

NO. 08-0421

STATE OF TEXAS, *ET AL.*,
Petitioners,

v.

PUBLIC UTILITY COMMISSION OF TEXAS, *ET AL.*,
Respondents.

RESPONDENT'S RESPONSE TO POST-SUBMISSION BRIEFS

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Glossary

AR	Administrative Record. The administrative record of CenterPoint's true-up proceeding before the PUC was admitted into evidence at the district court. (RR Vol. 2 at 6.) Cites to documents in the administrative record will be in the following format: AR, Item _____ at ____ (for filings); AR, _____ (party) Ex. _____ (for exhibits); and AR, Tr. at ____ (for transcripts).
capacity auction	Auction of a minimum percentage of the affiliated generation provider's capacity during the first years of competition. <i>See</i> Tex. Util. Code § 39.153.
CenterPoint	Collectively, the former Reliant companies: CenterPoint Energy Houston Electric, LLC; Texas Genco, LP; and Reliant Energy Retail Services, LLC; which were required to jointly file this true-up case, or in context CenterPoint Energy Houston Electric, LLC.
Customers	Those parties that intervened in the true-up proceeding, were plaintiffs in the district court, and are petitioners before this Court, which includes all petitioners except CenterPoint.
ECOM	Excess cost over market. <i>See</i> Tex. Util. Code §§ 39.201(h), .262(i).
Genco	Texas Genco, LP, the affiliated power generation company, also called TGN. <i>See</i> Tex. Util. Code § 31.002(2) (defining affiliated power generation company).
generation assets	"[A]ll assets associated with the production of electricity, including generation plants, electrical interconnections of the generation plant to the transmission system, fuel contracts, fuel transportation contracts, water, contracts, lands, surface or subsurface water rights, emissions-related allowances, and gas pipeline interconnections." Tex. Util. Code § 39.251(3).
IPO	Initial Public Offering

**Glossary
(Cont'd)**

market value	“[F]or nonnuclear assets and certain nuclear assets, the value the assets would have if bought and sold in a bona fide third-party transaction or transactions on the open market under Section 39.262(h) or, for certain nuclear assets, as described by Section 39.262(i), the value determined under the method provided by that subsection.” Tex. Util. Code § 39.251(4).
Option	The option that CenterPoint granted RRI to buy TGN.
Order	The PUC’s Order on Rehearing in this case. It is Item 842 in the Administrative Record. The Order is cited simply as Order. Findings of Fact in the Order are cited as “FF” and Conclusions of Law in the Order are cited as “CL.”
PUC	Public Utility Commission of Texas, sometimes called Commission.
PURA	Public Utility Regulatory Act, Tex. Gov’t Code Ann. §§ 11.001-64.158.
RRI	Reliant Resources, Inc., an unregulated wholesale electric company affiliated with CenterPoint.
stranded costs	Generally the net book value minus market value. Defined as “the positive excess of the net book value of generation assets over the market value of the assets, taking into account all of the electric utility’s generation assets, any above market purchased power costs, and any deferred debit related to a utility’s discontinuance of the application of Statement of Financial Accounting Standards No. 71 (‘Accounting for the Effects of Certain types of Regulation’) for generation-related assets if required by the provisions of this chapter. For purposes of Section 39.262, book value shall be established as of December 31, 2001, or the date a market value is established through a market valuation method under Section 39.252(h) whichever is earlier, and shall include stranded costs incurred under Section 39.263.” Tex. Util. Code § 39.251(7).

Response to Post-Submission Briefs

The Commission files this response to post-submission briefs filed by Customers and CenterPoint.

The PUC's role is different from that of other parties. Maximizing recovery is the logical goal for the utility, and minimizing it is the logical goal of customers. But the Commission's goal differs. The Commission was created to implement PURA. To that end, the Commission applies the statute's plain language to the record presented. In this case, even though the stranded-cost applicants did not follow the statute and PUC rules, the obvious legislative intent that utilities recover their stranded costs through the transition to competition made it unreasonable for the Commission to simply refuse to act. Action was required for the PUC to accomplish the statutory goals in circumstances not specifically addressed by the statute or rules, and the PUC accomplished those goals within its statutory authority and based on the record. The Commission navigated these constraints to award the utility no more and no less than its statutorily mandated stranded costs as well as other transition-to-competition adjustments. Therefore, the PUC's order should be affirmed.

