total CEHE adjustments to CEHE's request, and provides inputs into the class cost of service study. The class cost of service model, file "49421 – Model of CEHE's CCOSS – PFD.xlsm," includes the functional allocations necessary to determine the appropriate level of retail transmission expense, and it is this model that is used in calculating the rates.

In its exceptions, CEHE refers to a figure from an intermediate step in the ratemaking process, upstream from Attachment C1 to the PFD, before the functionalization was performed. As indicated above, CEHE used Account 565 as a plug in CEHE's cost study to produce a transmission functional revenue total that matches CEHE's total ERCOT transmission expenses it incurs as a DSP. Following CEHE's method of presentation, the required adjustment to Account 565 in the amount of $40.38 million is shown in the PFD's electronic workpapers. As explained in the above quote, the PFD's number-running rates were set based on the fully adjusted amounts. CEHE's Exceptions represent this as an error, but in fact it is not, because there is no compelling need to reach back and adjust upstream values from intermediate steps in the ratemaking process that occur before the functionalization of costs.

In addition to the general objections to the number run, CEHE also identified several specific purported errors,[204] in bold, which Staff addresses in turn below:

1. **The amounts requested by CEHE Houston should be derived from its errata filing.[205] Certain items in the PFD number run models do not tie to amounts contained in the CEHE's errata filing and require correction.**

   Staff identified the incorrect starting point for the PFD's flow-through adjustment to cash working capital and noted this issue in Staff's Exceptions in this docket.[206]

   There are no other departures from using CEHE's errata request for the starting point for the number run in this docket.

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[204] *Id.*

[205] CEHE Ex. 2 Errata 1 Schedules and Schedule Workpapers.

[206] Staff Exceptions at 4.

Finally, Staff notes the vague and unspecified nature of this criticism; CEHE should have explicitly provided all the departures from its errata request that it believes it has identified.

2. **Certain proposed capital disallowances were not applied to the correct FERC accounts resulting in inaccurate adjustments to depreciation expense.**

Staff's execution of the number-running instructions complied with the ALJs' instructions. Where Staff was ordered to remove amounts, Staff did so according to the FERC accounts provided on the record in this docket, if any were provided.

Staff believes that here CEHE is referring to a reduction for which there is no breakdown by FERC account on the record in this docket.

Finally, Staff again notes the vague and unspecified nature of this criticism; CEHE should have explicitly provided all the instances of incorrect FERC accounts, as well as all the specific locations of the breakdowns by FERC Account for those instances on the record, that CEHE believes it has identified in this second item.

3. **Certain capital disallowances are duplicative.**

Staff's execution of the number-running instructions complied with those instructions. Where Staff was ordered to remove capitalized amounts, Staff removed the specified amounts.

Staff believes that here CEHE is taking issue with the PFD and the number-running instructions, not with the execution of those instructions.

Finally, Staff again notes the vague and unspecified nature of this criticism; CEHE should have explicitly provided all the instances of duplicative capital adjustments that CEHE believes it has identified in the PFD and identified all of the information on the record that CEHE proposes using to correct this alleged error. It is impossible to guess to which certain capital disallowances CEHE here refers.

4. **There are calculation errors due to the use of wrong inputs for the STI disallowance. First, the adjustment started with the book numbers rather than the**

test year requested numbers. Second, the calculation neglected to remove capitalized STI in order to calculate the O&M adjustment.

In Staff's exceptions, Staff identified an error in the number run; while the number run complied with the number-running instructions, the PFD provided an exact specification of the starting amount included in CEHE's request for rates in this docket.[207]

Regarding the capitalized portion of STI, Staff's number run correctly removed amounts of capitalized STI amounts per the number-running instructions and the PFD. Again, here CEHE's issue appears to be with the PFD and not with the number run.

5. **Bad debt amortization is missing from the PFD number run model.**

The number run complied with the number-running instructions that ordered number-running Staff to start with CEHE's request in its errata filing and make a number of adjustments, including providing for a regulatory asset for bad debt and then "approving CEHE's proposed amortization period for all assets and liabilities recommended by the ALJs in Section I above." Number-running Staff looked to CEHE's request in its errata for the requested amortization treatment of its regulatory assets. As shown on WP II-E-4.1.1 in CEHE's errata, CEHE did not request amortization of its bad debt along with its request for amortization of its regulatory assets. Accordingly, the number run complied with the number running instructions and, by following CEHE's errata request, did not include amortization of bad debt.

