

**NO. 08-0727**

TEXAS INDUSTRIAL ENERGY CONSUMERS;  
GULF COAST COALITION OF CITIES,  
Petitioners,

v.

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC;  
PUBLIC UTILITY COMMISSION OF TEXAS,  
Respondents.

**RESPONDENT'S BRIEF ON THE MERITS**

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## **STATEMENT OF JURISDICTION**

Petitioners assert jurisdiction under Tex. Gov't Code §§ 22.001(a)(1),(3), & (6). Jurisdiction is proper under sub-sections (3) insofar as the issues involve the correct construction of the Public Utility Regulatory Act ("PURA"). Sub-section (6) jurisdiction likewise appears proper in as much as Petitioners assert that the Supreme Court must correct an error of law made by the court of appeals. Jurisdiction under sub-section (1) does not appear appropriate—the courts of appeal do not disagree with one another on any question of law decided in this case.

## **ISSUES PRESENTED**

I. Whether the court of appeals correctly upheld the PUC's decision to apply the interest rate specified in PUC rule 25.263(1)(3) to CenterPoint's competition transition charge.

II. Whether the court of appeals correctly upheld the PUC's decision to permit CenterPoint to recover as rate case expenses the amounts CenterPoint paid for a control premium valuation panel.

## STATEMENT OF FACTS

This is another case about the transition from regulated retail electric rates to retail electric charges determined in a competitive market. As part of that transition, the Texas Legislature allowed formerly regulated utilities to recover investments stranded by competition through a competition transition charge (“CTC”) beginning on the first day of competition. Tex. Util. Code § 39.201 (d), (g), & (h) (The Public Utility Regulatory Act (“PURA”) is found in the Texas Utilities Code as Sections 11.001 - 66.017.). After two years of competition, the statute required the Public Utility Commission of Texas (“PUC”) to conduct a true up proceeding to determine remaining stranded costs as well as other amounts. *Id.* § 39.262. Based on that proceeding, the PUC could modify the CTC. *See* Tex. Util. Code § 39.262(g).

This appeal involves the proceeding to set the CTC that CenterPoint Energy Houston Electric, LLC (“CenterPoint”) would charge after the CenterPoint true-up proceeding. Because CenterPoint securitized most of its remaining stranded costs, the costs collected through this CTC are called “non-stranded” costs. The non-stranded costs contained in the CTC were first set, with interest, in CenterPoint’s true-up proceeding.<sup>1</sup> In CenterPoint’s true-up, the PUC set interest on the non-stranded amounts at 11.075

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<sup>1</sup> *See* Tex. Pub. Util. Comm’n, *Application of CenterPoint Energy Houston Electric, LLC for a Competition Transition Charge*, Docket No. 30706, AR, Item 145 at 3-5 (July 14, 2005) (“Order”) (attached in Appendix). Citations to exhibits and testimony in the administrative record of this docket will be in the following format: AR, Item \_\_ at \_\_ (name of document). Fact findings are “FFs,” Conclusions of Law are “COLs,” and Transcript cites are “Tr.”

percent,<sup>2</sup> and concluded that rate was appropriate independent of whether its rule compelled it to do so.<sup>3</sup> That decision, which approved of interest at 11.075 percent through December 2004, was initially challenged by ratepayers on appeal of CenterPoint’s true-up docket in district court, but was not pursued further. *See generally CenterPoint Energy Houston Elec., LLC v. Gulf Coast Coal. of Cities*, 252 S.W.3d 1 (Tex. App.—Austin 2008, pet. filed).

Less than one year later, the PUC approved the CTC for CenterPoint in Docket No. 30706.<sup>4</sup> At the time, the non-stranded amounts recovered through the CTC included updated interest at 11.075 percent<sup>5</sup> to account for the period between December 2004 until they were fully recovered.

Another amount recovered through the CTC was rate-case expenses arising out of the true-up proceeding, including a fee for the services of a “control premium valuation panel” of independent financial experts convened by the PUC pursuant to PURA § 39.262(h)(3).<sup>6</sup>

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<sup>2</sup> *See* Tex. Pub. Util. Comm’n, *Application of CenterPoint Energy Houston Electric, LLC, Reliant Energy Retail Services, LLC and Texas Genco, LP to Determine Stranded Costs and Other True-Up Balances Pursuant to PURA § 39.262*, Docket No. 29526 (Dec. 17, 2004) (Order on Rehearing). Petitions for review addressing certain issues from that docket—excluding the PUC’s decision to set interest at 11.075%—are now pending before this Court in Case No. 08-0421.

