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No. 08-0727

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In The Supreme Court of Texas

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 THE PUBLIC UTILITY COMMISSION OF TEXAS'
RESPONSE TO TEXAS INDUSTRIAL ENERGY CONSUMERS AND
GULF COAST COALITION OF CITIES' PETITIONS FOR REVIEW**

December 23, 2008

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**ATTORNEY FOR THE GULF
COAST COALITION OF CITIES**

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Rulemaking Proceeding to Amend Subst. R. § 25.263
Relating to True-Up Proceeding, PUC Project No. 320087

TO THE HONORABLE SUPREME COURT OF TEXAS:

The Gulf Coast Coalition of Cities¹ (“GCCC”) hereby submits this Reply to the Public Utility Commission of Texas’ Response to Texas Industrial Energy Consumers (“TIEC”) and GCCC’s Petitions for Review (“Petition”) filed by the Public Utility Commission of Texas (“PUC” or “Commission”) on December 8, 2008.

This is an appeal from PUC Docket No. 30706 in which the PUC inappropriately applied an 11.075% interest rate to CenterPoint Energy Houston Electric, LLC’s (“CenterPoint’s” or “Company’s”) competition transition charge (“CTC”) based on P.U.C. SUBST. R. 25.263(1)(3) (the “Rule”), which had previously been invalidated by the Texas Supreme Court holding in *CenterPoint Energy, Inc. v. Public Util. Comm’n of Texas* (“*CenterPoint*”).² Alternatively, if this Court finds that the *CenterPoint* holding invalidated only a portion of the rule then, under the doctrine of severability, the entire rule should be invalidated because severance is not justified. The result of the PUC’s error is that CenterPoint 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 is no evidence in the record indicating that the 11.075% interest rate reflected CenterPoint’s

¹ The Gulf Coast Coalition of Cities is a group of six incorporated municipalities (Friendswood, La Marque, 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”).

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.

ARGUMENT

The PUC has incorrectly cited the standard of review in this case. It is correct that this case involves a question of law that should be reviewed under a *de novo* standard.⁴ However, this case involves the PUC’s interpretation of the *CenterPoint* case and alternatively the PUC’s interpretation of the doctrine of severability as established by Texas courts. The PUC does not have ‘expertise’ in the interpretation of judicial decisions; therefore, it is not entitled deference in this case.⁵

Texas courts “do not defer to administrative interpretation in regard to questions which do not lie within administrative expertise, or deal with a nontechnical question of law.”⁶ In fact, the case the PUC cites in an attempt to establish its version of the standard of review for this case makes the point that the substantial evidence rule gives deference to an agency only “in its field of expertise.”⁷ Because this appeal involves questions of law that are not technical matters peculiar to the Commission’s area of expertise, the Court is not required to, and should not give deference to, the PUC’s decision in PUC Docket No. 30706.

⁴ *Continental Casualty Company v. Esther Rivera*, 124 S.W.3d 705, 709 (Tex. App.-Austin 2003, pet. denied); *Double Diamond, Inc. v. Hilco Electric Cooperative, Inc.*, 195 S.W.3d 336, 338 (Tex. App.-Waco 2006, pet. denied).

⁵ *Rylander v. Fisher Controls Int’l, Inc.*, 45 S.W.3d 291, 302 (Tex. App.-Austin 2001, no pet.).

⁶ *Id.*

⁷ *Railroad Commission of Texas v. Torch Operating Co.*, 912 S.W.2d 790, 792 (Tex. 1995).

I. The PUC incorrectly analyzes this Court's opinion in *CenterPoint Energy, Inc. v. Pub. Util. Comm'n of Texas*, 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 was to commence and determined the interest rate to apply. In 2004, this Court, in the *CenterPoint* case, found that “[f]or the reasons considered above, we hold that Rule 25.263(1)(3) is invalid.”⁸ This Court, in the *CenterPoint* case, addressed the starting date for accrual of carrying costs on true-up balances, which was the issue before it, and crafted a holding to address that issue. The holding was that the Rule is invalid. This Court could have broken the Rule into separate pieces and crafted a decision holding only part of the Rule invalid, but it did not. The decision to invalidate the entire Rule was appropriate given the fundamental interconnection between interest rates and the time period over which they are collected. In its Response, the PUC incorrectly states that this Court, in the *CenterPoint* case, “announced the narrow decision to strike the interest date portion.”⁹ The PUC cites four examples from the *CenterPoint* case in which this Court addressed the starting date for accrual of carrying costs on true-up balances, but the PUC fails to address the fact that this Court chose to hold the rule invalid as the remedy for the issue that it was addressing. This court did not hold a portion of the Rule invalid; it held that “...Rule 25.263(1)(3) is invalid.”¹⁰

⁸ *CenterPoint* at 99 (emphasis added). 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.

