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In The Supreme Court of Texas

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GULF COAST COALITION OF CITIES

Petitioner

v.

PUBLIC UTILITY COMMISSION OF TEXAS

Respondent

**On Petition For Review From the
Third Court of Appeals at Austin, Texas
No. 03-06-00285-CV**

**REPLY TO CENTERPOINT ENERGY HOUSTON
ELECTRIC, LLC'S RESPONSE TO PETITION FOR REVIEW**

October 23, 2008

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COAST COALITION OF CITIES**

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TO THE HONORABLE SUPREME COURT OF TEXAS:

The Gulf Coast Coalition of Cities¹ (“GCCC”) hereby submits this reply to the response to GCCC’s petition for review (“Petition”) filed by CenterPoint Energy Houston Electric, LLC (“CenterPoint” or “Company”).

This is an appeal from Public Utility Commission of Texas (“PUC”) Docket No. 30706 in which the PUC inappropriately applied an 11.075% interest rate to the competition transition charge (“CTC”) based on a rule, P.U.C. SUBST. R. 25.263(1)(3), that was previously invalidated by the Texas Supreme Court holding in *CenterPoint Energy, Inc. v. Public Util. Comm’n of Texas* (“*CenterPoint*”).² In the alternative, if the Court in *CenterPoint* invalidated only a portion of the rule then, under the doctrine of severability, the entire rule should, nevertheless, be invalidated. The result of the PUC’s error is that the Company will over-recover stranded costs through the CTC in violation of PURA § 39.262(a).³ Furthermore, an 11.075% interest rate is arbitrary and capricious because there was no evidence in the record indicating that the 11.075% interest rate reflected CenterPoint’s current weighted average cost of capital (“WACC”). Affirmance of an 11.075% interest rate will provide a windfall for the Company and have an injurious effect on ratepayers already facing billions of dollars in stranded cost charges.

¹ The Gulf Coast Coalition of Cities is a group of six incorporated municipalities (Friendswood, LaMarque, Lake Jackson, League City, Missouri City, and Spring Valley) that are each located within CenterPoint’s service area and are materially affected by the Commission’s Order in Docket No. 30706.

² *CenterPoint Energy, Inc. v. Pub. Util. Comm’n of Texas*, 143 S.W.3d 81, 99 (Tex. 2004).

³ Public Utility Regulatory Act, TEX. UTIL. CODE ANN. § 39.262 (Vernon 2007 & Supp. 2008) (“PURA”).

ARGUMENT

I. **CenterPoint incorrectly analyzes this Court's opinion in *CenterPoint Energy, Inc. v. Pub. Util. Comm'n* 143 S.W. 3d 81 (Tex. 2004).**

In 2001, the PUC adopted Substantive Rule 25.263(1)(3) which established the date upon which interest on stranded cost recovery is to commence and determined the interest rate to apply. In 2004, this Court, in the *CenterPoint* case, found that "Rule 25.263(1)(3) is invalid."⁴

The Company, in its Response to GCCC's Petition, correctly states that in the *CenterPoint* case this Court addressed the issue of the proper starting date for accrual of carrying costs on true-up balances. However, CenterPoint then erroneously concludes that the Supreme Court of Texas could not have intended the result clearly stated in its opinion. CenterPoint gives three reasons for its erroneous conclusion, none of which are compelling.

The first reason CenterPoint gives is that, in the *CenterPoint* case, this Court stated that the only issue that was before it was when the carrying costs began accruing.⁵ CenterPoint asserts that it is "not credible" that this Court would invalidate the entire Rule 25.263(1)(3) based on an analysis of a portion of the rule.⁶ CenterPoint's assertion is clearly wrong. This Court analyzed the issue that was before it and crafted a holding to address that issue. The holding was that the rule is invalid. This Court did not deem it

⁴ *CenterPoint* at 84 and 99. By allowing CenterPoint to accrue interest only on its true-up balance almost three years prior to the date that stranded costs were quantified, the *CenterPoint* decision resulted in almost a billion dollars of additional interest recovery by the Company.

⁵ *Id.* at 83.

⁶ CenterPoint's Response at 5-6 (Oct. 8, 2008).

appropriate to break the rule into separate pieces and hold only part of it invalid. This was the appropriate decision given the fundamental interconnection between interest rates and the time period over which they are collected. This Court could easily have crafted a holding that invalidated only a portion of P.U.C. SUBST. R. 25.263(1)(3), but it did not do so. Therefore, it is safe to assume that this Court intended to invalidate the entire rule and not just a portion of the rule.

