

Control Number: 49421



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PUC DOCKET NO. 49421

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

BEFORE THE STATE OFFICE  
OF PUBLIC UTILITY COMMISSION  
FILING CLERK  
ADMINISTRATIVE HEARINGS

**STAFF'S RESPONSE TO COMMISSION BRIEFING ORDER**

COMES NOW the Staff (Staff) of the Public Utility Commission of Texas (Commission), representing the public interest, and files this Commission Staff's Response to Commission Briefing Order, and would show the following:

On November 15, 2019, the Office of Policy and Docket Management (OPDM) issued a Briefing Order in response to comments made by CenterPoint Energy Houston (CenterPoint) in relation to the Commission's preliminary decisions at the November 14, 2019 open meeting. The Briefing Order solicits briefs from interested parties on two issues:

- Will CenterPoint's compliance with the Commission's tentative decision on CenterPoint's capital structure necessitate noncompliance with its decision on ring fencing? In addressing this issue, please reference the specific provisions of PURA or the Commission rules that requires CenterPoint to make its actual capital structure match the capital structure the Commission uses to set rates.
- If the answer to question 1 is yes, what are the Commission's options to avoid or mitigate this conflict while maintaining the Commissions proposed ring-fencing requirement and capital structure?

Staff offers the attached argument and incorporates it into this brief by reference. The attached argument by Darryl Tietjen, Director of the Commission's Rate Regulation Division, is not offered as evidence, but is based on the evidentiary record as it stands today. Staff answers:

- No, CenterPoint's compliance with the Commission's tentative decision on CenterPoint's capital structure does not necessitate noncompliance with its decision on ring fencing. No specific provisions of the Public Utility Regulatory Act (PURA) or

Tldc

Commission rules require CenterPoint to maintain an actual capital structure that precisely matches the capital structure that the Commission uses to set rates.

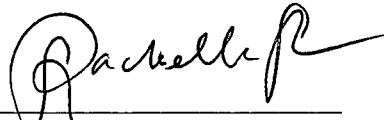
- Even if the Commission finds in the affirmative the answer to the first question, the Commission may avail itself of a number of options to mitigate the potential of noncompliance, including, but not limited, to:
  - An express waiver;
  - Giving CenterPoint a timeframe by which to move to its authorized capital structure;
  - CenterPoint may incorporate the effects of the changes to its authorized capital structure into planning for capital expenditures; or
  - CenterPoint may use its access to CenterPoint Energy's money pool to facilitate moving to its authorized capital structure.

CenterPoint's argument that the Commission's preliminary decisions would purportedly necessitate noncompliance are without merit. Thus, Staff respectfully requests for the Commission to disregard CenterPoint's contentions and affirm their preliminary decisions regarding CenterPoint's rate case.

**DATE: November 25, 2019**

Respectfully Submitted,

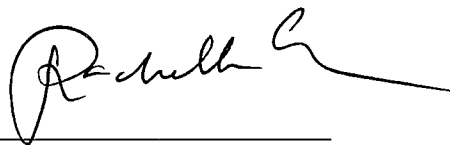
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**PUC DOCKET NO. 49421**

I certify that a copy of this document will be served on all parties of record on November 25, 2019 in accordance with 16 TAC § 22.74.



Rachelle Nicolette Robles

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# *Public Utility Commission of Texas*

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## **Memorandum**

To: Legal Division

From: Darryl Tietjen, Rate Regulation

Re: Docket No. 49421, *Application of CenterPoint Energy Houston Electric, LLC for Authority to Change Rates*  
**Response to Commission's Briefing Order filed November 15, 2019**

Date: November 25, 2019

### **BRIEFING OF ISSUES ORDERED BY COMMISSION**

#### **Introduction**

At the Commission's Open Meeting on November 14, 2019, counsel for CenterPoint Energy Houston Electric (CEHE), referencing the Commission's earlier discussion regarding certain decision points with respect to this proceeding, addressed the Commission and made comments that included the following:

...a 60/40 capital structure would require the company to maintain that level of debt relative to equity to send \$800 million to the parent, from CenterPoint Houston to the parent so that it has a 60 to 40 debt to equity ratio. On the other hand, the dividend restriction related to net income would prohibit us from doing that because we couldn't send that much cash to the parent pursuant to that provision.

