OFFICE OF GENERAL COUNSEL

GUD NO. 9902

STATEMENT OF INTENT OF CENTERPOINT ENERGY CORP.

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PROPOSAL FOR DECISION

PROCEDURAL HISTORY:

Docket Established:	July 31, 2008
Final Hearing Date:	November 4, 5, 6, 2009
Heard By:	Gene Montes, Hearings Examiner Rose Ruiz, Technical Examiner
Record Closed:	December 17, 2009
PFD Circulation:	December 18, 2009

STATEMENT OF THE CASE

CenterPoint initially requested a base revenue requirement to be recovered from regulated customers in the amount of $216,361,949. In its rebuttal filing CenterPoint reduced its requested revenue requirement to $210,206,600. That would signify an increase over prior rates of $20,351,747. It represents a 10.72% increase over prior revenues. The Examiners recommend a revenue increase of $5,693,227 and that represents an increase of 3.0% over prior revenues. The Examiners have recommended that Hurricane Ike expenses be recovered through a separate tariff. Thus, the base rate increase is $4,838,711, or 2.11%. The Examiners find that CenterPoint has established the reasonableness of expenses related to Hurricane Ike in the amount of up to $2,571,915 and agree that recovery of those amounts should be accomplished over a three-year period. That would result in a recovery of approximately $857,305. The total amount, however, has not been established, as proceeds from insurance claims have not been fully determined. Accordingly, the Examiners recommend that a tariff be approved that allows recovery of those actual expenses and direct that they be adjusted for any insurance proceeds recovered.

The City of Houston/Houston Coalition of Cities recommended a reduction of $10,675,529 to current rates – not considering the impact of factoring of accounts receivable raised during the hearing and discussed in detail in the proposal for decision. The impact of that decision would reduce the City of Houston/Houston Coalition of Cities proposed revenue requirement an additional $5,558,687 over current rates. The GCCC recommended a reduction to current rates in the amount of $31,015,484. Again, this does consider the impact of factoring raised during the hearing.

The issues considered in this proceeding include the following:

Rate Base: Gross Plant

1. Should CenterPoint be allowed to update its filing to reflect plant balances as of September 30, 2009, even though that filing was made three working days before the hearing? On the other hand, should plant balances be updated through June 30, 2009 as proposed by GCCC or should they be set at test year levels as proposed by the City of Houston/Houston Coalition of Cities. The Examiners recommend that the late filing be rejected and that plant balances be updated through June 30, 2009.

2. If the update is rejected, should the update to accumulated deferred income taxes (ADIT) also be rejected? The Examiners recommend that the update to accumulated deferred income taxes be rejected to match ADIT figures correctly even though this results in an increase to rate base.

Rate Base: Cash Working Capital (CWC)

3. Should CenterPoint's factoring agreement be considered in calculating the collection lag? In the alternative, should an adjustment be made to the sample

used to determine the collection lag? The Examiners recommend that the company's practice of factoring accounts receivable be reflected in the CWC.

4. The Commission must determine the appropriate billing lag. Is six days reasonable to ensure accurate bills or should a lesser number of days be considered to reduce the billing lag included in the cash working capital? The Examiners recommend that billing lag established by CenterPoint be found to be just and reasonable.

5. The Commission must determine whether CenterPoint has correctly calculated the appropriate gas expense lead? The Examiners recommend an adjustment to reflect the fact that some of the bills were paid early.

6. The Commission must determine whether CenterPoint has correctly calculated the vacation practices of its employees for purposes of computing the CWC? The Examiners find that the vacation practices were accurately measured.

7. Should CenterPoint be required to maintain underlying receipts to confirm that it has correctly calculated the expense lead for O&M non-labor? The Examiners found that this was necessary to ensure the veracity of the data.

8. Has CenterPoint correctly calculated the expense lead associated with payment of federal income taxes? The Examiners concluded that the expense lead was consistent with the requirements of the IRS.

Rate Base: ADIT

9. Has CenterPoint correctly included debits in its calculation of accumulated deferred income tax (ADIT), or should they be included only if the associated reserve is deducted from rate base? The Examiners concluded that unless the associated reserve is deducted from rate base it would be inappropriate to add the corresponding ADIT to rate base. This is a policy question that is currently before the Commission in two cases.

Expenses

10. Should the test-year level of base payroll expense be adjusted to account for a potential increase in expense (as suggested by CenterPoint) or a potential decrease in the number of employees (as suggested by the City of Houston/Houston Coalition of Cities and GCCC)? The Examiners recommend that no adjustment be made to test-year levels for the test-year ending March 31, 2009.

11. Was the test-year level of merit increases reasonable? The Examiners found that they were reasonable and any adjustment that reduced base payroll below the test-year level was not reasonable.

12. Was the test-year level of overtime expense reasonable? The Examiners found that the test-year level of overtime expense was reasonable.

13. Has CenterPoint established that its incentive compensation plans are reasonable? The Examiners found that the company has established the reasonableness of those programs.

14. Was the test-year level of sick leave expense reasonable? The Examiners found that the level of sick leave expense was reasonable.

15. If the level of payroll expense is adjusted should an adjustment be made to the level of benefit expenses and payroll taxes? The Examiners recommend that if an adjustment is made to the level of payroll expense an adjustment should be made to the saving plan expenses and the level of payroll taxes.

16. Should the test-year level of medical expenses be adjusted. The Examiners recommend that any adjustment be based on a historical average not based upon the months of the year with the highest level of expense.

17. Should the test-year level of expense related to pensions be adjusted by a 525% increase. The Examiners recommend that the increase to test-year level of pension expense be limited to 125%.

18. Should the test-year level of post retirement expense be increased by $528,153 or $145,806? The Examiners recommend that the test-year level be increased by $145,806.

19. Should the test-year level of post employment benefits be increased by $514,974 or $57,488? The Examiners recommend that the test-year level of post employment benefits should not be increased beyond $57,488.

20. Should the company be allowed to recover expenses related to the recovery efforts after Hurricane Ike? The Examiners recommend that the company should be allowed to recover all expenses that are just and reasonable and not otherwise reimbursed by insurance.

21. Should an adjustment be made to reduce the company's test-year gasoline expense? The Examiners find that no adjustment should be made as the proposed adjustment cannot be known and measurable.

22. Should the company be allowed to include expenses for workers compensation when those expenses have been paid by the company's insurance carrier? The Examiners find that expenses paid by insurance carriers should not be included in the calculation of the cost of service.

23. Should an adjustment to bad debt expense be made to reflect the company's factoring arrangement? The Examiners find that factoring of accounts receivable

has an impact on the level of uncollectible expense and an adjustment is appropriate.

24. Has CenterPoint satisfied the statutory requirements regarding affiliate transactions? The Examiners find that CenterPoint has satisfied those statutory requirements.

25. Should an adjustment be made to the company's depreciation accounts? The Examiners find that only one of the three challenged accounts should be adjusted. The account was not correctly booked. Thus, the depreciation rates associated with that account have not been correctly measured.

26. Are the proposed changes to *ad valorem* taxes known and measurable? The Examiners find that the company has not established that those proposed adjustments are known and measurable.

Rate of Return

27. Should the capital structure include a short-term debt component? The Examiners find that CenterPoint has correctly calculated its capital structure by not including a short-term debt component.

28. Is the appropriate return on equity 11.25%? The Examiners find that the appropriate return on equity is 10.50%.

Rate Design and Allocation

29. Should revenues from a proposed new service charge be included in the cost of service calculation? The Examiners find that revenues from the proposed service charge should be included in the proposed cost of service study.

30. Has the company correctly calculated the allocation of costs? The Examiners find that CenterPoint's proposed minimum system study and design day study are appropriate.

31. Has CenterPoint correctly calculated a billing determinant adjustment and is the proposed rate design just and reasonable. The Examiners find that CenterPoint has correctly calculated the billing determinants by reducing the projected increase in the number of customers to match historic trends and the rate design is just and reasonable.

Proposed Tariffs

32. Should COSA, or other alternative tariffs be approved in this proceeding? In light of a recent decision by the district court related to COSA-3 approved in GUD No. 9791, the Examiners recommend that none of the proposed alternative tariffs be approved in this proceeding.

33. Should the recovery of franchise fee be made on a system-wide basis? Taxes and franchise fees should be recovered from customers within the jurisdictions that generated those fees.

34. Should certain changes to the purchase gas adjustment clause be made? The Examiners found that the proposal to charge a carrying charge on storage gas was reasonable. Likewise the proposal to change the charge on the over/under recovery of gas cost was reasonable. The Examiners found, however, that the request to recover the gas cost portion of uncollectible expenses through the purchase gas adjustment clause was not reasonable.

The Commission directed the Examiners to reserve all questions related to gas cost for consideration by the Commission directly. Accordingly, copies of the record regarding those issues will be forwarded under separate cover.

1. Procedural History

On July 31, 2009, CenterPoint Energy Resources Corp., d/b/a CenterPoint Energy Entex and CenterPoint Energy Texas ("CenterPoint") filed a *Statement of Intent* to increase rates with the Railroad Commission of Texas (Commission). The case was docketed as GUD No. 9902. CenterPoint simultaneously filed *Statement of Intent* proceedings in all municipalities served within its Houston Division. The proposed rates were suspended in GUD No. 9902 on August 18, 2009. Notice of the proposed increase was published on August 15, 2009, August 18, 2009, August 25, 2009, and September 1, 2009.[1]

The cities of Galena Park, Jacinto City, Southside Place, and West University ceded their original jurisdiction to the Commission pursuant to GURA § 103.003(a).[2] The Cities of Hedwig Village and Hunters Creek Village denied the proposed rate increase and CenterPoint appealed. That case was docketed as GUD No. 9908, *Appeal of CenterPoint Energy Resources Corp., d/b/a CenterPoint Energy Entex and CenterPoint Energy Texas Gas, from the Actions of the Cities of Hedwig Village and Hunters Creek Village.* The cities of Bunker Hill Village, Conroe, Hilshire Village, Houston, Humble, Jersey Village, Nassau, Shenandoah, Spring Valley Village, and Stafford denied the proposed increase. CenterPoint appealed and that case was docketed as GUD No. 9929, *Appeal of CenterPoint Energy Resources Corp., d/b/a CenterPoint Energy Entex and CenterPoint Energy Texas Gas from the actions of Bunker Hill Village, Conroe, Hillshire Village, Houston, Humble, Jersey Village, Nassau, Shenandoah, Spring Valley Village, and Stafford.* The cities of Deer Park, Meadow Place and Missouri City also denied the proposed increase and CenterPoint filed an appeal that was docket as GUD No. 9929, *Appeal of CenterPoint Energy Resources Corp., d/b/a CenterPoint Energy Entex and CenterPoint Energy Texas Gas from the actions of Deer Park, Meadows Place, and Missouri City.* Those proceedings were consolidated into GUD No. 9902.

