

NO. 08-0421

IN THE SUPREME COURT OF TEXAS

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.

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

CENTERPOINT'S REPLY TO RESPONSES TO CENTERPOINT'S BRIEF ON THE MERITS

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CenterPoint Energy Houston Electric, LLC and Texas Genco, LP (collectively, “CenterPoint”) file this reply to the response briefs filed by Joint Petitioners and Respondent the Public Utility Commission of Texas (PUC). Notably, the PUC does not dispute that the court of appeals erred in certain respects. (PUC Br. 64.) The PUC nevertheless suggests that the Court deny review because the PUC and the court of appeals did their best to “navigate[] the difficult waters of a new and complicated statute.” (*Id.* at 20.) But this point actually demonstrates the importance to the state’s jurisprudence of the court of appeals’ decision. This case involves the proper interpretation and application of the Legislature’s comprehensive scheme to restructure the Texas electric industry. The Legislature designed the true-up to ensure that utilities (and their shareholders) are made whole for the costs associated with the transition to competition. PURA § 39.001(b)(2). The assurances of an agency with no monetary stake in this litigation that it did its best is no consolation for a utility like CenterPoint, with hundreds of millions of dollars at stake,¹ or for the Texas consumers necessarily affected by this proceeding. The Court should grant review.

I. There is no valid reason to prevent CenterPoint from recouping \$385 million in excess mitigation credits it was wrongly ordered to pay to Reliant AREP.

Only Joint Petitioners still try to defend the court of appeals’ reversal of the PUC’s order allowing CenterPoint to recoup the \$385 million in EMCs it had been wrongly ordered to pay Reliant AREP. (*See* PUC Br. 64, 87 (agreeing that the court of

¹ As a result of the PUC’s decision, CenterPoint was required to take a \$947 million after-tax write-off. CENTERPOINT ENERGY HOUSTON ELECTRIC LLC, QUARTERLY REPORT (FORM 10-Q), at 8 (Aug. 13, 2008).

appeals’ EMCs holding was error and urging its reversal if the Court grants review).) But even they do not dispute several crucial truths about these EMCs. They do not dispute that the PUC’s order to pay EMCs to Reliant AREP was designed to, and did in fact, increase CenterPoint’s stranded costs by \$385 million. (*See* Jt. Pets. Resp. Br. 7 (“For every dollar of EMC payments made, CenterPoint wrote *up* its NBV by one dollar.”).) Joint Petitioners concede that the EMC order was illegal and that if the PUC had acted lawfully, CenterPoint would still have the \$385 million it was forced to pay. (*Id.* at 8 n.1). Nor do they dispute that both CenterPoint and Reliant AREP complied with all PUC orders and rules governing EMCs.

Instead, Joint Petitioners offer two primary arguments, both adopted by the court of appeals, for why they believe CenterPoint should be “penalize[d] . . . for following a Commission order” (CNP Br. App. B at 74), when the PUC itself expressly declined to do so: (1) Reliant AREP was technically CenterPoint’s “Joint Applicant” and “affiliate” during the true-up, and (2) Reliant AREP did not pass EMCs through to consumers. Neither point justifies denying CenterPoint its full stranded-cost recovery.

A. The undisputed illegality of the EMCs justifies CenterPoint’s recoupment of EMCs paid to Reliant AREP.

Joint Petitioners, the PUC, and CenterPoint all agree that the PUC’s 2001 order requiring CenterPoint to pay EMCs was unlawful. The only question is whether CenterPoint can recoup the EMCs it was unlawfully forced to pay Reliant AREP, and which indisputably increased CenterPoint’s stranded costs.

Joint Petitioners criticize CenterPoint for its “fixation on the illegality” of

EMCs. (Jt. Pets. Resp. Br. 8.) But the EMCs’ illegality goes to the heart of the issue for at least two reasons. First, agencies have broad discretion to provide remedies to those who incurred losses because of an order later held unlawful, as the PUC did here.² Joint Petitioners completely ignore this bedrock principle of administrative law. Having erroneously ordered the payment of EMCs to all REPs—including Reliant AREP—the PUC reasonably exercised its discretion to remedy its unlawful EMC order by allowing CenterPoint to recoup EMCs paid to all REPs—including Reliant AREP. The PUC’s reasonable exercise of its undisputed discretion alone requires reversal with respect to EMCs.

Second, contrary to Joint Petitioners’ unsupported assertion, (*id.* at 8-9), common sense dictates that the Legislature never intended to prohibit the recoupment of EMCs, because it had never authorized the PUC to order payment of EMCs in the first place. Indeed, Section 39.262(a) explicitly provides that a prohibited “overrecover[y] [of] stranded costs” can occur only “through the procedures established by this section or through the application of the measures provided by the other sections of this chapter.” The *extrastatutory* payment of EMCs was neither. Consequently, Section 39.262(a) does not and cannot reflect an intent to prohibit the recoupment of EMCs paid to Reliant AREP.

² See *United Gas Improvement Co. v. Callery Props., Inc.*, 382 U.S. 223, 229 (1965) (“An agency, like a court, can undo what is wrongfully done by virtue of its order.”); *Sw. Bell Tel. Co. v. PUC*, 615 S.W.2d 947, 954 (Tex. Civ. App.—Austin 1981, writ ref’d n.r.e.) (concluding that agency has discretion to remedy effects of unlawful order).

B. Reliant AREP’s technical status as a “Joint Applicant” or “affiliate” does not make CenterPoint’s recoupment of EMCs paid to Reliant AREP an “overrecovery” within the meaning of PURA § 39.262(a).

That Reliant AREP and CenterPoint were “Joint Applicants” and statutory “affiliates” at the time of the true-up filing is irrelevant to the overrecovery question. (*See* Jt. Pets. Resp. Br. 10-15.) Neither of these facts changes the PUC’s discretion to remedy its unlawful EMC order. Nor do they overcome the total absence of legislative intent to prohibit recoupment of EMC payments that undisputedly increased CenterPoint’s stranded costs. Even setting aside those dispositive reasons, Reliant AREP’s former technical relationship to CenterPoint provides no basis for denying recoupment of EMCs paid to Reliant AREP.

Reliant AREP’s technical status as a Joint Applicant does not mean that CenterPoint and Reliant AREP should be treated as a “single unit” in determining whether CenterPoint’s recoupment of EMCs would constitute an overrecovery of stranded costs under PURA § 39.262(a). These companies, along with Texas Genco, were Joint Applicants simply because PURA required them to jointly file a true-up application. PURA § 39.262(c); *accord* 16 TEX. ADMIN. CODE § 25.263(d)(1). This joint-filing requirement merely allowed the PUC to conveniently address in one proceeding all of the companies unbundled from the formerly integrated utility, Old Reliant. This procedural convenience does not alter the fact that CenterPoint and Reliant AREP are separate companies that must be treated as such for purposes of EMC recoupment.

Indeed, before the true-up proceeding, both the PUC and Joint Petitioners

consistently treated CenterPoint and Reliant AREP as separate companies for purposes of EMCs. At Joint Petitioners' behest, the PUC ordered CenterPoint to pay EMCs to its REPs (including Reliant AREP) for the express purpose of increasing CenterPoint's net book value. (Jt. Pets. Resp. Br. 7.) The PUC (and Joint Petitioners) correctly believed that CenterPoint's \$385 million EMC payment to Reliant AREP would affect CenterPoint's stranded costs by that amount. Just as it treated CenterPoint and Reliant AREP as separate entities when it improperly ordered the EMCs, the PUC properly treated CenterPoint and Reliant AREP as separate entities when it remedied its prior unlawful order by allowing CenterPoint to recoup \$385 million in stranded costs it undeniably incurred. Joint Petitioners never explain why the PUC's order—issued at their own request—requiring EMCs to Reliant AREP should be treated as a meaningless transfer within a single unit that did not affect CenterPoint's stranded costs.

The reference to the three Joint Applicants in PURA § 39.262(a) similarly does not require artificially treating CenterPoint and Reliant as a single unit for EMC purposes. As noted above, PURA § 39.262(a) provides that an overrecovery is not caused merely by recouping payments—such as EMCs—that were neither “established by this section” nor “provided by the other sections of this chapter.” (*See Part I.A supra.*) The statute also only prohibits “an overrecovery [of] *stranded costs*,” PURA § 39.262(a) (emphasis added), and as a matter of law, Reliant AREP's receipt of EMCs did not constitute a recovery of stranded costs by Reliant AREP. (CNP Br. 20.) Reliant AREP received EMCs from CenterPoint not as a form of stranded-cost recovery, but as part of a misguided PUC scheme to *prevent an overrecovery of stranded costs by CenterPoint*.

