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APPLICATION OF CENTERPOINT §
ENERGY HOUSTON ELECTRIC, LLC §
FOR A FINANCING ORDER §

BEFORE THE
PUBLIC UTILITY COMMISSION
OF TEXAS

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January 24, 2005

TABLE OF CONTENTS

<u>Description</u>	<u>Page</u>
Rebuttal Testimony of James S. Brian.....	2-60
ELECTRONIC FILES:	
Rebuttal Testimony James S. Brian.pdf	
Workpapers.....	61-90
Certificate of Service.....	91

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**APPLICATION OF CENTERPOINT
ENERGY HOUSTON ELECTRIC, LLC
FOR A FINANCING ORDER**

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**BEFORE THE
PUBLIC UTILITY COMMISSION
OF TEXAS**

REBUTTAL TESTIMONY OF

JAMES S. BRIAN

FOR

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC

JANUARY 24, 2005

TABLE OF CONTENTS

TABLE OF FIGURES..... i

EXECUTIVE SUMMARYES-1

I. INTRODUCTION1

II. ADFIT ISSUES1

A. ADFIT ASSOCIATED WITH GENERATION ASSETS AND THE PORTION OF ADFIT ALLOCABLE TO STRANDED COSTS AND REGULATORY ASSETS BEING SECURITIZED.....5

B. ADFIT BENEFIT ON ADFIT NOT RELATED TO STRANDED COSTS OR SFAS 109 REGULATORY ASSETS.....17

C. PROPER PERIOD OVER WHICH TO CALCULATE ADFIT BENEFITS21

D. PROPER DISCOUNT RATE TO COMPUTE ADFIT BENEFITS.....24

III. INTEREST AND EMC ISSUES.....30

TABLE OF FIGURES

<u>FIGURE</u>	<u>DESCRIPTION</u>
JSB-1R	Excerpts from Testimony and Workpapers in Docket No. 29526
JSB-2R	Schedule IX from Docket No. 29526
JSB-3R	Correction of Exhibit EB-2 of Ms. Blumenthal's Direct Testimony
JSB-4R	Correction of Exhibit DT-4 of Mr. Tietjen's Direct Testimony
JSB-5R	ADFIT Benefit at 7.2%
JSB-6R	Benefit of Securitizing Post-December 17, 2004 Interest and EMC
JSB-7R	Securitization Amount as of June 1, 2005

EXECUTIVE SUMMARY

James S. Brian is the Senior Vice President and Chief Accounting Officer of CenterPoint Energy, Inc. and CenterPoint Energy Houston Electric, LLC ("CenterPoint Houston"). Mr. Brian's rebuttal testimony focuses on issues relating to accumulated deferred federal income taxes ("ADFIT"), interest on stranded costs, and excess mitigation credits ("EMCs").

ADFIT balances represent amounts that will be paid in taxes at a later time. The Commission decided in the true-up proceeding, Docket No. 29526, that reducing stranded costs by ADFIT was inappropriate but that benefits CenterPoint Houston receives from the cost-free capital it believed was associated with ADFIT should be accounted for in the securitization proceeding. This benefit is calculated by first determining the amount of ADFIT allocable to the stranded costs and SFAS 109 regulatory assets being securitized; then determining the amount of benefit CenterPoint Houston receives during the securitization period; and then determining the present value of such benefit. The calculation should be made using the interest rate from the transition bonds issued in this proceeding but in any event should be an after-tax rate. In his rebuttal testimony, Mr. Brian identifies four overarching errors Intervenor witnesses make in their ADFIT-related calculations.

1. *Intervenor witnesses incorrectly determine the amount of ADFIT associated with generation assets and the amount allocable to stranded costs and SFAS 109 regulatory assets.* Overly simplistic methods of calculating ADFIT associated with generation assets that fail to allocate actual ADFIT amounts result in double counting of ADFIT. Time value benefits already settled in Docket No. 21665 must be accounted for, and recoverable stranded costs should not be reduced by benefit amounts calculated on ADFIT not provided by ratepayers. ADFIT amounts that accrued after generation assets became deregulated on December 31, 2001, do not affect

ADFIT benefits being determined in this proceeding because post-deregulation amounts are not provided by ratepayers

2. *Intervenor witnesses overstate the amount of the ADFIT benefit CenterPoint Houston has received by including an ADFIT benefit not related to CenterPoint Houston's stranded costs and SFAS 109 regulatory assets recovery.* After December 31, 2001, generation assets were no longer included in rate base and were no longer subject to Commission regulatory rate regulation. The market value of those assets is to be recovered through unregulated market transactions and not from ratepayers; therefore, ADFIT related to market value is not relevant. Only ADFIT allocable to stranded costs and SFAS 109 regulatory assets is relevant.

3. *Intervenor witnesses double-dip by calculating benefits for 2002 and 2003, which the Commission already used to calculate the return included in the capacity auction true-up amounts in Docket No. 29526.* The ADFIT benefit allocable to stranded cost recovery should be computed over the securitization period, as directed by the Commission in its final order in Docket No. 29526. Even if ADFIT benefits were to be measured from January 1, 2002, ratepayers have already received the cost-free capital benefit of ADFIT for 2002 and 2003, and including it again in this proceeding would pay the ratepayer twice for the same benefit.

4. *Intervenor witnesses use an inappropriate discount rate to calculate the benefits of cost-free capital and the present value of the ADFIT benefit.* One of the basic principles of conventional ratemaking that also applies to the securitization proceeding is that ADFIT benefit is shared with ratepayers at the same rate of return ratepayers pay on the asset to which such ADFIT relates. If there is a change in a utility's rate of return, then the rate of return the ratepayers pay on the asset and the ADFIT associated with such asset both change. In the securitization proceeding, the rate will change from CenterPoint Houston's weighted average

cost of capital to the transition bond interest rate. Therefore, the bond rate set forth in Mr. Brian's direct testimony is the correct rate to use to determine the ADFIT benefit. If the Commission determines the bond rate is not the correct rate, then the correct rate cannot exceed CenterPoint Houston's after-tax average weighted cost of capital of 7.2%. Although the witnesses purport to be calculating benefits CenterPoint Houston would receive through investment of allegedly cost-free capital, they ignore the effect of federal income taxes on the return CenterPoint Houston earns. By using a pre-tax, instead of an after-tax return to compute benefits, they significantly overstate the benefits CenterPoint Houston can actually receive and effectively preclude it from recovering its stranded costs. Regardless of the rate chosen, the rate must be the same for the rate of return and for the discount rate to ensure comparison of equivalent sums.

Some Intervenors suggest that the entire ADFIT benefit should be considered in the competition transition charge ("CTC") proceeding, which will occur subsequent to this securitization proceeding. The ADFIT associated with securitized stranded costs and SFAS 109 regulatory assets will convert to a current tax obligation as the transition charges are received. Consequently, any benefit derived from ADFIT related to those costs and assets ties directly to the transition charge payment stream. As long as the amount and present value of the benefit are correctly determined by reference to the transition charge payment stream, CenterPoint Houston does not object to using that present value to reduce the CTC instead of reducing the amount securitized.

CenterPoint Houston is entitled to carrying costs on stranded costs and to recover all EMCs paid out through the date of issuance of the transition bonds. There is no longer any dispute that CenterPoint Houston is entitled to recover carrying costs on stranded costs from

December 31, 2001. Despite Intervenor claims, no authority suggests that there is a gap (from the date of the final order in Docket No. 29526 until the transition bonds are issued) during which no carrying costs accrue.

I. INTRODUCTION

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Q. PLEASE STATE YOUR NAME AND OCCUPATION.

A. My name is James S. Brian. I am the Senior Vice President and Chief Accounting Officer of CenterPoint Energy, Inc. ("CenterPoint Energy") and of CenterPoint Energy Houston Electric, LLC ("CenterPoint Houston").

Q. ARE YOU THE SAME JAMES S. BRIAN WHO OFFERED DIRECT TESTIMONY IN THIS CASE?

A. Yes.

Q. PLEASE STATE THE PURPOSE OF YOUR REBUTTAL TESTIMONY.

A. The purpose of my testimony is to: (1) respond to the Intervenor testimony concerning accumulated deferred federal income taxes ("ADFIT") and (2) address issues related to interest and excess mitigation credits ("EMCs").

II. ADFIT ISSUES

Q. WHAT IS THE ADFIT ISSUE?

A. Put simply, the ADFIT issue for this proceeding is: What is the present value of the benefit CenterPoint Houston derives from cost-free capital reflected in the ADFIT balance that relates to the stranded costs and SFAS 109 regulatory assets to be securitized? (For purposes of this proceeding, it is assumed that such ADFIT are a source of cost-free capital.) One of the many issues in Docket No. 29526 was whether and how the ADFIT balance associated with generation assets affected the amount of stranded costs CenterPoint Houston was permitted to recover. ADFIT balances generally represent tax amounts that under book accounting must be accrued but under federal tax

1 law do not have to be paid in taxes until a later date. They arise primarily from
2 differences between the time at which income or expenses are recognized for book
3 accounting purposes and the time at which the same income or expenses are recognized
4 for tax purposes. In Docket No. 29526, the Commission concluded that, because the
5 ADFIT balance eventually would be paid to the IRS, it was inappropriate to reduce
6 CenterPoint Houston's recovery in the true-up proceeding by the ADFIT balance, but that
7 the "benefit enjoyed by CenterPoint due to the *cost-free capital* provided by its ADFIT
8 reserve should be accounted for in the subsequent proceeding." Conclusion of Law 147
9 at 202 (emphasis added).