The following entities intervened in this proceeding: The City of Houston and the Houston Coalition of Cities ("City of Houston/Houston Coalition" or "COH/HCC") representing the City of Houston, the City of Deer Park, the City of Pasadena, the City of Humble, and the City of Meadows Place; the Gulf Coast Coalition of Cities ("GCCC") representing Bunker Hill Village, Jersey Village, Nassau Bay, Shenandoah, and Spring Valley Village; the Steering Committee of Cities ("SCC") representing the City of Conroe and the City of Oak Ridge North; the State of Texas ("State") and Staff of the Railroad Commission ("Staff").

The hearing in this matter commenced on November 4, 2009, and was concluded on November 6, 2009. The following individuals testified on behalf of CenterPoint in its direct case: Richard A. Zapalac, Regional Vice President of Gas Operations; Kelly Guager, Director of Financial Accounting; Charles Dean Woods, Vice President of Human Resources; Mary Kirk, Finance Director, Gas Reporting and Performance; Robert Hevert, Concentric Energy Advisors, Inc.; Jay Joyce, Expergy; Dane Watson, Alliance Consulting, and Matthew Troxle, Manager of Gas Rates, Rates and Regulatory Research. The Houston Coalition of Cities presented the following witnesses: Sara Coleman, Senior Analyst, Diversified Utility

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[1] CenterPoint Exhibit 3 Affidavit of Publication from Gail Chastun.
[2] Tex. Utils. Code Ann. § 103.003(a).

Consultants; Jacob Pous, Principal, Diversified Utility Consultants; Lee Smith, Managing Consultant together with Melissa Whitten, Consultant with La Capra Associates; Bertram Soloman, Executive Consultant, GDS Associates, Inc.; and Hugh Larkin, Jr, Accountant, Larkin & Associates, PLLC. The following individuals testified on behalf of the Gulf Coast Coalition of Cities: Constance T. Cannady, Manager, J. Stowe & Co., and Karl Nalepa, President, R.J. Covington. The State of Texas presented the following witnesses: Dr. Eugenio J. Miravete, Associate Professor of Economics, University of Texas at Austin, and William Novak, President, WHN Consulting. Staff of the Railroad Commission offered testimony from Mark Brock, Advising Utility Specialist, Gas Services Division Market Oversight Section—Railroad Commission of Texas and Frank M. Tomicek, Gas Services Division, Market Oversight Section, Utility Specialist—Railroad Commission of Texas. Rebuttal testimony was provided for CenterPoint by the following individuals: Mr. Zapalac, Ms. Gauger, Mr. Woods, and David Weaver, Vice President-Tax of CenterPoint Energy, Inc.; Ms. Kirk, Mr. Joyce, Mr. Watson. Mr. Troxle, and Bruce Coogler, Division Vice-President of Gas Supply & Contracts and Debra Depeña, Director of Rates, both with CenterPoint Energy Resources Corp.

On October 14, 2009, the Commission issued an Interim Order and ruled as follows:

a. The issue of whether a utility may seek system-wide rates shall not be litigated in this proceeding. The ruling, however, did not preclude litigation regarding whether CenterPoint has established that system-wide rates are appropriate for the Houston Division.

b. For purposes of 16 Tex. Admin. Code § 7.5519(a) an uncollectible gas cost is a "gas cost." CenterPoint must establish, however, that it is reasonable for it to recover the gas cost portion of uncollectible expenses through its purchase gas adjustment clause.

c. Issues related to the federal income tax rate to be applied in this proceeding shall be precluded from further litigation. The ruling, however, did not preclude litigation of other calculations used to arrive at the proposed allowance for federal income taxes.

d. Rate cases expense will be considered by the Commission in accordance with Tex. Util. Code Ann. § 103.022 and §104.008 (Vernon 2008), and Tex Admin. Code § 7.5530, in a separate proceeding.

The Commission also determined that it shall consider directly any issues related to the prudence of the company's gas costs. The Texas Administrative Procedure Act requires that state agency officials who are to render a final decision, and who have not heard the case, must read the record.[3] Accordingly, the Examiners have, under separate cover, prepared the record for the Commission to review on issues related to the prudence of the company's gas costs. The parties were requested to identify the issues to be considered related to the utility's gas costs.

[3] Tex. Admin. Proc. § 2001.062(a).

2. Jurisdiction

The Commission has jurisdiction over CenterPoint and over the matters at issue in this proceeding pursuant to *Tex. Util. Code Ann*. §§ 102.001, 103.003, 103.051, 104.001, 121.051, 121.052, and 121.151 (Vernon 2008). The statutes and rules involved in this proceeding include, but are not limited to *Tex. Util. Code Ann*. §§ 104.101, 104.102, 104.103, 104.105, 104.106, 104.107, 104.110, 104.301, and 16 *Tex. Admin. Code* Chapter 7.

3. The Houston Division

CenterPoint Energy Resources Corp. ("CERC" or "CenterPoint Energy Resources") is a wholly-owned subsidiary of CenterPoint Energy, Inc. ("CNP" or CenterPoint Energy"). CenterPoint Energy Entex consists of CERC's natural gas distribution operations in Texas (other than Texarkana) South Louisiana, and Mississippi. CenterPoint Energy Texas Gas operates as a natural gas local distribution company in the State of Texas. Operations of CenterPoint in Texas (other than Texarkana) are divided into four divisions: (1) The Houston Division, (2) the Beaumont/East Texas Division, (3) the South Texas Division, and (4) the Texas Coast Division. CenterPoint estimated that as of December 2008, approximately 929,000 customers in the Houston Division would be affected by the proposed change in rates. Of that amount approximately 415,000 are unincorporated customers and approximately 514,000 are customers within incorporated areas of the Houston Division.[4] A copy of a map outlining the general contours of the Houston Division is attached as Proposal for Decision Exhibit 1.

4. Books and Records

Commission Rule 7.310 requires that utilities utilize the FERC USOA.[5] Kelly Gauger, Director of Financial Accounting affirmed that the books and records are kept in accordance with the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts ("USOA"). Specifically, Ms. Gauger testified that to ensure that transactions are properly recorded, CenterPoint maintains an internal process to ensure that financial statements are fairly presented and compliance with applicable laws and regulations. Accordingly, she asserted that the company's systems of internal controls and its adherence to FERC USOA assured compliance with Commission Rule 7.310. As a result, Ms. Gauger concluded that the company is entitled to the presumption encapsulated in Commission Rule 7.503.[6] That rule provides that the amounts shown on the company's books and records as well as summaries and excerpts taken from those records shall be considered *prima facie* evidence of the amount of investment or expense reflected when introduced into evidence, and such amounts are presumed to have been reasonably incurred.[7] The Examiners find that, with one exception related to Account FERC Acct No. 392 - Transportation Equipment, CenterPoint has established that CenterPoint maintains its books and records in accordance with FERC USOA. Accordingly, the books and records are accorded the presumption found in Commission Rule 7.503.

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[4] CenterPoint Exhibit 4, Direct Testimony of Richard A. Zapalac, pp. 2 – 4; CenterPoint Exhibit 5, Direct Testimony of Kelly Gauger, p. 3.
[5] TEX. ADMIN. CODE § 7.310 (Tex. R.R. Comm'n, System of Accounts) (Commission Rule 7.310);.
[6] TEX. ADMIN. CODE § 7.501 (Tex. R.R. Comm'n, Evidentiary Treatment of Uncontroverted Books and Records of Gas Utilities) (Commission Rule 7.503).
[7] CenterPoint Exhibit 5, Direct Testimony of Kelly Gauger, pp. 6 – 7.

5. Rate Base

a. Introduction

The calculation of rate base included in CenterPoint's rebuttal filing asserted that the total rate base, before allocation to the various customer classes, was $379,140,177. This is the rate-base figure that CenterPoint is currently requesting in this case.[8] This amount was lower than the amount included for rate base in the utility's original filing by approximately $44,121,720. In the *Statement of Intent* filing CenterPoint included a rate-base figure of $423,261,897. That figure was predicated upon the test-year per book value in each account for the twelve-month period ending March 1, 2009, and adjusted for construction work in progress and other *pro-forma* estimates for expenses through March 1, 2010.

The principal components that were changed between the two filings were (1) the removal of gas cost from rate base, (2) a corresponding adjustment to the reserve for depreciation, (3) a reduction in the original cost as a result of using plant balances as of September 2009, and (4) a change in the calculation of the accumulated deferred income taxes.[9] The Intervenors specifically challenged the calculation of three components of rate base: (1) Total Original Cost, (2) Cash Working Capital, and (3) Accumulated Deferred Income Taxes. CenterPoint's calculation of rate base in each of the filings is set out in Table 5.1, below. The specific areas challenged are highlighted.

8 CenterPoint Initial Brief, p. 4.

9 Original cost was decreased by $12,740,977 and the reserve for depreciation, which is deducted from original cost decreased by $5,226,822. Gas costs in the amount of $16,130,953 were removed. Accumulated Deferred Income Taxes, which is deducted from rate base, was increased by $20,476,612. Customer advances and deposits were simply combined.

Table 5.1
CenterPoint's Requested Rate Base and
Areas Challenged by Intervenors

Description		Test Year March 1, 2009	Initial Request SOI Filing	Adjusted Request Rebuttal Filing
Original Cost				
	Intangible Plant	$ 25,943,919	$ 26,207,892	$ 25,965,560
	Transmission Plant	-	-	-
	Distribution Plant	801,495,953	828,841,369	812,410,305
	General Plant	35,193,610	35,028,003	38,960,422
Total Original Cost		$ 862,579,482	$ 890,077,264	$ 877,336,287
Deduct:				
	Reserve for Depreciation	(430,248,544)	(444,979,608)	(439,752,786)
Total Net Plant		$ 432,330,938	$ 445,097,656	$ 437,583,501
Add:	Cash Working Capital	$ 2,151,434	$ 2,151,434	$ 2,151,434
	Materials and Supplies	6,509,270	6,509,270	6,509,270
	Storage Gas	78,922,818	16,130,953	-
	Prepayments	418,921	418,921	418,921
	Total Working Capital	$ 88,002,443	$ 25,210,578	$ 9,079,625
Less:	Customer Deposits	(14,736,812)	(14,736,812)	(14,795,820)
	Customer Advances	(59,008)	(59,008)	-
	Accumulated Deferred Income Taxes	$ (32,250,517)	$ (32,250,517)	$ (52,727,129)
Total Rate Base		$ 473,287,044	$ 423,261,897	$ 379,140,177

In the context of total original cost, the Intervenors focused their complaints on the post-test-year adjustments. The cash working capital is added to the calculation of total rate base and in this area the Intervenors challenged the calculation of lead days and lag. Accumulated deferred income tax is deducted from the calculation of total rate base and in this context the Intervenors contended that key components of the calculation of accumulated deferred income taxes were ignored.