6. **Incorrect functionalization factors were used.**

CEHE has made a non-specific and conclusory assertion regarding the functionalization factors used in the PFD's number run. To the extent CEHE has identified in its Exceptions specific functionalization factors that the CEHE believes should be adjusted in subsequent number runs, those are addressed on a case-by-case basis in this document.

[207] Previously, Staff had used the amounts that CEHE had identified were the amounts it had included in its request for rates in this docket, as provided in CEHE's response and updated response to RFI No. Staff 03-01. See Section

To the extent the PFD number-run implements a decision that CEHE disagrees with, that does not represent an error in the number-running process. To this point, Staff notes that it follows well-established internal protocols during number runs; these protocols provide for carrying out ALJs' (or Commission) decisions based solely on the specific number-running instructions and preclude Staff from substituting independent judgment.

7. **Flow through impacts are not complete even though the Number Running Communications memo specifically indicated these should be made as outlined in the "Global instructions" on bates page 4. For example, Accumulated Depreciation and ADFIT related to disallowed plant in service was not adjusted in the models. Attachment C provides a summary of the attendant impacts for the capital disallowances.**

The number run did not reflect flow-through impacts for accumulated depreciation and ADFIT because CenterPoint did not provide such information on the record. Attachment C to CenterPoint's Exceptions to the Proposal for Decision is the first time that CenterPoint provided information regarding accumulated depreciation and ADFIT for any recommended disallowances in this proceeding.

8. **The D2 allocator appears to use information for the ERCOT 4CP at the meter, rather than at the source.**

For the allocation of costs that vary based on demand, allocation factors are based on load information from a load study performed by the utility. In this proceeding, one of the categories of costs that varies based on demand is the ERCOT transmission payments that CEHE, acting in its role as DSP, must pay to all the TSPs in ERCOT, including itself, for the use of the ERCOT transmission system. In this proceeding, there were two issues regarding which demand information from the load study should be used to allocate CEHE's ERCOT transmission payments, representing almost one billion dollars per year, among the classes. The first issue was: should the allocation information be based on demands on CEHE's distribution system only or the ERCOT transmission system as a whole? The second issue was: should the demand information be measured

IV.C.1 above and refer back to Staff's exceptions, for a full explanation of contradictory information that CEHE provided in response to RFI No. Staff 03-01.

at the customer's meter or at the source (point of interconnection with the ERCOT transmission grid)? In the PFD, the ALJs decided that ERCOT demands should be used.[208] In its exceptions, CEHE states that number-running Staff inadvertently used at-meter demand information to effectuate the ALJs' decision on this issue, rather than at-source information. Staff has reviewed the load information in this case and has verified that the load information used in the PFD number-run to allocate ERCOT transmission payments among the classes correctly corresponds with class ERCOT demands **at source**. Each class's monthly at-source ERCOT demand information was measured by CEHE and provided in Schedule II-H-1.3 to its application.

The data can be seen in the following table:

	Demand @ source coincident with ERCOT peak demand[209]						
Class	June	July	August	September	Average 4CP	Share	PFD[210]
	a	b	c	d	e = Σa:d ÷ 4	e ÷ Σe	
Residential	8,197.93	8,652.68	8,411.54	7,777.78	8,259.99	.476096	.476096
Secondary-sm.	141.52	146.20	146.60	145.10	144.85	.008349	.008349
Secondary-lg.							
Non-IDR	3,571.16	3,662.99	3,702.51	3,634.35	3,642.75	.209964	.209964
IDR	2,313.05	2,332.73	2,419.12	2,435.49	2,375.10	.136897	.136897
Primary							
Non-IDR	51.01	54.02	54.41	53.76	53.30	.003072	.003072
IDR	548.96	545.68	508.57	549.68	538.22	.031022	.031022
Transmission	2,202.58	2,416.66	2,424.16	2,297.34	2,335.19	.134597	.134597
Lighting-MLS	0	0	0	0	0	.000000	.000000
Lighting-SLS	0	0	0	0	0	.000000	.000000
Total	17,026.22	17,810.96	17,666.91	16,893.51	17,349.40	1.000000	1.000000

The class demands coincident with ERCOT average 4CP demands at source were correctly calculated in the PFD number run using the 4CP months from CEHE's Schedule II-H-1.3. In alleging error in its Exceptions, CEHE is apparently confusing other demand information for class demands coincident with ERCOT average 4CP demands. The possibilities are: CEHE average 4CP demands at source, CEHE 4CP average demands at meter, or ERCOT average 4CP demands at meter. In its application,

[208] PFD at 347.
[209] Application, electronic Microsoft Excel workbook "Schedule H-I-J and CA.xls," worksheet "II-H-1.3," at Microsoft Excel rows 159 – 182, labeled as "Coincident Peak Demand at the Time of the ERCOT Peak @ Source."
[210] Number-Running Workpapers, Microsoft Excel workbook "49421 – Model of CEHE's CCOSS – PFD.xls," worksheet "WP Class 4CP," at Microsoft Excel row 186 (Sep. 17, 2019).