The second reason that CenterPoint gives for its conclusion is that no party in *CenterPoint* had assigned error to the Commission's decision to use the rate established in the UCOS order.⁷ CenterPoint ignores the doctrine of severability which invalidates the entirety of a rule where, if after an invalid portion of the rule has been stricken out, it is no longer capable of self-sustaining without the stricken portion. Moreover, CenterPoint misinterprets the decision in *CenterPoint*. In that case, the Court invalidated the entirety of P.U.C. SUBST. R. 25.263(1)(3), not simply a portion of the rule.

As noted above, CenterPoint is incorrect in its analysis that the validity of P.U.C. Subst. R. 25.263(1)(3) has not been appropriately raised in this case. CenterPoint also incorrectly interprets the precedent that it cited in support of its analysis. CenterPoint cites *Newman v. King* for the legal principle that the "right of an appellate court to reverse a trial court judgment on unassigned error is limited to.... 'fundamental error.'"⁸ That case goes on to establish that it does not "particularize every error which will be regarded as fundamental" and it states at least one general rule, which is that "[e]rror

⁷ *Id.*

⁸ *Newman v. King*, 433 S.W.2d 420, 421 (Tex. 1968).

which directly and adversely affects the interest of the public generally was specifically held to be fundamental.”⁹ The case at hand meets the definition of fundamental error because CenterPoint would garner an enormous windfall at the cost of ratepayers were the decision not reversed. Significantly, CenterPoint's argument ignores the clear language of the Court in *CenterPoint* and the relationship between the interest rate and the interest term.

The third reason CenterPoint gives for its conclusion that the Supreme Court could not have intended the result clearly stated in its opinion, is that overbroad pronouncements in an opinion cannot be taken at face value when they conflict with the remainder of the opinion.¹⁰ However, CenterPoint's argument fails to address how holding P.U.C. SUBST. R. 25.263(1)(3) invalid is overly broad in the context of a ruling on the validity of P.U.C. SUBST. R. 25.263(1)(3).

CenterPoint attempts to cast doubt over GCCC's argument that there is a logical and common place connection between the length of recovery and the interest rate applied. A glance at mortgage rates in a daily newspaper or other source will suffice to make GCCC's point. It is common for the rates on long-term mortgages to be higher than on short-term mortgages as the associated risk changes over time. This Court was acting prudently and in line with accepted financial standards when it invalidated the entire P.U.C. SUBST. R. 25.263(1)(3).

⁹ *Id.* at 422.

¹⁰ CenterPoint's Response at 6.

II. CenterPoint incorrectly analyzes the doctrine of severability.

CenterPoint correctly identifies the following two-prong test used by Texas courts when applying the doctrine of severability:

(1) will the function of the regulatory statute as a whole be impaired without the invalid part of the rule; and (2) is there *any indication* that the agency would not have adopted the rule but for the invalid part? If the answer to either query is “yes,” in the court’s view, then severance is not justified and the entire rule must fall.¹¹

However, CenterPoint incorrectly applies the test in this case.

Applying the doctrine of severability in the immediate case must result in the conclusion that even if the *CenterPoint* case invalidated only a portion of P.U.C. SUBST. R. 25.263(1)(3), despite the clear language used by this Court in that case, the entire rule must be held invalid. Regarding the first prong of the test, it is clear that the interest rate, interest period, and the balance to which interest is to be applied are closely intertwined, and that the function of P.U.C. SUBST. R. 25.263(1)(3) as a whole is impaired without the invalid portion of the rule. To conclude that the interest rate portion of P.U.C. SUBST. R. 25.263(1)(3) can be given effect without the severed netting and timing portions, causes entirely unanticipated consequences and would result in a windfall for the Company.

Applying the second prong of the test to this case confirms that the doctrine of severability is applicable. The test is not whether there is *some* indication that the PUC would have adopted the rule without the invalid portion. The test is whether there is *any*

¹¹ *Texas Dept. of Banking v. Restland Funeral Home, Inc.*, 847 S.W.2d 680, 683 (Tex. App.-Austin 1993) (citing *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 295 (1988)) (emphasis added). See also *Southwestern Bell Telephone Co. v. Pub. Util. Comm’n of Texas*, 888 S.W.2d 921, 929 (Tex. App.-Austin 1994).

indication that the PUC would *not* have adopted the rule but for the invalid portion, and there is clearly such evidence. Staff witness, Mr. Tietjen, testified that in authoring the rule he believed that “everybody expected that the Final Order would be issued, a few months later the bonds would be issued, and even if the UCOS rate was applied, it would only be for a very short period of time.”¹² As a long-time experienced senior PUC employee in charge of the true-up rulemaking project, Mr. Tietjen’s testimony is clearly an indication that the PUC would not have adopted the rule but for the invalid part.