As will be discussed below, the Intervenors argued strenuously that any attempt to update the filing through September 30, 2009, should be rejected. Among the problems noted is the fact that the update was provided three working days before the hearing. Rejecting that filing, of course, results in an overall increase to the rate base requested. The Examiners find that it would be unreasonable to reject only those portions of the updated filing that reduce rate base. Thus, if the Commission were to reject the filing, as the Examiners recommend below, the updated to accumulated deferred income taxes, must also be rejected. Nevertheless, as will be discussed below, the updated filing is problematic from a procedural perspective and from a substantive perspective. The effect of rejecting that filing is to increase requested rate base by $44,121,720. The impact on the revenue requested to be recovered from the standard rate classes is to increase it by $2,260,978. Despite this effect the Examiners find that the correct methodology requires a matching of adjustments to the dates applicable to each account.

b. Total Original Cost: Post Test Year Adjustments to Plant

As originally filed, the utility's test year in this proceeding is the twelve-month period ending March 31, 2009. The utility extended portions of its calculation of the rate base request beyond the end of the test year. In its original filing the company included the plant balances as of March 31, 2009, adjusted by *pro-forma* adjustments through March 31, 2010, and included construction work in progress (CWIP). The total original plant in service originally requested was $890,077,264.[10] In the rebuttal filing the company revised its request. The rebuttal testimony included an update of the company's rate base to reflect actual plant investment balances as of September 30, 2009.[11] The total original cost reflected in that filing is $877,336,287.[12] The Houston Coalition of Cities objected to this proposal and recommended that Gross Plant in Service be set at unadjusted test-year levels. Thus, the Houston Coalition of Cities recommended that Gross Plant in Service be reduced to $862,579,482.[13] The Gulf Coast Coalition of Cities recommended that Gross Plant in Service be updated for known and measurable changes through June of 2009. Thus, the Gulf Coast Coalition of Cities recommended that Gross Plant in Service be reduced to $867,477,452.[14] Table 5.2 summarizes the relative requests of Centerpoint, the adjustments proposed by the Intervenors, and the basis for each figure.

Table 5.2
Gross Plant Requests/Recommendations

Party/Filing	Gross Plant Amt	Basis of the Gross Plant Amount	
CenterPoint – Original	$890,077,264	Test Year 03/31/2009	Adjusted for CWIP and Pro-forma estimates through March 31, 2010.
CenterPoint – Rebuttal	$877,336,287	Test Year 03/31/2009	Adjusted for known and measurable changes through September 1, 2009.
Gulf Coast Coalition of Cities	$867,477,452	Test Year 03/31/2009	Adjusted for known and measurable changes through June 30, 2009.
Houston Coalition of Cities	$862,579,482	Test Year 03/31/2009	No adjustments to the test-year figures.

The impact on the calculation of gross plant is set out in Table 5.3, below. The recommendations of both parties reduce the calculated gross plant. Since part of the requested

10 CenterPoint Ex. 1, Schedule 2a, ln. 57, col. (H).
11 CenterPoint Ex. 13, Rebuttal Testimony of Kelly G. Gauger, p. 2, lns. 3 – 6.
12 CenterPoint Ex. 13, Rebuttal Testimony of Kelly G. Gauger, Rebuttal Exhibit KCG-3, 1, ln. 58, col (H).
13 City of Houston/Houston Coalition of Cities, Ex. 1, Direct Testimony of Jacob Pous, p. 20, lns. 17 – 18; Houston Coalition of Cities Ex. 2, Direct Testimony of Sara Coleman, Schedule (SEC 1), p. 3, ln. 57, col. (H).
14 GCCC Ex. 1 Direct Testimony of Constance T. Cannady, p. 8, lns. 1 – 4. Ms. Cannady indicated a reduction to the proposed Gross Plant of $22,599,813, resulting in a figure of $867,477,451 for Gross Plant. ($890,077,264 - $22,599,813 = $867,477,451.

adjustment requires rejection of the rebuttal filing and the stand-alone impact on the revenue requirement is set out below on that table.

Table 5.3
Impact on Standard Rate Classes

	Gross Plant Impact	Impact on Revenue Requirement
COH/HCC	($14,756,804)	$65,256
GCCC	($9,858,832)	$659,833

The parties do not dispute the gross plant figures established during the test year. The dispute centers on the proposed adjustment to the test-year amounts. Thus, the Commission must determine which adjustment to gross plant is appropriate.

Issues Raised by the Intervenors.

The testimony filed by Mr. Pous, who testified on behalf of the City of Houston/Houston Coalition of Cities, focused on the proposed cost of service included in the *Statement of Intent* filing. Mr. Pous argued that the extension beyond the test year was based on budgeted or projected figures. Further, he asserted that the utility was selective in its proposed adjustment and focused only on gross plant, construction work in progress and accumulated provisions for depreciation. He argued that the Texas Utilities Code provides that invested capital recognized for ratemaking purposes must be used and useful in providing service and must already exist. Forecasted and budgeted amounts do not qualify for consideration as invested capital. Further, he pointed out that the statute specifically prohibited the inclusion of construction work in progress absent a finding that it is "necessary to the financial integrity of the utility." Mr. Pous noted that the statute did not contemplate that rates be based on budgeted amounts. Instead, the normal standard applicable in rate proceedings is the historical test year. He contended that CenterPoint concedes that the adjustments are not "known and measurable," but are based on budgeted amounts. Budgeted values cannot be known and measurable. Finally, he argued that the Gas Reliability Infrastructure Program (GRIP), 16 *Tex. Admin. Code* § 7.7101, provides a remedy for the company. Namely, any changes in invested capital that occur after rates are set in this proceeding may be recovered by making a filing pursuant to GRIP.[15]

In general, Ms. Cannady, who testified on behalf of the Gulf Coast Coalition of Cities, agreed with Mr. Pous. Again, her testimony focused upon issues raised by the original *Statement of Intent* filing that purported to update test-year figures, based upon the twelve-month period from March 1, 2009, through March 1, 2010. She recommended that the Commission disallow all proposed adjustments that are based on CenterPoint's projected plant and operating expense for the twelve months ending March 2010. She contended that the proposed methodology was tantamount to a forecasted test year. In her opinion, forecasted figures are not allowed under the definition of what constitutes an appropriate test year.[16] Thus, Ms. Cannady concurred with Mr.Pous' assessment that the adjustments proposed by

[15] Houston Coalition of Cities, Ex. 1, Direct Testimony of Jacob Pous, p. 16, ln 12 to p. 20, ln. 19.
[16] GCCC Ex. 1, Direct Testimony of Constance T. Cannady, p. 4, ln. 1 – 10.

CenterPoint were not based upon known and measurable changes. She contended that it was inappropriate for the utility to include budgeted capital expenditures, estimated requirements, estimated cost of removal, and construction work in progress beyond that which is the actual cost of investment that is used and useful to ratepayers.[17] Ms. Cannady, however, did not recommend removal of all construction work in progress. Instead, she argued that adjustments to gross plant in service should be made based upon construction work in progress that has been closed to plant-in-service accounts as of June 30, 2009.[18] Finally, Ms. Cannady noted an alleged company error that should be corrected in the amount of $121,386.[19]

The updated filing based upon the twelve-month period ending September 30, 2009, was addressed in briefing. In their initial brief and reply brief, the Gulf Coast Coalition of Cities specifically disagreed with the late change to the company's rate base calculation. GCCC conceded that the utility has removed some of the original expenses requested. Nevertheless, GCCC maintained that the company has not provided the parties an opportunity to meaningfully and adequately review the costs that are proposed to be included in the calculation of base rates and has failed to account for all impacts. GCCC maintained that the parties were precluded from any meaningful review of the data as the revisions were filed three days prior to the hearing. Further, the Gulf Coast Coalition of Cities noted that all other test-year amounts included in the revised filing were not updated to reflect balances as of September 30, 2009.[20] On this issue, the City of Houston/Houston Coalition of Cities parallels the position of GCCC. They contended that the company's continual updates completely obliterated the test-year concept and asserted that it results in a denial of due process.[21]

CenterPoint Response

Ms. Gauger, who testified on behalf of CenterPoint, noted that Mr. Pous and Ms. Cannady did not offer a basis for ignoring the most current actual plant balances available through September 30, 2009.[22] She claimed that she relied on the policy established in GUD No. 9791, where the Commission allowed an update to the test-year balances to reflect the date of the most current actual balances. This position was reasserted by CenterPoint in its briefing.[23] Ms. Gauger also noted that the company updated the test-year per book amount of rate base in this proceeding on August 24, September 25, and most recently on October 5, 2009, with updated amounts through June, July and August 2009 and that the parties have had an opportunity to review these amounts through discovery.[24] In its Initial Brief, the company asserted that the initial filing placed the parties on notice that the company's rate base would eventually be updated.[25]

Ms. Gauger also responded to Mr. Pous suggestion that GRIP may be employed to ensure recovery of post-test-year investment in plant. She noted that the Examiners in GUD

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[17] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 6, ln. 1 – 22.
[18] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 7, ln. 4 – p. 8, ln. 4.
[19] GCCC Ex. 1, Direct Testimony of Constance Cannady, CTC – 19.
[20] Gulf Coast Coalition of Cities, pp. 5 – 7.
[21] City of Houston/Houston Coalition of Cities, Reply Brief, p. 3.
[22] CenterPoint Ex. 13, Rebuttal Testimony of Kelly C. Gauger, p. 2, lns. 17 – 21.
[23] CenterPoint Reply Brief, pp. 2 – 4.
[24] CenterPoint Ex. 13, Rebuttal Testimony of Kelly C. Gauger, p. 3, ln 1 – p. 4, ln. 12 & lns. 18 – 21.
[25] CenterPoint Initial Brief, p. 4.

No. 9869 argued that, "the better policy is to allow the post test year adjustments to rate base in order to have these additions recovered in rate base as opposed to any subsequent GRIP tariff filing, if there is ample time and opportunity for regulatory scrutiny by the Examiners and the Intervenors."