Reliant AREP’s statutory classification as CenterPoint’s “affiliate” at the time of the true-up likewise adds nothing to Joint Petitioners’ bid to treat them as one company for EMC purposes. (Jt. Pets. Resp. Br. 11.) Under PURA § 11.003(2)(D)(ii), affiliates include corporations that share a mere 5% of common stock ownership. Under this definition, CenterPoint was considered an affiliate of Reliant AREP, Wendy’s Restaurants—and even certain Joint Petitioners—because the same mutual fund owned 5% or more of each company.³ But affiliate status under PURA § 11.003(2) is relevant only to certain PURA provisions prohibiting affiliates from giving each other preferential treatment. *See* PURA §§ 36.058, 39.157(d); *see also* 16 TEX. ADMIN. CODE §§ 25.272-.273. It certainly does not require treating completely independent companies as a “single unit” for purposes of recouping PUC-mandated EMCs that the Legislature never even contemplated when it enacted PURA.⁴

Joint Petitioners never contest the hard evidence that CenterPoint and Reliant have operated as separate companies since January 1, 2002, and have been fully independent of each other since October 2002. (Binder 25, CNP Ex. 18 at 4-5 & Fig. JBM-2; *see also* PUC Br. 65.) Instead, Joint Petitioners embark on a three-page digression concerning the unbundling of Old Reliant and early operation of New Reliant (Reliant AREP’s parent) that has absolutely no relevance to whether CenterPoint and New Reliant were (and are) separate companies. (Jt. Pets. Resp. Br. 12-15.) It aims

³ In 2005, the Legislature clarified that companies would no longer be considered affiliates as a result of common ownership by a mutual fund. *See* PURA § 11.0042.

⁴ Thus, the fact that CenterPoint withdrew a motion for reconsideration of its “affiliate” status under PURA § 11.003(2) has no bearing on the issues here. (Jt. Pets. Resp. Br. 11.)

instead to defame New Reliant by associating it with Enron and referencing a criminal indictment that was dismissed. Joint Petitioners' diversionary tactics only underscore the complete lack of merit to their argument in support of the court of appeals' EMC holding.

C. Reliant AREP's inability to pass EMCs through to its Price-to-Beat customers provides no basis to penalize CenterPoint.

Contrary to what Joint Petitioners suggest, Reliant AREP's "retention" of the EMCs, rather than passing them through to ratepayers, does not mean that CenterPoint's recoupment of the EMCs would "requir[e] ratepayers to pay \$385 million twice." (Jt. Pets. Resp. Br. 15-16.) Joint Petitioners' lone paragraph of substantive argument on this issue completely fails to respond to CenterPoint's brief on the merits. (CNP Br. 20-22.)

The statutory touchstone for whether EMCs are recoverable as stranded costs is not whether they were passed on to ratepayers, but whether they increased the net book value of CenterPoint's generation assets. Joint Petitioners concede that the EMCs paid to Reliant undeniably did just that. (Jt Pets. Resp. Br. 7; CNP Br. App. B at 166 FOF 375; Binder 25, CNP Ex. 18 at 14-15.) Indeed, Joint Petitioners do not challenge CenterPoint's recoupment of EMCs paid to other REPs, even though those REPs, like Reliant AREP, were not required to return EMCs to ratepayers,⁵ and Joint Petitioners can only speculate whether they did so. (Jt. Pets. Resp. Br. 7.)

Just as importantly, Joint Petitioners conveniently omit the reason why the PUC expressly prohibited Reliant AREP from passing EMCs through to its customers—

⁵ (CNP Br. App. B at 74, 167 FOF 383.) 252 S.W.3d at 37.

because doing so would conflict with the Price-to-Beat statute, PURA § 39.202. (CNP Br. App. B at 166 FOF 373-74, 167 FOF 384.) The PUC reasoned that allowing new REPs to pass through EMCs—while prohibiting AREPs like Reliant AREP from doing so—would enable those new REPs to use lower prices to lure customers away from AREPs, thus increasing competition and providing consumer benefits. (See CNP Br. 21-22; *accord* PUC Br. 64-65.) Reliant AREP’s retention of EMCs was an integral part of the PUC’s plan—in accord with legislative intent—to increase competition and benefit all customers. Even if consumer harm could justify prohibiting CenterPoint from recouping EMCs paid to Reliant AREP, Joint Petitioners cannot show that any such harm occurred.⁶

II. CenterPoint is entitled to enforcement of the capacity auction true-up statute and rule as written.

A. The PUC had no authority to tamper with the legislative and regulatory formula for the capacity auction true-up, regardless of whether Texas Genco met the separate 15% requirement or safe-harbor provision.

Neither the PUC nor Joint Petitioners seriously dispute that the PUC reduced CenterPoint’s capacity auction true-up balance by \$440 million because Texas Genco could not find a buyer at the capacity auctions for \$5,250 in gas-intermediate

⁶ Joint Petitioners relegate to a footnote their once-central argument that CenterPoint and New Reliant should have “addressed the allocation of responsibility” for EMCs in the business separation plan (BSP). (Jt. Pets. Resp. Br. 8 & n.2; *compare* Intervenors Resp. to Pet. 5-6.) Absent time travel or preternatural foresight, this was impossible because the PUC did not order EMCs until October 3, 2001, (CNP Br. App. E; *see id.* App. B at 165 FOF 371-72), nearly two years after Old Reliant filed its BSP application on January 10, 2000, *see* PUC Docket No. 21956, Application of Reliant Energy, Inc. for Approval of Business Separation Plan (Jan. 10, 2000), and several months after the PUC approved the BSP as amended. *Id.*, Order on Rehearing (May 25, 2001) (“BSP Order”).

product. Instead, they argue that the PUC had the implied power to order an enormous disallowance based on a minor “deficiency”—or even to disallow recovery altogether—because the capacity auction true-up statute, PURA § 39.262(d)(2), is conditioned on compliance with either the 15% requirement in PURA § 39.153(a) or the safe-harbor provision in Rule 25.381(h)(1)(B)(iv) and (7)(C). (PUC Br. 75-76; Jt. Pets. Resp. Br. 24-25.) While they purport to base this contention on the literal text of PURA § 39.262(d)(2), it is indisputable that the statute does not specifically refer to either the 15% requirement or PURA § 39.153(a), much less condition the capacity auction true-up on compliance with the 15% requirement. (*See* CNP Br. 24 & n.35.) The PUC tacitly concedes as much, admitting that “neither the statute nor the rule specified what action the PUC should take if the 15% auction requirement were not met.” (PUC Br. 75; *see* CNP Br. App. B at 105.) And contrary to Joint Petitioners’ contention, the mere fact that PURA §§ 39.262(d)(2) and 39.153(a) deal with “the same general subject matter” does not justify subordinating use of the first statute’s formula to the satisfaction of the second statute’s requirements. (Jt. Pets. Resp. Br. 24.)

The PUC’s and Joint Petitioners’ real argument, then, is that such a condition should be *implied* into unambiguous PURA § 39.262(d)(2) in contravention of its plain text as well as Rule 25.263(i) as written. Their argument, however, reflects nothing more than their fundamental disagreement with the Legislature’s deliberate decision to true-up to the utility’s “capacity auction prices,” instead of a different reference point, i.e., the prices of all products sold. The PUC and Joint Petitioners both treat this legislative mandate as hortatory language that should be disregarded whenever

they believe capacity auction prices do not serve as an accurate “proxy for the market price of power.” (Jt. Pets. Resp. Br. 25; *see* PUC Br. 78; CNP Br. App. B at 107.) But they cite no evidence that the Legislature intended capacity auction prices to serve as a mere proxy for prices in an altogether different market. Nor is there any evidence that the Legislature intended that the use of capacity auction prices in calculating the capacity auction true-up would somehow be optional if they diverged from the prices in this different market.

