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APPLICATION OF CENTERPOINT §
ENERGY HOUSTON ELECTRIC, LLC §
FOR AUTHORITY TO CHANGE §
RATES §

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BEFORE THE
PUBLIC UTILITY COMMISSION
OF TEXAS

AEP TEXAS INC.'S AMICUS CURIAE BRIEF

At the Commission's November 14, 2019 Open Meeting, both Texas Industrial Energy Consumers and CenterPoint Energy Houston Electric (CenterPoint) discussed the connection between the Commission's tentative decisions regarding capital structure, return on equity (ROE), and ring fencing. At the conclusion of the November 14 meeting, CenterPoint highlighted a very real and significant impact of the Commission's tentative capital structure decision – the returning of \$800 million of equity to CenterPoint's parent company – and the conflict between that decision and the Commission's decisions related to ring fencing. AEP Texas Inc. (AEP Texas) wishes to provide context to this discussion, make clear there are significant financial implications for all Texas utilities associated with these decisions, and address the questions posed in the Commission's November 15, 2019 Briefing Order.

The actual capital structure to which AEP Texas is currently managed is 55 percent debt and 45 percent equity.¹ CenterPoint is also managed to a capital structure of 55 percent debt and 45 percent equity² – the capital structure most recently approved by the Commission for CenterPoint.³ To order a capital structure of 60 percent debt and 40 percent equity means that the

¹ *Application of AEP Texas Inc. for Authority to Change Rates*, Docket No. 49494, Proposal for Decision (PFD) at 140 (Nov. 12, 2019).

² *Application of CenterPoint Energy Houston Electric, LLC for Authority to Change Rates*, Docket No. 49421, PFD at 173 (Sept. 16, 2019).

³ *Application of CenterPoint Electric Delivery Company, LLC, for Authority to Change Rates*, Docket No. 38339, Order on Rehearing at Finding of Fact (FoF) Nos. 67-69, 75A (Jun. 23, 2011).

Commission finds that the utility is better managed by being saddled with more debt and less equity. To be very specific, if the Commission orders a 60/40 capital structure, CenterPoint has represented that it will need to return \$800 million of equity to its parent and take on an additional \$800 million in debt. In the pending AEP Texas rate case, in its testimony and briefing, AEP Texas has stated, if the Commission orders it to maintain a 60/40 capital structure, AEP Texas will need to return \$300 million of equity to its parent and take on an additional \$300 million in debt.⁴ Requiring similar debt levels for other Texas utilities would result in corresponding removals of equity investment from those utilities.

AEP Texas does not understand the Commission to desire that Texas utilities be more financially leveraged and, thus, more risky. In fact, the Commissioners' discussion of ring fencing provisions at the November 14 Open Meeting leads to the opposite conclusion – that the Commission desires financially sound utilities that are ready to provide reliable service to customers, even in the face of adverse events such as hurricanes and other natural disasters that frequent Texas. The ordering of a 60/40 capital structure will have the direct effect of increasing leverage and financial risk that would be contrary to our understanding of the Commission's overall objective.

The Commission has not ordered a 60/40 capital structure in a fully litigated rate case in a decade.⁵ The Proposal for Decision entered in AEP Texas' pending rate case observes that the Commission has moved away from a 60/40 capital structure for transmission and distribution utilities:

The existing 60/40 capital structure [of AEP Texas] was adopted at the outset of competition. The market and its participants have changed since then. The

⁴ See Docket No. 49494, Rebuttal Testimony of Renee Hawkins at 2 (Aug. 13, 2019).

⁵ *Application of Oncor Electric Delivery Company LLC for Authority to Change Rates*, Docket No. 35717, Order on Rehearing (Nov. 30, 2009).

Commission has changed the capital structure awarded to similarly situated utilities, moving toward the [55/45] capital structure advocated by AEP Texas.⁶

The more recent Commission precedent in fully litigated rate cases for ERCOT (wires only) utilities is to approve a 55/45 capital structure.⁷ In the most recent of these, the Proposal for Decision, which the Commission adopted, explained, “[t]he starting point for determining a utility’s capital structure should always be the utility’s actual capital structure.”⁸ The starting point should be no different in the cases pending before the Commission now. AEP Texas is managed to and has requested a 55/45 capital structure. AEP Texas understands CenterPoint also to be managed to a 55/45 capital structure. The Commission should not feel constrained by the fact that CenterPoint requested a 50/50 capital structure and others recommended a 60/40 capital structure. The Commission’s discretion in setting rates is not limited to the parties’ recommendations. Rather, the Commission has the authority to select amounts within the range of reasonable options supported by record evidence.⁹

The Commission should not be biased toward a more leveraged capital structure for Texas utilities. More debt creates more financial risk for the utility and its debt and equity holders because of lower cash flows. A higher debt level also increases the cost of debt for each new issuance – an increased cost to customers that is long-term in nature, lasting for the term of the bonds, which may be ten years or more. This additional risk increases not only the cost of debt

⁶ Docket No. 49494, PFD at 139-40.