The following day, in response to CEHE counsel's comments, the Commission's Office of Policy & Docket Management filed in this proceeding a request for briefing on the following issues:

1. Will CenterPoint's compliance with the Commission's tentative decision on CenterPoint's capital structure necessitate noncompliance with its decision on ring fencing? In addressing this issue, please reference the specific provisions of PURA or the Commission rules that requires CenterPoint to make its actual capital structure match the capital structure the Commission uses to set rates.
2. If the answer to question 1 is yes, what are the Commission's options to avoid or mitigate this conflict while maintaining the Commission's proposed ring-fencing requirement and capital structure?

It should be stated at the outset of this discussion that the concerns expressed by CEHE's counsel have no merit. His basic concern appears to reflect a misperception by CEHE that there is a conflict between CEHE's ability to implement the Commission's tentative decision regarding the capital structure used to set CEHE's rates and the Commission's tentative decision regarding certain ring-fencing provisions. Staff does not believe that there is any such conflict. A conflict may exist between the Commission's tentative decisions and CEHE's internal policies and practices, or between the Commission's tentative decisions and CEHE's *desired outcome* of this proceeding. No *actual* conflict, however, exists between the Commission's tentative decisions regarding capital structure and ring-fencing. The Commission's decisions are compatible. Assuming, *arguendo*, that there is a conflict, Staff believes practical and appropriate remedies are available to CEHE, as discussed below.

**Response to briefing issue 1:**

The response to the initial, central question in briefing issue 1 can be stated plainly and simply: No, CEHE's compliance with the Commission's tentative decision on CEHE's capital structure will *not* necessitate noncompliance with the Commission's decision on ring fencing. With regard to the second question included in briefing issue 1, Staff notes that no specific provisions of the Public Utility Regulatory Act (PURA) or Commission rules require CEHE—or any regulated utility company—to maintain an actual capital structure that precisely matches the capital structure that the Commission *uses to set rates*. In fact, as further discussed below, achieving and maintaining equivalence between actual and authorized capital structures is, as a practical matter, not possible, for a variety of reasons. Staff additionally points out that one of the ring-fencing provisions that the Commission has tentatively approved in this case expressly recognizes that actual and authorized capital structures will be different. That ring-fencing provision, included on page 217 of the Proposal for Decision, states that “CenterPoint’s debt shall be limited so that its debt-to-equity ratio is at *or below* the debt-to-equity ratio established from time to time by the Commission *for ratemaking purposes* in CenterPoint rate proceedings [emphasis added].” Clearly, this ring-fencing requirement reflects the reality that a utility’s actual debt-to-equity ratio is not required or expected to match the ratio used to establish the company’s rates. By their very nature, actual capital structures cannot be etched in stone, and in fact, they are subject to constant

change because of the effects of normal, ongoing business activities and inevitable changes in economic conditions.

Although the answer to briefing issue 1 is that CEHE's compliance with the Commission's tentative decision on CEHE's capital structure will *not* necessitate noncompliance with the Commission's decision on ring fencing—*and thus the need for a response to briefing issue 2 is not reached*—Staff provides additional discussion on this issue below.

The Commission's tentative decisions on capital structure and ring-fencing provisions are compatible.

The setting of a company's authorized capital structure is among the most fundamental of all elements of the regulatory rate-setting process. Utility companies are capital-intensive—i.e., the nature of the utility business requires significant amounts of investment—and their capital structures thus reflect the large amounts of equity and debt required to finance the company's operations. Because the possibility of changes in Commission-authorized proportions of debt and equity on which rates are set is a fact of life for utility companies, there should be no major surprises for industry stakeholders—including the utility companies—when the Commission makes critical decisions on such issues *on the basis of relevant data in the evidentiary record*. In this proceeding, the Commission's decision to authorize a capital structure for CEHE of 60% debt and 40% equity is exactly consistent with the recommendations made by four of the five non-CEHE parties that provided recommendations on this issue.<sup>1</sup> The detailed justifications for these 60/40 recommendations are included in the record in this case and are not repeated here, but generally took into account the comparatively lesser amount of business risk for transmission and distribution utilities (which do not have generation-related risk), the Commission's well-established methods of streamlined and accelerated recovery of both transmission and distribution investment, and the long history of the 60/40 debt-to-equity ratio for transmission and distribution utilities (TDUs) that the Commission approved during the 2000-2001 “unbundling” proceedings that established ratemaking standards for Texas utility companies that had previously been vertically integrated. Accordingly, industry stakeholders—including utility companies such as

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<sup>1</sup> “TIEC, TCUC, HEB, and Staff argue that the Commission should adopt a capital structure consisting of 60% debt and 40% equity, and OPUC argues for the adoption of a capital structure consisting of 54.5% debt and 45.5% equity.” Proposal for Decision, page 174.

