

# NO. 08-0421

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IN THE SUPREME COURT OF TEXAS

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The State of Texas, by and through the Office of the Attorney General, Consumer Protection and Public Health Division, Public Agency Representation Section,

PETITIONERS,

vs.

Public Utility Commission of Texas,

RESPONDENT.

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ON APPEAL FROM THE COURT OF APPEALS FOR THE THIRD  
JUDICIAL DISTRICT OF TEXAS AT AUSTIN

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**CENTERPOINT'S REPLY TO THE PUC'S RESPONSE TO  
PETITIONS FOR REVIEW**

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CenterPoint Energy Houston Electric, LLC and Texas Genco, LP (collectively, “CenterPoint”) file this reply to the response to petitions for review filed by the Public Utility Commission of Texas (PUC). This reply addresses issue one of the response, in which the PUC attempts to defend the court of appeals’ reinstatement of its \$440 million reduction of CenterPoint’s capacity auction true-up balance. (*See* PUC’s Resp. 7-11.) The PUC’s remaining issues respond to the separate petitions filed by the State of Texas and the Joint Intervenors.

The PUC’s defense of the court of appeals’ capacity auction true-up holding consists primarily of repeating the court’s opinion. Strikingly, it offers no rebuttal to the several critical flaws in the court’s reasoning pointed out by CenterPoint. For example, the PUC offers no justification for the patent unfairness of basing a \$440 million disallowance on an alleged deficiency of \$5250—a “deficiency” that resulted solely from a lack of demand for the PUC-designed gas-intermediate product and the PUC’s initial insistence on an above-market minimum price. (CNP’s Pet. 6-7 & n.17, 12-15.) The order thus unreasonably penalizes Texas Genco \$440 million for doing nothing more than faithfully following the PUC’s capacity-auction rules every step of the way. As noted in CenterPoint’s petition but ignored by the PUC’s response, the PUC could have corrected for the effect of any perceived deficiency in the capacity auctions without contravening the plain text of the capacity auction true-up statute and rule, PURA § 39.262(d)(2) and Rule 25.263(i). (*See id.* at 14.)

The PUC also has no response to CenterPoint’s argument that the term “sell” in PURA § 39.153(a) cannot require the actual conveyance of 15% of Texas

Genco’s generation-capacity products because no seller can ensure that customers will actually buy everything it offers for sale. (*See id.* at 12-13.) The legislative purpose of the 15% requirement—to increase “the *availability* of generation”<sup>1</sup> to new retail electric providers (REPs)—was satisfied when Texas Genco offered the requisite 15% of its capacity to the market participants specified by PURA under terms and at prices approved by the PUC. *See* PURA § 39.153(c), (e)-(f). CenterPoint cannot be lawfully punished because there were simply no buyers for this product.

Next, the PUC only perfunctorily attempts to defend the court of appeals’ wildly inaccurate statement that PURA § 39.262(d)(2) and Rule 25.263(i) make “explicit reference to the 15% requirement.” 252 S.W.3d at 52. This premise, which underpins the court’s conclusion that the true-up formula is conditioned on compliance with the separate 15% requirement, *id.*, is simply wrong.

The PUC’s response also sidesteps the most glaring defect in the court of appeals’ affirmance of its conduct: the wholesale disregard of the Legislature’s deliberate decision to base the capacity auction true-up on capacity-auction prices. In arguing that it was entitled to revise the legislative formula, the PUC relies on an assertion that the “[p]rices the utility obtained through its inadequate capacity auction failed to reflect the market price of power during the first two years of competition.” (PUC’s Resp. 10.) It is true that “[t]he Legislature was . . . concerned that distortions and fluctuations in the market price of power during the first two years of deregulation could harm consumers

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<sup>1</sup> 16 TEX. ADMIN. CODE § 25.381(b) (emphasis added).

and generation companies alike. The Legislature accordingly designed the capacity auction true-up proceeding because of the likelihood that no stable market would exist until up to two years after the first day of deregulation.” *CenterPoint Energy, Inc. v. Pub. Util. Comm’n of Tex.*, 143 S.W.3d 81, 96 (Tex. 2004). But unlike in the stranded-cost context,<sup>2</sup> the Legislature did not direct the PUC to use broad market values or prices to calculate the capacity auction true-up. Nor did it tell the PUC to use capacity-auction prices only if the PUC found that they mirrored the broader market. Instead, the Legislature unambiguously mandated that the calculation be based on “the price of power obtained through the capacity auctions”<sup>3</sup>—a transparent, PUC-supervised market that specifically excluded affiliate transactions. PURA § 39.153(c).