On the contrary, the use of capacity auction prices plainly reflects a legislative choice to base the capacity auction true-up on prices from the transparent, PUC-supervised market, which involved uniform terms and conditions and which excluded affiliate and other private, non-standardized transactions. By choosing this particular market, the Legislature facilitated price comparisons and eliminated any risk of affiliate manipulation. Texas Genco’s capacity auction prices accurately reflect this market, regardless of whether the 15% requirement was met. (*See* 6/22/04 Tr. (Tees) at 757-58 (testifying that Texas Genco’s capacity auction prices accurately reflected prices in a market that excluded its AREP).)

Thus, even if Texas Genco had not met the 15% requirement or safe-harbor provision, which as discussed below it did, PURA did not authorize the PUC’s reduction of CenterPoint’s capacity auction true-up award. The PUC complains that “CenterPoint does not want the PUC to be powerless, they merely desire a different result.” (PUC Br. 77.) On the contrary, CenterPoint’s position is that whatever implied powers the PUC might have to address any failure to comply with the capacity auction requirements, they

cannot extend to rewriting the unambiguous text of PURA § 39.262(d)(2) and Rule 25.263(i) and subverting the Legislature’s intent to base the capacity auction true-up on prices from a specific market.⁷

The PUC’s disregard of the statutory and regulatory formula also finds no support in Joint Petitioners’ “windfall” theory that “[f]ailing to meet the 15% sales requirement results in a downward bias of the capacity auction price used in the true-up, thereby causing an overstatement of the capacity-auction true-up amount.”⁸ As the court of appeals recognized, the safe-harbor provision in Rule 25.381(h) expressly contemplates that a utility can sell “significantly less than 15% of the entitlements” and still be deemed in compliance with PURA § 39.153(a). 252 S.W.3d at 49; *cf. id.* at 57 (stating that Texas Genco “sold significantly fewer entitlements than was required under the utilities code”).⁹

⁷ Both problems would have been avoided if, for example, the PUC had instead imputed the prices of the seven gas-intermediate product entitlements that were actually sold in the November 2003 auction to the remaining unsold 21 entitlements. The evidence shows, as one would expect, that the impact of such action on the capacity auction true-up calculation would be de minimis. (Binder 47, OPC Ex. 5 (Falkenberg Dir.) at 24-25; Binder 29, CNP Ex. 34 (Purdue Reb.) at 7-8.)

⁸ (CNP Br. App. B at 107, 179 FOF 506; *see* Jt. Pets. Resp. Br. 22, 26-27; PUC Br. 75.) *See also* 252 S.W.3d at 58 n.46.

⁹ Similarly, other statutory and regulatory provisions implicitly contemplate that a utility required to conduct a capacity auction true-up might not have sales of the full 15% of its capacity for all of 2002 and 2003 to input into the formula. *See, e.g.*, PURA § 39.153(b) (providing that utility’s obligation to conduct capacity auctions will terminate prematurely if “40 percent or more of the electric power consumed by residential and small commercial customers within the affiliated transmission and distribution utility’s certificated service area before the onset of customer choice is provided by nonaffiliated retail electric providers”); 16 TEX. ADMIN. CODE § 25.381(d) (“Divestiture of a portion of an affiliated PGC’s Texas jurisdictional installed generation capacity will be counted toward satisfaction of the affiliated PGC’s capacity auction requirement . . .”).

Thus, the PUC’s and Joint Petitioners’ “downward bias” argument is necessarily premised on an alleged inherent problem in the capacity auction true-up formula itself—and in particular its reliance on an average “capacity auction price”—that purportedly causes it to “malfunction” whenever a utility fails to sell all 15% of its capacity—even if the utility meets the safe-harbor provision. (Jt. Pets. Resp. Br. 25.) As Joint Petitioners previously acknowledged, “even if CenterPoint had sold an additional few thousand dollars worth of gas products in order to meet the Safe Harbor provision, the formula would still have dramatically malfunctioned.” (Intervenors’ Post-Submission Ct. App. Br. 3 (Feb. 5, 2007).)¹⁰

This is a belated complaint that the formula is defective as written and can cause a “windfall” even when a utility follows the PUC’s rules for conducting the capacity auctions. (See Binder 50, TIEC Ex. 1 (Pollock) at 35 (opining that “there is an inherent mismatch in the capacity auction true-up formula itself, which, if not corrected will result in a windfall of over \$400 million”).) Joint Petitioners’ attack on the validity of Rule 25.263(i)(1) cannot be made as part of this true-up proceeding because the time to appeal the rule’s adoption is long expired. If Joint Petitioners believed that the formula in the capacity auction true-up rule malfunctioned whenever a utility complied with the safe-harbor provision instead of selling a full 15% of its capacity, they should have timely appealed the adoption of the rule. See PURA § 39.001(f) (“A person who

¹⁰ (See also Binder 47, OPC Ex. 5 at 25 & Binder 51, vol. Q at 2715-16 (OPC witness Randall Falkenberg) (opining that the “problem with the formula” cannot be addressed by imputing enough sales to Texas Genco to bring it into compliance with the safe-harbor provision).)

challenges the validity of a competition rule must file a notice of appeal with the court of appeals and serve the notice on the commission not later than the 15th day after the date on which the rule as adopted is published in the Texas Register. . . .”).¹¹ Thus, the PUC and the court of appeals were barred from accepting this backdoor challenge to the rule. *See City of Alvin v. PUC*, 143 S.W.3d 872, 880 (Tex. App.—Austin 2004, no pet.) (affirming dismissal of challenges to competition rule not timely brought under PURA § 39.001(f) because “[t]he statute does not provide that persons challenging the validity of a rule may wait until the rule is applied to them before challenging the validity of its terms under another provision”). The court further erred in upholding the PUC’s alleged “fix” for the perceived problem that deviated not only from the rule, but also from PURA § 39.262(d)(2)’s required use of “the price of power obtained through the capacity auctions.”

Finally, the PUC suggests that, regardless of any statutory or regulatory support for its decision, its actions were justified because “the PUC did precisely what CenterPoint asked it to do in its April 2003 request; it used non-PUC auction prices in the capacity auction true-up.” (PUC Br. 78.) But the PUC’s suggestion that it did only what CenterPoint requested is directly contradicted by the PUC’s own order, which expressly found that “[Texas Genco] did not request the use of the non-PUC auction prices in the

¹¹ Instead, certain Joint Petitioners unsuccessfully attempted—just months before the true-up—to persuade the PUC to amend Rule 25.263(i) to accomplish the same result as the order now on appeal. (*See* Binder 35, CNP Ex. 136.) When the PUC refused to amend the rule, it knew about the lack of demand for gas-intermediate product at the 2003 capacity auctions. (Binder 51, vol. N at 1840-41, vol. P at 2483-84.)

capacity auction true-up.” (CNP Br. App. B at 108; *see also* 6/25/04 Tr. (Goins) at 1527-28.)

Instead, Texas Genco’s April 2003 proposal asked the PUC to find the 15% requirement met because when both the PUC and private auctions were considered, “the Company sold more than 15% of its Texas installed generation capacity *to parties other than its affiliated retail electric provider* in January 2003 and each of the months of June through August 2003.”¹² The proposal informed the PUC that “[t]his action will have no effect on the [capacity auction true-up] because . . . only PUC auction prices are used in this calculation” and “Texas Genco proposes using the non-PUC auctions solely for satisfying the 15% requirement and for no other purpose.” PUC Docket No. 27744, Texas Genco, LP’s Request for Ruling That the Company Has Met Its Obligation Under PURA § 39.153(a), at 6-7 (April 23, 2003). Thus, CenterPoint has always insisted on its right to a capacity auction true-up balance precisely calculated under the statute and rule as written, and the court of appeals erred in upholding the PUC’s refusal to award such a balance.

B. The PUC’s and Joint Petitioners’ arguments why Texas Genco did not meet the 15% requirement or safe-harbor provision lack any support in either PURA or the record.