CEHE erroneously labeled its D2 allocation factor as "ERCOT" demand when in fact it was "CEHE" demand information.[211] Staff suspects that CEHE's exceptions to the D2 allocation factor used in the PFD number run stem from failing to note that, per the CEHE's errata filing, the CEHE initially mislabeled "CEHE" demand information as "ERCOT" demand information in its application, and therefore in its exceptions, the CEHE is looking at CEHE demand at source and concluding erroneously that it represents ERCOT demand at source.

9. **The PFD number run does not appear to have used Dr. McMenamin's weather normalization adjustment as applied to a 10-year normalization period as directed by the PFD.**

To calculate rates and to accurately characterize the revenue increase that customers will experience under the rates adopted by the Commission in this proceeding, adjusted test-year billing units must be determined. These adjusted test-year billing units are used to calculate the "present revenues" which are compared to the Commission-adopted revenue requirement. The determination of present revenues as an input into the revenue-increase calculation is a standard part of the ratemaking process. To determine present revenues in this case, CEHE measured the amount of revenues it collected during the Test Year, and requested a number of adjustments to Test-Year revenues. Two of the CEHE's proposed adjustments were disputed: weather normalization of sales (i.e., kilowatt-hours of energy),[212] and the energy-efficiency adjustment to sales.[213] In practice, the only rate classes affected by adjustments to Test-Year energy sales are the Residential and Secondary voltage (small) classes, as the other classes are not subject to energy charges for their retail delivery base rates.[214] In the PFD, the ALJs adopted CEHE's weather normalization modeling, but using a ten-year weather normal period as opposed to the

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[211] Errata to the Direct Testimony of Matthew Troxle.
[212] PFD at 313-321.
[213] Id. 321-325.
[214] The rate design schedules for the other classes (all of which are not subject to energy rates) can be found in the Direct Testimony of Matthew A. Troxle, Exhibit MAT-9 at 89-100. CEHE presents weather normalization data for all classes, to both energy and demand values. However, the contested weather normalization issue only implicated the adjustments to Test-Year energy values, not demand values, and hence only the Residential and small secondary classes. In the event the Commission wishes to apply Mr. McMenamin's 10-year weather normalization adjustment to the demand billing units for the classes with demand charges, the information required to do so is present in the evidentiary record; and, such an adjustment could be implemented in the final Commission number run.

20-year period requested by the CEHE.[215] The ALJs also rejected CEHE's proposed energy-efficiency adjustment.[216] In its exceptions, CEHE states that the PFD number run "does not appear" to have used Mr. McMenamin's weather normalization adjustment as directed by the PFD, which is incorrect. The PFD number-run correctly incorporates the adjustment directed by the ALJs. In the number-running communications for the PFD, the ALJs directed Staff as follows:

The ALJs recommend approving CEHE witness Stuart McMenamin's weather adjustment as applied to his alternative 10-year normal weather period. Dr. McMenamin provided information and data regarding his estimated weather adjustment based on a 10-year normal weather period as electronic attachments to his rebuttal testimony. *See* CenterPoint Ex. 44, Exh. R-JSM-1.[217]

CEHE's originally requested weather-normalization to the Test-Year level of sales, based on a 20-year weather normal period, included downward adjustments of 1,578,040,193 kWhs for the residential class,[218] and 11,584,670 kWhs for the secondary voltage (small) class.[219] The present revenue impact of CEHE's requested weather normalization was a downward adjustment of $39.5 million.[220] The PFD's adjustments are smaller, resulting in a higher level of adjusted Test-Year sales as compared to the CEHE's requested For the residential class, the weather normalization adjustment to Test-Year sales from CEHE Exhibit R-JSM-1 is a downward adjustment of 1,140,057,980 kWhs.[221] For the secondary voltage (small) class, the downward adjustment is 8,479,130 kWhs.[222] The CEHE's requested weather normalization of Test-

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[215] PFD at 319.
[216] *Id.* at 325.
[217] Number-running communications at Bates 10 (Sep 17, 2019).
[218] Application, Schedule II-H-1.1 at Microsoft Excel cell G13.
[219] *Id.*, at cell G16.
[220] Application, Schedule II-H-4.1.5 at column (11). Although CEHE performed a weather normalization of Test-Year energy for other rate classes (Secondary voltage-large, and primary), the adjustments for other classes has no bearing on present revenues or rates because, as discussed above, other classes are not subject to energy rates as part of the rate structure under existing and proposed rate schedules. For the CEHE's existing and proposed rate schedules, *see* direct testimony of Matthew A. Troxle at Exhibit MAT-9.
[221] Rebuttal testimony of J. Stuart McMenamin, Exhibit R-JSM-1, Figure R-1 at Microsoft Excel cell O21 (June 19, 2019).
[222] *Id.*, at cell O22.

