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IN SUPREME COURT  
OF TEXAS

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No. 08-0421

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In The Supreme Court of Texas

TEXAS INDUSTRIAL ENERGY CONSUMERS,  
CITY OF HOUSTON AND COALITION OF CITIES,  
HOUSTON COUNCIL FOR HEALTH AND EDUCATION,  
GULF COAST COALITION OF CITIES

Joint Petitioners

v.

PUBLIC UTILITY COMMISSION OF TEXAS

Respondent

On Petition For Review From the  
Third Court of Appeals at Austin, Texas  
No. 03-05-00557-CV

JOINT REPLY TO THE PUBLIC UTILITY COMMISSION OF  
TEXAS'S RESPONSE TO PETITION FOR REVIEW

October 20, 2008

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Texas Industrial Energy  
Consumers

# No. 08-0421

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In The Supreme Court of Texas

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TO THE HONORABLE SUPREME COURT OF TEXAS:

Texas Industrial Energy Consumers, the City of Houston and Coalition of Cities, the Houston Council for Health and Education, and the Gulf Coast Coalition of Cities (“Customers”) submit this reply to the Response to Petitions for Review (“Response”) filed by the Public Utility Commission of Texas (“PUC” or “Commission”).

The Commission’s Response adds little in the form of new legal analysis or argument. Instead, the PUC asks this Court “not to grant the petitions for review, but to leave the court of appeals decision standing.” PUC Response at 5.<sup>1</sup> On the points of the PUC’s Response directed to Customers’ Joint Petition, the Commission continues to invent statutory authority for the stranded cost valuation method it fashioned out of whole cloth instead of using one of the legislatively required methods. On the issue of adjusting CenterPoint’s stranded cost for commercially unreasonable conduct, the Commission misses the Customers’ point entirely, rendering that portion of its Response of little use. If the Court grants any of the petitions, these errors should be addressed.

**I. The PUC lacked authority to fashion an extra-statutory valuation method for CenterPoint’s generation assets, especially since a statutorily approved method was available.**

Public Utility Regulatory Act (“PURA”) § 39.262(h) provides that stranded costs “shall” be quantified using one of four enumerated valuation methods, except as provided in PURA § 39.262(i), which provides a fifth valuation method for nuclear assets. Tex. Util. Code Ann. § 39.262(h-i) (Vernon 2007). CenterPoint attempted to use one of these five

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<sup>1</sup> This is one of a series of cases pending before this Court in which the Commission has consistently recommended that Petitions seeking review of the court of appeals’ decisions regarding the capacity auction true-up and the excess mitigation credits be denied. The other two such cases are *Texas-New Mexico Power Co. v. Pub. Util. Comm’n*, No. 08-0187 (Tex. filed Mar. 10, 2008), and *AEP Tex. Cent. Co. v. Pub. Util. Comm’n*, No. 08-0634 (Tex. filed Aug. 8, 2008).

methods—the Partial Stock Valuation (“PSV”) method—but failed to meet the requirements of that method. Slip op. at 28-29 (Customers’ Pet. App. C). Instead of using the Sale-of-Assets method (which was statutorily approved and available despite CenterPoint’s failure to successfully complete its chosen PSV method),<sup>2</sup> the Commission fashioned its own valuation method based on a report prepared by a panel of investment bankers employed by JPMorgan (“JPMorgan Panel”). *Id.* at 39. The arguments in favor of this *ad hoc* valuation method in the PUC’s Response do not cure this abuse of discretion.

Through its use of the word “shall” in the statute, the legislature clearly mandated that the Commission had a duty to use one of the five enumerated methods to calculate CenterPoint’s stranded costs. *See* Tex. Gov’t Code Ann. § 311.016(2) (Vernon 2004 & Supp. 2007). The PUC brushes this mandate aside, pointing to the “tremendous legislative emphasis placed on the need for stranded-cost recovery.” PUC Response at 12, quoting slip op. at 39. This argument is faulty, however, since it renders the detailed list of approved valuation methods in PURA § 39.262(h) meaningless and useless. *Liberty Mutual Ins. Co. v. Garrison Contractors, Inc.*, 966 S.W.2d. 482, 485 (Tex. 1998); *Hunter v. Fort Worth Capital Corp.*, 620 S.W.2d 547, 552 (Tex. 1981). This is especially true given that the statutorily approved Sale-of-Assets method was readily available.

The PUC incorrectly argues that it was not actually able to use the Sale-of-Assets method in the case below, despite the fact that CenterPoint entered into a detailed, binding agreement to sell its generating assets during the hearing. That document, which was admitted into the record, included the price CenterPoint received as a result of that sale,

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<sup>2</sup> The excess costs over market (“ECOM”) method was also available for CenterPoint’s share of the South Texas Nuclear Project. Tex. Util. Code Ann. § 39.262(i) (Vernon 2007).

which was the only input the PUC needed to employ the Sale-of-Assets method. The PUC relies on the court of appeals' conclusion that the Sale-of-Assets method required the generation assets to be sold prior to the stranded-cost reconciliation. PUC Response at 12. However, that conclusion is contradicted by the plain words of the statute. PURA § 39.262(h)(1) states that "If, *at any time after* December 31, 1999, an electric utility or its affiliated power generation company has sold some or all of its generation assets . . . the total net value realized from the sale establishes the market value of the generation assets sold." Tex. Util. Code Ann. § 39.262(h)(1) (Vernon 2007) (emphasis added). The statute provides no ending date for the time at which the sale must be completed, and the PUC's attempt to invent such an ending date should be rejected.