⁷ Docket No. 38339, Order on Rehearing at FoF Nos. 67-69, 75A; *Application of Lone Star Transmission, LLC for Authority to Establish Interim and Final Rates and Tariffs*, Docket No. 40020, PFD at 69 (Sept. 6, 2012).

⁸ Docket No. 40020, PFD at 69.

⁹ *City of El Paso v. Pub. Util. Comm’n of Tex.*, 883 S.W.2d 179, 186 (Tex. 1994) (holding that where record contains substantial evidence to support a disallowance figure of either zero or fifty percent for decisional imprudence, “there is a reasonable basis for the Commission to, in its discretion, select an amount within the range of figures provided by expert testimony of the parties”); *Pioneer Nat. Res. USA, Inc. v. Pub. Util. Comm’n of Tex.*, 303 S.W.3d 363, 373 (Tex. App.—Austin 2009, no pet.) (expressly rejecting claim that “Commission cannot apply a capital structure that no single witness or party explicitly proposed.”).

but also the cost of equity because of the increased risk. In other words, more debt makes the remaining equity more expensive, not less expensive while at the same time making this new debt more expensive.

In past cases, the Commission has recognized the interrelationship between the level of debt in the utility's capital structure and the utility's authorized ROE. In Docket No. 22355, for example, the Commission concluded that, as a general proposition, "an increase in [the] debt [ratio] should result in an increase in ROE unless offset by lower business risk."¹⁰ In that case, the Commission further concluded that a 0.5 percent upward adjustment to ROE above the midpoint was appropriate to account for, among other issues, "potential rating uncertainty due to higher debt, based on the adoption of 60% debt and 40% equity for capital structure."¹¹ In this case, however, the Commission's tentative decisions on capital structure and ROE would depart from this reasoned position and increase the debt in CenterPoint's capital structure while simultaneously decreasing CenterPoint's authorized ROE.

All things being equal, the credit metrics for utilities with weaker capital structures will always be weaker than for utilities with stronger capital structures. Credit metrics are a primary tool used by credit rating agencies to determine creditworthiness. One of the specific ring fencing provisions being considered by the Commission is that the utility ensure that its credit ratings remain at or above its current credit ratings. Ordering a capital structure with more debt runs counter to this provision. For example, AEP Texas' current credit profile and access to capital are supported and maintained by its actual 55/45 capital structure. That the Commission might order a capital structure resulting in the utility taking on hundreds of millions of dollars of additional

¹⁰ *Application of Reliant Energy for Approval of Unbundled Cost of Service Rate Pursuant to PURA § 39.201 and Public Utility Commission Substantive Rule § 25.344*, Docket No. 22355, Order at 26 (Oct. 4, 2001).

¹¹ *Id.* at 25.

debt, and the adverse impact of that change on creditworthiness, highlights the disconnect between the Commission's tentative capital structure and ROE decisions and the ring fencing provisions under consideration. AEP Texas asks the Commission to keep in mind its goal of protecting Texas utilities when considering the appropriate ROE, capital structure, and ring fencing provisions, if any, in each case based on the facts associated with that utility. Relevant to this consideration is the fact that Texas utilities are in competition for capital, not only with other Texas utilities, but also with similarly situated utilities operating across the nation.

In its November 15, 2019 Briefing Order, the Commission asks what provisions of PURA or Commission rules require CenterPoint to make its actual capital structure match the capital structure the Commission uses to set rates. The implication of this question is that the Commission could use a 60/40 capital structure to set rates but then expect or even require through ring fencing provisions that the utility maintain a level of equity capital higher than 40% for the purpose of maintaining its credit rating. Such a situation would violate PURA § 36.051, which requires the Commission to establish rates that will permit the utility an opportunity to earn a reasonable return on invested capital in excess of reasonable and necessary operating expenses. To use one capital structure to set rates and expect or require the utility to maintain a more prudent, higher level of equity would deny the utility the opportunity to earn a reasonable return on all of its prudently invested capital.

There is good reason that AEP Texas is managed to a 55/45 capital structure, and no party has alleged that AEP Texas has been imprudent for doing so. To order a capital structure that results in the utility taking on hundreds of millions of dollars more debt and jettisoning hundreds of millions of dollars of equity is clearly at odds with what AEP Texas understands to be a desire of the Commission to protect Texas utilities and their customers.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that a true and correct copy of this document was served via electronic mail, facsimile, hand-delivery, overnight delivery, or First Class U.S. mail on all parties of record in this proceeding on November 25, 2019.


William Coe