<sup>3</sup> *See id.* at 94.

<sup>4</sup> Order at 1, 50.

<sup>5</sup> *See* Order at 8-11, FFs 19-21, COLs 9-15.

<sup>6</sup> *Id.* at 29-31, FFs 65-69, COL 29.

Initially, four parties filed suits for judicial review against the PUC that raised three issues. The suits were consolidated into Cause No. GN5-03381 at the Travis County District Court.<sup>7</sup> The Travis County District Court, the Honorable W. Jeanne Meurer presiding, reversed the PUC’s final order.<sup>8</sup> Both the PUC and CenterPoint appealed, and the Third Court of Appeals reversed the District Court’s judgment and affirmed the PUC’s Order. *See CenterPoint Energy Houston Elec., LLC v. Gulf Coast Coal. of Cities*, 263 S.W.3d 448, 457-58 (Tex. App.—Austin 2008, pet. filed).

Two of the plaintiffs—the Gulf Coast Coalition of Cities (“Cities”) and the Texas Industrial Energy Consumers (“TIEC”) (jointly “Petitioners”)—have petitioned the Court for review of the Court of Appeals’ decision. They both challenge the PUC’s decision to use the 11.075 percent interest rate,<sup>9</sup> and TIEC alone challenges the PUC’s decision that CenterPoint could recover costs that were attributable to the control premium valuation panel’s fee.<sup>10</sup>

### **SUMMARY OF THE ARGUMENT**

The PUC properly applied an interest rate of 11.075 percent to CenterPoint’s CTC. Because the portion of PUC rule 25.263(l)(3) that specified the rate was not invalidated by this Court in *CenterPoint Energy v. Public Util. Comm’n*, 143 S.W.3d 81 (Tex. 2004),

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<sup>7</sup> Clerk’s Record (hereinafter, “CR”) at 002 *et seq.*; CR at 075 *et seq.*; CR at 148 *et seq.*; CR at 219 *et seq.*

<sup>8</sup> CR at 552 *et seq.*

<sup>9</sup> *See generally* TIEC’s and Cities’ Briefs on the Merits.

<sup>10</sup> *See* TIEC’s Petition at 11-14.

the PUC appropriately severed the still-valid rate portion of the rule and applied it to set interest. That rate is supported by substantial evidence.

The PUC also reasonably permitted CenterPoint to recover through its CTC a rate-case expense: the control premium valuation panel's fee from the true-up proceeding. The statute requiring the utility to pay for the panel, Tex. Util. Code section 39.262(h)(3), explains that the PUC is not liable to pay for the panel. It does not replace the long-standing ability of utilities to recover the reasonable costs of participating in agency proceedings.

## **ARGUMENT**

### **Standard of Review**

The Court reviews questions of law such as issues of statutory construction and rule severability *de novo*. See, e.g., *Liberty Mut. Ins. Co. v. Tex. Dep't of Ins.*, 187 S.W.3d 808, 819 (Tex. App.—Austin 2006, pet. denied). 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).

Under the arbitrary and capricious standard, an agency decision generally is not arbitrary and capricious if it is supported by substantial evidence. *See Hinkley v. Tex. State Bd. of Med. Exam'rs*, 140 S.W.3d 737, 743 (Tex. App.—Austin 2004, pet. denied) (“An administrative decision is generally not arbitrary and capricious if it is supported by substantial evidence.”).

**I. The PUC properly applied the interest rate required by its rule 25.263(l)(3) to the unpaid true-up amounts. (Responds to TIEC’s Issue 1 and Cities’ sole issue)**

**A. The Court of Appeals rightly read this Court’s opinion in *CenterPoint Energy* as having left the rule setting interest on the true-up balances intact.**

Twice now, the Court of Appeals has affirmed the PUC’s use of its original true-up rule to set interest on the true-up balances. Once, in the appellate decision below,<sup>11</sup> and again in another utility’s true up.<sup>12</sup> These decisions properly concluded that this Court, in *CenterPoint Energy*, invalidated only the portion of rule 25.263(l)(3) governing the interest accrual date. The Petitioners rigid adherence to a single clause in single sentence in the *CenterPoint Energy* opinion cannot change this Court’s deliberately-stated