Examiners' Recommendation

As to the original filing, the Examiners find that the original filing in this case was not consistent with (1) the Final Order issued by this Commission in GUD No. 9791 or (2) the Gas Utility Regulatory Act. In GUD No. 9791 the Commission found that a rate base that was estimated on a *pro-forma* test year was not reasonable. The Commissioners ruled specifically on this point and stated that proposed adjustments are merely estimates of investments that may be made at some time in the future.[26] That is <u>exactly</u> what was done in the original filing here. Additionally, as argued by the City of Houston/Houston Coalition of Cities, Section 104.053 provides that the invested capital for ratemaking purposes must be used and useful in providing service. Thus, plant must already exist and cannot be based upon forecasted budgeted amounts.[27] CenterPoint attempted to cure this defect in its updated filing.

On October 29, 2009, CenterPoint revised its request to reflect allegedly known and measurable adjustments through September 30, 2009. The revised filing presented procedural issues and due process considerations that were not part of GUD No. 9791. There are no rules governing the timing of an update to the rate request made by a utility. Thus, the filing must be evaluated based upon Commission precedent, upon whether the filing operates to deprive the due process rights of the Intervenors, and whether there is an opportunity to review that update by the Railroad Commission.

The revised filing was made after the Intervenor testimony was filed and three working days before the commencement of the hearing. While the Commission approved an update to reflect test-year data with updated values in GUD No. 9791, the procedural facts do not appear to be comparable. In GUD No. 9791, the company updated its figures through May 31, 2008. The hearing commenced August 18, 2008. Thus, there were seventy-nine days between the date of the updated test-year data and the commencement of the hearing in GUD No. 9791. On the other hand, in this case there were thirty-four days between the date of the updated test-year data and the commencement of the hearing. The problem is compounded because books and records upon which the update is based are not closed after the date upon which the update is based. In other words, the books and records upon which the update is based were not available in GUD No. 9791 seventy-nine days prior to hearing and in this case they were not available thirty-four days prior to hearing.

In fact, the figures were not even available thirteen working days prior to the hearing. In response to a discovery request CenterPoint revealed that those figures were not available to the utility as of October 16, 2009. On October 8, 2009, the Examiners requested that the utility

[26] Tex. R.R. Comm'n, Statement of Intent Filed by CenterPoint Energy Entex to Increase the Rates in the Unincorporated Areas of the Texas Coast Division and all Consolidated Dockets, Finding of Fact No. 23.

[27] City of Houston and Houston Coalition of Cities, Initial Brief, p. 3.

provide a revised set of schedules showing the impact of only adopting the test-year per book values for the twelve-months ending March 31, 2009, adjusted for actual incurred known and measurable changes through *September 30, 2009*.[28] CenterPoint responded on October 16, 2009, by stating as follows:

> The Company has not closed its books and records for the month of September 2009. Please see the attachment to this response for the information requested through August 31, 2009.[29]

CenterPoint's position is that the Intervenors have had an opportunity to evaluate the updated filing, but the books and records necessary to evaluate that filing were not even available as late as October 16, 2009. The problem is compounded because the update itself was not provided until three working days prior to the hearing. As noted by the Examiner in GUD No. 9869, the use of post test-year adjustments is reasonable, "if there is ample opportunity for regulatory scrutiny by the Examiners and the Intervenors." In this case, the Examiners find that three working days prior to the commencement of the hearing is not "ample opportunity."

Two additional points suggest that there has not been ample opportunity to evaluate that filing. First, the workpapers provided in support of the original *Statement of Intent* were not updated to provide support for the updated figures included in the Rebuttal Filing. Second, the Examiners note that Plant in Service was updated to include a new expense, totaling $3,679,892 – an amount not included in the original *Statement of Intent*.[30]

Furthermore, while the updated figures may have been available prior to the filing of October 29, 2009, the parties were simply not on notice that the company sought a rate based upon those figures until October 29, 2009. There is nothing in the testimony cited by CenterPoint in its Initial Brief that places the parties on notice of the *actual* amount of any updates or changes to the filing CenterPoint intended to seek in this case. Mr. Zapalac's nebulous statement that "the Company has allowed for the Commission to update rate base to ensure that the rates established reflect as closely as possible the Company's expenses and investment at the time the rates will go into effect" does not place the parties or the Commission on notice as to the *actual* rate increase sought. Ms. Gauger's initial testimony filed with the *Statement of Intent* that a *pro-forma* adjustment is required in order to allow a true up at a later time is equally enigmatic as to the ultimate rate the company intended. Indeed, the argument appears to be that a utility may file a rate case seeking some estimated upper limit in rates, but the precise rate increase was not be revealed until three days prior to the hearing. Such a proposal imposes tremendous costs on an already expensive process and would appear to deprive parties of fundamental due process accorded in administrative hearings. Further, such a proposal imposes a tremendous administrative burden that will directly impact the cost of processing rate cases.

In conclusion, the Examiners find that it would be unreasonable to base the decisions in this proceeding on the updated figures included in the rebuttal filing. Additionally, the

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[28] Examiners' Letter No. 13 (October 8, 2009).
[29] Examiners' Ex. No. 1, CenterPoint Energy Resources Corp.'s Response to Examiners' Letter No. 13.
[30] CenterPoint Ex. 13, Rebuttal Testimony of Kelly Gauger, Rebuttal Exhibit KCG-3, ln. 49.

Examiners find that Ms. Cannady's proposal appears to be consistent with both the policy and the underlying procedural facts reflected in the Final Order issued in GUD No. 9791. Her proposed adjustment is based upon figures that were known as of June 30, 2009. Thus, the adjustment provides an update to test-year values with known and measurable changes. Additionally, as in GUD No. 9791, the proposed adjustment, relative to the hearing date, provided the parties ample opportunity to evaluate those figures. As noted, rejection of the updates included in the rebuttal requires that the updated accumulated deferred income taxes also be rejected. Thus, while this adjustment results in a decrease to gross plant, it results in an overall increase to the requested rate base that was included in the rebuttal filing made by CenterPoint. Thus, the overall impact of these two adjustments is to increase rate base by $2,472,841. Finally, the Examiners recommend that a correction be made to address the error identified by Ms. Cannady in the amount of $121,386.

c. Storage Gas

CenterPoint initially requested that storage gas be treated in one of two possible methods. The company requested that the PGA be modified to allow the recovery of carrying charges on the balance of gas in storage inventory at a pre-tax rate of return established in this case. In the alternative, the company requested that the balance of gas in storage inventory be included as a component to rate base. By letter dated October 27, 2009, CenterPoint withdrew the alternative request and indicated that the company sought only to continue to recover the balance of gas in storage inventory and carrying costs through its PGA at a pre-tax rate of return. This fact was reiterated by Ms. Gauger and Mr. Troxle in rebuttal testimony and storage gas has been removed from rate base.[31]

d. Cash Working Capital (CWC)

(A) Introduction

Cash working capital represents an amount of cash that a utility must have available to meet current obligations as they arise due to the time lag between payment of expenses and collection of revenues. The need for working cash has long been recognized by regulatory bodies and the courts. An allowance of cash working capital, however, is not guaranteed as a matter of course and the utility carries the burden of establishing the need for cash working capital. CenterPoint prepared a lead-lag study to determine the cash working capital needs of the CenterPoint system. A lead-lag study empirically identifies the difference in timing between outward cash flow for labor, materials and supplies, inventory, other expenses, and inward cash flow of revenue from payments to customers.

Cash working capital requirements may be positive or negative. Positive working capital is investor-supplied. In contrast, negative working capital reduces the need for investor-supplied capital and arises when the utility receives customer payments before service is rendered, or when it receives funds before it must satisfy a corresponding liability. To illustrate the concept of cash working capital, if one assumed that the utility paid for natural gas before it

[31] CenterPoint Ex. 13, Rebuttal Testimony of Kelly C. Gauger, p. 7, lns. 1 – 10; CenterPoint Ex. 11, Rebuttal Testimony of Mathew Troxle, p. 28, ln. 16 – p. 29, ln. 6.

supplied the natural gas to the consumer, then the utility would be using positive cash working capital, i.e., money from its investors, to pay for natural gas until the consumer paid the utility. In that case, the investors have an expectation of receiving a reasonable return on its investment. If, however, the consumer paid the utility in advance for use of the product, the company has negative cash working capital and the investor would have no expectation of return because the investor's capital was not being used.

Jay Joyce provided testimony in support of CenterPoint's cash working capital requirement. The lead-lag study for the Houston Division reflects costs associated with the test period of January 1, 2008, through December 31, 2008 ("CWC Test Year"). Mr. Joyce testified that the test year used for the lead-lag study differed from the test year in the case because the CenterPoint had recently conducted a study for the Texas Coast Division. In order to conserve expenses in the preparation of a lead-lag study, the decision was made to rely on much of the same data in preparation of this proceeding.[32] The Examiners presume that the allocation of the costs of the study will be appropriately reflected in the rate case expense phase of this proceeding. As will be discussed below, several issues were raised by the Intervenors regarding the lead-lag study. No party, however, challenged the reasonableness of CenterPoint's CWC Test Year.

(B) Revenue Lag

Mr. Joyce explained that revenue lag is comprised of four components: (1) the service lag measured from the middle of the month for which the service is billed, (2) the billing lag reflects the time required to process and record bills, (3) the collection lag that identifies the time delay between recording of bills and receipt of billed revenues, and (4) the delay in the bank's clearance of deposited check payments. The total number of days produced by the four components represents the amount of time between the delivery of service to customers and the receipt of the related revenues for such service.[33]

The Intervenors challenged two components of the revenue lag. First, the Intervenors challenged the calculation of the collection lag. In that context two alternative issues were raised. On the one hand, the Intervenors argued that the company engaged in *factoring* of account receivables through an affiliate and the benefits of that factoring should be passed through to the Houston Division. On the other hand, if the impact of factoring is not taken into account, the Intervenors argued that the company did not establish that the collection lag was correctly *calculated*. Second, the Intervenors challenged the reasonableness of the billing lag. Thus, the Commission must determine whether the collection lag and the billing lag proposed by CenterPoint were just and reasonable.

(a) Collection Lag – Factoring of Accounts Receivable.