Year energy for classes subject to energy rates, the PFD's recommended weather normalization, and the effects on present revenues can be seen in the following table:

Class	Weather normalization of sales (in kWh)			Effect of weather normalization on present base revenues (in millions of dollars)		
	CEHE[223]	PFD[224]	Difference	CEHE[225]	PFD	Difference
Residential	1,578,040,193	1,140,057,980	437,982,213	- $39.34M	-$28.42M[226]	+ $10.92M
Secondary-Small	11,584,670	8,479,130	3,105,540	-$0.19M	-$0.14M[227]	+ $0.05M
Total	1,589,624,863	1,148,537,110	441,087,753	-$39.53M	-$28.56M	+ $10.97M

The total PFD-adopted increase to CEHE's present revenues resulting from the ALJs' decision on the weather normalization issue is $10,969,743. The increase to CEHE's present revenues resulting from the PFD's rejection of CEHE's energy-efficiency adjustment to present revenues is $1,205,285.58. The sum of the PFD's adjustments to present revenues is $12,175,029.[228] The correct amount is shown in the PFD number-running workpapers as the PFD-adopted increase to present revenues.[229]

CEHE fails to refer to the record to assert that the inputs to the number run model were incorrect. However, in researching the CEHE's claims, Staff discovered that there was an ancillary flow-through effect of the PFD's weather normalization and energy-efficiency plant decisions that were not reflected in the PFD number-run. It involves an interaction between the weather normalization adjustment, the energy-efficiency adjustment, and a third adjustment to kWh that was not contested in the case—the flow-through effect of the weather and energy-efficiency adjustments on the *customer-related* kWh adjustment. Staff believes it is appropriate

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223 Schedule II-H-1.2 at Microsoft Excel column D.

224 Rebuttal testimony of J. Stuart McMenamin, Exhibit R-JSM-1 at Figure R-1.

225 Schedule II-H-4.1.5 at column (11).

226 The effect of the PFD's weather normalization adjustment on residential present base revenues is calculated by multiplying the current residential transmission and distribution charges by the kWh adjustment. For current transmission and distribution charges, *see* Schedule IV-J-7 Residential. The current residential transmission charge of $0.008439 per kWh can be found in Microsoft Excel cell Q16. The current residential distribution charge of $0.016489 can be found in Microsoft Excel cell Q18. The full calculation is as follows: (1,140,057,980 kWhs x $0.008439 per kWh) + (1,140,057,980 kWhs x $0.016489 per kWh) = $28,419,365.

227 The effect of the PFD's weather normalization adjustment on secondary voltage-small present base revenues is calculated by multiplying the current secondary-small transmission and distribution charges by the kWh adjustment. For current transmission and distribution charges, *see* Schedule IV-J-7 Secondary - Small. The current secondary-small transmission charge of $0.004437 per kWh can be found in Microsoft Excel cell Q15. The current secondary-small distribution charge of $0.012218 can be found in Microsoft Excel cell Q17. The full calculation is as follows: (8,479,130 kWhs x $0.004437 per kWh) + (8,479,130 kWhs x $0.012218 per kWh) = $141,220.

228 $10,969,743 + $1,205,285.58 = $12,175,029.

229 Number-running communications, Attachment C.1, column "PFD adjustment," row "CEHE total present base revenues." (Sep 17, 2019)

to incorporate the customer-related adjustment to kWh that arises from changes to the weather normalization and energy-efficiency plan adjustments. Staff believes that it would be possible to incorporate such a flow-through adjustment in subsequent number-runs using information that is already on the record, should the Commission direct Staff to do so.

XII. CONCLUSION

As stated in its exceptions and in this pleading, Staff supports most of the PFD's recommendations. Staff respectfully requests the adoption of Staff's positions in the foregoing.

PUC DOCKET NO. 49421
SOAH DOCKET NO. 473-19-3864
CERTIFICATE OF SERVICE

I certify that a copy of this document will be served on all parties of record on October 24, 2019 in accordance with 16 TAC § 22.74.

Rachelle Nicolette Robles