The PUC and Joint Petitioners offer several unsatisfying rationales why Texas Genco’s significant good-faith efforts to sell the PUC-designed capacity products were insufficient to meet either the 15% requirement or the safe-harbor provision. It is

¹² (Binder 25, CNP Ex. 21, Att. DGT-4 at 5 (emphasis added); *see* CNP Br. App. B at 108.)

undisputed that Texas Genco offered at auction the full 15% of its capacity in both 2002 and 2003. Nevertheless, the PUC dismisses this evidence and asserts, without any support, that when the Legislature enacted PURA § 39.153(a), it “was . . . looking for . . . a robust market that actually resulted in the benefits of competition,” and “[t]o accomplish that, capacity must not be merely offered, it must be sold.” (PUC Br. 73.) Even assuming the PUC is right about the Legislature’s intent, it still cannot explain why offering the full 15% of Texas Genco’s generation capacity to new REPs at drastically low prices did not accomplish “the benefits of competition.” *See* 16 TEX. ADMIN. CODE § 25.381(b) (stating 15% requirement’s purpose as “increased availability of generation”). Certainly an absence of competition cannot be inferred from a mere lack of demand for the capacity products as they were designed by the PUC.¹³

The PUC’s belated criticism of how Texas Genco conducted the PUC auctions, which is based on the fact Texas Genco products sold for higher average prices in the private auctions than in the PUC auctions, cannot be squared with the PUC’s prior orders and conduct. The PUC now claims “[i]t is apparent that CenterPoint knew what features would make the product sell, but failed to promptly employ them in the PUC auctions.” (PUC Br. 74; *see also* Jt. Pets. Resp. Br. 23.) But the PUC’s order never blamed the lack of buyers at the PUC auctions on Texas Genco’s failure to offer capacity

¹³ Joint Petitioners claim that offering capacity cannot constitute compliance with the statute because otherwise “a utility could offer capacity for sale at a price or pursuant to terms and conditions that no REP would find appealing,” thus undermining the legislative goal of making generation available to new REPs. (Jt. Pets. Resp. Br. 20.) This is one of several implausible “worst-case-scenario” arguments in Joint Petitioners’ response that has no basis in fact or law, given the PUC’s strict control of all facets of the capacity auction.

auction products identical to those offered in the private auctions. Such a finding would have been quite strange, given that the PUC designed and controlled every aspect of the products, and Texas Genco had much less flexibility to modify prices and products in the PUC auctions as compared to private auctions. (*See* 6/22/04 Tr. (Tees) at 755-56; Binder 25, CNP Ex. 21, Att. DGT-4 at 8.) The PUC’s newfound negative inference from the higher average prices in the private auctions is unreasonable in light of this fact, and the fact that Reliant AREP, the largest purchaser of generation in the area, (Binder 29, CNP Ex. 33 at 28-29), was statutorily prohibited from buying capacity at the PUC auctions, which greatly suppressed demand and prices. PURA § 39.153(c).¹⁴

The PUC and Joint Petitioners also fault Texas Genco’s efforts to modify the terms of the capacity auction, with the PUC claiming that “the proposal to drastically reduce the price came too late in the season to be effective.” (PUC Br. 74; *see also* Jt. Pets. Resp. Br. 23.) The PUC conveniently ignores the fact that Texas Genco proposed a minimum price of \$0/kWm for all product categories *before the very first auction* in September 2001, but the PUC Staff objected.¹⁵ The PUC’s criticism is doubly ironic because the PUC sat on the April 2003 proposal for months, until it became moot and had

¹⁴ The PUC selectively quotes CCR witness Dennis Goins’s testimony discussing “Genco’s success at making its own products more attractive” to omit an important conclusion: “RRI was eligible to bid in the TGN auction, but not the PUC auction. As a result, TGN was somewhat more successful selling its gas-fired intermediate, cyclic and peaking products (primarily to RRI) in their company auctions compared to the PUC auction.” (CCR Ex. 2 at 14; *see* PUC Br. 74.)

¹⁵ PUC Docket No. 23774, Reliant Energy, Incorporated’s Notice of Capacity Auction Concluding on September 1, 2001, at 6 (“Reliant Energy has proposed that the opening bid price for all Entitlements will be zero dollars per kW-month (\$0/kW-month).”) (July 3, 2001). (*See also* Binder 25, CNP Ex. 21, Att. DGT-4 at 4.)

to be withdrawn.¹⁶

The PUC's insinuation that Texas Genco wanted "to get as close as possible to the minimum capacity-auction prices that the safe-harbor provisions would allow" in order to inflate the capacity auction true-up award, (PUC Br. 76), has no basis in either the PUC's order or the record. There is no finding, much less any evidence, that Texas Genco acted in anything other than good faith in conducting the capacity auctions.

Finally, the PUC's order cannot be supported by Texas Genco's purported failure to meet the safe-harbor provision for 2002, when the order was premised on a finding that Texas Genco failed to meet the safe-harbor provision for 2003. (Jt. Pets. Resp. Br. 22.) Joint Petitioners' argument to the contrary, which the PUC does not make, is a red herring. Joint Petitioners argue that the safe-harbor provision in Rule 25.381(h) was not adopted until August 2002,¹⁷ but they completely ignore two PUC orders that predated the rule and adopted the following safe-harbor provision for 2002: "Upon completion of the initial auction, if all of the offered auction entitlements are awarded for a given month the seller shall be deemed to have met the 15% requirement."¹⁸ Joint

¹⁶ (Binder 25, CNP Ex. 21, Att. DGT-4 at 6.)

¹⁷ By contrast, the PUC now concedes that the safe harbors were in effect for all of 2002. (PUC Br. 17-18 & n.7.)

¹⁸ PUC Docket No. 23774, Revised Stipulation and Agreement Regarding Capacity Auction Mechanics and Joint Motion for Reconsideration of Interim Order, Ex. A at 1, § 4(a) (Aug. 9, 2001); *see id.*, Order at 18, 22 (Sept. 6, 2001) (approving stipulation and providing that it will "govern[] the auction and use of capacity auction products in the statutorily required 15% capacity auctions"); *see also* PUC Docket No. 24888, Non-Unanimous Stipulation and Agreement Regarding March and July 2002 Capacity Auction Mechanics and Joint Motion for Good Cause Exception (Stipulation), Ex. A at 2, § 5(a) (Dec. 5, 2001) ("Upon completion of the initial auction, if all of the offered auction Entitlements are awarded for a given month the Seller shall be deemed to have met the 15% requirement."); *id.*, Order at 11 (Feb. 7, 2002) (approving

Petitioners also ignore the PUC’s finding that “[i]n 2002, TGN offered products in all product categories and successfully sold all of the entitlements offered in one particular month for each product category.” (CNP Br. App. B at 103; *accord* 6/25/04 Tr. (Goins) at 1516 (conceding that Texas Genco met the safe-harbor provision for 2002).) And the only evidence Joint Petitioners cite is the testimony of David Tees, who repeatedly explained that *Texas Genco met the 2002 safe-harbor provision*. (See Binder 25, CNP Ex. 21, Att. DGT-4 at 3, 25, Tables DGT-4A & 4B; Binder 29, CNP Ex. 33 at 15-16.)¹⁹

III. CenterPoint properly used the Partial Stock Valuation method to establish the market value of its generation assets.

A utility successfully uses the Partial Stock Valuation (PSV) method if “at least 19 percent, but less than 51 percent, of the common stock of [the generation] company is spun off and sold to public investors through a national stock exchange.” PURA § 39.262(h)(3). It is undisputed that CenterPoint validly distributed (“spun off”) 19.04% of Texas Genco stock to CenterPoint shareholders and that the stock subsequently traded on the NYSE, thereby establishing an accurate market valuation. The only question is whether CenterPoint also had to somehow guarantee that at least 19% of individual Texas Genco shares—i.e., virtually every one of the 15.2 million shares spun off—changed hands between each CenterPoint shareholder and investors on the NYSE. The statute should not be read to impose this impossible condition on

stipulation and providing that it will “govern[] the auction and use of capacity auction products in the statutorily required 15% capacity auctions”).

¹⁹ For example, Tees’s Table DGT-4A, cited by Joint Petitioners, shows that at the March 2002 auction, Texas Genco sold all offerings in all product categories for the month of July 2002. (Binder 25, CNP Ex. 21, Att. DGT-4, Table DGT-4A.)

CenterPoint.

A. The statute’s plain text does not require CenterPoint to guarantee that virtually all individual Texas Genco shareholders trade their shares.