Collection lag reflects the time between the billing for services rendered and the receipt from customers of the revenues billed. The collection lag was determined by a random sample

[32] CenterPoint Ex. 9, Direct Testimony of Jay Joyce, p. 4, lns. 14 – p. 5, 10.
[33] CenterPoint Ex. 9, Direct Testimony of Jay Joyce, p. 8, lns. 1 – 10.

of customer billing for each class of customers compared to the actual payment receipt dates.[34] The effect of the collection lag may be ameliorated through factor of accounts receivable. CenterPoint acknowledged that it factored accounts receivables:

> CenterPoint Energy Resources Corp. ("CERC") presently sells (factors) certain of its customer accounts receivable, including those generated by customers of CenterPoint Energy Houston Division ("Houston Division") to an affiliate, CenterPoint Energy Gas Receivables, in turn, sells an interest in these receivables to an unaffiliated entity.[35]

The Intervenors argued that any benefit derived from the factoring of accounts receivable should be reflected in the collection lag of the Houston Division. CenterPoint maintained that no benefit was derived from the practice and that no adjustment to the collection lag should be made based upon a theory that the company received a benefit from this practice. The Commission must determine whether a benefit is derived from the factoring of accounts receivable and, if so, whether an adjustment should be made to the collection lag to account for that benefit.

Issues Raised by the Intervenors

The State of Texas, the City of Houston/Houston Coalition of Cities, and the Gulf Coast Coalition of Cities all argue that the company's practice regarding the factoring of accounts receivable should impact the collection lag of the Houston Division.[36] Essentially, the Intervenors argued that the company has structured its factoring arrangement so that any benefit derived from the factoring of accounts receivable generated by the Houston Division are enjoyed solely by the affiliates, and in particular, CenterPoint Energy Gas Receivables. The Intervenors presented three primary alternative proposals regarding the collection lag and two factors must be decided within each alternative.

The first issue to consider was the level of factoring. The Intervenors suggested three options related to the level of factoring. Option 1 assumed that 100% of all accounts were factored, Option 2 assumed that 65.03% of all accounts receivable were factored and Option 3 assumed that only 27.35% of accounts receivable were factored. The second issue to be considered is the number of collection days. In that context, the Intervenors proposed two options: either zero or one day. Zero days assume that the benefits of the factoring transaction are realized immediately and one day assumes that the benefits are realized after one day. Mr. Nalepa and Mr. Pous testified that a collection lag of zero or one day is typical when a company factors accounts receivable.[37] The collection lag alternatives proposed by the Intervenors are set forth in Table 5.4, below.

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[34] CenterPoint Ex. 9, Direct Testimony of Jay Joyce, p. 9, lns. 14 – 16; and CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce, p. 10, lns. 20 – 23.

[35] States Ex. 6, Response to RFI COH16-01, "CenterPoint Energy Houston Division Accounts Receivable Factoring Arrangement.

[36] Initial Brief of the State of Texas, pp. 13 – 15; City of Houston/Houston Coalition of Cities' Post Hearing Brief, pp. 9 – 10; and, Gulf Coast Coalition of Cities' Initial Brief, pp. 8 – 9; City of Houston Ex. 1A, and GCCC Ex. 3A and 3B.

[37] Tr. Vol. 3, p. 104, lns. 3 – 17.

Table 5.4
Collection Lag Alternatives

	Alternative 1		Alternative 2		Alternative 3	
Factoring Level	100%		65.03%		27.35%	
Collection Lag Days	0	1	0	1	0	1
Rev Req. Impact	$5,558,687	$5,273,765	$3,661,993	$3,426,800	$1,519,546	$1,439,684

The Intervenors recommended that the Commission determine the collection lag based upon the assumption that 100% of the accounts receivables are factored and that the collection lag is zero days. Mr. Pous, who testified on behalf of the City of Houston/Houston Coalition of Cities, recognized that there is a cost associated with factoring of accounts receivables and recommend that the cost be established at 11%.[38]

CenterPoint Response

The company's primary argument is that the Intervenor's argument is based on the assumption that CenterPoint factors its accounts receivables. Instead, the relevant analysis is whether the Houston Division received any cash from the factoring arrangement.[39] Furthermore, CenterPoint argued that the Houston Division does not sell receivables. Instead it transfers those receivables to an affiliate, CenterPoint Energy Gas Receivables, LLC ("Gas Receivables"). CenterPoint claimed that the Houston Division received no benefit from factoring nor are ratepayers charged for any fees associated with factoring. The company asserted that the Houston Division receives cash when the customer actually pays an invoice. As to the proposals of the Intervenors, CenterPoint contended that assuming 100% factoring is unrealistic; a 65% factoring arrangement is unsupported by the evidence and that Gas Receivables actually factored 27% of the Houston Division's receivables.

Examiners' Recommendation

CenterPoint has not established that its proposed collection lag is just and reasonable because the utility has not acknowledge the fact that it factors accounts receivable in its lead/lag study. There is no dispute that factoring accounts receivables reduces the collection lag. There is no dispute that the company is a party to an Accounts Receivables Factoring Arrangement. This is clearly established by the evidence presented at the hearing and the briefing submitted by CenterPoint. Furthermore, the utility concedes that at least 27% of the Houston Division's receivables are factored.[40] There is no dispute that any benefits derived from the factoring

[38] Tr. Vol 2, p. 197, ln. 24 – p. 200, ln. 25; Tr. Vol. 3.

[39] Initial Brief of CenterPoint Energy Resources Corp., D/B/A CenterPoint Energy Entex and CenterPoint Energy Texas Gas, p. 7.

[40] Reply Brief of CenterPoint Energy Resources Corp., D/B/A CenterPoint Energy Entex and CenterPoint Energy Texas Gas, p. 6. ("Ms. Gauger's actual testimony was that all (or 100%) of customer receivables are covered by the Company's Accounts Receivables Factoring Arrangement."); Reply Brief of CenterPoint Energy Resources Corp., D/B/A CenterPoint Energy Entex and CenterPoint Energy Texas Gas, p. 7. ("Gas Receivables [an affiliate] actually factored about 27% of the Houston Division's receivables."); State's Exhibit 6, CenterPoint Response to RFI No. COH16-01 ("CenterPoint Energy Resources Corp . . . presently sells (factors) certain of its customer accounts receivable, including those generated by customers of CenterPoint Energy Houston Division . . . to an affiliate.").

arrangement flow to an affiliate of the Houston Division. On those facts alone the Examiners find that it is unreasonable to ignore the impact of factoring on the collection lag.

CenterPoint suggested that the proceedings and holding in GUD No. 9670 provide guidance in this case. The cases, however, are distinguishable. In that case the company did *not* engage in any factoring. There was no factoring arrangement and that fact was established at the hearing. The predecessor in interest to the utility in that case previously factored its accounts receivables and the Intervenors in GUD No. 9670 argued that the utility's decision to refrain from factoring by the acquiring utility was imprudent. The Intervenors argued that the Commission should impute a collection lag based upon a practice not engaged by the utility. Of course, the facts in this proceeding are distinguishable because the utility in this case engages in factoring of accounts receivables. Furthermore, the company does not dispute that the benefits of factoring flow to an affiliate of CenterPoint.

CenterPoint refused to offer any quantification of the factoring arrangement except to argue that the assumption that 100%, 65.03%, or 27.35% of its receivables are factored is unrealistic. The burden of proof is on the utility to establish that its collection lag is reasonable and the company has not met that burden. Accordingly, it would be reasonable to calculate a collection lag as proposed by the Intervenors based upon an assumption that 100% of the utility's accounts receivables are factored. The evidence in the record, however, suggested that the utility factors less than 100% of its accounts receivables. As Mr. Pous conceded, utilities have brought up the concept that they cannot factor 100% of average monthly revenues. Evidence in the record established that the ratio between the lowest monthly level of revenues divided by the average monthly revenues is 65.03%.[41] On the other hand, the utility presented evidence that it factors only 27.35% of accounts receivable. Accordingly, the Examiners recommend that the Commission set the collection lag based upon the assumption that only 65.03% of the Houston Division accounts receivables are factored and that the collection lag is one day. The recommended adjustment would reduce the revenue requirement to be recovered from the standard rate customers by $1,439,684.

(b) Collection Lag – The Revenue Lag Day Samples.

Introduction

As noted above, the collection lag reflects the time between the billing for services rendered and the receipt from customers of the revenues billed. If the Commission determines that the collection lag should be adjusted to reflect the impact of factoring on accounts receivable, no further adjustment is required. On the other hand, if the Commission determines that the collection lag of the Houston Division is unaffected by the practices of CenterPoint related to factoring then the Commission must next consider whether the calculated lag for collections proposed by CenterPoint was just and reasonable. The Intervenors contend that the collection lag was not correctly calculated. The collection lag was determined by a random sample of customer billing for each class of customers compared to the actual payment receipt

[41] Tr. Vol. 3, p. 201 – p. 203, ln. 25, City of Houston/Houston Coalition of Cities Ex. 1A, Revenue Requirement Impacts of Factoring.

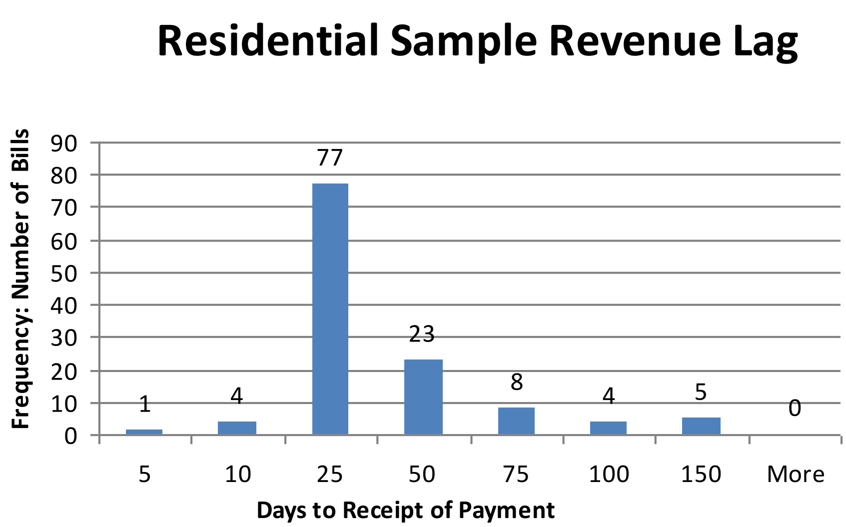
dates.[42] Thus, the Commission must determine whether the collection lag was accurately calculated.

Issues Raised by the Intervenors

Mr. Pous disputed whether the random sample used to calculate the revenue lag days was reasonable. He noted that the company included individual customer bills over ninety days. Based upon the company's stated write-off period, those bills are written off as bad debt. The bad debt expense is recovered as a separate expense item in the cost of service study. He argued that the purpose of a lead-lag study is to measure those components of invested capital that are not addressed elsewhere in the cost of service study. Accordingly, he recommended that the revenue lag sample be adjusted to remove those sample items that reflected payments greater than ninety days after a bill was issued. He proposed a change to reduce the overall revenue lag days from 41.76 days to 39.2 days.[43] This would reduce the revenue requirement by approximately $732,136.