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<sup>11</sup> *See CenterPoint Energy Houston Elec.*, 263 S.W.3d at 458 (holding that the appellate court’s previous decision in *AEP Tex. Cent. Co. v. Public Util. Comm’n*, 258 S.W.3d 272, 296-97 (Tex. App.—Austin 2008, pet. filed), in which the court upheld the PUC’s use of the severed-rate portion, controlled, and that “[a]s the rule’s rate provision had remained in effect, the Commission did not err or act arbitrarily or capriciously by complying with the mandate of its own rule and awarding CenterPoint 11.075 percent interest on its uncollected [competition transition charge] balance.”).

<sup>12</sup> *See AEP Tex. Cent. Co.*, 258 S.W.3d at 296-97 (“[T]he supreme court’s decision in *CenterPoint Energy* did not invalidate that portion of the rule regarding the interest rate . . . .”) (Patterson, J., concurring and dissenting).

decision on the sole question before it about the PUC's true-up interest rule. Numerous times, the Court announced the only issue for decision was whether the PUC's interest rule allowed sufficient time for interest on stranded costs to accrue. The Court should reject the Petitioners arguments to the contrary, and should affirm the court of appeals' decision.

This Court precisely stated the issue decided in *CenterPoint Energy* and announced the narrow decision to strike the interest date portion of rule 25.263(l)(3)<sup>13</sup> no fewer than four times: "The *only* issue before us is the date from which carrying costs may be recovered once deregulation commenced[.]" *CenterPoint Energy*, 143 S.W.3d at 83 (emphasis added). "The *only* issue is whether the Act contemplates roughly a two-year gap in recovery of carrying costs between the date regulation ceased (January 1, 2002) and the date of a final true-up order (2004 or perhaps beyond)." *Id.* at 86 (emphasis added). "We must decide whether the Commission's failure to permit the recovery of carrying costs for approximately a two-year period after regulated rates ended and customer choice began violates the Act." *Id.* "We conclude that the Commission's construction of chapter 39 was incorrect regarding the *date* as of which stranded costs are to be determined. . . . Because the Commission's rule is based on an incorrect construction of the Act *in this regard*, it is infirm." *Id.* at 87 (emphasis added).

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<sup>13</sup> At the time, Rule 25.263(l)(3) provided in pertinent part: "The TDU shall be allowed to recover . . . carrying costs on the true-up balance. Carrying costs shall be calculated using the utility's cost of capital established in the utility's [unbundled cost of service] proceeding, and shall be calculated from the period of time from the date of the true-up final order until fully recovered." 26 Tex. Reg. 10498 (2001).

Despite these statements, Petitioners maintain that the Court unqualifiedly struck the entire rule.<sup>14</sup> But the sentence Petitioners rely upon contains a limitation in its dependent clause: “[f]or the reasons considered above, we hold that Rule 25.263(l)(3) is invalid, and we remand this proceeding to the Commission for further consideration.” *CenterPoint Energy*, 143 S.W.3d at 99 (emphasis added). Since the opinion does not mention the interest rate provision—because no party challenged its validity—the “reasons considered above” necessarily refer to the Court’s discussion of the interest rate provision’s validity. Thus, the Court’s holding demonstrates once more that the Court only decided the issue of when interest on stranded costs began accruing.

The court of appeals appreciated the specificity of the *CenterPoint Energy* opinion. But Petitioners claim the Court could “easily have crafted a holding that invalidated only a portion of P.U.C. Subst. R. 25.263(l)(3),”<sup>15</sup> and that “[the Court] could have held that ‘the portion of the Rule addressing when interest begins to accrue is inconsistent with the Legislature’s intent.’”<sup>16</sup> Albeit not verbatim, the Court effectively stated as much:

We hold that Rule 25.263(l)(3) is inconsistent with the Legislature’s intent, expressed in Chapter 39 of the PURA, that utilities fully recover their ‘net, verifiable, nonmitigable stranded costs incurred in purchasing power and providing electric generation service,’ that ‘exist on the last day of the freeze period [December 31, 2001].’ A two- or three-year gap in recovery of carrying costs would not permit generation companies full recovery of their stranded costs as the Legislature envisioned.