I. The court of appeals' decision to affirm the PUC's capacity-auction true up should be upheld. (Responds to CenterPoint IV)

A. An auction that violates § 39.153 does not provide prices from an auction "under Section 39.153."

As this Court explained in *CenterPoint*, the capacity-auction true up guarantees that the utility will recover through its wholesale sales of electricity in the first two years of

competition no more and no less than the margin predicted by the ECOM model.

CenterPoint Energy, Inc. v. Pub. Util. Comm'n, 143 S.W.3d 81, 96 (Tex. 2004). A valid market price for sales is necessary to true up to the ECOM margin. As CenterPoint recognizes, the capacity auctions were to provide “transparent, market-based auctions free from AREPs’ potential exercise of market power.” (CenterPoint Post-Submission Br. (CenterPoint Br.) at 17.) And the Legislature selected the capacity auctions to provide the market price used in the capacity-auction true up: The Legislature required the Commission to reconcile “any difference between the price of power obtained through the capacity auctions *under Section[] 39.153* ... and the power cost projections that were employed for the same time in period in the ECOM model” Tex. Util. Code § 39.262(d) (emphasis added). Although CenterPoint acknowledges that part of “[t]he defining feature of the auctions under Utilities Code § 39.153 was that capacity be made available in a transparent, *PUC-regulated* market ...,” (CenterPoint Br. at 16 (emphasis added)) the company insists that failure to comply with PUC regulation does not disqualify the resulting price. This is irrational; CenterPoint’s conclusion cannot follow from its premise.

B. CenterPoint’s private auctions provided a market price that could be used in place of the capacity-auction price.

Because prices from a capacity auction that violates the capacity-auction statute and rule are not prices “under Section[] 39.153,” they are not the prices required by the true-up statute, Utilities Code § 39.262(d). And CenterPoint did not comply with the

capacity-auction statute and rules.¹ So the Commission looked at the record to accomplish the purpose of the statute²—that the utility recover no more and no less than its ECOM-predicted margin from its sale of electricity at wholesale during the first two years of competition. *CenterPoint*, 143 S.W.3d at 96.

At the same time that CenterPoint failed to sell the amount and the full range of products in the PUC-regulated auction, CenterPoint was selling all of the rest of its output, including the full range of products, at its private auctions. CenterPoint testified that it “designed its [private] auction products to the extent permitted by the Commission’s rules to attract bidders; and the auctions insured that [CenterPoint’s] biggest customer, RRI, was paying a market price for the power it received.” (CNP Ex. 33, at 6 (ES 3).) Because the statutorily defined price was unavailable and the record showed another price from an untainted market that accomplished the purpose of the

¹ There are several errors in CenterPoint’s footnote 26. Contrary to the utility’s claims, failing to comply with the capacity-auction rule was not merely a matter of timing. Over the entire two-year period, CenterPoint only sold about two-thirds of the required 15% of its capacity, thereby failing to create the intended market. CenterPoint also failed to sell the different products it generated. It sold less than one-half of the minimum required quantity of gas-intermediate capacity. (Order, FF 497.) Moreover, the safe-harbor in the PUC rule applied only to capacity auctions for 2003 power. (Order FF 498.) And, although settlements, which applied to all the stranded-cost utilities, created a safe harbor for two of the four 2002 auctions, those settlements were specific to individual auctions and did not apply to the other two auctions of 2002 power. Tex. Pub. Util. Comm’n, *Proceeding to Implement the Capacity Auction Rule*, Docket No. 23774 (Sept. 6, 2001) (Final Order at 17-18); Tex. Pub. Util. Comm’n, *Proceeding to Address March 2002 and July 2002 Capacity Auctions*, Docket No. 24888 (Feb. 8, 2002) (Order at 9 (FF 35)) (approving terms of March and July 2002 Mechanics, as adopted in the Capacity Auction Mechanics Stipulation). The Capacity Auction Mechanics Stipulation is available at the PUC website Interchange (<http://interchange.puc.state.tx.us/WebApp/Interchange/application/dbapps/login/pgLogin.asp>) under document 22 in Docket 24888.