10 The Commission's decision that ratepayers should receive the benefit associated with the
11 deferred tax balance reflected its understanding that "the funds represented by the ADFIT
12 balance were *received from ratepayers* over the depreciable lives of the assets, and the
13 joint applicants will have use of those funds through the recovery period in a declining
14 amount as the account is reversed upon the company incurring current tax liability on its
15 stranded-costs recovery." Order at 80 (emphasis added).

16 **Q. WHAT STEPS ARE INVOLVED IN CALCULATING THE ADFIT BENEFIT?**

17 **A.** The first step in calculating the ADFIT benefit is to determine the amount of ADFIT that
18 is properly allocable to stranded costs and SFAS 109 regulatory assets that are being
19 securitized in this proceeding. After the appropriate ADFIT balance is determined, it is
20 then necessary to determine how much benefit, if any, CenterPoint Houston receives over
21 the securitization period from having the cost-free capital provided by the ADFIT in a
22 declining amount. The amount declines as CenterPoint Houston pays tax liability on its

1 recovery of stranded costs. The final step is to determine the present value of those
2 future benefits.

3 **Q. WHAT IS CENTERPOINT HOUSTON'S POSITION REGARDING THE**
4 **PROPER CALCULATION OF ADFIT BENEFITS?**

5 A. The proper method for calculating the ADFIT benefits is as follows:

- 6 • The only ADFIT benefits to be determined in this proceeding are those related to
7 the stranded costs and SFAS 109 regulatory assets being securitized.
- 8 • The ADFIT benefits should be computed on the basis of actual ADFIT balances,
9 with total ADFIT balances related to the net book value of generation assets
10 allocated between stranded costs and market value on the basis of the ratio of
11 stranded costs to the net book value of generation assets. To provide ratepayers
12 ADFIT benefits related to market value is inconsistent with the statutory
13 framework which unbundled and deregulated electric generation assets effective
14 January 1, 2002.
- 15 • Ratepayers are entitled to an ADFIT benefit only with respect to ADFIT that was
16 derived from amounts paid by ratepayers through the federal income tax
17 component of CenterPoint Houston's rates.
- 18 • ADFIT that does not provide any capital to CenterPoint Houston cannot be treated
19 as if it were providing "cost-free capital."
- 20 • The amortization schedule for the ADFIT balance must match the amortization
21 schedule of the transition bonds, because CenterPoint Houston will pay the
22 current tax liability associated with the stranded costs and SFAS 109 regulatory

1 assets that are being securitized as the principal amount of the transition charges
2 are collected.

- 3 • Consistent with historical regulatory treatment, the ADFIT benefit should be
4 computed using the interest rate from the transition bonds to be issued under the
5 financing order in this proceeding. In no event should the interest rate be higher
6 than CenterPoint Houston's after-tax weighted average cost of capital, because
7 the value to CenterPoint Houston can be measured only on an after-tax basis.
- 8 • The discount rate used to determine the present value of the benefits should be
9 identical to the interest rate used to calculate the benefits, and, like the benefits
10 themselves, must be computed on an after-tax basis.

11 **Q. WHAT TYPES OF ERRORS DID THE INTERVENOR AND STAFF**
12 **WITNESSES MAKE?**

13 A. The witnesses' errors essentially fall into four broad categories. First, they erroneously
14 compute the amount of ADFIT associated with generation assets (as of December 31,
15 2001) and the portion of such ADFIT that is allocable to the stranded costs and SFAS 109
16 regulatory assets to be recovered through securitization in this docket. In many cases,
17 they calculate benefits on amounts that have never been paid by ratepayers. Second, their
18 calculations overreach, because they are not limited to computing the benefit of ADFIT
19 associated with the stranded costs and SFAS 109 regulatory assets to be recovered
20 through securitization, but also include a benefit for ADFIT unrelated to CenterPoint
21 Houston's stranded costs and SFAS 109 regulatory assets recovery. Third, some
22 witnesses (but not Staff) double dip by calculating benefits for periods (2002 and 2003)
23 for which the ADFIT balance was used by the Commission in computing the return

1 included in the capacity auction true-up amounts in Docket No. 29526 and the related
2 interest computation; ratepayers have already received the full benefit of ADFIT for those
3 years. Fourth, the witnesses use an inappropriate interest rate to compute the benefits of
4 cost-free capital and an inappropriate discount rate to determine the present value of that
5 benefit. I discuss each of these items sequentially.

6 **A. ADFIT ASSOCIATED WITH GENERATION ASSETS AND THE PORTION OF**
7 **ADFIT ALLOCABLE TO STRANDED COSTS AND REGULATORY ASSETS**
8 **BEING SECURITIZED**

9 **1. Mr. Tietjen and Mr. Efron**

10 **Q. DO STAFF WITNESS DARYL TIETJEN AND OPC/TIEC WITNESS DAVID**
11 **EFFRON USE SIMILAR METHODS TO COMPUTE THE ADFIT BENEFIT?**

12 **A.** Yes, they both use essentially the same incorrect method. The ADFIT amount associated
13 with the generation assets is a fixed dollar amount. The task is to determine how much of
14 the total ADFIT balance (that was built up through the tax allowance embedded in the
15 regulated rates paid by ratepayers) is properly allocable to the stranded costs and SFAS
16 109 regulatory assets that will be securitized and how much of the balance is properly
17 allocable to market value. Mr. Tietjen and Mr. Efron do not attempt to allocate the
18 *actual* ADFIT amounts. Instead, they compute a new ADFIT value that is not related to
19 the existing ADFIT balances through the simple process of (i) multiplying the stranded
20 costs amount by 35% then (ii) adding to that product the actual ADFIT amount related to
21 SFAS 109 regulatory assets. Their method is simple, but wrong.

22 **Q. DOES THE METHODOLOGY USED BY MESSRS. TIETJEN AND EFFRON**
23 **CAUSE THEM TO DOUBLE COUNT ADFIT?**

1 A. Yes. By taking the sum of (i) 35% of the difference between net book value and fair
2 market value of the generation assets and (ii) the actual ADFIT balance attributable to
3 SFAS 109 regulatory assets also being securitized in this proceeding, both Mr. Tietjen
4 and Mr. Effron overstate total ADFIT. Their error relates primarily to double counting
5 ADFIT on the stranded portion of the Equity and Debt allowance for funds used during
6 construction (“AFUDC”) amounts which are included in the net book value of generation
7 assets. When they compute stranded cost ADFIT as 35% of stranded costs, a portion of
8 that ADFIT is attributable to Equity and Debt AFUDC that is included in net book value.
9 As I will explain in more detail below, ADFIT time value benefits related to Equity and
10 Debt AFUDC were either already considered in Docket No. 21665 or are included in the
11 \$141,162,927 amount of ADFIT associated with SFAS 109 regulatory assets. Mr. Effron
12 and Mr. Tietjen ignore these facts. Their methodology of adding (i) 35% of the value of
13 stranded costs to (ii) actual ADFIT associated with SFAS 109 regulatory assets causes
14 both Mr. Effron and Mr. Tietjen to double-count ADFIT. In order to appreciate their
15 double counting, it is necessary to understand the nature of the ADFIT associated with
16 the SFAS 109 assets that are being securitized. I provide this explanation below.

17 **Q. BOTH MR. EFFRON AND MR. TIETJEN CHARACTERIZE THE \$141,162,927**
18 **AS ADFIT RELATED TO REGULATORY ASSETS. WOULD YOU DESCRIBE**
19 **WHAT THIS AMOUNT REPRESENTS AND HOW IT IS CALCULATED?**

20 A. The ADFIT described as associated with “regulatory assets” is more precisely described
21 as ADFIT associated with SFAS 109 regulatory assets. In Docket No. 29526, Mr.
22 Hriszko provided workpapers supporting the \$141,162,927, which demonstrate that it is
23 computed as ADFIT at 35% on the remaining regulatory asset of \$150,473,181, plus

1 ADFIT at 35% on the Equity and Debt AFUDC balances, which were not "covered" in
2 Docket No. 21665. Figure JSB-1R (Hriszko Dir. Test. at 14, lines 26-31; Hriszko's
3 workpaper IX-1/1 and IX-1/2 (Docket No. 29526)), demonstrates that \$141,162,927 is
4 the sum of (1) ADFIT of \$52,665,613 on the regulatory asset, (2) \$62,574,994 on the
5 undepreciated Equity AFUDC as of December 31, 2001, and (3) \$25,922,320 of
6 undepreciated Debt AFUDC as of December 31, 2001 not previously securitized.