The central statutory-interpretation issue is whether the 19%-minimum requirement modifies both “[1] spun off and [2] sold . . . through a national stock exchange.” PURA § 39.262(h)(3) (bracketed numbers added). To state that proposition is to answer it. While CenterPoint alone has the ability to “sp[i]n off” 19% of Texas Genco stock, it lacks the corresponding ability to ensure that the same 19% of shares are “sold . . . through a national stock exchange” by each shareholder after the spin-off. Recipients of the spun-off stock—not CenterPoint—are the ones who traded individual Texas Genco shares on the NYSE. The statute does not impose on CenterPoint an impossible requirement to force shareholders to trade all 19% of distributed stock. Rather, read in context and in accord with the evident legislative intent, it requires CenterPoint to spin off at least 19% of Texas Genco shares and then list them on a national stock exchange so that they can be publicly traded and provide an accurate valuation.²⁰ This CenterPoint indisputably did.

Joint Petitioners and the PUC defend the court of appeals’ holding that the 19% requirement modifies the word “sold” and therefore requires 19% of individual shares to have changed hands on the NYSE. Besides imposing an impossible burden on CenterPoint, that interpretation divorces the words “spun off and sold” from the sentence

²⁰ CenterPoint’s interpretation does not rob the statutory reference to 19%-to-51% of meaning, as the PUC claims. (PUC Br. 26.) The 19%-to-51% range modifies the words “spun off,” requiring CenterPoint to spin off at least 19% of Texas Genco stock, which it did.

and section of the statute in which they appear. *See Jones v. Fowler*, 969 S.W.2d 429, 432 (Tex. 1998) (holding that courts must look to statutory context).

The “spun off and sold” requirements are part of a sentence mandating in the passive voice that “at least 19 percent, but less than 51% percent, of the common stock of each corporation *is spun off and sold to public investors . . . through a national stock exchange.*” PURA § 39.262(h)(3) (emphasis added). The most natural reading of that unified passive clause indicates that the same actor—which the preceding clause reveals to be the “electric utility” (i.e., CenterPoint)—is doing both the “spinning off” and the “selling” of the new corporation’s stock. To be consistent with the sentence’s framework, then, the words “spun off” and “sold” must both be given a meaning that is within *the utility’s* ability to execute. Since the utility simply lists the new generation corporation’s stock on a national exchange after its spin-off, but cannot force shareholders to subsequently sell their individual shares, the term “sold” must mean that CenterPoint is required to “offer for sale” Texas Genco shares on a national stock exchange.²¹ It would make no sense to require CenterPoint to trade stock it no longer owns; individual investors trade the stock, not CenterPoint. The statute’s implicit recognition of CenterPoint as the “seller” of the stock confirms that “sold” means listed for sale on an exchange, but does not impose a requirement that an artificial number of

²¹ This interpretation accords not only with the context of the entire sentence, but also with a common dictionary definition of “sold” as “offer[ed] for sale.” (CNP Br. 32-33 & n.43.) Joint Petitioners’ cases interpreting the word “sold” did not arise in contexts where “offered for sale” was a possible—or even proposed—meaning of the term. (Jt. Pets. Resp. Br. 30-31.)

individual shares change hands between parties other than CenterPoint.²²

Comparing the identical “spun off and sold” language in PURA § 39.262(h)(2)’s “Stock Valuation Method” (SV) further confirms the absurdity of Joint Petitioners’ view that the minimum percentage modifies both the amount to be spun off and the number of individual shares that must change hands on an exchange. Section 39.262(h)(2) allows use of the SV method if “not less than 51% of the common stock of each corporation is spun off and sold to public investors through a national stock exchange.” The 51% minimum requirement in that statute plainly applies to the amount of stock to be spun off, thus ensuring that the utility does not control the majority of the corporation’s shares and eliminating the need for a control premium. *Compare* PURA § 39.262(h)(2) (SV) (containing no provision for control premium), *with id.* § 39.262(h)(3) (PSV) (providing that PUC may impose control premium). But there is no conceivable reason why the Legislature would require all 51% of the shares to subsequently change hands on a national exchange, particularly when even the court of appeals would concede that 19% is a sufficient number of sales to determine an accurate valuation. 252 S.W.3d at 21. The statutory design common to Subsections (h)(2) and (h)(3) reveals that the percentage requirement applies only to the duty to spin off. In both subsections, it furthers no discernible legislative purpose to extend the percentage

²² The PSV method stands in contrast to the sale-of-assets method, which straightforwardly applies if “the utility or its [APGC] has sold . . . its generation assets.” PURA § 39.262(h)(1). There, the word “sold” plainly requires the utility to execute a completed sale of its generation assets, something the utility has the sole ability to do. Under the PSV method, as discussed above, the utility does not have the sole ability—or indeed any ability—to guarantee that a given number of individual shareholders trade their shares. The court of appeals incorrectly equated the use of the word “sold” in these vastly different statutory contexts. *See* 252 S.W.3d at 21.

requirement to compel utilities to find some unspecified means of forcing shareholders to trade a certain number of shares.

B. Only CenterPoint’s interpretation is consistent with the Legislature’s evident intent.

The PUC and Joint Petitioners do not seriously dispute that their interpretation would vitiate the Legislature’s evident intent to allow a utility to spin off less than 20% of the generation company’s shares and thus maintain its ability to file a joint tax return with its subsidiary.²³ (*See* CNP Br. 32, 34, 35.) Instead, Joint Petitioners set up a strawman argument that “CenterPoint asserts that the Legislature only expected a utility to spin-off 19% at most,” which they knock down as inconsistent with the statute’s plain language. (Jt. Pets. Resp. Br. 32 n.11; *see* PUC Br. 29.) On the contrary, CenterPoint contends that the statutory percentage range reflects the Legislature’s desire for utilities to have *the option* to “sp[i]n off” less than 20% and thus preserve the right to file a consolidated tax return. The court of appeals’ interpretation effectively eliminates this option because it is plainly impossible for a utility to spin off less than 20% of the generation company’s shares and still ensure compliance with that court’s requirement that 19% of individual shares change hands on a national stock exchange.²⁴

CenterPoint and its opponents agree that the goal of the PSV method is to

²³ *See* 26 U.S.C. § 1504. The ability to file jointly is important because it allows a parent company to reduce its tax burden by offsetting one subsidiary’s losses against another subsidiary’s gains. *Id.* § 1502; Treas. Reg. § 1.1502-2.

²⁴ Contrary to the PUC’s suggestion, (PUC Br. 29-30), an IPO of 19% of Texas Genco shares would not have complied with the court of appeals’ erroneous statutory interpretation and therefore would not have preserved CenterPoint’s ability to file a joint tax return with Texas Genco. (*See* Part III.C *infra.*)

obtain an accurate market value of generation assets. Only CenterPoint’s interpretation, however, rationally furthers that legislative goal and is consistent with the clear legislative history. As the statutory text reflects, the Legislature mandated a significant spin-off of stock, followed by trading on a major stock exchange for more than a year. The Legislature understood that unrestricted market trading—in which some people sell and others hold—is the way market values are established.

The legislative history shows that the PUC’s report recommended a spin-off with subsequent trading on an exchange as the best guarantor of an accurate market value. 3 TEX. PUC, REPORT TO THE 75TH TEX. LEGIS., VOL. III, “POTENTIALLY STRANDABLE INVESTMENT (ECOM): A DETAILED ANALYSIS 11-12 (1997). Faced with this inconvenient fact, the PUC remarkably contends that the Legislature must not have adopted the PUC’s proposal because the “[PUC] report makes no reference to the minimum amount that the legislature required to be sold.” (PUC Br. 28.) That assertion just begs the question whether the Legislature in fact required a minimum number of sales. The far more reasonable explanation is that the Legislature *followed* the PUC’s report and therefore did *not* adopt an arbitrary minimum-sales requirement.