² It was the failure to sell enough electricity and to sell the proper mix of products that created a “distortion” in the capacity-auction price. (See CL 178-80.)

statute, the Commission used the price from all of CenterPoint's sales to determine the market price of wholesale electricity for the true up. (Order at 107-08.)

CenterPoint's attempt to blame the Commission obscures the facts. The record shows that CenterPoint failed to comply with the capacity-auction statute and rule; less than 10% of the capacity was sold and very little of the gas-intermediate product was sold. But even if the failure were not CenterPoint's fault, the wholly inadequate capacity auction did not reflect the market price of CenterPoint's wholesale electricity. And, because the PUC used all of CenterPoint's sales to determine the price, CenterPoint was not harmed by the Commission's order. CenterPoint received what was intended—no more and no less than the ECOM-predicted margin. CenterPoint is not entitled to use a grossly flawed number just because it might result in a greater recovery.

II. The court of appeals' decision to affirm the PUC's stranded-cost true up should be upheld.

A. CenterPoint failed to comply with the partial-stock-valuation method to determine the market value of generation assets. (Responds to CenterPoint II)

Based on the plain language of the statute, the Commission determined that CenterPoint failed to comply with statutory requirements for a partial stock valuation. Contrary to CenterPoint's arguments, the plain language of the statute is reasonable.

1. The plain language of the statute required CenterPoint to sell at least 19% but less than 51% of its stock.

As this Court explained, "The meaning of a statute is a legal question, which we review *de novo* to ascertain and give effect to the Legislature's intent. Where text is

clear, text is determinative of that intent.” *Entergy Gulf States, Inc. v. Summers*, 282 S.W.3d 433, 437 (Tex. 2009) (citations omitted). The language of the statute is clear: “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.” Tex. Util. Code § 39.262(h)(3). In that clause, “at least 19 percent, but less than 51 percent” is the subject.³ It applies to *both* verbs: spun off and sold. That the phrase “to public investors through a national stock exchange” modifies “sold” fails to separate “sold” from the subject—“at least 19 percent, but less than 51 percent, of the common stock.”

No one questions that CenterPoint spun off slightly more than 19% of the generation company’s common stock. But CenterPoint failed to prove that 19% sold, and the evidence conclusively proved that less than 19% of the stock was sold.

CenterPoint’s argument that “sell” means something other than a sale is also unavailing. “Sell” cannot mean “list.” All of the common stock is listed. So, if “sell” means “list,” by listing the stock, CenterPoint sold 100% of the stock, violating the less-than-51% requirement. Nor is it sufficient that enough shares be sold so that the stock remains on the national stock exchange. Citing only extra-record evidence, CenterPoint claims that the national stock exchange’s requirement is that 100,000 share of stock sell. That must be placed in context. There were 80,000,000 shares of common stock of the generation company. Thus, the stock-exchange limit would only require one-eighth of

³ Although the same range—at least 19% but less than 51%—applies to both verbs, there is no requirement that the same percentage of stock that is spun off be sold. It is sufficient that both percentages of stock are within the statutory range.

one percent of the stock to be sold. There is no proof that the sale of such a small percentage of the stock would develop a sufficiently accurate market to impose billions of dollars of recovery upon Texas electric customers.

2. The plain language of the statute is neither absurd nor ambiguous.

In addition to stating, “Where text is clear, text is determinative of that intent,” this Court has also explained: “This general rule applies unless enforcing the plain language of the statute as written would produce absurd results.” *Entergy*, 282 S.W.3d at 437 (citing *Fleming Foods of Tex., Inc. v. Rylander*, 6 S.W.3d 278, 284 (Tex. 1999)). “Only when those words are ambiguous do we ‘resort to rules of construction or extrinsic aids.’” *Entergy*, 282 S.W.3d at 437 (citing *In re Estate of Nash*, 220 S.W.3d 914, 917 (Tex. 2007)).

The plain language of the partial-stock-valuation method is unambiguous and does not lead to absurd results. It plainly requires that “at least 19 percent, but less than 51 percent of the common stock of each corporation” be “sold to public investors through a national stock exchange.” The requirement is easily understood and reasonable.

a. How much must be sold to obtain a valid market value is an inherently legislative question.