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<sup>14</sup> See TIEC’s Brief on the Merits at 5; see also Cities’ Brief on the Merits at 6.

<sup>15</sup> Cities’ Brief on the Merits at 8.

<sup>16</sup> TIEC’s Brief on the Merits at 7.

*CenterPoint Energy*, 143 S.W.3d at 84. Relying on the quoted section, the court of appeals in *AEP Tex. Cent. Co.* found that “the text of the supreme court’s opinion . . . only invalidated that portion of the rule relating to the date on which carrying costs, or interest, began to accrue.” *AEP Tex. Cent. Co.*, 258 S.W.3d at 297. This holding did not “dramatically oversimplif[y]” the *CenterPoint Energy* opinion, as Petitioner TIEC argues.<sup>17</sup> Instead, the court of appeals follows the Court’s express holding and avoids imputing to the Court a decision on an issue not before it.

The court of appeals, like the PUC, reasonably hewed to the Court’s many statements about the sole issue it resolved.<sup>18</sup> It is unlikely that the Court unilaterally invalidated the interest rate provision of the rule when no party requested such relief and without explanation. Courts carefully adjudicate validity because overbroad pronouncements could encroach upon an agency’s rulemaking authority—presenting a separation of powers problem. *See Tex. Dep’t of Banking v. Restland Funeral Homes, Inc.*, 847 S.W.2d 680, 683 (Tex. App.—Austin 1993, no writ) (“We are obliged to respect the autonomy of state administrative agencies in their administration of regulatory statutes. And this attitude requires caution in what we may impute to their rulemaking and other actions.”).

Since the Court itself did not address the rate provision, the Petitioners can only speculate as to why the Court might have invalidated it. The Petitioners’ hypothesis that

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<sup>17</sup> TIEC’s Brief on the Merits at 7.

<sup>18</sup> *See* Order at 8-11.

the Court could have invalidated the rate portion of the rule because of the integral relationship between interest rates and their recovery periods is internally inconsistent.<sup>19</sup> Petitioners argue that the rate was relatively high because the PUC originally intended it to apply only for a short period.<sup>20</sup> But Petitioners' illustration that loans with longer recovery periods have higher interest rates disproves their argument considering that the Court in *CenterPoint Energy* lengthened the recovery period for stranded cost interest recovery to include the intervening years between competition's inception and the true-up proceeding. *See CenterPoint Energy*, 143 S.W.3d at 84. This result from the *CenterPoint Energy* decision would arguably call for an even higher rate than the 11.075 percent rate Petitioners decry as excessive.

For these reasons, the court of appeals' and the PUC's conclusion that the Court had only partially invalidated the rule was supported by the whole text of the *CenterPoint* opinion, and was, in any event, reasonable. So too was the PUC's decision to conduct a severance analysis on the rule's remaining rate portion.

**B. The Court of Appeals correctly affirmed the PUC's severance analysis.**

The valid interest rate part of the rule withstands the *Restland Funeral Homes* severability test. Both the PUC and the court of appeals reached that conclusion, and it should be affirmed.

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<sup>19</sup> *See* TIEC's Brief on the Merits at 8; *see also* Cities' Brief on the Merits at 9.

<sup>20</sup> *See* TIEC's Brief on the Merits at 10.

*Restland Funeral Homes* created a two-part test. If only part of an agency rule is invalid, the court must decide “(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.” *Restland Funeral Homes, Inc.*, 847 S.W.2d at 683.

All agree that the interest rate part of the rule passes the first prong, but Petitioners complain that the valid interest rate part fails the test’s second prong. For several reasons, their argument is wrong—there is no indication that the PUC would not have adopted the interest-rate provision but for the invalid interest-date provision.

First, nothing in the contemporaneous rulemaking record indicates that the PUC would have adopted the rate and date portions only in tandem. *See* 26 Tex. Reg. 10498, 10519 (2001). The PUC’s rulemaking statements that interest accrued on true-up balances “only accrue from [the date of the final true-up order] forward”<sup>21</sup> gives no indication that the chosen interest rate is inseparable from the interest date, and merely recognizes the obvious fact that interest cannot accrue until the balance exists. In contrast, the court in *Restland Funeral Homes* found that the agency’s response to comments in the rulemaking record provided “very strong and affirmative indications” that the rule sections at issue were inseparable from the invalidated provision. *Restland*

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<sup>21</sup> Tex. Pub. Util. Comm’n, *Rulemaking Concerning True-Up Proceeding Under PURA § 39.262*, Project No. 23571 (Order at 98) (Dec. 4, 2001).