Reiterating the court of appeals’ reasoning, the PUC claims that it had to deviate from the statute’s plain text to effectuate the Legislature’s intent that utilities “receive no more and no less than a margin predetermined by the Commission in 2001 when the ECOM model was run.” (PUC’s Resp. 9 (quoting *CenterPoint Energy*, 143 S.W.3d at 96).) *See* 252 S.W.3d at 56. But again, this reasoning ignores the fact that the Legislature (and the PUC in its own rule) chose to use the capacity-auction prices to calculate the margin it wanted the utility to achieve. This scheme reflects the legislative choice to provide a margin that was unaffected by either affiliate or private, non-

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<sup>2</sup> *Cf.* PURA § 39.251(7) (defining “stranded costs” as “the positive excess of the net book value of generation assets over the market value of the assets”); *id.* § 39.251(4) (broadly defining “market value” as “the value the assets would have if bought and sold in a bona fide third-party transaction or transactions on the open market”).

<sup>3</sup> PURA § 39.262(d)(2).

standardized transactions. Far from accomplishing the Legislature’s intent that CenterPoint “recover[] exactly the margin predicted,” (PUC’s Resp. 10), the PUC’s unauthorized tampering with the legislative and regulatory formula directly undermined that intent.

Thus, although it urges the Court not to grant the petitions, the PUC provides no substantive rationale why the Court should not review and correct the court of appeals’ distortion of the capacity auction true-up calculation, or the other errors in the court’s interpretation and application of the Legislature’s electric restructuring scheme raised by CenterPoint’s petition. And it concedes, in a spectacular understatement, that this case as a whole “involves large sums.” (*Id.* at 4.) Indeed, the \$3.7 billion total true-up balance at issue here, *see* 252 S.W.3d at 12, 14, is *\$1 billion greater* than the two true-up balances at issue in the AEP and Texas New Mexico Power (TNMP) appeals *combined*.<sup>4</sup> As a direct result of the true-up order, CenterPoint recorded a \$947 million after-tax write-off, which it believes to be one of the largest—if not the largest—non-nuclear disallowance ever suffered by a regulated utility.<sup>5</sup> In these extraordinary circumstances, the PUC’s contention that “the court of appeals thoroughly considered” the appeal is no consolation, much less a reason to deny review. (PUC’s Resp. 4.)

The PUC also exhorts the Court not to review the issues raised here

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<sup>4</sup> *See AEP Tex. Cent. Co. v. Pub. Util. Comm’n of Tex.*, 258 S.W.3d 272, 277 (Tex. App.—Austin 2008, pet. filed) (08-0634) (involving AEP’s request for “a total true-up balance of \$2,406,271,176”); *State v. Pub. Util. Comm’n of Tex.*, 246 S.W.3d 324, 329 (Tex. App.—Austin 2008, pet. filed) (08-0187) (involving TNMP’s request for true-up balance of \$373 million).

<sup>5</sup> CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC, QUARTERLY REPORT (FORM 10-Q), at 8 (August 13, 2008).

because they are “unlikely to arise in any subsequent cases.” (*Id.*) That there will not be any further true-up proceedings under the Texas Electric Choice Act of 1999 misses the import of the court of appeals’ decision. The true-up proceeding—and a utility’s right to recover a statutorily-delineated true-up balance in that proceeding—were integral parts of the Legislature’s comprehensive scheme to restructure the electric industry in Texas. *See CenterPoint Energy*, 143 S.W.3d at 83 (recognizing Legislature’s conclusion that “it was in the public interest for utilities to be made whole” for costs associated with transition to competition). By misinterpreting the Act and depriving CenterPoint of the recovery that the Legislature intended it to have, the court of appeals upset the delicate, policy-driven balance crafted by the Legislature, with ramifications not only for CenterPoint, its shareholders, and its ratepayers, but also for the way investors and financial markets view the stability and predictability of the regulatory process in Texas. This Court should grant review.

Respectfully submitted,

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I certify that a true and correct copy of CenterPoint's Reply to the PUC's Response to Petitions for Review was served on all counsel of record for Respondents listed below by certified mail on the 20th day of October, 2008.

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