Mr. Nalepa's testimony coincided, in principle, with the testimony offered by Mr. Pous. He noted that bills in excess of 90 days were written off and an expense item is included elsewhere for bad debt. Including those bills in the cash working capital study would result in a double counting.[44] He also noted that inclusion of these bills skewed the results of the cash working capital study and does not represent a typical collection lag. Most bills in the sample were collected within seventy-five days of the issuance of the bill. He graphically represented this fact. Figure 5.1 below is reproduced from Mr. Nalepa's testimony.

Figure 5.1[45]



[42] CenterPoint Ex. 9, Direct Testimony of Jay Joyce, p. 9, lns. 14 -16; and, CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce, p. 10, lns. 20 – 23.
[43] City of Houston/Houston Coalition of Cities, Ex. 1, Direct Testimony of Jacob Pous, p. 24, ln. 11 – p. 26, ln. 13.
[44] GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, p. 12, lns. 1 – 6.
[45] GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, p. 10.

As Mr. Nalepa argued that the graph established that of the 122 bills included in the residential sample, 81 bills were paid within 25 days. Furthermore, the longer a bill is not paid, the greater the weighting given that bill in the analysis. Thus, the few bills that were included in the sample beyond 75 days are given a disproportionate weighting in the calculation. Thus, he argued that removing these bills was not only necessary because they were addressed as part of the company's bad debt expense but also it was appropriate to remove them to preserve the integrity of the sample. Mr. Nalepa's proposal would reduce the revenue requirement by approximately $433,038.

CenterPoint Response

Mr. Joyce argued that the Intervenors misunderstood the bad-debt expense process. An account may be written-off, then paid, and then recovered. In that case, the account is no longer considered as a write-off. On the other hand, the bad debt percentage is based upon accounts that are never paid. Those bills were not included in the collection lag. To exclude those from the collection lag sample would be inappropriate. He contended that the collection lag calculation included only those invoices that were paid – it does not include unpaid bills.[46]

Examiners' Recommendation

The Examiners find that CenterPoint has not established that the calculation of the revenue lag days is just and reasonable. The Examiners find, however, that CenterPoint excluded bills that were never paid from the sample used to calculate the collection lag. Nevertheless, the Examiners find that the sample should be adjusted to ameliorate the impact of a small proportion of the bills on the overall collection lag and the collection lag should be set at the level suggested by GCCC. The impact on the revenue requirement to be recovered from the Standard Rate customers is $433,038.

(c) Meter Reading to Billing Lag Days.

Introduction

The billing lag is the time consumed in the billing process.[47] In the CWC study CenterPoint indicated that the billing lag for residential and commercial customers was approximately six days. The transportation class billing lag was approximately nineteen days. Table 5.5 below sets out the billing lag for each class of the standard customers:

[46] CenterPoint Ex. No. 17, Rebuttal Testimony of Jay Joyce, p. 10, ln. 17 – p. 12, ln. 6.
[47] CenterPoint Ex. 9, Rebuttal Testimony of Jay Joyce, p. 2, ln. 11.

Table 5.5
Cash Working Capital Study: Billing Lag Days[48]

Customer Class	Billing Lag Days
Residential	5.900
Small Commercial	5.880
Large Commercial	6.080
Industrial	5.980
Transportation	18.690

Mr. Joyce, who prepared the lead-lag study, asserted that he examined the actual working capital requirements of the company. In the context of the billing lag, the company provided detailed information outlining the billing process. The steps, from scheduling the read date to issuing a bill, were set out as follows: (1) Scheduled read date for cycle and bills are read using hand-held meter reading devices which may be electronically uploaded to the billing system;[49] (2) if read was not accomplished on read date due to weather, or other factor, meter reading is obtained on the second day; (3) bills are reviewed for consistency and evaluated, (4) re-reads are reviewed, (5) all bills processed for mailing, and, finally, (6) bills are mailed.[50] The total number of days for all customers, except industrial customers, to complete these steps was approximately six days.

The City of Houston/Houston Coalition of Cities and the Gulf Coast Coalition of Cities disputed the reasonableness of the alleged billing lag days. They argued that the total number of days consumed in the billing process was not correctly measured. They also argued that the total number of days was unreasonable and the company's billing process was inefficient. In response, the company asserted, in part, that the cash working capital is an empirical study that evaluates the company's processes. It is not the proper venue to determine whether a company process is reasonable or efficient. Additionally, CenterPoint argued that its billing process was, in fact, reasonable and efficient.

In the context of the billing lag, the Commission must make two determinations. The Commission must determine whether the conclusions of the lead/lag study accurately measured the billing lag. Second, the Commission must determine whether the billing process and, the associated billing lag, are reasonable.

Issues Raised by the Intervenors

The focus of the testimony filed by Mr. Pous, on behalf of the City of Houston/Houston Coalition of Cities, was the apparent inefficiency of a billing process that consumed nearly six days. He maintained that the company's process of issuing a bill was economically inefficient and pointed out that in a recent rate proceedings the Commission established a billing lag of one day for a different utility. He also noted that the billing sample evaluated by the company included several bills that were processed within three days of the meter reading date. Mr. Pous

[48] CenterPoint Ex. 9, Direct Testimony of Jay Joyce, Workpapers of James Joyce, CenterPoint Gas Lead Lag Study, WorkPaper A, p. 1.
[49] CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce, Rebuttal Ex. JJJ-1, p. 8 (CenterPoint Response to RFI COH07-05).
[50] CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce, Rebuttal Ex. JJJ-1.

recommended that the Commission order the utility to perform a detailed analysis of the company's billing process. The goal of the analysis would be to identify factors that preclude billing within one or two days. The study should evaluate the ability of other companies to issue bills more efficiently and contrast those efficient billing procedures with the procedures employed by CenterPoint. In the interim, Mr. Pous recommended that the Commission recognize nothing greater than a three-day lag for the meter reading to billing process. The overall effect of Mr. Pous' recommendation appears to be to reduce the revenue lag days by 2.88 days. Mr. Pous asserted that the stand-alone effect of the proposed adjustment would be to reduce the revenue requirement by $877,472.[51]

Mr. Nalepa, who testified on behalf of the Gulf Coast Coalition of Cities, focused on the quality of the data analyzed by the company. Mr. Nalepa testified that he reviewed data provided by the company and concluded that the company overstated the time required to prepare bills. He recommended a billing lag of 4.5 days. He noted that the company sampled four to eleven bills for each of the twelve months of the test year instead of reviewing an entire month of data encompassing all billing cycles within the month. Furthermore, he noted that the majority of the observations made occurred during the last few days of the month. This, he contended, was a skewed sample that could bias the results because it is affected by end-of-month billing problems that might have been encountered.[52] Additionally, Mr. Nalepa examined the billing lag of other gas distribution utilities. Mr. Nalepa's proposed adjustment would reduce the revenue requirement by $393,153. His findings are set out in Table 5.6 below.

Table 5.6
Billing Lag Analysis: Comparison with Other Gas Distribution Utilities

Utility	Billing Lag Day
Atmos Mid-Tex[53]	4.47
Equitable Gas Company[54]	4.88
Peoples Gas Light and Coke Company [55]	1.36
Atmos Mid-Tex[56]	2.72

CenterPoint Response

CenterPoint responded to the issues raised by the Intervenors through testimony filed by Richard Zapalac and Jay Joyce. Mr. Joyce addressed the mechanics of the cash working capital study whereas Mr. Zapalac testified as to the reasonableness of the billing practices of the company. Mr. Zapalac and Mr. Joyce were critical of any suggestion that the result of the lead/lag study should be used to examine the reasonableness of the billing practices of the

[51] City of Houston/Houston Coalition of Cities, Ex. 1, Direct Testimony of Jacob Pous, 26, ln. 15 – p. 30, ln. 11.
[52] GCCC Ex. 2, Direct Testimony of Karl Nalepa, p. 9, lns. 9 – 16.
[53] GCCC Ex. 2, Direct Testimony of Karl Nalepa, p. 9, lns. 17-18, citing to GUD No. 9670.
[54] GCCC Ex. 2, Direct Testimony of Karl Nalepa, p. 9, lns. 18-19, citing to Pennsylvania Public Utility Commission, Docket R-2008-2029325.
[55] GCCC Ex. 2, Direct Testimony of Karl Nalepa, p. 9, lns. 18, citing to Illinois Commerce Commission, Docket No. 09-0167.
[56] GCCC Ex. 2, Direct Testimony of Karl Nalepa, p. 9, lns. 17-18, citing to GUD No. 9762.

company. Instead, a cash working capital study should simply measure the amount of capital needed to implement company policies based on actual experience.[57]

Mr. Joyce refuted allegations regarding the quality of the data examined and the quality of the study. He dismissed Mr. Nalepa's criticism that the data was skewed by populating his underlying data with end-of-month samples. He contended that only 22% of the data was made up of samples taken at the end of the month – an amount consistent with data collected evenly throughout the test year.[58] Mr. Joyce also presented data that he contended refuted Mr. Nelapa's assertion that the end of month billing process resulted in longer billing lags. Furthermore, Mr. Joyce asserted that the company has not indicated that there is any evidence of end-of-month billing problems, contrary to the assertions of Mr. Nalepa.[59] Finally, Mr. Joyce argued that imputing a billing lag based on the billing lag determined in other cases is not reasonable.

Mr. Zapalac asserted that the billing practice of the company is, in fact, reasonable. He argued that the billing practices are designed to ensure that bills rendered to customers are as accurate as possible. CenterPoint reads approximately 950,000 gas meters for its Houston Division every month. The billing time provided is intended to allow the utility an opportunity to research and correct any errors or exceptions in the bill. Finally, he and Mr. Joyce contended that a shorter billing lag would impose additional costs on the company as a result of increased meter readers and an increase in customer service personnel to respond to increased customer complaints.[60]

Examiners Recommendation

The Examiners find that the company has established the sample of data relied upon to determine the billing lag was reasonable and representative of the bills of the standard customer classes, industrial, and transportation classes. The Examiners find that the company has also established that the billing process that could encompass up to six days for residential, small commercial, large commercial, and industrial customers is reasonable. The company detailed the billing process and explained the reason for each potential day in the billing process. Furthermore, the evidence submitted established that through that billing process the company identified a small percentage of meter reads that required further investigation before bills were rendered. These all were corrected.[61] Correcting these bills would, in the long run, reduce expenses as it would potentially reduce customer complaints.