*Funeral Homes, Inc.*, 847 S.W.2d at 683. Absent such agency statements here, it is unreasonable to impute to the PUC any intent to adopt the provisions only in tandem. The interest-rate portion of the rule stands.

Second, Petitioners claim that only contemporaneous statements are appropriate but then cite *post-hoc* testimony of a PUC staff member in this proceeding as well as a commissioner dissenting in this proceeding.<sup>22</sup> But, neither staff testimony nor a single commissioner’s dissent represents the agency’s official decision. The Court reviews the agency’s decision as stated by its majority. *See State v. Pub. Util. Comm’n*, 110 S.W.3d 580, 588 (Tex. App.—Austin 2003, no pet.) (“It is the order of the Commission . . . that is reviewed by the Courts.”). The *Restland Funeral Homes* test recognizes this principle and expressly looks for “any indication that the *agency* would not have adopted the rule but for the invalid part.” *Restland Funeral Homes, Inc.*, 847 S.W.2d at 683 (emphasis added). It does not consider the indications of “anyone in the agency” who might hold the view that a rule’s provisions are inseparable. The problem with denying severance on the basis of such un-official statements is apparent: “any” unofficial example of conflicting testimony or dissent could subvert an agency’s majority decision.

For the same reasons, Petitioners argument for a “more demanding severability test (satisfied by ‘any indication’ that the Rule’s interest rate would not have been adopted without the Rule’s date” poses an additional problem.<sup>23</sup> It undermines the *Restland*

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<sup>22</sup> *See* TIEC’s Brief on the Merits at 10, 12; *see also* Cities’ Brief on the Merits at 11-12.

<sup>23</sup> TIEC’s Brief on the Merits at 11-12.

*Funeral Homes* test’s intrinsic appreciation for an agency’s “autonomy. . . in [its] administration of regulatory statutes” by allowing the Court to indirectly make policy by bestowing veto power on un-official agency statements. *Restland Funeral Homes, Inc.*, 847 S.W.2d at 683. This argument should be rejected

Third, if any weight is to be given to *post-hoc* severance positions, the Court should defer to the PUC’s decision in its order that it *would have* adopted the valid interest rate without the invalid interest date. That decision shows the illogic of inseparably linking the two portions of the rule:

There is no logical connection between the accrual of interest at a utility’s UCOS WACC and the time period specified by the rule, and accrual period beginning on the date of the true-up order and ending upon full recovery of the true-up balance. The independence of these two concepts—the required interest rate and accrual period—is demonstrated by the fact that the rule requires interest to accrue over an unknown period that would only begin several years after the adoption of the rule. Because the Commission could not know when the accrual period would begin or how long it would last, there can be no link between that period and the rate specified in the rule.<sup>24</sup>

The PUC made it clear that it would have adopted the rule even without the invalidated part, thus satisfying the second prong of the severability test. The agency’s interpretation of its own rule should be afforded deference. *See Pub. Util. Comm’n v. Gulf States Utils. Co.*, 809 S.W.2d 201, 207 (Tex. 1991) (“The Commission’s interpretation of its own regulations is entitled to deference by the courts.”).

Petitioners wrongfully assert that the Court affords no deference to the PUC’s decision to sever the interest rate provision. When determining an agency rule’s validity,

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<sup>24</sup> Order at 10.

the Court considers its constitutionality and whether it conforms procedurally and substantively to the agency's enabling legislation. *See Restland Funeral Homes, Inc.*, 847 S.W.2d at 683. In defense of its challenged rule, the agency's construction of the underlying statute upon which its rule is based receives deference. This Court has so held in a previous PUC rule challenge. *See Pub. Util. Comm'n v. City Pub. Serv. Bd. of San Antonio*, 53 S.W.3d 310, 316 (Tex. 2001) (“[W]e consider the agency's interpretation of its own powers only if that interpretation is reasonable and not inconsistent with the statute.”) (citing *Tarrant Appraisal Dist. v. Moore*, 845 S.W.2d 820, 823 (Tex. 1993) (“Construction of a statute by the administrative agency charged with its enforcement is entitled to serious consideration, so long as the construction is reasonable and does not contradict the plain language of the statute.”))).