CEHE—are well aware of the possibility that the Commission will reasonably find in a contested rate proceeding that the continuation of the long-standing 60/40 capital structure is appropriate. That CEHE appeared surprised at the Commission’s apparent decision on this issue—and, during literally the final minutes of the Commission’s discussion of the major decisions in this proceeding, suggested that there would be “profound” implications resulting from the Commission’s decision—should not dissuade the Commission from making an appropriate capital structure determination based on the record in this case.

Similarly, the Commission’s authorization—and the possible implications—of various ring-fencing provisions should not be a surprise to CEHE. Indeed, in its *Preliminary Order* filed on May 9, 2019, the Commission gave all parties early notice that it was interested in receiving parties’ views on the issue of ring-fencing protective measures. In response, both Staff and Texas Industrial Energy Consumers (TIEC) addressed the issue in testimony and made largely similar recommendations. In the same way that CEHE was well aware of the possibility that the Commission could adopt a 60/40 debt-to-equity capital structure, it was also well aware that the Commission could adopt some, many, or even all of Staff’s and TIEC’s recommendations on ring-fencing measures. After having multiple opportunities (in direct and rebuttal testimony, initial and reply briefs, and exceptions and replies to exceptions to the Proposal for Decision) to address or respond to parties’ recommendations on both capital structure and ring-fencing issues, for CEHE at the 59<sup>th</sup> minute of the 11<sup>th</sup> hour of this case to beseech the Commission for yet another opportunity to make the same arguments on these issues is procedurally untenable, and the Commission should disregard CEHE’s attempts to circumvent the normal decision-making process.

Regardless of CEHE’s last-minute efforts, any reasonable application of the Commission’s decisions confirms that there is no irreconcilable incompatibility between an authorized 60/40 capital structure and the implementation of ring-fencing provisions containing dividend restrictions. The Commission’s decisions on these issues are part of the overall Commission order in this case, and CEHE’s compliance with these findings is simply part of its overall compliance with all the other discrete elements of the order. A capital structure *that is used for setting rates* and the implementation of dividend restrictions do not create a situation that is



inherently incompatible or contradictory, such as having in a Commission order one provision that sets a residential customer charge at \$10 while simultaneously having another provision in the order that sets the residential customer charge at \$11. Rather, the Commission has tentatively ordered that one of the components of the rate-setting process for CEHE will be an authorized capital structure of 60% debt and 40% equity—and as already stated, there is no explicit requirement in PURA or Commission rules (or, for that matter, any practical way) that a company's capital structure will, at all times—or, in reality, hardly ever—exactly equal its authorized amounts.

At the same time that the Commission has tentatively approved a 60/40 capital structure, it has also tentatively approved a ring-fencing provision that limits dividends to the amount of CEHE's net income. As noted above, however, changes to the capital structure should not be construed as conflicting with compliance with the dividend restrictions. Each of these provisions is part of an entire set of order provisions, and each requires CEHE's implementation. A transfer of funds to the parent, if done for purposes of moving to the authorized capital structure, is an event that is separate and independent from compliance with future dividend restrictions pertaining to net income amounts. For CEHE to suggest that these requirements irreconcilably conflict is not a reasonable interpretation of what the order requires for CEHE or of CEHE's proper implementation of those requirements.

### **Response to briefing issue 2**

As discussed above, the answer to question 1 is no, and so the need for a response to briefing issue 2 is not reached. In the interest of completeness, however, Staff includes additional discussion below to provide to the Commission further information on these issues.

### **The Commission's order could include an express waiver.**

If the Commission believes it is necessary or appropriate to remove all ambiguity about the perception of conflicting decisions, it could include in its order a provision expressly stating that any transfers that CEHE undertakes to reflect a change in its authorized capital structure is not a violation of dividend-restriction provisions. For example, the Commission could add to its order a simple sentence such as, "A transfer of funds to CEHE's parent company for purposes of

moving CEHE to the Commission's authorized capital structure shall not constitute a violation of the dividend-restriction provisions contained in Finding of Fact XX."