7 **Q. HOW DID DOCKET 21665 AFFECT THE ADFIT BALANCES APPLICABLE**
8 **TO EQUITY AND DEBT AFUDC?**

9 A. The parties to Docket No. 21665 stipulated in the Settlement Agreement at p. 3 as
10 follows:

11 The specific generation related regulatory assets which comprise
12 the \$1,070,530,866 and the associated accumulated deferred
13 income taxes as of December 31, 1998 are listed on Exhibit B and
14 are referred to as "Covered Regulatory Assets" and "Covered
15 ADIT," respectively. The \$740 million is a final resolution of all
16 potential issues regarding recovery of the Covered Regulatory
17 Assets and Covered ADIT.

18 This means that the benefits associated with most of the SFAS 109 regulatory assets and
19 related ADFIT (a portion of which was related to Equity and Debt AFUDC) were
20 resolved in Docket No. 21665. Because the time value benefits of the ADFIT on the
21 Equity and Debt AFUDC were already given to customers in Docket No. 21665, it is
22 inappropriate for Mr. Tietjen and Mr. Effron to give them back again in this proceeding.
23 That is precisely what they do when they simply subtract market value of the generation
24 assets from net book value of the generation assets and multiply such amount by 35%
25 because net book value of the generation assets contains undepreciated Equity and Debt
26 AFUDC amounts.

1 **Q. WHAT ARE THE NET BOOK VALUE AMOUNTS RELATED TO EQUITY AND**
2 **DEBT AFUDC AS OF DECEMBER 31, 2001?**

3 A. As shown in Workpaper IX-1/2 of Mr. Robert Hriszko in Docket No. 29526, the
4 temporary difference for Equity AFUDC is \$440.6 million, and the temporary difference
5 for Debt AFUDC is \$179.7 million, for a total of \$620.3 million. Each of these items has
6 book basis with no tax basis, and each is a component of net book value as of December
7 31, 2001. (These amounts were also provided in response to RFI COH 4-1 in this
8 proceeding.)

9 **Q. HOW SHOULD THE NET BOOK VALUE OF \$620.3 MILLION RELATED TO**
10 **EQUITY AND DEBT AFUDC BE TREATED BY MR. TIETJEN AND MR.**
11 **EFFRON IN THEIR CALCULATIONS?**

12 A. Because both Mr. Effron and Mr. Tietjen separately add the \$141,162,927 of ADFIT
13 related to the SFAS 109 regulatory asset and the Equity and Debt AFUDC, they should
14 first reduce net book value by the \$620.3 million before multiplying it by 35% to
15 recognize that the ADFIT benefit of the \$620.3 million of the net book value has already
16 been reflected either in Docket No. 21665 or in the \$141,162,927.

17 **Q. SHOULD ANY OTHER REDUCTIONS BE MADE TO MR. TIETJEN'S AND**
18 **MR. EFFRON'S NET BOOK VALUE AMOUNTS?**

19 A. Yes. Both fail to reduce the net book value of the generation assets by reductions the
20 Commission made in Docket No. 29526 to such net book value for (i) investment tax
21 credits ("TTCs") of \$115,574,965; (ii) excess accumulated deferred income taxes
22 ("EADIT") of \$30,531,574, and (iii) excess interest on the capacity auction of

1 \$17,871,366, for a cumulative total of \$163,997,895. Because the Commission reduced
2 the generation assets net book value by these amounts, CenterPoint Houston will recover
3 less stranded costs; therefore, the starting net book value from which ADFIT on stranded
4 costs is determined must be similarly reduced. Further, given that Mr. Effron and Mr.
5 Tietjen are attempting to determine ADFIT allocable to stranded costs as determined by
6 the Commission in Docket No. 29526, the stranded costs and market value numbers in
7 their analysis should be, but are not, identical to those in the Commission's Order.

8 **Q. HOW WOULD THEIR ADFIT CALCULATIONS BE REDUCED AFTER**
9 **CORRECTING THEIR ERRORS?**

10 **A.** The following table illustrates how Mr. Tietjen's and Mr. Effron's calculations would
11 change by correcting the (i) double counting of ADFIT related to Equity and Debt
12 AFUDC and (ii) the erroneously high starting point of net book value of the generation
13 assets:

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	(Amounts in Dollars)
Tietjen/Effron Starting Net Book Value of Generation Assets	4,803,652,497
Equity and Debt AFUDC Component Contained Within Net Book Value	(620,291,410)
Commission Ordered Reductions to Net Book Value for ITCs, EADIT, and Excess Capacity Auction Interest	(163,977,895)
Adjusted Net Book Value	4,019,383,192
Market Value	3,417,428,222
Stranded Cost for ADFIT Calculation	(601,954,970)
Tax Rate	35%
ADFIT on Stranded Cost	210,484,239
SFAS 109 ADFIT	141,162,927
TOTAL ADFIT	351,647,166

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Thus, as corrected Mr. Tietjen's and Mr. Effron's computations would compute the total ADFIT allocable to stranded costs and SFAS 109 regulatory assets as the sum of approximately (i) \$211 million ADFIT allocable to stranded costs and (ii) \$141 million ADFIT allocable to SFAS 109 regulatory assets, for a total of approximately \$352 million of ADFIT. This total is very close to the computation in my direct testimony of approximately \$336 million of ADFIT allocable to stranded costs and SFAS 109 regulatory assets.

Q. DO THE ALLOCATIONS RESULTING FROM MR. TIETJEN AND MR. EFFRON'S CALCULATIONS MAKE SENSE?

A. No. Another way to illustrate the errors in Mr. Effron's and Mr. Tietjen's computations is to observe the clearly incorrect allocations that would result if their computations were not corrected.

1 The total ADFIT related to generation assets is \$741 million (Figure JSB-1, Schedule 3,
2 line 5). The \$741 million of ADFIT relates to the total book value of the generating
3 assets and must be divided between the stranded costs and market components of that
4 total value. Under their computations, \$485 million of the total ADFIT would be deemed
5 related to stranded costs. Thus, Messrs. Tietjen and Efron assign approximately 65%
6 (\$485 mm ÷ \$741 mm) of the ADFIT to stranded costs even though stranded costs are
7 only 26% of total net book value of the generation assets. Conversely they assign
8 approximately 35% (\$256 mm ÷ \$741 mm) of the ADFIT to market value even though
9 market value constitutes 74% of total book value.¹ These allocations defy reality.

10 **Q. IS IT APPROPRIATE TO REDUCE RECOVERABLE STRANDED COSTS BY**
11 **ADFIT BENEFITS THAT WERE NOT PROVIDED BY RATEPAYERS?**

12 **A.** No. The concept of giving benefit ratepayers the benefit of cost-free capital necessarily
13 implies that cost-free capital has been provided by the ratepayers.

14 **Q. MR. EFFRON CRITICIZES YOUR FAILURE TO INCREASE THE ADFIT**
15 **BALANCE BY ADFIT RELATED TO ENVIRONMENTAL EXPENDITURES**
16 **INCURRED AFTER DECEMBER 31, 2001. IS HIS CRITICISM JUSTIFIED?**

17 **A.** No. The environmental expenditures at issue relate to environmental expenditures
18 incurred after December 31, 2001. ADFIT related to post-December 31, 2001
19 expenditures were never included in rate base, and ratepayers never paid a tax allowance
20 that funded either current or deferred taxes associated with these amounts. The fact that

¹ The Commission's final order in Docket No. 29526 found that the net book value of the generation assets was \$4,639,674,602; the total market value was \$3,417,428,222; and the stranded costs were \$1,222,246,380.

1 ratepayers will pay for the environmental costs in the future cannot be construed as the
2 provision of cost-free capital because nothing that could be construed as constituting
3 capital has been received by CenterPoint Houston. Thus, it would be completely
4 improper to treat post-December 31, 2001 ADFIT as if it were a source of cost-free
5 capital provided by ratepayers.²

6 **Q. MR. EFFRON ALSO CRITICIZES YOU FOR BEING INCONSISTENT BY**
7 **INCLUDING 2002 AND 2003 BOOK DEPRECIATION BUT NOT 2002 AND 2003**
8 **TAX DEPRECIATION IN YOUR ADFIT CALCULATIONS. IS HIS CRITICISM**
9 **JUSTIFIED?**

10 **A.** No. In Docket No. 29526, the Commission decided that stranded costs should be reduced
11 by \$378 million of book depreciation on generation assets in 2002 and 2003. The ADFIT
12 balance was also reduced due to such book depreciation. The ratepayers did not provide
13 any tax expense associated with post-2001 tax depreciation; so such depreciation cannot
14 be construed as providing cost-free capital. Moreover, even if ratepayers were
15 determined to be entitled to tax depreciation benefits, it would not be necessary to or
16 appropriate to adjust ADFIT balances for tax depreciation during those years because any
17 theoretical benefit of the tax depreciation was fully reflected in calculation of the return
18 included in the capacity auction true-up and related interest computation made by the
19 Commission in Docket No. 29526.

² Mr. Effron further argues I must take into account the tax depreciation associated with such environmental expenditures. Even if I were incorrect in excluding ADFIT related to post-2001 environmental expenditures, Mr. Effron's estimate of the alleged tax depreciation benefit that should be taken into account is grossly overstated. Mr. Effron, in his Exhibit DJE-3, assumes that all environmental expenditures through August 2004 are eligible for 50% bonus depreciation. His assumption is wrong. Capital projects that began prior to September 11, 2001 are not eligible for bonus depreciation even for those dollars spent after September 11, 2001. Contrary to his assumption, most of the environmental expenditures are not eligible for bonus depreciation.