Whether another part of the same rule may be severed likewise depends on its validity. The severance test determines that validity by examining agency-generated indicia of connectedness between the invalid and remaining portion. *See Restland Funeral Homes, Inc.*, 847 S.W.2d at 683. Since failing the severance test invalidates the remaining provision, the agency's opinion about that part's independence from the stricken portion—and thus its continued validity in the context of the statutory framework—receives deference, just as when the provision is challenged directly.

In sum, this Court should affirm the court of appeals' and PUC's proper severance of the interest rate portion of rule 25.263(I)(3): there is no simple indication that the PUC would not have adopted the interest rate provision but for the invalid interest rate portion.

And in any event, the PUC’s interpretation of the rule’s interest rate provision as independent from the date of accrual is reasonable.

**C. The interest decision is not arbitrary and capricious.**

The PUC properly applied the remaining, valid interest rate portion of the rule and set CenterPoint’s interest using its cost of capital from its unbundled cost of service (“UCOS”) proceeding.<sup>25</sup> To do otherwise would have been arbitrary and capricious. *Rodriguez v. Service Lloyds Ins. Co.*, 997 S.W.2d 248, 255 (Tex. 1999) (“If [an agency] does not follow the clear, unambiguous language of its own regulation, we reverse its action as arbitrary and capricious.”). Thus, the PUC did not need to make independent findings of the rate’s reasonableness, as petitioners contend,<sup>26</sup> since the rule compelled setting CenterPoint’s interest at the utility’s UCOS cost of capital. The record shows that rate was 11.075%.<sup>27</sup>

The record evidence supports the reasonableness of the PUC’s decision to adopt the 11.075 percent rate.<sup>28</sup> The rebuttal testimony of CenterPoint witness Frank Huntowski provides ample evidence upon which the PUC could reasonably have based its

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<sup>25</sup> See Order at FFs 19-21.

<sup>26</sup> See TIEC’s Brief on the Merits at 13-14; see also Cities’ Brief on the Merits at 15.

<sup>27</sup> See AR, CNP Ex. 11 (Huntowski Rebuttal) at 4.

<sup>28</sup> See *Tex. Health Facilities Comm’n v. Charter Medical Dallas, Inc.*, 665 S.W.2d 446, 452 (Tex. 1984) (holding that under the substantial evidence rule the “true test is not whether the agency reached the correct conclusion but whether some reasonable basis exists in the record for the action taken by the agency” and that “[a] reviewing court is not bound by the reasons given by the agency in its order, provided there is a valid basis for the action taken by the agency”).

rate choice. His testimony squarely addresses the Petitioners' concerns about the appropriateness of the rate given the associated risk in CTC recovery.<sup>29</sup> The Petitioners have therefore failed to carry their burden to prove that substantial evidence does not support the PUC's decision.

The PUC's decision to set interest on the CTC using CenterPoint's UCOS cost of capital is reasonable even if the Court struck the entire rule in *CenterPoint Energy*. In the earlier CenterPoint true-up proceeding, the appeal of which is also before this Court, the PUC—considering the Court's *CenterPoint Energy* opinion—found that it would have adopted the same rate even if the rule had not applied.<sup>30</sup> That decision preceded the CTC docket by less than one year. The PUC's use of CenterPoint's UCOS cost of capital to set CTC interest is also reasonable because it is logically consistent with the Court's holding in *CenterPoint Energy* that PURA contemplated the accrual of interest on stranded costs as of the start of competition. *See CenterPoint Energy*, 143 S.W.3d at 84. The PUC's decision to apply the still-valid rate provision of that rule comports with *CenterPoint Energy* because it calculates interest with a rate reflecting CenterPoint's capital costs at the beginning of competition. By contrast, Petitioners maintain that the appropriate cost of capital to apply would be CenterPoint's rate *after* the accrual period had passed and

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<sup>29</sup> *See* Huntowski Rebuttal at 6 (beginning line 3).