The PUC and Joint Petitioners speculate that the Legislature must have considered 19% the minimum number of trades necessary to establish a fair market value. (Jt. Pets. Resp. Br. 33-34; PUC Br. 27.) But they offer no reason why an arbitrary number of discrete shares changing hands would establish a more accurate valuation than a significant spin-off and subsequent trading for one year on the NYSE. Nor—notably—do they contest that Texas Genco’s trading volume of 37.8 million shares actually

resulted in an accurate market valuation. (PUC Br. 34; *see* CNP Br. 33-34 & n.45.) Finally, they cannot explain why the Legislature would deem 37.8 million trades insufficient to establish an accurate market value, yet deem 15.2 million trades—19% of shares trading hands once—sufficient.²⁵

C. The court of appeals’ interpretation imposes an impossible requirement upon utilities.

The court of appeals’ interpretation unreasonably places an impossible burden on utilities to guarantee that myriad investors trade at least 19% of individual shares. (*See* CNP Br. 35.) Under CenterPoint’s interpretation, a utility can always be sure that it has complied with the PSV method if it spins off 19% of the generation company’s stock and lists it on a national stock exchange. Not so under the court of appeals’ interpretation. Having declared it “in the public interest” that utilities fully recover their stranded costs, PURA § 39.2001(b)(2), it is inconceivable that the Legislature placed utilities’ recovery at the whim of thousands of individual investors.

Neither the PUC nor Joint Petitioners posit any legitimate way to guarantee compliance with the court of appeals’ interpretation, and there is none. While implicitly conceding that conducting an IPO was not feasible given the economic climate at the

²⁵ In another one of their implausible “worst-case-scenario” arguments, Joint Petitioners endorse the court of appeals’ farfetched hypothetical that under CenterPoint’s interpretation, the PSV method could be satisfied even if only *one share* actually changed hands on a national exchange after the spin-off. (Jt. Pets. Resp. Br. 34 & n.12; *see* CNP Br. 36-37.) A stock cannot remain listed on the NYSE if trading volume averages less than 100,000 shares per month over a 12-month period. *New York Stock Exchange Listed Company Manual*, § 802.01 (Continued Listing Criteria). The principle of *Smith v. State* that courts should not use fanciful hypotheticals to discredit an otherwise valid interpretation of a statute is directly on point here. 737 S.W.2d 933, 939 (Tex. App.—Dallas 1987, writ ref’d) (Hecht, J.).

time, (*see* CNP Br. 36 & n.48), Joint Petitioners declare that CenterPoint should have “wait[ed] for the markets to rebound” and then conducted an IPO. (Jt. Pets. Resp. Br. 32; *see also* PUC Br. 28.) But the statute certainly does not *require* that CenterPoint execute an IPO at all costs; instead, its express terms broadly permit any type of “sp[i]n off.” That textual promise alone defeats the PUC’s and Joint Petitioners’ claim that CenterPoint was all but required to execute an IPO to guarantee compliance with the PSV method.²⁶

Nor could CenterPoint afford to just “wait” it out, because PURA § 39.262(h)(3) required Texas Genco’s stock to trade for an entire year on a national stock exchange before the 2004 true-up proceeding. Thus, Joint Petitioners’ unsupported allegation that CenterPoint “forced the PSV market valuation forward” and “improvised its ‘spin off’ method” is outrageous. (Jt. Pets. Resp. Br. 32-33.) Instead, CenterPoint carefully chose a method expressly contemplated by the statute, a method the PUC had approved in CenterPoint’s BSP,²⁷ and a method that undisputedly resulted in an accurate valuation of Texas Genco.

Moreover, the PUC’s and Joint Petitioners’ focus on an IPO ignores the undisputed evidence that in an IPO, underwriters do not sell shares on an exchange to the initial purchasers, although “the initial purchasers are free to sell their shares on a stock exchange *if they feel it is prudent to do so.*” (Tr. 937 (Kind) (emphasis added).) Thus, an

²⁶ Indeed, before the PUC, the Joint Petitioners unashamedly embraced the facially untenable position that “the phrase ‘spun off and sold’ *requires* an initial public offering of the stock.” (CNP Br. App. B at 16 (emphasis added).)

²⁷ (CNP Ex. 1 at 15; *id.* at B-3.) BSP Order at 2.

IPO would have provided no more guarantee than CenterPoint's spin-off that 19% of individual Texas Genco shares would be "sold to public investors through a national stock exchange."²⁸ This Court should not endorse a statutory interpretation under which a utility cannot guarantee compliance with the statute regardless of the method it chooses.

Joint Petitioners and the PUC make only feeble attempts to explain how CenterPoint could have guaranteed compliance with the court of appeals' interpretation in the context of a spin-off. They baldly assert that CenterPoint could have spun off a greater percentage of stock to "ensure" that 19% of individual shares changed hands. (Jt. Pets. Resp. Br. 31-32; PUC Br. 28-29.) But CenterPoint's opponents have never been able to explain how CenterPoint could force countless shareholders to sell their shares, no matter how much stock it spun off. The PUC makes the vague *post hoc* claim that "most of the institutional investors" sold their Texas Genco shares, (PUC Br. 29), but that does not prove that CenterPoint could *guarantee* that a sufficient percentage of *all* investors would sell their shares. The Legislature surely did not intend to predicate something as fundamental as a utility's stranded-cost recovery on such uncertainty.

Joint Petitioners' separate arguments fare even worse. They speculate that CenterPoint need only have ensured that the 1% of shares distributed to CenterPoint executives and employees' 401(k) plans changed hands because these were the "only shares the Commission deducted from the 19% distribution." (Jt. Pets. Resp. Br. 33.)

²⁸ The PUC implicitly concedes this point by arguing that an IPO would guarantee that 19% of shares would be sold "in bona fide third-party market transactions"—conspicuously neglecting to argue that the shares would be "sold through a national stock exchange" under PURA § 39.262(h)(3). (PUC Br. 29.)

The PUC, however, does not endorse Joint Petitioners' implicit view that it must be assumed that all distributed shares were sold unless proven otherwise, and neither Joint Petitioners nor the PUC suggest any way CenterPoint could affirmatively prove that 15.2 million individual shares (19%) changed hands. In any event, Joint Petitioners do not explain how CenterPoint could force even those 401(k) shareholders to sell their shares if they did not wish to. The fact that minority shareholders "were all required to relinquish their shares" when private investors purchased Texas Genco later in 2004 quite obviously does not mean that CenterPoint could have forced shareholders to sell their shares "on a national stock exchange" long *before* that corporate buyout. (Jt. Pets. Resp. Br. 33.)

IV. Neither of the PUC's and Joint Petitioners' polar opposite explanations provides any support for the PUC's alternate holding deducting the purported value of the RRI Option.

The PUC and Joint Petitioners both defend the PUC's alternate holding reducing CenterPoint's stranded-cost recovery under the PSV method by \$330 million—the purported value of the RRI Option—but, as explained below, they do so on diametrically opposed grounds.

The PUC contends that the disallowance was proper because the Option's restrictions on Texas Genco's operations had an "adverse effect on the value of Genco's stock." (PUC Br. 49.) But the PUC does not deny that it made no factual finding in its order regarding the Option's effect on Texas Genco's stock value. (*See* CNP Br. App. B at 159-61 FOF 307-30.) Presumably, if this were the true basis for the PUC's alternate holding, it would have noted that fact somewhere in its lengthy order. Nor is there substantial evidence that supports an implicit finding that the Option negatively affected

the value of Texas Genco's stock. The vague testimony the PUC relies on regarding the Option's effect does not even concern the Option's effect during the 30-day valuation period chosen by the PUC. (*See* PUC Br. 49-50.) Further, it is undisputed that the Option expired before both the true-up proceeding and the valuation period the PUC selected. (*See* CNP Br. App. B at 21 (selecting valuation period of February 12-March 25, 2004); CNP Ex. 18 (McGoldrick) at 18 (testifying that RRI Option expired January 24, 2004).) Once the Option expired, it obviously had no effect on the value of the stock.

The PUC tries to escape this logic by arguing that the RRI Option was still in effect during a portion of the 120-day period preceding the true-up from which it selected the 30-day valuation period under PURA § 39.262(h)(3). (PUC Br. 50-51.) It conjectures that absent the Option, it might have been able to select a different 30-day period with a higher average stock value. (*Id.* at 51.) Such rank speculation does not support the PUC's alternate holding. It also ignores the fact that the PUC intentionally delayed the filing of CenterPoint's true-up proceeding until 45 trading days after the Option's expiration to "enable[] the 120-day trading period used in the partial stock valuation methodology to encompass time periods both before *and* after the exercise date of the option," so that "the commission will have the discretion of using whichever time period provides the higher valuation for purposes of determining stranded costs."²⁹ The PUC could have delayed the filing until a full 120 trading days after the Option expired,³⁰

²⁹ PUC Project No. 27401, Order Adopting Amendment to § 25.263, Relating to True-Up Proceedings, as Approved at the June 18, 2003 Open Meeting at 27-28 (July 18, 2003).