1 Q. BEGINNING ON PAGE 20 OF HIS TESTIMONY, MR. TIETJEN USES A
2 NUMERICAL EXAMPLE IN AN ATTEMPT TO ILLUSTRATE THAT YOUR
3 METHODOLOGY UNDERSTATES ADFIT ALLOCABLE TO STRANDED
4 COSTS. IS HE CORRECT?

5 A. No. As discussed above, his example is flawed because he is double counting ADFIT
6 related to Equity and Debt AFUDC and he begins with an erroneously high net book
7 value associated with generation assets. Once his calculation is corrected for these errors,
8 his methodology produces an amount of ADFIT allocable to stranded costs and SFAS
9 109 regulatory assets that is very close to the amount of ADFIT determined under my
10 methodology. Essentially, we use different methodologies to achieve similar results.

11 2. Ms. Blumenthal

12 Q. DOES COH/COC WITNESS ELLEN BLUMENTHAL'S COMPUTATION
13 OVERSTATE THE ADFIT AMOUNTS?

14 A. Yes. Ms. Blumenthal overstates the relevant ADFIT amounts by \$360 million because
15 she fails to adjust total ADFIT to reflect amounts that relate *only* to generation assets as
16 of December 31, 2001. Ms. Blumenthal gives lip service to the notion that she is
17 calculating benefits on cost-free capital derived from payments by ratepayers in the form
18 of tax allowances that, because of book/tax timing differences, will not be paid to the
19 federal government until a later date. But she nonetheless ignores the fact that the
20 generation assets became deregulated on December 31, 2001. By definition, there has
21 been no ADFIT *provided by ratepayers* through regulated rates after December 31, 2001.
22 Ratepayers no longer paid regulated rates on these assets and thus no longer paid a

1 deferred tax expense through which CenterPoint Houston could be said to have obtained
2 cost-free capital.

3 There are three errors in her computations. First, she does not properly reflect the effect
4 of EMCs. The Commission's order in Docket No. 22355, which required reversal of the
5 additional depreciation taken by CenterPoint in 1998-2001 and the refund of such
6 amounts through EMCs, had two effects on the ADFIT benefit calculation. Reversal of
7 the book depreciation effectively increased ADFIT by increasing the difference between
8 the net book and net tax basis of the generation assets. EMCs not refunded to customers,
9 on the other hand, reduced net book value of generation assets, and consequently
10 stranded costs. Ms. Blumenthal seems to understand this concept. Blumenthal at 5-6. I
11 made EMC related adjustments in two steps so that I could tie the calculation to Schedule
12 IX in Docket No. 29526. *See* Figure JSB-2R. First, I reduced the generation assets by all
13 EMCs at December 31, 2001, and then I also reduced the related ADFIT by
14 \$395,956,839. Second, I then reversed depreciation for the EMCs refunded from January
15 1, 2002, through August 31, 2004, and also reversed the related ADFIT, thereby
16 increasing ADFIT by \$164,389,370, to obtain a balance of net book value and its related
17 ADFIT that was reduced by EMCs not refunded to customers. Ms. Blumenthal failed to
18 make these adjustments.

19 Ms. Blumenthal made a second error when she failed to adjust ADFIT amounts for book
20 depreciation on generation assets in 2002 and 2003. The Commission's order in Docket
21 No. 29526 reduced stranded costs by \$378,421,000 attributable to 2002 and 2003 book
22 depreciation. ADFIT associated with these amounts are properly excluded because the

1 net book value of generation assets has been reduced by 2002 and 2003 book
2 depreciation.

3 Ms. Blumenthal made a third error by failing to increase ADFIT by deferred taxes
4 associated with unamortized loss on reacquired debt of \$3,881,000. Unamortized loss on
5 reacquired debt arose prior to December 31, 2001, and is included as part of the stranded
6 cost recovery. Its corresponding ADFIT is appropriately included in the benefits of cost-
7 free capital determination.

8 After adjusting Ms. Blumenthal's ADFIT amounts to correct the errors she made with
9 respect to EMCs, 2002-2003 depreciation, and unamortized loss on reacquired debt,
10 Ms. Blumenthal's ADFIT balance would equal \$741,347,199, which corresponds to the
11 ADFIT as computed in my direct testimony. *See* Figure JSB-3R.

12 **Q. DOES MS. BLUMENTHAL PROPERLY COMPUTE THE PORTION OF THE**
13 **TOTAL ADFIT BALANCE THAT RELATES TO THE STRANDED COSTS**
14 **BEING RECOVERED IN THIS SECURITIZATION?**

15 **A.** No. She correctly recognizes that the total ADFIT balance relating to generation assets
16 must be allocated between stranded costs and market value but relies upon two incorrect
17 inputs in her calculations. Her resulting calculation overstates the ADFIT amount
18 allocable to stranded cost recovery by \$93,450,926. *See* Figure JSB-3R.

19 The two incorrect inputs are (1) the amount of ADFIT associated with generation assets
20 (as I detail above), and (2) the incorrect percentage resulting from her attempt to allocate
21 total market value and stranded costs between nuclear and non-nuclear assets.

1 While it is essential to allocate ADFIT between stranded and non-stranded costs, there is
2 no reason to differentiate between nuclear and non-nuclear generation assets.
3 Ms. Blumenthal's errors result in large part from her decision to assign a specific fair
4 market value to nuclear assets based on a value the City of Houston suggested for such
5 assets during Docket No. 29526. In doing so, she ignores the fact that the Commission's
6 Final Order in Docket No. 29526 did not adopt City of Houston's estimate of the value of
7 the nuclear assets. Indeed, it did not adopt any of the parties' estimates of values of
8 individual assets or of generation assets as a whole. The Commission, instead, relied on
9 an analysis by its consultant, JP Morgan. JP Morgan's analysis did not assign separate
10 values to nuclear and non-nuclear assets.

11 By overstating the market value of the nuclear assets, Ms. Blumenthal understates their
12 stranded costs, derives an artificially low ratio of stranded cost to book value, and as a
13 result assigns too little of the ADFIT to stranded costs related to nuclear assets. Because
14 she then assigns the remaining market and stranded costs to non-nuclear assets, she
15 assigns too much of the ADFIT to stranded costs related to non-nuclear assets. Her
16 separate calculations of nuclear and non-nuclear ADFIT do not lend more precision to the
17 process, but rather lead to distorted results. Because the Commission did not determine
18 separate market value for nuclear assets and other assets, there is no evidence to support
19 Ms. Blumenthal's determination of relative fair market value of these two classes of
20 assets or the portion of stranded costs allocable to each.

21 Even if one were to assume Ms. Blumenthal's assignment of market values to the nuclear
22 and non-nuclear assets were correct, her allocation of ADFIT between stranded and non-
23 stranded costs would still be wrong. Given that Ms. Blumenthal is attempting to allocate

1 ADFIT to the stranded costs determined by the Commission in Docket No. 29526, the
2 stranded costs and market value numbers she uses in her analysis should be identical to
3 those in the Commission's order. They are not. Instead, she overstates stranded costs by
4 \$23,428,222 and understates market value by \$23,428,222.

5 When Ms. Blumenthal's allocation percentages are corrected for her total ADFIT balance
6 errors, her approach would result in approximately \$313 million of ADFIT allocable to
7 stranded cost recovery, which is *lower* than the amount of ADFIT I conclude is allocable
8 to CenterPoint's stranded cost recovery. See Figure JSB-3.

9 **B. ADFIT BENEFIT ON ADFIT NOT RELATED TO STRANDED**
10 **COSTS OR SFAS 109 REGULATORY ASSETS**

11 **Q. DID THE COMMISSION'S ORDER IN DOCKET NO. 29526 REQUIRE THE**
12 **COMMISSION TO COMPUTE A BENEFIT ON ANY ADFIT OTHER THAN**
13 **ADFIT RELATED TO THE TRUE-UP BALANCE?**

14 **A.** No. As an initial matter, it is important to place this securitization proceeding in its
15 proper legislative and administrative context. December 31, 2001, brought an important
16 change to the regulation of electric generation in Texas. From that date forward, the
17 generating assets were no longer included in rate base and more generally, were no
18 longer subject to Commission rate regulation. The economic value of the generating
19 assets was effectively split into two categories. The market value of the assets was to be
20 recovered through future, unregulated market transactions. Only the stranded cost
21 portion of the book value was to be recovered through future Commission-determined
22 charges.

1 It is in this context that the benefits associated with ADFIT must be considered. The
2 ADFIT allocable to the stranded costs and SFAS 109 regulatory assets being securitized
3 has relevance because those costs will be paid through the transition charges established
4 in this proceeding. The ADFIT related to market value does not have relevance because
5 there are no longer regulated rates through which the market value will be recovered from
6 ratepayers. Since 2001, ratepayers have not paid rates designed to fund either current or
7 deferred taxes and cannot be construed as having provided any cost-free capital to
8 CenterPoint Houston. Providing ADFIT benefits related to market value would
9 effectively take only one component of generation assets and re-introduce it to rate
10 regulation while no others are considered.