<sup>30</sup> *See* Tex. Pub. Util. Comm'n, *Application of CenterPoint Energy Houston Electric, LLC, Reliant Energy Retail Services, LLC and Texas Genco, LP to Determine Stranded Costs and Other True-Up Balances Pursuant to PURA § 39.262*, Docket No. 29526 at 94 (Dec. 17, 2004) (Order on Rehearing). As noted *supra*, approval of interest on CenterPoint's non-stranded cost amounts at 11.075 percent through December 2004 is no longer being challenged.

after the true-up began. This argument is plainly inconsistent with *CenterPoint Energy's* recognition that interest on stranded costs existed before the true-up and should be rejected.

Petitioners' complaints that an 11.075% interest rate is outdated and unreasonably high improperly ask this Court to weigh the evidence. Petitioners cite no legal principle that required the PUC to re-determine CenterPoint's capital costs in this proceeding. Nor does this Court's *CenterPoint Energy* opinion provide support. Instead, Petitioners claim amounts to an argument that their evidence is more credible. That invites the Court to weigh the evidence in violation of the substantial evidence rule. *See* Tex. Gov't Code § 2001.174.

Petitioners' other argument that the PUC's later amendment of the rule setting interest on stranded costs somehow constitutes a recognition that it erred in setting CenterPoint's rate in this case should also be rejected.<sup>31</sup> The rule as amended applies prospectively only. *See* 31 Tex. Reg. 5603, 5608 (2006) (stating that "changes to the interest rates on utilities' unsecuritized balances will be applied on a prospective basis"). Thus, the appropriate interest rate in the PUC decision challenged in this proceeding remains governed by the previous, and properly severed version of Rule 25.263(l)(3).

For the foregoing reasons, the court of appeals committed no error by finding that the PUC properly applied its still-valid interest-rate rule.

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<sup>31</sup> *See id.* 14; *see also* Cities' Brief on the Merits at 15.

**II. The PUC complied with the governing statutes—PURA §§ 39.262(h)(3) and 36.061(b)(2)—when it included the valuation panel’s fee in the CTC.  
(Responds to TIEC’s Issue 2)**

The PUC did not exceed its statutory authority but exercised its statutorily-granted discretion when it allowed CenterPoint to recover the valuation-panel fee as a reasonable cost of participating in a proceeding under PURA.<sup>32</sup> The decision does not conflict with either the requirement that Texas Genco (the transferee)—as opposed to the PUC—pay the cost of the valuation panel in PURA § 39.262(h)(3), or the provision permitting CenterPoint to recover the reasonable expenses of participating in PURA-authorized proceedings in PURA § 36.061(b)(2). The court of appeals correctly recognized that the PUC’s construction of the two statutes harmonized them, and that decision should be affirmed. *See Gulf Coast Coal. of Cities*, 263 S.W.3d at 458-62.

PURA section 39.262(h) provides the four methods to quantify an electric utility’s stranded costs. Subsection (h)(3) details the “partial stock valuation method” to determine the market value of generation assets as part of determining stranded costs. This subsection fixes market value based on the spin off and sale of between 19% and 51% of stock after the utility has transferred its generation assets to another company—here Texas Genco. *See* Tex. Util. Code § 39.262(h)(3). After trading establishes the market value of those shares, the statute permits the PUC to convene a valuation panel of independent financial experts to determine whether a premium exists for the shares the utility retained. Subsection (h)(3) also provides “[t]he costs and

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<sup>32</sup> *See* Order at 29-30, FFs 65-69.

expenses of the panel, as approved by the commission, shall be paid by each transferee corporation.” *Id.*

Instead of recognizing that the partial-stock-valuation method does not prohibit utility recovery of the valuation panel expenses, TIEC argues that the PUC erred by permitting CenterPoint to recover the valuation-panel fee because section 39.262(h)(3) expressly requires that the transferee pay that cost.<sup>33</sup>

TIEC’s argument fails. Subsection 39.262(h)(3) is satisfied because, under the pertinent agreements among the parties, the transferee was legally and contractually responsible for the payment of the fee to JP Morgan.<sup>34</sup> That provision exempts the PUC from liability for convening the panel. And it imposes no limit on one of the joint applicants guaranteeing and ultimately paying for the panel. The record established that, in order to engage the panel, JP Morgan required CenterPoint to guarantee the panel’s fee, rather than Texas Genco. And CenterPoint ultimately bore the expense.<sup>35</sup>

TIEC also wrongfully posits that the Legislature intended only the transferee to pay for the panel because CenterPoint could have chosen a different stranded-cost valuation method which would not have included such an expense.<sup>36</sup> This argument ignores that section 39.262(h)(3) vests the PUC, not the utility, with the option to convene

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<sup>33</sup> See TIEC’s Brief on the Merits at 15-19.