³⁰ *See* PURA § 39.262(c) (requiring utility to file true-up application "[a]fter January 10,

but presumably deemed the 45-day delay sufficient to alleviate any effects on Texas Genco stock. It cannot argue otherwise now.

The PUC also candidly admits that not only is there no evidence that the RRI Option reduced the value of Texas Genco stock by \$330 million, but that “it is impossible to know” the amount of the effect the Option had on Texas Genco’s stock price. (*Id.* at 56.) Instead, the PUC by sheer *ipse dixit* decided to use this figure as a stand-in because it “needed some method to determine how much to adjust stranded costs” for CenterPoint’s allegedly commercially unreasonable conduct under PURA § 39.252(d). (*Id.*) The PUC thus essentially concedes that there is no “rational connection” between the purported reason the Option was commercially unreasonable—because it depressed Texas Genco’s stock value—and the decision to reduce stranded-cost recovery by \$330 million. *State v. Mid-South Powers, Inc.*, 246 S.W.3d 711, 726 (Tex. App.—Austin 2007, pet. denied).

In contrast, Joint Petitioners contend that the lack of any PUC finding that the Option depressed the value of Texas Genco stock is “entirely irrelevant” because the “Commission made its adjustment, not because the RRI option affected the stock price, but because the RRI option should have been sold rather than given away and the sale price of the RRI option should have been used to reduce NBV and thus mitigate stranded costs.” (Jt. Pets. Resp. Br. 40.) But as discussed in CenterPoint’s initial and response briefs, CenterPoint did not “give” the Option to RRI (New Reliant); rather, *Old Reliant*

2004, at a schedule and under procedures to be determined by the commission”).

assigned the Option to RRI as part of its statutorily-required unbundling.³¹ Joint Petitioners do not dispute that cash compensation is not a relevant concept in the unbundling context. (Jt. Pets. Resp. Br. 42; *see also* PUC Br. 54.) That concession is fatal to their contention that CenterPoint should have received cash for the Option in the context of Old Reliant’s unbundling.

Joint Petitioners and the PUC both try to downplay the significance of the PUC’s 2001 BSP order, which approved Old Reliant’s BSP and found the RRI Option to be “an integral part” of the unbundling. *See* BSP Order at 15-16 FOF 52; *see id.* at 16 FOF 54 (“The Commission finds that the granting of the stock option and the transfer of the stock . . . if the option is exercised, would be part of the unbundling required by PURA § 39.051.”). By finding in the true-up that the Option was commercially unreasonable “because the option never should have been executed” in the first place, (CNP Br. App. B at 65), the PUC necessarily held that an integral part of Old Reliant’s PUC-approved unbundling was improper. The PUC and Joint Petitioners nevertheless contend that the true-up order is not inconsistent with the BSP Order, relying on a statement in the BSP Order that “[t]he Commission’s approval of Reliant’s Second Amended Plan does not preclude a review in the 2004 true-up proceeding of whether Reliant pursued reasonable means to reduce its potential stranded costs, including good-faith efforts to renegotiate above-cost fuel and purchased power contracts or the exercise

³¹ *See* BSP Order at 15 FOF 51 (“As part of the separation of its business activities, Reliant [i.e., Old Reliant] proposed to grant UNREGCO [i.e., RRI] an option to purchase all of REGCO’s [i.e., CenterPoint’s] capital stock in ERCOT GENCO [i.e., Texas Genco].”).

of normal business practices to protect the value of its assets.”³²

This boilerplate language merely paraphrased PURA § 39.252(d) and acknowledged the PUC’s statutory obligation at the true-up proceeding to review CenterPoint’s commercial behavior *after unbundling*. (See Jt. Pets. Resp. Br. 36 (“The Legislature recognized the importance of providing the Commission with the discretion to adjust stranded cost recovery in the event a utility engaged in commercially unreasonable behavior *after unbundling* and prior to the true-up proceeding.”) (emphasis added).) It certainly gave no indication that the PUC would completely reverse course in the true-up proceeding—based not on any post-unbundling conduct by CenterPoint, but on the ground that “the option never should have been executed” as part of the BSP. (CNP Br. App. B at 65.)³³ The PUC’s and Joint Petitioners’ interpretation of the BSP Order renders the BSP’s approval effectively meaningless because no rational utility would expend the significant funds and effort required to divide its assets and implement a BSP under such an illusory form of approval.

The very fact that Joint Petitioners and PUC, which are otherwise aligned parties, provide such divergent explanations for the same alternate holding confirms that it was merely tacked onto the order to dissuade CenterPoint from appealing the PUC’s primary holding. Regardless of the PUC’s motivation in making its alternate holding, it

³² BSP Order at 16 FOF 53. (See PUC Br. 51-53; Jt. Pets. Resp. Br. 38.)

³³ While both the PUC and Joint Petitioners note that the RRI Option had not been formally executed at the time the PUC signed the BSP Order, neither disputes that all the Option’s terms as it was later executed were fully known to the PUC at the time of the BSP Order. (See PUC Br. 53; Jt. Pets. Resp. Br. 38.) See BSP Order at 4, 15-16.

should be reversed.

V. The PUC’s \$178 million “gross-up” of the RRI Option disallowance was not necessary to prevent an overrecovery of stranded costs.

Once the Court determines that the PUC’s deduction of the RRI Option’s purported value was improper, it necessarily follows that the PUC erred in “grossing up” that deduction by \$178 million to capture alleged tax benefits to CenterPoint. But even if the Court does not reverse the Option disallowance, neither the PUC nor Joint Petitioners provide any basis for affirming the separate tax gross-up in the PUC’s alternate holding.

The PUC and Joint Petitioners contend that the gross-up is necessary to prevent an overrecovery of stranded costs because otherwise CenterPoint would retain a portion of the accumulated deferred income tax (ADFIT) balance that it previously collected from ratepayers to pay income taxes. (PUC Br. 59-60 (reasoning that “to the extent that stranded costs are disallowed, the utility will not need ADFIT to pay federal income tax” on those amounts); *accord* Jt. Pets. Resp. Br. 43-44.) But neither cites any authority that the PUC’s determination of CenterPoint’s stranded costs—including disallowances of those costs—affects either the amount of CenterPoint’s ADFIT balance or its obligation to ultimately repay such ADFIT to the IRS.³⁴ ADFIT is essentially a loan from the federal government—not ratepayers—to the utility. *See* FERC Order No. 144, FERC STATS. & REGS. [1977-1981] ¶ 30,254 at 31,539 (referring to “the erroneous

³⁴ The PUC’s order relied only on the *ipse dixit* opinion testimony of PUC Staff witness Daryl Tietjen, a non-lawyer who did not purport to base his legal opinion on any statute, caselaw, or other authority. (*See* CNP Br. App. B at 87-89.) Although Joint Petitioners similarly rely on Tietjen’s testimony to assert that “substantial evidence supports the Commission’s finding” that a gross-up is necessary to prevent CenterPoint’s alleged retention of a portion of its ADFIT balance, (Jt. Pets. Resp. Br. 43-44), this is a purely legal issue subject to *de novo* review.

premise that a loan is being made by ratepayers to utilities” in connection with ADFIT).³⁵ Accordingly, the utility must repay the ADFIT balances on its books to the IRS regardless of the amount of stranded costs the utility recovers. A gross-up of disallowed stranded costs does not prevent an overrecovery of stranded costs; it instead results in CenterPoint underrecovering its stranded costs.