11 In Docket No. 29526, the Commission made clear that the only ADFIT upon which a
12 benefit should be computed is ADFIT allocable to stranded costs and SFAS 109
13 regulatory assets being securitized and not ADFIT related to market value. At page 80 of
14 its Order in explaining why it was necessary to compute an ADFIT benefit, the
15 Commission described the benefit CenterPoint Houston would receive from having the
16 ADFIT balance before it incurs tax liability on the transition charges over the
17 securitization period. The Commission's explanation was premised on the understanding
18 that the only ADFIT that was relevant was ADFIT that would reverse as transition
19 charges were recovered—*i.e.*, ADFIT allocable to stranded costs and regulatory assets
20 being securitized.

21 In determining offsets to the amounts that will be securitized, no benefit should be
22 computed on any ADFIT amount that is not part of the securitizable stranded costs and
23 SFAS 109 regulatory assets. It is only the stranded cost ADFIT that can provide a benefit

1 to ratepayers. Finally, even if it were otherwise appropriate to reflect benefits of market
2 value ADFIT, it would be improper to do so for 2002 and 2003 because the calculations
3 the Commission made to compute capacity auction return and stranded cost interest
4 effectively provided ratepayers the value of ADFIT for those years.

5 **Q. IS THE BENEFIT ALLOCABLE TO MARKET VALUE ADFIT RELEVANT TO**
6 **THIS PROCEEDING?**

7 A. No. All of the witnesses erroneously compute a benefit attributable to market value
8 ADFIT. Ms. Blumenthal proposed to reduce CenterPoint's securitization by \$351.6
9 million which she characterizes as the "time value benefit of the *non-stranded* cost
10 portion of ADFIT." Mr. Kollen, Mr. Effron, and Mr. Tietjen propose similar reductions.
11 For reasons set forth above, no benefit on ADFIT related to market value should be
12 considered. Under the Commission's Preliminary Order, the only cost that can be
13 securitized through this proceeding are qualified costs as defined in PURA § 39.302(4).
14 A necessary corollary of limiting costs that can be securitized is that only benefits of
15 ADFIT associated with those securitized costs should be used to reduce the securitizable
16 amount.

17 **Q. IS MR. EFFRON CORRECT WHEN HE STATES THAT YOUR TESTIMONY**
18 **WAS PREMISED ON THE FACT THAT CENTERPOINT ENERGY HAS**
19 **ALREADY SOLD ITS INTEREST IN TEXAS GENCO?**

20 A. No. The sale of Texas Genco is not relevant to my analysis. The total ADFIT balance
21 associated with the generation assets is attributable in part to the stranded costs and SFAS
22 109 regulatory assets that are being recovered in this securitization and in part to the
23 market value component. Only the portion of CenterPoint Houston's total costs that

1 constitute stranded costs and SFAS 109 regulatory assets will be recovered from
2 ratepayers. Consequently, only the benefits of the ADFIT that are related to the stranded
3 costs and SFAS 109 regulatory assets should be used to reduce the amount securitized.
4 As discussed in my previous two answers, the ADFIT related to market value has no
5 relevance to the analysis.

6 **Q. DOES MR. EFFRON COMPUTE A BENEFIT ON ANY ADFIT AMOUNT NOT**
7 **RELATED TO STRANDED COST RECOVERY?**

8 A. Yes. First, Mr. Effron believes that the ADFIT benefit should be computed on a “new
9 balance of ADFIT.” Effron at 9. The Commission decided that the cost-free capital
10 benefit of ADFIT allocable to stranded costs should be taken into account in this
11 proceeding because CenterPoint Houston had recovered taxes from ratepayers on its
12 stranded cost recovery before such taxes had to be paid to the IRS on the transition
13 charges from ratepayers under securitization. After December 31, 2001, CenterPoint
14 Houston does not receive additional cost-free capital because the ratepayers are no longer
15 paying *any* tax expense on *any* of the generation assets and thus do not provide additional
16 ADFIT on which such a benefit could exist.

17 **Q. MR. EFFRON COMPUTES AN ADFIT BENEFIT ON THE INTEREST**
18 **CENTERPOINT HOUSTON IS ALLOWED TO RECOVER IN THE TRUE-UP**
19 **PROCEEDING. IS THIS CORRECT?**

20 A. No. The ratepayers have not yet paid any interest to CenterPoint Houston. Any interest
21 will be paid over time through a transition charge (“TC”) (or a competitive transition
22 charge (“CTC”)). The right to receive interest in the future does not give rise to any
23 current tax or tax benefit. Because the ratepayers have not yet paid any interest and any

1 right to receive interest does not give rise to any current tax or tax benefit, (future tax
2 liability will be recorded as ADFIT, but not collected from ratepayers) the ratepayers also
3 have not paid any tax expense (current or deferred) associated with such interest. The
4 right to receive payments in the future and the related obligation to pay taxes on those
5 funds when they are received does not provide CenterPoint Houston any current capital,
6 much less cost-free capital. Because the ratepayers have not supplied any ADFIT related
7 to such interest, there is no cost-free capital ADFIT benefit related to such interest.

8 **C. PROPER PERIOD OVER WHICH TO CALCULATE ADFIT BENEFITS**

9 **Q. WHAT IS THE PROPER PERIOD OVER WHICH TO COMPUTE THE**
10 **BENEFIT OF ADFIT ALLOCABLE TO STRANDED COST RECOVERY?**

11 **A.** The proper period is the securitization period. The Commission's Final Order in Docket
12 No. 29526 provided at page 80 that "the funds represented by ADFIT balance were
13 received from ratepayers over the depreciable lives of the assets, and the joint applicants
14 will have use of those funds through the *recovery period* in a declining amount as the
15 account is reversed upon the company incurring current tax liability on its stranded-costs
16 recovery" (emphasis added). Thus, the order directed that the ADFIT benefit CenterPoint
17 Houston enjoys be computed over the recovery period of the securitization.

18 **Q. WHY SHOULD THE BENEFIT PERIOD NOT BEGIN ON JANUARY 1, 2002?**

19 **A.** I will first answer this question with respect to non-stranded cost ADFIT because
20 Intervenor and Staff witnesses compute an ADFIT benefit both on ADFIT that is
21 allocable to stranded costs and SFAS 109 regulatory assets that are being securitized and
22 on ADFIT that is allocable to market value, which is not being securitized. (Ms.

1 Blumenthal and Mr. Tietjen accurately characterize this latter amount as ADFIT related
2 to “non-stranded costs.”)

3 With respect to the “non-stranded cost” portion of ADFIT, no benefit should be
4 computed. It would be inappropriate to reflect any benefit of market value ADFIT
5 because CenterPoint Houston has not and will not receive any market value from
6 ratepayers. To require transfer of those benefits would mean that one component of the
7 generation operations is still being treated as regulated. However, even if “non-stranded
8 cost” ADFIT recovery were relevant, any benefit allocable to the cost-free use of ADFIT
9 in 2002 and 2003 has already been computed and shared with ratepayers.

10 As Mr. Tietjen testified, the ADFIT benefit for 2002 and 2003 has already been shared
11 with ratepayers because “the benefit of ADFIT for 2002 and 2003 were taken into
12 account by the Commission’s decisions regarding the capacity auction true-up balance
13 and the amount of interest contributed thereby.” Tietjen at 23. The ECOM model
14 deducted all ADFIT from rate base and thus effectively provided ratepayers the full
15 benefit of ADFIT for those years through a reduction in the interest CenterPoint Houston
16 received. If the ratepayers receive a benefit for ADFIT for 2002 and 2003 in this
17 proceeding, the ratepayers would be paid twice for the same benefit. Even if the capacity
18 auction true-up were construed as a form of continued rate regulation, it terminated at the
19 end of 2003. After 2003, there can be no doubt that ratepayers provided none of the
20 capital associated with market value. In any event, the benefit had to terminate no later
21 than March 2005—when the estimated tax on the generation assets sale is paid.

22 The benefits Ms. Blumenthal computes at page 14 of her testimony; Mr. Effron computes
23 at page 18 of his testimony; and Mr. Kollen includes as part of his \$267 million

1 computation are each incorrect because they are based on "market value" or "non-
2 stranded cost" ADFIT benefits. Similarly, the portion of Mr. Tietjen's retrospective
3 ADFIT benefits on the market based portion of ADFIT in Exhibit DJT-4 are also
4 mistaken.

5 **Q. SHOULD THE BENEFIT PERIOD ON STRANDED COST ADFIT BE**
6 **MEASURED FROM JANUARY 1, 2002?**

7 **A.** No. I believe the Commission only ordered that the ADFIT benefit be computed over the
8 securitization recovery period. If I am wrong, however, as is the case with market value
9 ADFIT, no additional benefit for stranded cost ADFIT should be computed beginning
10 January 1, 2002, because as discussed above, ratepayers have already received the cost-
11 free capital benefit of ADFIT for 2002 and 2003. If it were included again in this
12 proceeding, the ratepayer would be paid twice for a single benefit as it relates to 2002 and
13 2003. Mr. Tietjen agrees that ratepayers have already received the benefit for ADFIT for
14 2002 and 2003.