<sup>34</sup> See AR, Ex. CNP-38 at 2, 4 (contract between JP Morgan and the PUC for the valuation panel fee making Texas Genco liable for payment).

<sup>35</sup> AR, Tr. Vol. E at 773-75; AR, COMM. Ex. 1.

<sup>36</sup> See TIEC’s Brief on the Merits at 19.

the panel. *See* Tex. Util. Code § 39.262(h)(3) (“The commission may accept the market valuation to conclusively establish the value of the . . . transferee corporation *or convene a valuation panel* . . . to determine . . . whether a control premium exists for the retained interest.”) (emphasis added). Because the PUC—not CenterPoint—decided to convene the panel, TIEC’s complaint about the inequity of ratepayers bearing this expense rings hollow. The statute was not designed to foreclose use of the partial-stock-valuation method.

The PUC’s decision to allow CenterPoint to recover the fee also complied with PURA § 36.061(b)(2). That subsection grants the PUC express discretion to permit recovery of the reasonable cost of participating in proceedings that are authorized under PURA. *See* Tex. Util. Code § 36.061(b)(2). Indisputably, the CTC proceeding is authorized by PURA. And the PUC found that the expenses were reasonable.<sup>37</sup> Using its discretion under an express grant of authority to permit CenterPoint recovery of its costs for the control premium does not constitute an *ultra vires* act for an unreasonable expense as TIEC alleges.<sup>38</sup> Because the control panel’s valuation work was an integral part of the Legislature’s design for quantifying stranded costs under the partial-stock-valuation method in section 39.262(h)(3)—it follows that recovery of expenses to execute this part of the de-regulatory plan is reasonable.<sup>39</sup>

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<sup>37</sup> Order at FF 68.

<sup>38</sup> *See* TIEC’s Brief on the Merits at 17.

<sup>39</sup> *See* Order at FF 69 (“The true-up applicants were required to incur this expense by the Commission, and the expense was necessary for the resolution of this case.”).

TIEC contends that those statutes conflict and that section 39.262(h)(3), the more specific statute, should be given precedence over the more general section 36.061(b)(2).<sup>40</sup> But, as the court of appeals correctly held, there is no conflict. *See Gulf Coast Coal. of Cities*, 263 S.W.3d at 461 (“Under ‘CenterPoint’s and the PUC’s construction of PURA section 39.262(h)(3) . . . the two provisions would be entirely harmonious with one another.”). Applying the presumption that the Legislature “enacts a statute . . . with awareness of the existing body of law,” the court of appeals noted, “the legislature gave no express indication in PURA section 39.262(h)(3) about prohibiting application of PURA section 36.061(b)(2)’s preexisting cost-recovery regime to true-up proceedings involving a valuation panel.” *Id.* TIEC’s argument that the PUC lacked the power to permit recovery of these costs should be rejected as it fails to harmonize the two provisions. The two statutes simply address different matters.

In sum, the court of appeals and the PUC reasonably interpreted PURA to allow CenterPoint, as a guarantor for the transferee’s obligation, recovery of the valuation panel’s fee and properly exercised its explicitly granted discretion to do so. That interpretation is entitled to deference and should be affirmed. *See State v. Pub. Util. Comm’n*, 883 S.W.2d 190, 196 (Tex. 1994) (explaining that courts give great weight to an agency’s own construction of a statute).

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<sup>40</sup> *See* TIEC’s Brief on the Merits at 15-19.

## **CONCLUSION AND PRAYER**

For the foregoing reasons, the PUC respectfully prays that the Court deny TIEC and Cities' petitions for review. Should the Court grant review, the PUC prays that the Court affirm the PUC's Order in all things.

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## Certificate of Service

I certify that a true and correct copy of this Respondent's Brief on the Merits has been sent by first class, United States mail unless otherwise indicated on this 27th day of April, 2009, to the attorneys listed below. As a courtesy, copies of the brief, without the appendix have been e-mailed.

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