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[57] CenterPoint Ex. 12, Rebuttal Testimony of Richard A. Zapalac, p. 8, lns. 7 – 16; CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce p. 3, lns. 1 – 9.

[58] CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce, p. 3, ln. 10 – p. 5, ln. 4.

[59] CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce, p. 3, ln 10 – p6, ln. 4.

[60] CenterPoint Ex. 12, Rebuttal Testimony of Richard A. Zapalac, p. 7, ln. 16 – p. 9, ln. 3; CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce, p. 10, lns. 1 – 16.

[61] CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce, Rebuttal Exhibit JJJ-1, p. 7. (CenterPoint Response to RFI, GCCC10-03).

(C) Expense Leads

(a) Gas Purchases

Introduction

CenterPoint paid for gas after the gas was received to provide service and the result of this practice is a lead for purposes of the cash working capital requirement.[62] The utility proposed a 40.56 expense lead days for purchases related to gas costs.[63]

Issues Raised by the Intervenors

Mr. Pous argued that the expense lead was not accurately calculated. Specifically, he noted that CenterPoint's payment practice appears to be inconsistent. He suggested that in certain months invoices for the same vender were paid on various dates throughout the month. He reviewed invoices for gas purchases and noted that typically those invoices were due twenty-eight, thirty-one, or thirty-two days after the end of the month in which service was provided. By including invoices in which payments were made at an earlier point, CenterPoint understated the level of gas purchase lead days. Mr. Pous recommended that would increase the predominant payment date reflected in the utility's presentation of all payments to reflect the normal billing practices observed. In other words, if some payments were made on the twenty-third of a month, while others were made on the twenty-fifth, those payments would be extended. This would eliminate data points from the lead-lag study that were inconsistent with the later payment dates. He asserted that his recommendation would increase the gas purchase expense lead days from CenterPoint's proposed 40.56 days to 40.75 days. This adjustment would reduce the revenue request by $44,131.

CenterPoint Response

Mr. Joyce asserted that the description of the adjustment by Mr. Pous was vague and unclear. He was particularly critical of the term "standard payment date" used by Mr. Pous and contended that it was not an industry defined term. Further, he argued that Mr. Pous assumed that all invoices for all suppliers are paid on the same date each month. He argued that the company made payment on individual invoices based on the date required by each contract. He also argued that a recent recommendation in GUD No. 9869 supported his conclusion that payment dates should be reflective of the company practices and not arbitrarily extended.[64]

Examiners' Recommendation

The Examiners find that CenterPoint has not established that a gas expense lead of 40.56 days is just and reasonable. Paying invoices prior to the due date is not reasonable and unnecessarily increases the cash working capital requirements of the company. Accordingly,

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[62] CenterPoint Ex. 9, Direct Testimony of Jay Joyce, p. 10, lns. 6 – 12; and, CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce, p. 13, lns. 17 – 23.

[63] CenterPoint Ex. 9, Direct Testimony of Jay Joyce, Exhibit JJJ-3, ln. 2, col. (e).

[64] CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce, p. 14, ln. 1 – p. 15, ln. 19.

the Examiners recommend that an adjustment be made to CenterPoint's calculation of the gas expense lead days.

(b) Other O&M Labor – Vacation.

Introduction

In order to determine the lead days for operations and maintenance expenses, total system operations and maintenance expenses were separated into two groups: labor and non-labor. The labor component, addressed here, was further subdivided into three categories: (1) payroll costs, (2) incentive pay, and (3) benefits costs. In calculating the payroll costs lead/lag that is incorporated into the calculation of the labor lead/lag, an adjustment must be made to incorporate the effects of vacation pay.[65]

All parties agree that expense lead days associated with deferred compensation are a component of payroll expense. Furthermore, all parties agree that there is a longer deferred compensation period associated with vacation related payroll.[66] The company proposed a payroll expense lead of 12.06 days and an expense lead to recognize the longer deferred compensation period associated with vacation related payroll of 194.56 days.[67] The result was a total vacation expense lead of 25.56 days.[68] The parties do not dispute the payroll expense lead of 12.06 days. The Intervenors dispute whether CenterPoint has properly recognized the longer deferred compensation period associated with vacation related payroll – the 194.56 days. The Intervenors recommend that the period associated with vacation related payroll be adjusted from 194.56 days to 1,331 days.

In this context the Commission must determine whether the proposed vacation expense lead of 194.56 days is reasonable. The Commission must evaluate two factors. The Commission must determine whether the assumption that vacation is taken evenly throughout the year is reasonable. The Commission must also determine whether an adjustment should be made to recognize the fact that employees accrue vacation at different rates – employees with longer service are entitled to more vacation time.

Issues Raised by the Intervenors

Mr. Pous alleged two problems with the utility's analysis. First, Mr. Pous observed that the average accrual of vacation time directly corresponds to the specific length of employment. In other words, employees gain additional vacation time per year depending on their length of employment. The more years an employee works the more vacation time the employee is entitled per year. He argued that the company's analysis failed to recognize this dynamic. Second, he noted that the company made the assumption that vacation is taken midyear, in July. He contended that the mid-year assumption failed to recognize that vacation pay is not

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[65] CenterPoint Ex. 9, Direct Testimony of Jay Joyce, p. 10, ln. 14 – p. 11, ln. 19.

[66] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 33, lns. 16 – 17 & lns. 23 – 24.

[67] CenterPoint Ex. 1, Workpapers of Jay Joyce, Lead-Lag Study Supporting Workpapers, Workpaper No. C-1.

[68] CenterPoint Ex. 1, Workpapers of Jay Joyce, Lead-Lag Study, Supporting Workpapers, Workpaper, No. C-1, ln. 11, col. (c); CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce, p. 16, lns. 8 – 9.

dispersed evenly throughout the year. Instead, the company should recognize August 5th as the appropriate point from which to calculate the employees use accumulated vacation days.[69]

He noted that the average length of service for the utility's employees is 14.8 years and he observed three key tiers regarding the accumulation of vacation days. Employees who worked less than four years accrued eighty hours per year of vacation. Employees who worked between five and thirteen years accrued one hundred twenty hours of vacation per year, and employees employed between fourteen and twenty-three years earned one hundred sixty hours per year. He proposed an adjustment that would recognize these tiers of service. Based on that analysis Mr. Pous proposed that the appropriate expense lead that recognized the longer deferred compensation period associated with vacation related payroll of 1,101 days.[70]

Mr. Pous maintained that the Public Utility Commission (PUC) of Texas in Docket No. 16705 adopted a similar approach. He asserted that the issue was presented there and that the PUC adopted his recommendation of expense lead day for post-retirement benefits of over three hundred (300) days. The PUC also adopted language recognizing vacation payroll as the "lag between when the employee earns the vacation time and when the Company pays for it in salary expense."[71]

As noted above, in addition to the problem associated with the accrual of vacation days, Mr Pous argued that the company failed to recognize that vacation pay is not dispersed evenly throughout the year. He argued that this fact has been recognized by the Commission in other cases involving other utilities and that in those cases, the timing of paid time off was demonstrated to be on average taken during August rather than at the midpoint of the year.[72]

In conclusion, Mr. Pous recommended extending the utility's assumed midyear vacation service period to August 5th, and recognizing an expense lead day associated with the vacation practices of the employees of 1,101 days. The overall result is an increase in vacation pay lag days to 1,331. The stand-alone impact of this recommendation would be to change the expense lead days from 35.43 days to 66.92 days. The overall impact on the revenue requirement allocated to the standard customers is a reduction of $1,187,538.

CenterPoint Response

Mr. Joyce contended that the two parts Mr. Pous' recommendation is based upon a calculation of a hypothetical vacation lead, not based upon the company's actual data. He explained that the method he applied was the same method that Mr. Pous proposed in GUD No. 9145. The commission there ruled that the proposed adjustment, based on the Intervenors calculation of vacation lead day, was appropriate. Mr. Joyce argued that Mr. Pous abandoned his prior methodology in favor of a new methodology that is not directly linked to the company's actual practices. Additionally, he was critical of Mr. Pous method for determining when employees take vacation. Mr. Pous based his recommended change not on the actual

[69] City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 32, ln. 6 – p. 33, ln. 11 and p. 35, ln. 21 – p. 36, ln. 6.
[70] City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 33. ln. 13 – p. 35, ln. 8.
[71] City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 35, lns. 10 – 19.
[72] City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 35, ln. 21 – p. 36, ln. 6.

practice of employees, but instead based upon the practice of employees in other utilities. He emphasized his assessment that Mr. Pous did not base the proposed adjustment on actual company data.

Examiners Recommendation

The Examiners find that the company has established that the calculation of a vacation lead of 25.56 days is reasonable. The Examiners find that the calculation of 194.56 vacation days is not based upon the actual experience of the company's employees. Instead adding the undisputed payroll expense lead to the assumed vacation lead derives that figure. Mr. Joyce derived the assumed vacation lead by dividing 365 (the number of days in the year) by two (based on the assumption that vacation is taken at the midpoint of the year). Thus, Mr. Joyce's assertions that Mr. Pous recommendation should be rejected because it is not based on the underlying data is irrelevant. Both witnesses have presented testimony based upon an underlying assumption and there is a dispute regarding two components of the assumption.

Nevertheless, this Commission has previously approved the underlying assumptions used by CenterPoint to calculate the vacation expense lead and no evidence regarding employee practice was presented to suggest that those assumptions are not appropriate here. First, Mr. Pous conceded that he conducted no empirical analysis to determine that the midpoint assumption was not reasonable.[73] Second, while Mr. Pous discussed what may be a reasonable assumption, that employees accrue vacation at differing rates, the assumption was not supported by empirical analysis. It is not reasonable to change the calculated vacation expense lead from half a year to three and a half years without data to support the proposed change. The company's calculation is based on a methodology approved in prior proceedings and no evidence was presented to suggest deviation from that methodology is appropriate here.[74]

(c) Other O&M Expense Non Labor

Introduction

As noted in the previous section, in order to determine the lead days for operations and maintenance expenses, total system operations and maintenance expenses were separated into two groups: labor and non-labor. CenterPoint proposed 29.24 expense lead days for other non-labor O&M Expenses.[75] The non-labor component was divided into two categories affiliate

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[73] Tr. Vol. 2, p. 236, lns. 7 – 13. (Q. On page 35 where you talk about vacation pay . . . and you talk about August rather than June, did you look at any empirical evidence as to what the company employees do for this particular company? A. Not for this particular company. No.)