15 The only additional benefit that arguably should be computed is the benefit CenterPoint
16 Houston received on the ADFIT allocable to stranded cost recovery from January 1,
17 2004, through the beginning of the securitization because the benefit prior to 2004 has
18 already been provided to ratepayers and the benefit after the securitization is captured in
19 the present value calculation of prospective ADFIT benefits. As shown in Figure JSB-
20 4R, the additional benefit from January 1, 2004, through the beginning of securitization
21 would be \$29,099,841, rather than \$136,236,240 calculated by Mr. Tietjen in Figure DT-
22 4.

1 Q. SHOULD A BENEFIT BE COMPUTED FOR ADFIT RELATED TO SFAS 109
2 REGULATORY ASSETS FOR THE PERIOD JANUARY 1, 2002 THROUGH
3 THE BEGINNING OF THE SECURITIZATION?

4 A. No. Ms. Blumenthal computes a benefit for ADFIT allocable to SFAS 109 regulatory
5 assets for this period. No such benefit should be computed because the SFAS 109
6 regulatory assets were not reflected in the calculated allowance for federal income taxes
7 and thus not paid by ratepayers. In other words, there was no cash balance of ADFIT on
8 which CenterPoint Houston enjoyed cost-free capital during this period. Therefore, no
9 such ADFIT benefit exists.

10 D. PROPER DISCOUNT RATE TO COMPUTE ADFIT BENEFITS

11 Q. THE INTERVENORS FIRST COMPUTED A RATE OF RETURN ON THE
12 ADFIT AMOUNT ALLOCABLE TO THE STRANDED COST RECOVERY AND
13 THEN DISCOUNTED SUCH AMOUNT TO DETERMINE THE PRESENT
14 VALUE OF THE ADFIT BENEFIT. IS THAT METHODOLOGY
15 FUNCTIONALLY EQUIVALENT TO THE METHODOLOGY YOU
16 PERFORMED?

17 A. Yes, as explained by Mr. Effron in his testimony at page 15, n. 4, these different
18 methodologies are equivalent as long as under the Intervenor methodology, the same rate
19 is used for the rate of return and the discount rate. Mr. Kollen's methodology is flawed
20 because he used different rates for the rate of return and the discount rate.

21 Q. WHY DID YOU USE THE ESTIMATED TRANSITION BOND INTEREST RATE
22 TO DETERMINE THE AMOUNT OF THE ADFIT BENEFIT?

1 A. While the securitization of the stranded cost recovery is not a conventional ratemaking
2 proceeding, the basic principles of conventional ratemaking still apply. Namely, the
3 ADFIT benefit is shared with ratepayers at the same rate of return ratepayers pay on the
4 asset to which such ADFIT relates. If there is a change in a utility's rate of return, then
5 the rate changes both for purposes of the rate that ratepayers pay on the asset and for
6 purposes of ADFIT. There is always a linkage between the rate of return the ratepayer is
7 paying on the asset and the return of ADFIT associated with such asset.

8 With securitization, there will be a change in rate from CenterPoint Houston's weighted
9 average cost of capital to the transition bond interest rate. At securitization, stranded
10 costs, or more precisely the right to recover stranded costs, are sold by CenterPoint
11 Houston to the transition bond company. CenterPoint Houston is not receiving its
12 weighted cost of capital on its stranded cost recovery from ratepayers; rather, ratepayers
13 are paying the bond rate that I describe in my direct testimony. Consequently, the bond
14 rate I set forth in my direct testimony is the rate that should be utilized. The legislature
15 crafted a method by which ratepayers are able to pay CenterPoint Houston's stranded
16 costs at a very low rate of return. They should not expect to recover benefits associated
17 with those stranded costs at any other rate.

18 **Q. IF THE COMMISSION DETERMINED THAT BOND RATE IS NOT THE**
19 **CORRECT RATE, WHAT IS THE PROPER DISCOUNT RATE?**

20 A. If the Commission determines the bond rate is not the correct rate for determining
21 benefits, the Commission should use 7.2%, because this rate reflects CenterPoint
22 Houston's true after-tax weighted average cost of capital rate from the UCOS proceeding.

23 **Q. WHY WOULD IT BE NECESSARY TO USE AN "AFTER-TAX RATE"?**

1 A. The benefit and discount rate should both be determined on an after-tax basis. If there is
2 actually value from cost-free ADFIT capital, that value by definition would be taxable.
3 As a result only the after-tax amount can be said to provide a real benefit. When the
4 amount to be discounted is an after-tax amount, the appropriate discount rate is the after-
5 tax rate.

6 The following very simple example demonstrates that the present value benefit must be
7 computed on an after-tax basis. For simplicity, assume that ADFIT associated with
8 stranded cost is \$1000 and the recovery period for stranded cost is one year, with the
9 principal payment being made at the end of one year. The ADFIT payment would also
10 be due at the end of the year since that is when the principal is due. Further, assume
11 CenterPoint Houston would earn its pre-tax weighted average cost of capital (11.075%)
12 and such earnings would be taxed at 35%. Because ADFIT converts from a deferred to a
13 current tax obligation as the stranded costs are recovered (year end in the example), the
14 taxes also become current at year-end. Thus, in the example, the company would need to
15 have \$1000 available at year-end to pay its taxes. The present value benefit effectively
16 computes how much the current ADFIT balance can be reduced (in the form of a
17 reduction of securitized stranded costs) and still leave enough funds to pay the \$1000
18 year-end tax obligation. The following chart demonstrates that if the present value of the
19 ADFIT benefits were calculated using the pre-tax weighted average cost of capital of
20 11.075% as Staff and Intervenors suggest, CenterPoint Houston would not be able to earn
21 enough on the remaining balance to have the required \$1000 available at year-end.
22 Calculating the present value benefit at the after-tax weighted average cost of capital
23 eliminates the shortfall.

<u>ADFIT Benefit Calculation Example:</u>		Present Value @ <u>11.075%</u>	Present Value @ <u>7.20%</u>
1	ADFIT associated with Stranded Cost	1,000.00	1,000.00
2	PV of above ADFIT (one year)	900.29	932.85
3	ADFIT Benefit (Reduction to Securitization) L1 - L2	99.71	67.15
4	Balance remaining to invest (ADFIT minus ADFIT Benefit) L1 - L3	900.29	932.85
5	Investment Rate (Pre-tax WACC)	11.07%	11.07%
6	Investment Income L4 * L5	99.71	103.31
7	Tax expense paid on investment income L6 *35%	34.90	36.16
8	Net after-tax investment proceeds L6 - L7	64.81	67.15
9	Balance remaining to invest (ADFIT minus ADFIT Benefit) L1 - L3	900.29	932.85
10	Net after-tax investment proceeds L8	64.81	67.15
11	Total available to pay income taxes	965.10	1,000.00
12	Income taxes due at end of year one (ADFIT Associated with Stranded Cost) L1	1,000.00	1,000.00
13	Cash Shortfall L12 - L11	(34.90)	0

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Q. IS USING THE AFTER-TAX DISCOUNT RATE A NEW CONCEPT?

6

A. No. Mr. Tietjen recommended, and the Commission approved, the use of the after-tax rate for the present value calculations for ITC and EADIT in Docket No. 29526

7

8

Q. HOW SHOULD THE CALCULATION OF ADFIT BENEFITS BE MADE TO USE THE AFTER-TAX WEIGHTED AVERAGE COST OF CAPITAL OF 7.2% APPROPRIATELY?

9

10

1 A. The discount rate could be changed to 7.2% in Figure JSB-2 attached to my direct
2 testimony. As Mr. Effron points out, the same result can be achieved by an alternative
3 calculation in which the return on the remaining balance of ADFIT is calculated and
4 discounted. Under this alternative method, both the return and the discount rate should
5 be 7.2%. This is demonstrated in Figure JSB-5R to my rebuttal testimony. Both methods
6 of calculation result in \$146,034,832 of ADFIT benefits under the levelized structure. In
7 contrast, the pre-tax rate of 11.075% were erroneously used for the discount rate in the
8 ADFIT benefit calculation, the apparent ADFIT benefit would be \$189,896,329, and
9 CenterPoint Houston would have a shortfall that would grow over the bond life to
10 \$116,094,179 under the levelized structure. *See JSB-5R.*

11 **Q. MR. KOLLEN USES THE PRE-TAX WEIGHTED AVERAGE COST OF**
12 **CAPITAL TO COMPUTE HIS BENEFITS BUT AN AFTER-TAX RATE FOR**
13 **THE DISCOUNT RATE. IS THIS METHODOLOGY DEFENSIBLE?**

14 A. No. Regardless of the rate that is chosen, the rate must be the same for the rate of return
15 and for the discount rate to ensure that equivalent sums are being compared. If benefits
16 or costs are calculated on a pre-tax basis, they must be discounted on a pre-tax basis and
17 vice versa. If he uses 7.2% as the discount rate, he must either use 7.2% as the rate of
18 return or reduce his high returns by tax expense. By failing to do so, Mr. Kollen has
19 constructed a computation that is internally and analytically flawed and would overstate
20 the ADFIT benefit by more than \$200 million.