CenterPoint invites the Court, as it invited the Commission, to take on the Legislature’s role. Much of CenterPoint’s argument questions whether it was really necessary to sell at least 19% of the stock to obtain an “accurate market valuation.” But how much stock must be sold was decided by the Legislature, and this Court does not

second guess the legislative choice. Only if it were absurd to require 19% to be sold would this Court ignore the plain language of the statute. *Entergy*, 282 S.W.3d at 437. Thus, whether some smaller percentage would also result in an accurate market valuation is irrelevant.

Contrary to CenterPoint's claim, choosing some minimum amount to be sold advances the purpose of finding a valid market value. It would be absurd to claim that the sale of one share of stock could determine the market value of the generation assets. Some limit must be set, and the Legislature chose that limit. The percentage chosen by the Legislature is not unreasonable; it even allows the utility a 32 percent range.

b. The statutory requirement that between 19% and 51% of the shares of stock be “sold to public investors through a national stock exchange” does not lead to absurd results.

There is nothing inherently absurd about requiring that somewhere between 19% and 51% of the shares of stock be “sold to public investors through a national stock exchange.” Nor does it lead to absurd results.

CenterPoint raises two claims: 1) that it might not be able to obtain consolidated tax savings and 2) that it cannot tell how many shares of stock are sold. The first is irrelevant and the second is untrue.

The statute is not absurd merely because the utility might not be able to claim consolidated tax savings. The only basis for CenterPoint's argument that the statute entitles it to obtain consolidated tax savings is the coincidence of numbers. The statute allows the utility to spin off as little as 19% of the stock, and a company that retains 80%

of the stock can take advantage of consolidated tax savings. That 19% is close to 20% is an insufficient basis for the utility to claim that the statute produces an absurd result because the utility might not obtain consolidated tax savings while using the partial-stock-valuation method.

And CenterPoint's claim that it cannot determine whether its stock is sold is unsupported by the record, as evidenced by the absence of any record citation. Instead, CenterPoint refers to the NYSE's manual, which was not admitted into evidence. Whatever weight should be given to that citation, the record shows that CenterPoint could track sales of stock, as was done for the institutional holders. (AR, CNP Ex. 19 at 7 & PHK-3.)

CenterPoint's argument that the PUC "tacitly concedes the unfairness" of the statute by explaining how CenterPoint could have complied reveals its own unreason. CenterPoint's claim that it could not comply with the statute logically invited examples of ways to comply. As shown above, the record reveals that CenterPoint could tell how many shares were sold, at least with regard to institutional investors.

It is also curious for CenterPoint to claim that an IPO would not meet the statutory requirement when that is the method the company initially chose. Much of CenterPoint's testimony explains why it did not use an IPO as it had initially planned. (*See* AR, Tr. 852-56; CNP Ex. 16 at 3; CNP Ex. 19 at 9-11.) That testimony relies upon the difficulties posed by the market, not on a sudden epiphany that an IPO would not comply with the statute.

c. The presence of risk fails to make the statute absurd.

It is the nature of the competitive market that participants take risks.⁴ A market with no risk would be useless because it would offer no benefit or would indicate a con game or some type of fraud. CenterPoint's complaints that it cannot control the behavior of its individual shareholders goes against the legislative choice that the market determine value. And the risks were not unreasonable. Even if CenterPoint could not be certain that every one of Genco's shareholders would sell the distributed shares of stock, the utility could distribute more than the minimum 19% to ensure that a sufficient percentage of shares would be sold. The record shows that CenterPoint could track at least the shares of institutional holders. If maintaining consolidated tax savings were the utility's goal, it had other statutory methods to choose among.

B. CenterPoint's failure to comply with the partial-stock-valuation method did not require the PUC to use CenterPoint's subsequent sale of generation assets to determine market value. (Responds to Customers III & IV)

For two reasons, the PUC was not compelled to use CenterPoint's subsequent sale of assets to determine the market value of CenterPoint's generation assets after CenterPoint failed to comply with the partial-stock-valuation method. Not only do utilities get to choose which method to use to value their generation assets, the sale was also not completed before the end of the true-up proceeding.

⁴ Moreover, there is a big difference between taking some risks and CenterPoint's allegation that the utility could never meet the requirements of the statute. (*See* CenterPoint Br. at 7, n.8.)