CenterPoint uses the Commission’s Order as evidence that the second part of this test is not met.¹³ However, CenterPoint mischaracterizes the Commission’s Order as a statement of its intent at the time that it promulgated the rule, which is what the two prong test requires; the Commission made no such statement of intent.¹⁴

There is no dispute as to the record, and the record shows that there is evidence that the Commission would not have adopted the rule without the invalidated portions. Therefore, the doctrine of severability must be applied and the entire P.U.C. SUBST. R. 25.263(1)(3) is invalid.

III. The evidence does not support the 11.075% interest rate.

This Court has held that the entire subsection P.U.C. SUBST. R. 25.263(1)(3) is invalid. Accordingly, the Commission was under no obligation to apply the interest rate adopted in CenterPoint’s 2001 unbundled cost of service (“UCOS”) case to the CTC

¹² Docket No. 30706, Tr. at 705 (Apr. 8, 2005).

¹³ CenterPoint’s Response at 9-10.

¹⁴ Docket No. 30706, Order at 10-11 (July 14, 2005).

balance, and in fact, it committed error by doing so. However, even if the Commission was correct in determining that portions of P.U.C. SUBST. R. 25.263(1)(3) remain valid, use of the UCOS rate of 11.075% is arbitrary and capricious because it is not supported by substantial evidence. Furthermore, CenterPoint's WACC was well below 11.075% at the time the case was heard by the Commission. As such, it was unreasonable to rely upon an 11.075% interest rate. Every intervenor witness who testified on this subject conducted an updated WACC analysis. Each of them calculated CenterPoint's WACC to be far below the level set in the UCOS proceedings. Significantly, the Company did not present any up-to-date rate of return analysis. Consequently, the record is void of evidence supporting the 11.075% rate.

CenterPoint asserts that the rebuttal testimony of its witness, Frank Huntowski, provides evidence that the 11.075% interest rate is reasonable in light of the risk involved in collecting the CTC.¹⁵ Mr. Huntowski's rebuttal testimony is merely evidence of the Company's preference for the excessive 11.075% interest rate from its 2001 UCOS case. It does not constitute substantial evidence as to the appropriate interest rate to be applied to the CTC balance. Mr. Huntowski's testimony presented no evidence supporting the conclusion that the 11.075% rate appropriately reflected the level of risk to CenterPoint associated with their recovery of the CTC.

CenterPoint, in its Response to GCCC's Petition, fails to address the issue that the application of an 11.075% return to the CTC balance will result in an enormous windfall to the Company, and that customers will be required to bear the burden of massive

¹⁵ CenterPoint's Response at 12.

additional costs in order to provide the Company with that windfall. The PUC has recognized that this result is inequitable, and it conducted a rulemaking in order to avoid this result in the future.¹⁶ At its June 29, 2006 Open Meeting, the PUC adopted an amendment to P.U.C. SUBST. R. 25.263 that lowered the interest rates applicable in this type of case. Therefore, it is only reasonable that this Court confirm that the 11.075% interest rate is inappropriate.

CONCLUSION AND PRAYER

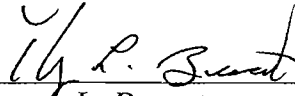
The Commission's decision in PUC Docket No. 30706 was based upon a rule that had been previously invalidated by the Supreme Court of Texas. However, even if the Court invalidated only the portion of the rule related to when interest would begin to accrue, the interest rate portion of the rule must be held invalid based upon the doctrine of severability, or because it is arbitrary and capricious and will result in a windfall to CenterPoint.

GCCC requests this Court clarify and confirm its intention to invalidate the entirety of P.U.C. SUBST. R. 25.263(1)(3) in *CenterPoint Energy*. GCCC further requests this Court remand the case to the PUC with directions to correct such errors. Finally, GCCC requests any other relief to which it may be entitled.

¹⁶ *Rulemaking Proceeding to Amend Subst. R. § 25.263 Relating to True-Up Proceeding*, Project No. 32008, Order Adopting Amendment to § 25.263 As Approved at the June 29, 2006, Open Meeting at 1 (June 30, 2006).

Respectfully Submitted,

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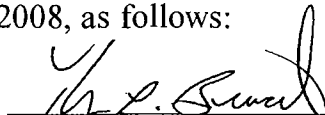


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CERTIFICATE OF SERVICE

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