21 **Q. SEVERAL WITNESSES ALSO SUGGEST THAT NO ADFIT BENEFIT**
22 **SHOULD BE CONSIDERED IN THIS PROCEEDING BUT THE ENTIRE ADFIT**

1 **BENEFIT SHOULD BE CONSIDERED IN THE SUBSEQUENT CTC**
2 **PROCEEDING. IS SUCH AN APPROACH CORRECT?**

3 A. It depends on what they are proposing. As is the case in traditional ratemaking, there is a
4 clear linkage between the ADFIT and the recovery of the asset that generated the ADFIT.
5 The ADFIT benefit must be computed by reference to the rate and recovery period of the
6 asset for which CenterPoint Houston is receiving recovery, whether such recovery occurs
7 in securitization or through a CTC proceeding. When the ADFIT benefit is calculated, it
8 cannot be delinked from the payment stream or recovery rate that CenterPoint Houston
9 receives. Thus, the ADFIT benefit associated with the costs to be securitized through
10 TCs must reflect the actual timing and payment of the TCs. Mr. Tietjen seems to
11 implicitly recognize that fact when he notes that the amount of the benefit would not
12 change. Tietjen at. 25-29.

13 As long as the amount and present value of the benefit is correctly determined by
14 reference to the TCs, the choice between using that present value to reduce the amount
15 securitized or to reduce the CTC is less important.

16 **Q. ARE THERE ANY ADDITIONAL ERRORS IN INTERVENOR'S ANALYSIS?**

17 A. Yes. On Ms. Blumenthal's schedule EB-3, she discounts her ADFIT payment to
18 January 1, 2005, instead of May 31, 2005. Further, Ms. Blumenthal, Mr. Kollen, and Mr.
19 Tietjen erroneously increase the ADFIT amount by compound interest when they
20 compute the retrospective ADFIT benefit, thus calculating a benefit on ADFIT not
21 provided by ratepayers. Mr. Tietjen also did not reduce the ADFIT balance by the
22 \$132,447,350 of ADFIT related to 2002-2003 book depreciation in his retrospective

1 computations. I previously corrected the interest and depreciation errors in Mr. Tietjen's
2 calculation in Figure JSB-4R.

3 III. INTEREST AND EMC ISSUES

4 Q. WHAT ARE THE INTEREST AND EMC ISSUES?

5 A. The Commission's final order in Docket No. 29526 includes a schedule (Schedule I)
6 showing a detailed computation of the true-up balance. Schedule I includes estimates of
7 interest accrued and excess mitigation credits provided through August 31, 2004. Stated
8 simply, the interest and EMC issues are: "Through what date should the securitization
9 amount be updated to reflect interest accrued and EMCs credited after August 31, 2004?"

10 Q. WHAT IS CENTERPOINT HOUSTON'S POSITION REGARDING THE
11 INTEREST AND EMC ISSUES?

12 A. All interest accrued and all EMCs provided up to the date the transition bonds are issued
13 should be securitized. CenterPoint Houston is entitled to interest on stranded costs and
14 the other components of the true-up balance until the amounts are recovered and,
15 pursuant to the Commission's final order in Docket No. 29526, to recover the principal
16 portion of EMCs³ it provides until the EMCs are terminated. Recovery of as much as
17 possible of these growing amounts through the securitization makes economic sense for
18 ratepayers. Although in theory recovery of the interest accrued and EMCs provided after
19 some arbitrary cut-off date could occur through CTCs instead of being securitized,⁴
20 sound public policy dictates that as much of these costs as possible be securitized so that

³ CenterPoint Energy also believes it is entitled to recover the interest portion of the EMCs. The Commission did not agree, and the matter is now on appeal with the Texas courts.

⁴ Indeed, any EMCs provided after the securitization occurs will have to be recovered in that way.

1 the significant cost savings created through securitization can be maximized. Figure
2 JSB-6R shows that ratepayer savings would exceed \$100 million if the interest and
3 EMCs accrued through the bond issuance date are securitized.

4 **Q. HOW CAN THE COMMISSION DESCRIBE THE SECURITIZATION AMOUNT**
5 **WITHOUT FINAL AMOUNTS FOR INTEREST AND EMCs?**

6 A. The simplest approach is to define the securitization amount as the \$1,493,747,264
7 balance of stranded costs and SFAS 109 regulatory assets as of August 31, 2004, and
8 provide that that amount will be adjusted by (1) the ADFIT benefit determined in this
9 proceeding, (2) interest earned at 11.075% on stranded costs and SFAS 109 regulatory
10 assets from August 31, 2004 up to the issuance advice letter preparation date, (3) actual
11 principal amounts refunded as EMCs from August 31, 2004 through the issuance advice
12 letter preparation date or termination date of EMCs if earlier, and (4) all other qualified
13 costs. I have included as Figure JSB-7R a calculation of the expected securitization
14 amount using the projected EMCs and the interest through May 31, 2005. The final
15 calculations will be included in the issuance advice letter.

16 **Q. WHICH INTERVENOR WITNESSES ADDRESS THE INTEREST AND EMC**
17 **ISSUES?**

18 A. Only two intervenor witnesses explicitly propose cut-off dates for interest or EMCs.
19 COH/COC Witness James Daniel claims that CenterPoint Houston is not entitled to
20 recover interest on stranded costs or SFAS 109 regulatory assets after December 17,
21 2004. HCHE Witness Lane Kollen claims that CenterPoint Houston is not entitled to
22 recover interest on stranded costs and SFAS 109 regulatory assets after November 23,

1 2004, and is not entitled to recover any portion of the EMCs it is required to provide after
2 November 23, 2004. Both are wrong.

3 **Q. COH/COC WITNESS JAMES W. DANIEL ASSERTS AT PAGE 11 OF HIS**
4 **DIRECT TESTIMONY THAT THERE IS A GAP FROM THE DATE OF THE**
5 **FINAL ORDER IN DOCKET NO. 29526 UNTIL SECURITIZATION IS**
6 **COMPLETED DURING WHICH CENTERPOINT HOUSTON IS PROHIBITED**
7 **FROM EARNING INTEREST ON STRANDED COSTS BECAUSE THE TEXAS**
8 **SUPREME COURT IN *CENTERPOINT ENERGY*⁵ INVALIDATED**
9 **SUBSTANTIVE RULE 25.263(1)(3). IS HE CORRECT?**

10 **A.** No. Mr. Daniel has misinterpreted the Texas Supreme Court's decision. The only issue
11 before the court was whether Substantive Rule 25.263(1)(3), which did not permit interest
12 to begin accruing until the Commission issued a final order determining the true-up
13 balance, was consistent with the statutory mandate that utilities be allowed to recover
14 their stranded costs as of December 31, 2001. To the best of my knowledge no party to
15 that appeal challenged the requirement in Substantive Rule 25.263(1)(3) that interest
16 apply from the final order date in the true-up proceeding until the stranded costs are
17 recovered.

18 After noting that the Commission recognized the utility is entitled to recover carrying
19 costs on stranded costs, the court in *CenterPoint Energy* states that "The only issue is
20 whether the Act contemplates roughly a two-year gap in recovery of carrying costs
21 between the date regulation ceased (January 1, 2002) and the date of a final true-up order

⁵ *CenterPoint Energy, Inc. v. Pub. Util. Comm'n*, 143 S.W.3d 81 (Tex. 2004).

1 (2004 or perhaps beyond)." In response, the Court concludes, "A two- or three-year gap
2 in recovery of carrying costs would not permit generation companies full recovery of
3 their stranded costs as the Legislature envisioned."

4 A gap in accrual of interest between the final order date in the true-up case and the date
5 recovery of stranded costs begins as proposed by Mr. Daniel would be as impermissible
6 as the originally-proposed gap between the advent of retail competition and
7 determination of the true-up balance. CenterPoint Houston continues to finance its
8 stranded costs until recovery is accomplished through a securitization or CTC. Not
9 providing recovery of interest until a recovery mechanism is in place would mean that
10 CenterPoint Houston would not fully recover its stranded costs.

11 It is important to note that Mr. Daniel does not dispute that CenterPoint Houston is due
12 interest for the period of January 1, 2002, through the date of the final order in Docket
13 No. 29526, and he does not dispute that customers must pay the carrying costs for the 14-
14 year recovery period between issuance and final retirement of the transition bonds.
15 Instead, he merely seeks to create a gap in the recovery of interest from December 18,
16 2004 through the date of issuance of the transition bonds. Not only would this create
17 exactly the kind of gap the Supreme Court closed, but it would also provide parties an
18 incentive to delay the issuance of the securitization bonds.

19 **Q. IS THERE ANY REASON TO BELIEVE MR. DANIEL'S ASSERTION (AT**
20 **PAGE 11 OF HIS DIRECT TESTIMONY) THAT THE LEGISLATURE**
21 **INTENDED TO CREATE A GAP DURING WHICH INTEREST WOULD NOT**
22 **ACCRUE?**

1 A. No. Mr. Daniel does not provide any citation to PURA or its legislative history to
2 support his bald assertion that the legislature *intended* to create a gap (from determination
3 of the stranded costs balance until securitization of the stranded costs) during which
4 interest would not accrue. Instead, he inexplicably suggests that the 90-day timeline for
5 the issuance of a financing order is reason enough that interest should not be earned until
6 the securitization is complete. There is no logical nexus between the legislature's
7 decision to provide expedited procedures for issuance of a financing order and Mr.
8 Daniel's suggestion that interest should not accrue. Indeed, Mr. Daniel's "gap" would
9 thwart the intention of the legislature by providing an incentive for parties to delay
10 securitization.