The Commission's order could recognize that CEHE's move to its authorized capital structure may take time.

Commission orders do not set points in time at which utility companies must reach their authorized capital structure. This is because, as previously noted, there are no provisions in PURA or Commission rules that mandate that a regulated utility's actual capital structure equal its authorized capital structure. Because of the effects of normal, day-to-day business activities, deviations from authorized amounts of debt and equity are unavoidable. Moreover, in some proceedings, the Commission sets rates based on *hypothetical* capital structures. In CEHE's last rate proceeding (Docket No. 38339<sup>2</sup>), the Proposal for Decision expressly acknowledged this very point, when on page 35 it referenced an order in Docket No. 22344<sup>3</sup> that stated, "The Commission adopted and applied the hypothetical capital structure to newly unbundled TDUs beginning in 2001."

That deviations between authorized and actual capital structures exist as a matter of course for all utility companies is readily observable in both historical and current data. The table below shows information reflecting perhaps one of the more notable examples of this fundamental reality, as it lists the capital structures of the various TDU companies during the first two years after the opening on January 1, 2002 of the competitive electricity market in Texas. As part of the transition to the competitive environment, the Commission authorized in Docket No. 22344 a "generic" capital structure of 60% debt and 40% equity for the newly restructured TDUs subsequent to their divestment of generation assets. In the last paragraph on page 11 of its order filed December 22, 2000, the Commission stated that it

... finds that a capital structure of 60/40 debt to equity ratio is reasonable and that it will allow TDUs to attract sufficient capital at reasonable rates, while minimizing costs to the ratepayers. The Commission also finds that any increase

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<sup>2</sup> *Application of CenterPoint Energy Houston Electric, LLC for Authority to Change Rates*, Order on Rehearing (June 23, 2011).

<sup>3</sup> *Generic Issues Associated with Applications for Approval of Unbundled Cost of Service Rate Pursuant to PURA § 39.201 and Public Utility Commission Substantive Rule § 25.344*, Docket No. 22344, Order No. 42 at 11 (Dec. 18, 000).

in the financial risk due to the higher debt leverage is offset by the lower business risk faced by the TDUs. The Commission, therefore, adopts a 60% debt and 40% equity ratio as the capital structure for ratemaking purposes for Texas TDUs.

Accordingly, when the competitive electricity market opened in Texas on January 1, 2002, all the new TDU companies began charging rates based on authorized capital structures of 60% debt and 40% equity.

Two years later, however, none of those TDUs' *actual* capital structures, as reported in filed Commission earnings reports, matched the authorized 60/40 ratio. The table below shows this, as the upper portion of the table indicates each TDU's capital structure as reported in its earnings report one year after the opening of the market, and the lower portion shows the capital structures two years after the opening of the market.<sup>4</sup> As the information reveals, the actual capital structures varied widely—both in terms of changes from the first year to the second year, as well as in deviations from the authorized 60/40 ratio.<sup>5</sup>

**Capital Structures Reported in Year-end 2002 Earnings Reports (one year after start of deregulation)**

	<u>Oncor</u>	<u>CenterPoint</u>	<u>AEP Central</u>	<u>AEP North</u>	<u>TNMP</u>
Common Equity	36%	29%	69%	72%	42%
Long-term Debt	64%	71%		28%	28%
Short-term Debt			16%		31%
Preferred Trust Securities			15%		

**Capital Structures Reported in Year-end 2003 Earnings Reports (two years after start of deregulation)**

	<u>Oncor</u>	<u>CenterPoint</u>	<u>AEP Central</u>	<u>AEP North</u>	<u>TNMP</u>
Common Equity	42%	31%	pending rate case; did	42%	37%
Long-term Debt	58%	69%	not file report	58%	63%

Looking at recent examples, consider the information for the three Texas utility companies listed below:

<sup>4</sup> Staff did not review the earnings reports for other years around this time period, but believes the capital structure information for the first two years following the opening of the competitive market provides appropriately illustrative examples of differences between actual and authorized capital structures.