Moreover, if the disallowance results in a tax loss, this Court has repeatedly held that any tax benefits arising from disallowances belong to the company, not ratepayers. *See, e.g., Gulf States Utils. Co. v. PUC*, 947 S.W.2d 887, 892 (Tex. 1997); *PUC v. Tex. Utils. Elec. Co.*, 935 S.W.2d 109, 110 (Tex. 1996); *PUC v. GTE-Sw., Inc.*, 901 S.W.2d 401, 411-12 & n.16 (Tex. 1995). The PUC and Joint Petitioners distinguish these cases as involving ratemaking, rather than true-up, proceedings. (Jt. Pets. Resp. Br. 44-45; PUC Br. 60-61.) But the disallowances at issue are analogous, and the result should be the same. In rate cases, disallowances occur when the PUC decides that a utility cannot recover through its rates investments paid for by the company (i.e., its shareholders). *See, e.g., Tex. Utils. Elec. Co.*, 935 S.W.2d at 110. The Legislature has

³⁵ *See Accounting Treatment of Inv. Tax Credit & Accelerated Depreciation for Pub. Util. Ratemaking Purposes: Hearing on H781-59 Before H. Comm. on Ways & Means*, 96TH CONG. 4 (1980) (statement of Daniel I. Halperin, Deputy Assistant Secretary of Treasury for Tax Legislation) (“Accelerated depreciation is no different than *an interest-free loan from the Government* and it should be treated as any other loan would be with the one exception that this loan is provided at a zero interest rate so it is not necessary to recover interest costs on this loan.”) (emphasis added); *Phantom Tax Reform: Hearing on H361-49 Before Subcomm. on Energy Conservation & Power of H. Comm. on Energy & Commerce*, 98TH CONG. 94 (1984) (statement of John G. Wilkins, Director, Office of Tax Analysis, Treasury Department) (“When tax depreciation rules permit deductions at a faster rate than the actual physical deterioration of capital assets, the economic effect is the deferral of tax liability. The result is the same as if *the Treasury were to extend a series of interest-free loans to the taxpayer* during the early years of the asset’s life, which are repayable in the later years.”) (emphasis added).

decided that, because shareholders bear the entire burden of disallowances, they are entitled to any tax benefit created by those disallowances. *See id.* Similarly, the reduction of stranded costs based on the RRI Option is a disallowance of investments made by shareholders, who should receive any associated tax benefit.³⁶ Thus, at a minimum, the PUC's \$178 million gross-up cannot stand.

VI. Neither PURA § 39.262(a) nor this Court's opinion in *CenterPoint Energy* authorizes a \$378 million reduction of CenterPoint's stranded-cost recovery for depreciation.

Both the PUC and Joint Petitioners concede that PURA unambiguously requires CenterPoint's net book value to be calculated as of December 31, 2001, *see* PURA § 39.251(7), and that CenterPoint's net book value as of that date does not reflect any deduction for the \$378 million in depreciation attributable to 2002 and 2003. (*See* PUC Br. 82; Jt. Pets. Resp. Br. 47.) They also do not dispute that to uphold the PUC's decision to make such a deduction anyway, the court of appeals effectively rewrote the statute to use a December 31, 2003 date for net book value.³⁷ They nevertheless contend that the deduction was mandated by PURA § 39.262(a)'s prohibition against

³⁶ Joint Petitioners attempt to further distinguish these cases on the ground that “[n]one of these cases address the situation of a utility that had already collected taxes (ADFIT) from ratepayers which, because of Commission disallowances, will never be paid to the federal government.” (Jt. Pets. Resp. Br. 45.) As discussed above, the PUC's disallowance does not relieve CenterPoint of its duty to repay the ADFIT balance to the government. The distinction is also inapt because the Court in those cases rejected a similar argument that, because the PUC's disallowances resulted in a tax loss for the company, the company collected from ratepayers more in tax expense than it actually owed in taxes. *See GTE-Sw., Inc.*, 901 S.W.2d at 411-12 & n.16 (addressing ratepayers' “actual taxes incurred” argument).

³⁷ Remarkably, the court of appeals' discussion of the \$378 million deduction contains no mention of PURA § 39.251(7) or the Legislature's mandate that a utility's net book value be calculated as of December 31, 2001. *See* 252 S.W.3d at 62-70.

overrecovering stranded costs, because otherwise CenterPoint would doubly recover these same depreciation amounts through the capacity auction true-up. (PUC Br. 82; Jt. Pets. Resp. Br. 46-48.)

On the contrary, CenterPoint cannot overrecover stranded costs merely by recovering both its statutorily-defined stranded costs and its statutorily-defined capacity auction true-up award. The Act is structured to ensure the recovery of both amounts. (See CNP Br. 48-49.) Whatever the precise scope of the PUC’s power to prevent an overrecovery of stranded costs may be, it cannot extend to rewriting or ignoring other specific provisions in the same statutory scheme. See *Tex. Dep’t of Transp. v. Needham*, 82 S.W.3d 314, 318 (Tex. 2002) (“[C]ourts should not give an undefined statutory term a meaning out of harmony or inconsistent with other provisions, although it might be susceptible of such a construction if standing alone.”).

CenterPoint Energy, Inc. v. PUC, 143 S.W.3d 81 (Tex. 2004) does not hold otherwise. The PUC and Joint Petitioners rely on statements in the opinion that “[t]he amount of stranded cost recovery, if any, through capacity auction true-ups will have to be considered in determining the amount of carrying costs on stranded costs from January 1, 2002 to ensure that there is no overrecovery of stranded costs.” *Id.* at 84. (See PUC Br. 83-84; Jt. Pets. Resp. Br. 49-50.) But nowhere did the Court hold that the PUC’s duty to prevent an overrecovery of carrying costs extends to disregarding express legislative mandates found elsewhere in the Act.³⁸ The Court instead indicated that the PUC could

³⁸ Any statement that PURA § 39.262(a) permits the PUC to disregard other express PURA provisions would have been advisory, because carrying costs on stranded costs—“[t]he only

address such overrecovery “[i]n setting a competition transition charge or allowing securitization of stranded costs at the conclusion of a final true-up proceeding.” *CenterPoint Energy*, 143 S.W.3d at 99.

Moreover, applying PURA § 39.262(a) to disregard the Legislature’s choice of a December 31, 2001 net-book-value date is inconsistent with the reasoning behind this Court’s primary holding in *CenterPoint Energy* that carrying costs on stranded costs run from January 1, 2002. The Court’s opinion details the many provisions in the Act where the Legislature stated its intent to calculate stranded costs as of December 31, 2001, including PURA § 39.251(7). *See id.* at 94 (“The Legislature defined stranded costs by *using December 31, 2001*, the day before customer service began, *as the benchmark for book value*, or an earlier date if assets were sold or exchanged.”) (citing PURA § 39.251(7)) (emphases added); *see also id.* at 87, 90, 93, 95 (citing other statutory provisions employing December 31, 2001 date). The Court specifically relied on this legislative mandate as a basis for holding that carrying costs must run from January 1, 2002, rather than the date of the true-up order. *See id.* at 90 (“It is highly significant to the question before us today that the Legislature said in section 39.201 that the pertinent date for quantifying stranded costs was December 31, 2001, ‘the last day of the freeze period’ and the last day before customer choice began on January 1, 2002.”).

In contrast, the PUC and Joint Petitioners contend that this mandate should

issue before” the Court in *CenterPoint Energy*—are not expressly mandated by PURA. 143 S.W.3d at 83, 85-86.

be disregarded not only in this case but in all cases, effectively writing the December 31, 2001 net book value provision out of the statute. *See* 252 S.W.3d at 69-70 (recognizing that the rationale behind the \$378 million deduction would support reducing a utility's stranded-cost recovery regardless of whether the utility was entitled to a capacity auction true-up award). This contention is inconsistent with *CenterPoint Energy*, not to mention basic principles of statutory construction. *See, e.g., State v. Shumake*, 199 S.W.3d 279, 287 (Tex. 2006) ("In construing a statute, we give effect to all its words and, if possible, do not treat any statutory language as mere surplusage."). The Court should apply the statute as written and reverse the \$378 million deduction.

PURA, the PUC's rules and orders, and CenterPoint's approved BSP laid out a clear path for CenterPoint, a regulated utility, to follow during the restructuring of the electric industry in Texas. The statute, the rules, and the BSP all imposed obligations on CenterPoint. In return, CenterPoint was given the right to recover a true-up balance that, for the most part, could be calculated using straightforward formulas specified in the statute or rules or taken from the results of other proceedings. The PUC's order and the court of appeals' decision below deprive CenterPoint of hundreds of millions of dollars that the statute and rules, when read in any but the most convoluted fashion, clearly entitled the company to receive. For the reasons stated herein and in CenterPoint's prior briefs, this Court should grant CenterPoint's petition for review and grant the relief requested therein. (*See* CNP Br. 50.)

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