11 **Q. IS AN INTEREST HIATUS NECESSARY TO PROVIDE CENTERPOINT**
12 **HOUSTON INCENTIVES TO EXPEDITE COMPLETION OF THE STEPS**
13 **REQUIRED TO SECURITIZE STRANDED COSTS AS MR. DANIEL ASSERTS**
14 **AT PAGE 11 OF HIS DIRECT TESTIMONY?**

15 A. Absolutely not. Access to the funds provided by securitization is reason enough for
16 CenterPoint Houston to expedite the process. There is no credible basis for assuming that
17 it is necessary to penalize CenterPoint Houston, through denial of carrying costs, in order
18 to expedite completion of the securitization process. To the contrary, creation of an
19 interest hiatus would provide incentives for Intervenor to delay securitization by
20 providing a reward for delays they might cause. In fact, it has been Intervenor, not
21 CenterPoint Houston, that have repeatedly sought to delay this proceeding. CenterPoint
22 Houston has done its best to accelerate the process. It filed its request for a financing
23 order within a few days after the Commission's initial order in Docket No. 29526. If

1 CenterPoint Houston's motivation were to delay issuance of the bonds, it would have
2 behaved differently throughout this process.

3 Moreover, Mr. Daniel's suggestion would also operate as a penalty for events outside
4 CenterPoint Houston's control. Mr. Daniel's proposal reflects an implicit assumption
5 that CenterPoint Houston has control over all factors that would lead to a successful
6 securitization. CenterPoint Houston has no control over the bond market conditions or
7 over efforts of other parties to delay securitization through appeals or otherwise or over
8 the time it will take to resolve any appeals that may be taken. In CenterPoint Houston's
9 first securitization, despite its best efforts to accelerate the process, it was not able to
10 issue transition bonds until two years after the application for a financing order was filed.
11 Other Texas utilities have experienced even longer delays.

12 **Q. HCHE WITNESS LANE KOLLEN AT PAGE 13 OF HIS DIRECT TESTIMONY**
13 **CLAIMS THAT THERE IS NO STATUTORY AUTHORITY TO MODIFY THE**
14 **FINAL TRUE-UP BALANCES FOR INTEREST EARNED AFTER THE FINAL**
15 **ORDER DATE IN DOCKET NO. 29526. IS HE CORRECT?**

16 **A.** No. The Texas Supreme Court in *CenterPoint Energy* addressed and resolved this point.
17 The Court concluded that PURA did not permit the Commission to create a gap in
18 carrying costs on stranded costs. As the December 17, 2004 Order on Rehearing in
19 Docket No. 29526 (at Conclusion of Law 154) states: "Under the decision of the
20 Supreme Court of Texas in *CenterPoint Energy v. Public Utility Commission of Texas*,
21 143 S.W.3d 81 (Tex 2004), interest *must* be paid on stranded costs from January 1, 2002"
22 (emphasis added).

1 Q. MR. KOLLEN ASSERTS AT PAGE 11 OF HIS DIRECT TESTIMONY THAT
2 EMC PAYMENTS CANNOT BE UPDATED AFTER THE FINAL ORDER DATE.
3 IS HE CORRECT?

4 A. No. Mr. Kollen claims there is no statutory authority that expressly provides for updating
5 the unpaid EMC balance included in the true-up balance. The fact is there is no statutory
6 language which discusses either creation or continuation of the EMCs. There is,
7 however, statutory language entitling CenterPoint Houston to recover its stranded costs,
8 and any obligation to continue paying EMCs (which increases stranded costs) without
9 recoupment would violate those provisions.

10 More important, the final order in Docket No. 29526 expressly recognizes that
11 CenterPoint Houston's net book value (and thus stranded costs) will have to be updated
12 until the EMCs are terminated. There was extended and repeated discussion in that
13 docket about the merits and equities of requiring continued payment of EMCs even
14 though it had become obvious that the underlying premise of the credits was wrong. The
15 final decision of the Commission effectively "split the baby," requiring continuation of
16 the EMCs but only with the understanding that the principal portion of the required
17 payments would be recovered by CenterPoint Houston as part of its stranded costs. The
18 Commission acknowledges this on page 72 of the Final Order when it says:

19 EMCs will continue to be paid out under CenterPoint's tariff until the
20 Commission terminates these credits. NBV is dependent, in part, on the
21 amount of EMCs paid out, or conversely, on the remaining unpaid balance
22 of EMCs. Accordingly, the affect of this item upon NBV will have to be
23 updated to reflect the actual payments *until termination* (emphasis added).

24 Q. MR. KOLLEN SEEMS TO BELIEVE THAT THE COMMISSION CANNOT
25 "FINALIZE STRANDED COSTS" WITH THE ADDITION OF EMCS AND

1 **INTEREST AFTER THE FINAL ORDER DATE. IS THIS A LEGITIMATE**
2 **CONCERN?**

3 A. No. An issuance advice letter is required to finalize all qualified costs and to substantiate
4 the cost/benefit of the issuance and ensure that the requirements of PURA are met. The
5 final securitization amount will not be known until a few days before the bonds are
6 issued. It is at this point that the Commission must “finalize” the amount to be
7 securitized. Computation of the final amount to be securitized requires only the opening
8 stranded costs and SFAS 109 regulatory asset balance (which was determined by the final
9 order in Docket No. 29526), the adjustment for ADFIT benefits (which will be
10 determined by the final order in this proceeding), and the monthly EMCs. Interest is a
11 simple calculation that can be performed in a matter of minutes. CenterPoint Houston
12 remits EMCs daily to the retail electric providers. The amounts can be determined the
13 very next day. The Commission should have no concern that amounts for interest and
14 EMCs will not be definitive as shown on the issuance advice letter.

15 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

16 A. Yes.

AFFIDAVIT

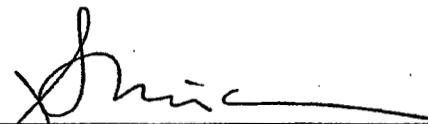
STATE OF TEXAS §

COUNTY OF HARRIS §

SWORN STATEMENT OF JAMES S. BRIAN

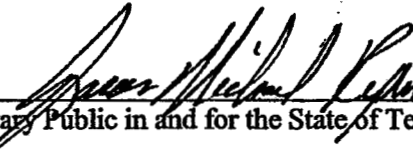
My name is James S. Brian. I am an authorized representative of CenterPoint Energy Houston Electric, LLC.

I swear or affirm that I have personal knowledge of the facts in the testimony and/or exhibits/attachments that I am sponsoring in this application for a financing order, and that I am competent to testify to them. I further swear or affirm that all of the statements and representations made therein are true and correct.



James S. Brian

SWORN TO AND SUBSCRIBED before me on the 22nd day of January,
2005.



Notary Public in and for the State of Texas

(SEAL)



**FIGURES OF JAMES S. BRIAN
REBUTTAL TESTIMONY
DOCKET NO. 30485**

DOCKET NO. _____

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 §

PUBLIC UTILITY COMMISSION
OF
TEXAS

DIRECT TESTIMONY OF

ROBERT W. HRISZKO

FOR

**CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC, RELIANT ENERGY
RETAIL SERVICES, LLC AND TEXAS GENCO, LP**

March 2004

1 A. No. None of these items are reflected in the calculation of the True Up amounts.
2 They are provided for information purposes only as required by the General
3 Instructions.

4
5 **ADIT**

6
7 **Q. Would you please describe the detailed components of ADIT included on**
8 **Schedule IX?**

9
10 A. Yes. Workpaper IX-1 shows the components of ADIT as of December 31, 2001,
11 which total \$867,783,937. Of this total amount, a portion would be related to the
12 stranded costs to be determined in this proceeding. The total amount includes ADIT
13 related to Method/Life, Basis, AFUDC, Unamortized Loss on Reacquired Debt, Final
14 Fuel Balance Underrecovery and Excess Mitigation Liability. Each of these will be
15 discussed in detail.

16
17 **Q. Would you please describe the Method/Life and Basis ADIT as of December 31,**
18 **2001?**

19
20 A. Yes, these amounts total \$1,101,480,037 and represent the ADIT on certain
21 depreciation temporary differences related to generation as of December 31, 2001.
22 The ADIT amounts were computed consistently with the requirements of the Final
23 Order in Docket No. 22355, which required reversal of redirected depreciation and
24 excess earnings depreciation.

25
26 **Q. Would you please describe the AFUDC related ADIT as of December 31, 2001?**
27

28 A. Yes. This amount is \$141,162,927 and includes ADIT at 35% on the sum of the
29 generation related net undepreciated equity AFUDC and debt AFUDC (not covered
30 in the securitization of Docket No. 21665) and the related regulatory assets as of
31 December 31, 2001.

Direct Testimony of Robert W. Hriszko
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