<sup>5</sup> The earnings reports for year-end 2002 and year-end 2003 are filed in Project Nos. 27312 and 29343, respectively.

	Authorized Capital Structure (Debt/Equity)	Actual Capital Structure (2018) (Debt/Equity)
Wind Energy Texas	60/40	54/46
Cross Transmission	60/40	62/38
Entergy Texas	49/51	46/54

The information in the tables above demonstrates that deviations between actual and authorized capital structures can be significant. A broad range of reasons can cause such deviations—business cycles, availability of cash, payment delinquencies, changes in tax policies, dividend activities, capital expenditures, and financing alternatives, to name just a few. The key takeaway of these data is that they are unambiguous illustrations of how there are no statutory provisions or Commission rules that require the actual and authorized capital structures of Texas electric utility companies to match. In fact, significant differences between a company’s authorized capital structure—that is, the proportions of debt and equity *used for the purpose of setting rates*—and its actual amounts are not unusual.

Accordingly, as a general administrative matter, Staff does not believe it is necessary for the Commission to explicitly provide to CEHE a degree of timing flexibility with regard to movement to a 60/40 capital structure. Nonetheless, should the Commission wish to do so, it could include a provision in its order that, instead of moving a sum of funds immediately, CEHE could take some period of time (for example, 12 months) for the company to move closer to its authorized capital structure.

CEHE can incorporate the effects of changes to its authorized capital structure into its planning for capital expenditures.

Another option for CEHE would be to use the alleged \$800 million “dividend” amount for capital expenditures. This would avoid the need to secure other financing of this amount. As part of the change to an authorized 60/40 capital structure, CEHE could coordinate its use of these equity funds with its needs for debt financing.

CEHE can use its access to CenterPoint Energy’s money pool to help facilitate moving to its authorized capital structure.

Similar to the point above regarding planning for capital spending (and as Diana Liebmann, representing H-E-B, LP, pointed out at the Commission's November 14, 2019 Open Meeting), CEHE could use its parent company's money pool as a means of helping to facilitate the move to the authorized capital structure. To this point, CenterPoint Energy, Inc.'s 2019 10K Report<sup>6</sup> includes the following statement on page 163:

Houston Electric and CERC participate in a money pool through which they can borrow or invest on a short-term basis. Funding needs are aggregated and external borrowing or investing is based on the net cash position. The net funding requirements of the money pool are expected to be met with borrowings under CenterPoint Energy's revolving credit facility or the sale of CenterPoint Energy's commercial paper.

#### Additional discussion

Finally, as a general matter, Staff is unclear on how CEHE's counsel arrived at the \$800 million figure that he indicated would be the dollar amount of the "dividend" necessary to move immediately to a 60/40 capital structure. Using the \$6.436 billion total capital-structure dollar amount of "Proposed" data that CEHE provided in Schedule II-C-2.1 of its filed application,<sup>7</sup> the amount of equity that CEHE would need to reallocate to debt in order to reach a 60/40 capital structure is not \$800 million, but approximately \$322 million. The data below illustrate the derivation of this figure.

<u>Total-Dollar Amount "Proposed"--From Schedule II-C-2.1 of CEHE's application</u>			
	<u>Amount (000s)</u>	<u>Proportion</u>	
Equity	\$2,896,247	45.00%	
Debt	\$3,539,857	55.00%	
	<b>\$6,436,104</b>	100.00%	
<u>Reallocate to 40% equity and 60% debt</u>			
	<u>Amount (000s)</u>	<u>Proportion</u>	<u>Reallocated Amt (000s)</u>
Equity	\$2,574,247	40.00%	<b>\$322,000</b>
Debt	\$3,861,857	60.00%	
	<b>\$6,436,104</b>	100.00%	

<sup>6</sup> The report is available at:

<http://investors.centerpointenergy.com/static-files/726ff078-d080-415f-a17a-4a52ba172c37>

<sup>7</sup> Schedule II-C-2.1 is included on Bates page 3875 of CEHE's application.

**Conclusion**

In summary, the answer to the Commission's briefing issue 1 is, no, CEHE's compliance with the Commission's tentative decision on CEHE's capital structure will not necessitate noncompliance with the Commission's decision on ring fencing. Consequently, the question in briefing issue 2 is not reached. Nonetheless, Staff has provided additional information it believes may be useful in the Commission's consideration of these matters.