As explained above, due to the inherent riskiness of markets, the utility was permitted to choose which statutory method to use for determining market value. CenterPoint chose the partial-stock-valuation method and was unwilling to use the sale-of-assets method even after CenterPoint's compliance with the stock-valuation method was challenged.

But more importantly, the sale was not completed by the time of the true-up proceeding. Although smaller generators were sold during the course of the true-up proceeding, CenterPoint's nuclear generation assets were sold four months after the proceeding ended. The fact that the sale was completed is outside the agency record and was merely stated in briefing by parties to the appeal. At the time of the true-up proceeding, permits necessary for completion of the sale had not been obtained. Moreover, to qualify as a § 39.262(h)(1) sale of assets, the sale must be a "bona fide third-party transaction under a competitive offering." Tex. Util. Code § 39.262(h)(1). The PUC has fleshed out demonstrations necessary to meet those criteria. *See AEP Tex. Cent. Co. v. Pub. Util. Comm'n*, 258 S.W.3d 272, 309-10 (Tex. App.—Austin 2009, pet. filed) (Pemberton, J., concurring). Because CenterPoint did not choose the sale-of-assets method, the PUC was not presented with the evidence necessary to determine whether the sale qualified under the statutory standard. And, in further answer to a question posed by Justice Medina at oral argument, the lack of evidence and of analysis using those criteria would require remand to the Commission were the Court to accept the Customers' argument that the sale-of-assets method had to be used.

C. The PUC reasonably adjusted net book value for commercially unreasonable conditions CenterPoint included in the RRI option. (Responds to CenterPoint III)

This issue, which was not addressed at oral argument but nonetheless re-urged post submission, arises only if the Court reverses the PUC’s decision that CenterPoint failed to comply with the partial-stock-valuation method.

If CenterPoint had complied with a statutory valuation method, the PUC would be required to consider whether the utility fully mitigated its stranded costs. Tex. Util. Code § 39.252(d) (requiring the Commission to “consider the utility’s efforts [to mitigate stranded costs] when determining the amount of the utility’s stranded costs” in the true up). One step the utility must take to mitigate is to “pursue commercially reasonable means to reduce potential stranded costs, including . . . the exercise of normal business practices to protect the value of its assets.” *Id.* Although Customers alleged numerous failures to mitigate stranded costs, the Commission only found one failure—the option CenterPoint granted to its subsidiary RRI to purchase Genco.

The Commission found that the Option contained limits on Genco’s ability to do business that lowered the value of the company’s stock—the same stock that was being used to determine market value. (Order at 64.)⁵ CenterPoint had disclosed in its SEC Form 10-K that the Option prohibited or limited Genco from taking many actions. (FF

⁵ In its reply brief, CenterPoint incorrectly argued that there was no fact finding supporting the PUC’s decision that the Option placed unreasonable burdens on the generation company’s ability to do business. The cited portion of the Order contains the PUC’s factual determination. *See Pub. Util. Comm’n v. Texland Elec. Co.*, 701 S.W.2d 261, 273 (Tex. App.—Austin 1985, writ ref’d n.r.e.) (relying on a discussion in the expository part of an order).

309.⁶) Genco admitted that “[c]ontractual restrictions on the operation of our business may adversely affect our ability to compete with companies that are not subject to similar restrictions.” (AR, Intervenor Ex. 45 at 28.)

Having found a failure to mitigate, the Commission complied with the statutory directive to consider that failure in trueing up stranded costs. CenterPoint’s post-submission brief challenges the amount rather than the existence of the Option adjustment. The Court reviews that challenge under the substantial evidence standard.

Under substantial evidence review, “a court may not substitute its judgment for the judgment of the state agency on the weight of the evidence on questions committed to agency discretion.” Tex. Gov’t Code § 2001.174. Thus, “[t]he issue for the reviewing court is not whether the agency reached the correct conclusion, but rather whether there is some reasonable basis in the record for the action taken by the agency. Substantial evidence requires only more than a mere scintilla, and the evidence on the record actually may preponderate against the decision of the agency and nonetheless amount to substantial evidence.” *R.R. Comm’n v. Torch Operating Co.*, 912 S.W.2d 790, 792-93 (Tex. 1995) (citations omitted).