The undisputed fact is that CenterPoint entered into a binding agreement to sell its generating assets to a third-party in July 2004, during the course of the hearing. The transaction agreement was admitted into evidence, and the sale was finalized at the exact price set forth in the transaction agreement. Admin. R. Binder 43, COMM. Ex. 2. Given that this sale occurred "after December 31, 1999" and that evidence of the sale was included in the record below, there is no plausible argument that the Sale-of-Assets method was not available to value CenterPoint's stranded costs.

The overall stock value that CenterPoint actually received from the sale was significantly higher than the JPMorgan Panel estimate used by the Commission. *Id.* The Commission's decision to stray from the statutory methods in order to arrive at a hypothetical "market valuation" therefore resulted in customers being forced to pay CenterPoint \$366 million for costs that were not actually stranded. CenterPoint received

that \$366 million twice—once from the purchaser of the assets in the actual sale, and once again from its own customers. Not only was the Commission’s use of the JPMorgan Panel estimate without statutory support, it created a grossly inequitable result.

The PUC tries to buttress its use of an extra-statutory valuation method by arguing that it looked at the entire record (rather than just the JPMorgan Panel) to determine a value for the assets. PUC Response at 12. This argument is belied by the fact that the value chosen was the exact value proposed by the Panel and was lower than that recommended by all the cited ratepayer groups. Order at 20 (Customers’ Pet. App. A). Ultimately, however, it does not matter how the PUC arrived at its extra-statutory valuation. Since the Commission impermissibly ignored the legislature’s mandate and fashioned its own valuation method, Customer’s Petition should be granted and the Commission’s Order should be reversed.

**II. The Commission was required to account for CenterPoint’s commercially unreasonable decision to give its affiliate a free option to purchase its generation assets because of CenterPoint’s duty to mitigate its stranded costs.**

The PUC admits that CenterPoint acted in a commercially unreasonable manner when it decided to give its affiliate an option to purchase its generation assets without demanding any payment whatsoever. However, the PUC argues that it was not required to adjust CenterPoint’s stranded costs to account for that commercially unreasonable decision because the option did not affect the market value that CenterPoint ultimately received from the sale of those assets. PUC Response at 14. This argument entirely misses the point.

The legislature stated that the Commission’s purpose in the stranded cost proceeding was to determine the amount of CenterPoint’s “verifiable, *nonmitigable* stranded costs.” See Tex. Util. Code Ann. § 39.252(a) (Vernon 2007) (emphasis added). In order to properly

mitigate stranded costs under PURA, the court of appeals has held (and this Court has affirmed) that utilities must take all commercially reasonable steps to reduce their stranded costs. *Reliant Energy, Inc. v. Pub. Util. Comm'n*, 101 S.W.3d 129, 133 (Tex. App.—Austin 2003), *rev'd in part sub nom, CenterPoint Energy, Inc. v. Pub. Util. Comm'n*, 143 S.W.3d 81 (Tex. 2004). CenterPoint thus had a statutory duty to demand payment for the option and use that payment to reduce the book value of the assets, which would have mitigated its stranded costs. Since CenterPoint failed to do so, its stranded costs equal to the value of the option were, in fact, “mitigable” and not subject to recovery from ratepayers.

Since the promise of stranded cost recovery provided utilities an incentive to reduce the value of their assets following deregulation and prior to the stranded cost true-up, the legislature required utilities to “exercise normal business practice to protect the value of its assets.” Tex. Util. Code Ann. § 39.252(d) (Vernon 2007). Because CenterPoint failed to mitigate its stranded costs by securing payment for the option (as a commercially reasonable actor exercising normal business practices would have done), the Commission was required to reduce CenterPoint’s recovery by the \$330 million value of the option. Customer’s Joint Petition on this issue should be granted and the Commission’s Order should be reversed.

### **III. Conclusion and Prayer**

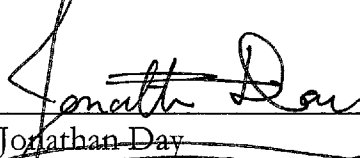
While the Commission is given great deference regarding the interpretation of PURA, it has no authority to circumvent statutory directives in favor of fashioning a method that it itself admitted was outside of the methods specified by the Legislature. Customers are mindful of the fact that the Commission has recommended that all petitions in this case be denied, including those issues presented in CenterPoint’s petition on which the Commission

and CenterPoint were aligned below. However, the Commission's decision to ignore both the statute and the arms-length market sale of Genco provided CenterPoint with a ratepayer-funded \$366 million windfall. Ratepayers should not be forced to shoulder this significant extra-statutory burden in addition to the almost \$2 billion dollars that they have been required to pay to CenterPoint for other deregulation-related costs.<sup>3</sup>

Customers hereby pray that their Joint Petition for Review be granted and the court of appeals' errors on the points raised in their Petition be reversed.

Respectfully Submitted,

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<sup>3</sup> Regarding the construction-work-in-progress issue addressed in the PUC's Response and the interest issue, Customers direct the Court to the discussion of Issues 3 and 4 in their Petition.

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**CERTIFICATE OF SERVICE**

I certify that I have served the foregoing Joint Reply to the PUC's Response to Petition for Review on counsel for the below parties, by Certified Mail Return Receipt Requested, on this 20th day of October 2008, as follows:



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