⁹ PUC Response at 5.

¹⁰ *CenterPoint* at 84 and 99 (emphasis added).

The PUC, in its Response, states that it is unlikely that the Court “unilaterally” invalidated the interest rate portion of the rule, and the PUC expressed concern about overbroad pronouncements made by this Court.¹¹ However, the PUC fails to explain what is unilateral or overbroad about the decision to invalidate Rule 25.263(1)(3) in the *CenterPoint* case. This Court addressed the issue at hand in the *CenterPoint* case and crafted an appropriate remedy by holding the entire Rule 25.263(1)(3) invalid.

II. The PUC incorrectly analyzes the doctrine of severability.

The PUC correctly identifies the following two-pronged 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.¹²

However, the PUC incorrectly applies the test. The dispute in this case is in regards to the second prong of the test. The PUC would like this Court to apply the second prong of this test in the opposite manner from which it applies. The PUC presents evidence that it would have adopted the Rule even without the time period provision. However, 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* indication that the PUC would *not*

¹¹ PUC Response at 6.

¹² *Texas Dept. of Banking v. Restland Funeral Home, Inc.*, 847 S.W.2d 680, 683 (Tex. App.-Austin 1993, no pet.) (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, pet. denied) (emphasis added).

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.”¹³ 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 time period provision.

Another indication that the PUC would not have adopted the Rule without the time period provision comes from Commissioner Parsley’s dissent in which she states: “When the rule was adopted, the Commission understood that the carrying costs would not begin to accrue until the date of the utility’s final true-up order, and that interest would accrue for a period of months, not years.”¹⁴ Commissioner Parsley’s statement of the Commission’s understanding at the time it adopted the Rule, that the interest rate portion of the Rule was closely tied to the time period portion of the Rule, is clearly some indication that the PUC would not have adopted Rule 25.263(1)(3) but for the time period portion therein.

It is irrelevant that neither Mr. Tietjen’s testimony nor Commissioner Parsley’s dissent represents the “agency’s official decision.”¹⁵ It is also irrelevant that the current Commission, in its Order in Docket No. 30706, held that it would have adopted Rule

¹³ PUC Docket No. 30706, Tr. at 705 (Apr. 8, 2005).

¹⁴ Order, Concurrence and Dissent of Commissioner Julie Parsley at 1-2, PUC Docket No. 30706 (July 14, 2005).

¹⁵ PUC Response at 8.

25.263(1)(3) even without the time period portion. The test is not whether the agency's official decision indicates that the rule would not have been adopted without the invalidated portion, or whether the *current* Commission would not have adopted the rule but for the invalidated portion; rather the test is whether there is *any* indication that the rule would not have been adopted without the invalidated portion. That test has clearly been met in this case.

Therefore, even if this Court finds that it did not invalidate the entire Rule 25.263(1)(3) in the *CenterPoint* case, it should nonetheless hold the rule invalid under the doctrine of severability because it meets the second prong of the test and so severance is not justified and the entire rule must fail.

III. The PUC's decision is arbitrary and capricious because the evidence does not support the 11.075% interest rate.

If this Court finds that the entire Rule 25.263(1)(3) was not invalidated by its decision in the *CenterPoint* case, and that the rule was properly severable, it must still rule in favor of GCCC and find that use of the unbundled cost of service ("UCOS") rate of 11.075% is arbitrary and capricious because it is not supported by substantial evidence. *CenterPoint's* WACC was well below 11.075% at the time this 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.

Furthermore, the application of an 11.075% return to the CTC balance will result in an enormous windfall to the Company, and cause customers the burden of massive additional costs. 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 arbitrary and capricious. The fact that the rule change only applies prospectively does not preclude this Court from using it as an indication that the PUC itself decided that an interest rate calculation conducted in this manner is unreasonable.

CONCLUSION AND PRAYER

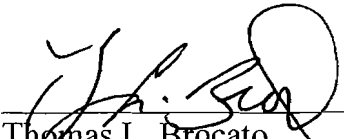
The Commission's decision in PUC Docket No. 30706 was based upon a rule that had been previously invalidated by the Supreme Court of Texas. However, even if the Court invalidated only the portion of the rule related to the time period in which interest would begin to accrue, the interest rate portion 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 at the expense of ratepayers.

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).

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.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I certify that I have served the foregoing Reply to the Public Utility Commission of Texas' Response to Texas Industrial Energy Consumers and Gulf Coast Coalition of Cities' Petitions for Review on counsel for the below parties, by Certified Mail Return Receipt Requested, on this 23rd day of December 2008, as follows:



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