⁶ The option limited Genco’s ability to merge or consolidate with another entity; sell assets; enter into long-term agreements and commitments for the purchase of fuel or the purchase of power or sale of power outside the ordinary course of business; engage in other business; construct or acquire new generation plants or capacity; encumber its assets; issue additional equity securities; pay special dividends; and make certain loans, investments or advances to, or engage in certain transactions with affiliates. (FF 309.)

CenterPoint failed to object at the PUC hearing to the admissibility of Mr. Gorman's evidence about the value of the Option. (AR, Tr. Vol. G at 215-16.) Thus, any such claim is waived, and the cases CenterPoint cites on page 15 of its brief are inapposite. CenterPoint cannot raise those questions at this late stage of its administrative appeal.

Moreover, the Commission reasonably used the \$330 million figure from Gorman's testimony as the amount of its adjustment. In essence, Gorman testified that the stock had the value assigned by the control premium panel, but that the Option allowed RRI to purchase the stock for \$330 million less. (AR, TIEC Ex. 2 at 51-52 (confidential).) The PUC was looking for evidence in the record of the difference between the trading price of the stock and the price it would have garnered without having been hamstrung for two years by the Option's unreasonable limits on Genco's ability to do business. Because the control panel's report valued the stock using comparables and discounted cash flow (AR, Comm. Ex. 1), the report gave a value of the stock free from the unreasonable restraints in the Option. That difference is a reasonable proxy for the amount by which the Option devalued the stock; there is no "analytical chasm." Furthermore, because the PUC was looking for how much the Option devalued the stock, there was no need to include Mr. Gorman's adjustment for dividends that CenterPoint had received from Genco—they did not affect the failure to mitigate found by the PUC. The Commission properly relied on only part of Gorman's testimony. *Southern Union Gas Co. v. R.R. Comm'n*, 692 S.W.2d 137, 141-42 (Tex. App.—Austin 1985, writ ref'd n.r.e.) (“[T]he agency may accept part of the testimony of one witness and disregard the remainder.”).

D. The PUC properly adjusted stranded costs for depreciation recovered through the capacity-auction true up. (Responds to CenterPoint V)

Utilities Code § 39.262 expressly prohibits the utility from overrecovering stranded costs through the true-up proceeding. The PUC's adjustment for depreciation of stranded costs recovered through the margin in the ECOM model prevents such an overrecovery.

Much of CenterPoint's complaint about the depreciation adjustment assumes that the PUC is using an improper amount for net book value. That is not so. The PUC's Order shows that the adjustment for depreciation was made after market value had been subtracted from net book value to determine stranded costs. *See* Order at 110-13.

The PUC could not allow CenterPoint to recover stranded costs both through the ECOM margin guaranteed by the capacity-auction true up and through the stranded-cost balance outstanding at the time of the true up. The PUC, which had created the ECOM model, knew that "the fixed costs in the ECOM model include depreciation and amortization." (Order at 111.) Thus, by ensuring recovery of the ECOM margin, the capacity-auction true up ensured that the utility recovered that part of stranded cost paid as amortization or depreciation through the ECOM margin. To avoid overrecovery, the PUC properly excluded these recovered costs from the stranded costs that remained owing at true up.

In its *CenterPoint* opinion this Court noted that CenterPoint itself had said in written comments that the capacity-auction-true-up calculation resulted in "a 'margin predicted to

be available to contribute to fixed costs and therefore *to reduce stranded costs.*” 143 S.W.3d at 97 (emphasis added).

Contrary to CenterPoint’s arguments, what competitive generators may recover is irrelevant. Only the incumbent utility has stranded costs; only the affiliated generation company is guaranteed recovery of the ECOM margin during the first two years of competition. There is no “irrational economic barrier” between the affiliated and competitive companies. Instead, the PUC followed the statutory directives that the utility recover, but not overrecover its stranded costs.

Conclusion

The record shows that the Court should affirm the PUC’s findings that CenterPoint failed to comply with both the statute’s plain language and the PUC rules adopted under the statute. The record also shows that the Court should affirm the PUC’s exercise of its discretion to true up stranded costs and other transition-to-competition amounts.

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Certificate of Service

I certify that a true and correct copy of this Response to Post-Submission Briefs has been sent by first class, United States mail unless otherwise indicated on this 11th day of December, 2009, to the attorneys listed below. As a courtesy, copies of the brief have been e-mailed.

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