[74] GUD No. 8976, Statement of Intent to Change City-Gate Rate of TXU LoneStar Pipeline, Formerly Known as Lone Star Pipeline Company Established in GUD No. 8664, Revised Proposal for Decision, p. 44 (The lag between when the employee earns the vacation time and when the utility pays him or her for it is relevant . . . .). GUD No. 9145 – 9148, Appeal of TXU Gas Distribution from the Action of the City of Dallas, City of University Park, and the Town of Highland Par, Texas and the Statement of Intent Filed by TXU Gas Distribution to Increase Rates Charged in the Environs of the City of Dallas, Proposal for Decision, p. 24 ("[T]he relevant point of reference in this analysis is the employee. The employee accrues vacation and that is what should be measured in the lead lag study: the lead-time between when the employee accrues the benefit and is later paid for such benefit. Mr. Pous properly calculated the lag using payroll figures provided by the Applicant.") and the Final Order Finding of Fact No. 53 adopting a vacation expense lead of 25.097 days.

[75] CenterPoint Ex. 1, Lead-Lag Study Supporting Workpapers, Workpaper No. C, ln. 8, col. (d).

changes and other third-party expenses.[76] The Intervenors do not challenge the component related to affiliate charges. On the other hand, the City of Houston/Houston Coalition of Cities challenged the expense lead associated with non-labor operations and maintenance expenses.

Issues Raised by the Intervenors

Mr. Pous raised several issues related to the expense lead associated with this category of expense. First, Mr. Pous criticized the fact that the utility collapsed all other expenses into a single category. Second, he argued that the sample selected to calculate the expense lead for this category or expense failed to properly recognize payment terms associated with numerous invoices. Third, he contended that the company failed to recognize the comparable service periods identified in other invoices. Fourth, in his view, CenterPoint failed to capture the service period on the occasions that it was clearly stated on the invoice. Fifth, CenterPoint simply misread certain invoices and pulled an incorrect date. Sixth, the utility failed to recognize shipping dates when it received the product and instead relied on the invoice date. Seventh, the utility did not present the actual invoice.[77]

Mr. Pous argued his final point, the fact that the company failed to provide the actual invoice, deprived the Commission and the Intervenors of the best evidence to establish the veracity of the company's analysis. The utility presented pages from its computerized accounting system. That data, however, did not identify the invoice, vendor or other items of pertinent information. Mr. Pous urged that, in addition to adjusting the expense lead days, the Commission should order the company to scan and retain legible electronic versions of invoices in support of any future claimed CWC requirements.[78]

Mr. Pous reviewed the data provided by CenterPoint and made adjustments to that data to address the concerns he noted. He concluded that the net effect of his recommended adjustments was to increase the expense lead days from 29.24 to 32.27 for non-labor O&M Expense. The stand alone impact of this proposed change is to increase the expense lead days to 37.06 days for all expenses within the category of O&M Expense. The stand-alone impact on the revenue requirement to be recovered from standard customers is $61,470.

CenterPoint Response

Mr. Joyce asserted that Mr. Pous failed to provide any support for his proposed adjustment. Mr Joyce argued that Mr. Pous failed to provide any basis for his recommendation other than to simply assert it and hardcode a change into a spreadsheet. He contended that support of the utility's request was contained within his testimony.

Examiners' Recommendation

The Examiners find that CenterPoint failed to establish that its proposed expense lead for non-labor operation and maintenance expense was just and reasonable. Mr. Joyce failed to respond to Mr. Pous' criticism of the underlying data. In particular, he failed to address the fact

[76] CenterPoint Ex. 9, Direct Testimony of Jay Joyce, p. 10, ln. 14 – p. 11, ln. 19.
[77] Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 36, ln. 18 – p. 38, ln. 17.
[78] Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 38, lns. 1 – 17.

that the company cannot provide the underlying invoice to establish the veracity of the underlying data. Without that invoice, the company has merely hard coded unsupported numbers into a spreadsheet – a practice that Mr. Joyce concedes should be avoided. Other factors raised by the City of Houston/Houston Coalition of Cities indicated that the company did not carefully evaluate the underlying evidence include the following: (1) the sample selected to calculate the expense lead for this category failed to properly recognize payment terms associated with numerous invoices; (2) the company failed to recognize the comparable service periods identified in other invoices; (3) CenterPoint failed to capture the service period on the occasions that it was clearly stated on the invoice; and, (4) CenterPoint simply misread certain invoices and pulled an incorrect date. Accordingly, the requested expense lead days of 29.24 for non-labor operation and maintenance expenses should be rejected and the expense lead for this category of expense should be set at 32.27 days. The stand-alone impact on the revenue requirement to be recovered from standard customers is $61,470

(d) Taxes Other than Income Taxes

Four categories of taxes are included in this group of taxes: (1) Payroll-related taxes (FICA, Federal Unemployment, and State Unemployment), (2) Revenue-related taxes (State Gross Receipts, Local Gross Receipts, and State Gross Margin Tax), (3) Ad Valorem Taxes, (4) Railroad Commission Gas Utility Tax.[79] The lead days for each of these groups were measured independently, and the results were combined to produce weighted lead days for taxes other than income taxes. CenterPoint proposed an expense lead of 42.95 days.[80] The City of Houston/ Houston Coalition of Cities initially objected to the calculation of the expense lead associated with the payment of local gross receipts taxes. In response to clarifications made in the rebuttal testimony, the City of Houston/Houston Coalition of Cities withdrew its objection and conceded that the expense lead associated with this category of expense was correctly calculated by CenterPoint: "[The City of Houston and the Houston Coalition of Cities] agree that the initial presentation on this topic is in error. Therefore the file adjustment of $1,846,587 should be disregarded."[81] The Examiners find that the company has established that its proposed expense lead of 42.95 days for this category of expense was just and reasonable.[82]

(e) Federal Income Taxes

Introduction

The utility proposed an expense lead of 37.25 days for federal income taxes. CenterPoint based its estimate on a standard proposed payment schedule that assumed 25% of the utility's current tax payments are made on each of the following dates April 15th, June 15th, September 15th, and December 15th.[83] The City of Houston and the Houston Coalition of Cities

[79] CenterPoint Ex. 9, Direct Testimony of James Joyce, p. 14, ln. 10 to p. 15, ln. 11.
[80] CenterPoint Ex. 9, Direct Testimony of James Joyce, Exhibit JJJ-3, ln. 11, col (E).
[81] City of Houston and Houston Coalition of Cities Initial Brief, p. 8.
[82] CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce, p. 26, ln. 1 – p. 24, ln. 11. Mr. Joyce established that the payment of franchise fees for the City of Houston is in advance not in arrears.
[83] CenterPoint Ex. 9, Direct Testimony of Jay Joyce, p. 13, ln. 18 – p. 14, ln. 3; CenterPoint Ex. 17, Rebuttal Testimony of Jay Joyce, p. 20, ln. 14 – p. 21, ln. 2; City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 41, lns. 15 – 18.

contended that CenterPoint failed to establish the reasonableness of the proposed expense lead. The Commission must determine whether the proposed expense lead was just and reasonable.

Issues Raised by Intervenors

Mr. Pous argued that the utility does not follow the standard payment practices. Instead, the company has availed itself of extension payment practices beyond those contemplated in the standard payment schedule. He argued that the extension practice effectively results in an opportunity to make a fifth payment on March 15th of the following calendar year. He noted that the Public Utility Commission of Texas has adopted a longer lead day for income tax purposes based on a similar recommendation. His recommendation resulted in an increase of the company's proposed expense lead from 37.25 days to 55.55 days. The stand-alone impact on CWC and rate base is $376,602.[84] The stand-alone impact on the revenue requirement to be recovered from standard customers is a reduction of $33,730.

CenterPoint Response

Mr. Joyce stated that Mr. Pous methodology is unsupported by precedent or practice and contrary to statutory deadlines. He contended that the extension to pay proposed by the City of Houston and the Houston Coalition of Cities is only applicable if the corporation is anticipating a net operating loss carry back in the current year. He also noted that in GUD No. 9145 the Commission rejected a similar proposal and adopted a recommendation based upon the statutory deadline. Finally, he explained that the company's proposal is consistent with relevant statutes, Commission precedent, and IRS guidelines.[85]

Examiners' Recommendation

The Examiners find that CenterPoint has established that its proposed expense lead for federal income taxes is just and reasonable. The methodology employed by the company is consistent with Commission precedent.[86] The proposed methodology is also consistent with the requirements of the Internal Revenue Service and accurately captures the company's payment practices.

e. Accumulated Deferred Income Tax (ADIT)

(A) Introduction

As noted on Table 5.1 above, part of the utility's calculation of total rate base is the calculation of the accumulated deferred income tax. The net calculation is added or subtracted from the total net plant. All parties agree that an adjustment for the net of credits and debits related to accumulated deferred income taxes should be made to total net plant. CenterPoint

[84] City of Houston/Houston Coalition of Cities, Ex. 1, Direct Testimony of Jacob Pous, p. 41, ln. 9 to p. 42, ln. 18. Mr. Pous calculated the effect of the proposed change to be $376,596. As noted above, the Examiners have calculated the effect on CWC and Rate Base as $376,602.

[85] Center

[86] GUD No. 9145, PFD, pp. 32 – 33; Final Order No. 68. In that case the Commission approved an expense lead of 37 days.

reported accumulated deferred income tax level of $52,727,129, and that calculation is summarized in Table 5.7, below.

Table 5.7
Accumulated Deferred Income Taxes

Line No.	Description	Original	Rebuttal
	Current Portion of Deferred Provision		
1	Total Employee Benefit Accruals	$ (93,667)	$ (109,530)
2	Total Miscellaneous Expenses (Bad Debt)	1,526,415	381,034
3	Total Current Assets / (Liabilities)		
	NonCurrent Portion of Deferred Provision		
4	Total Employee Benefit Accruals	12,408,627	12,333,100
5	Total Indemnifications & Other Reserves	2,546,948	2,863,109
6	Total Deferred Gas Costs	(1,252,287)	2,649,068
7	Taxes in Excess of Book Depreciation	(55,266,033)	(59,048,032)
8	Contributions in Aid of Construction	13,535,587	15,100,487
9	Gain or Loss on Sale of Assets	(3,960,107)	(5,256,551)
10	Tax Overhead Capitalization	(1,443,485)	(1,791,881)
11	Removal Costs	(2,289,587)	(2,893,442)
12	Ike Hurricane Deduction/Rate Case Expense	2,547,443	691,158
13	Deductible Repairs & Maintenance/481 (a) adj		(16,794,752)
14	Miscellaneous Reserves	-	-
15	Other	(127,074)	(116,933)
16	Total Deferred State Income Taxes	195,914	384,142
18	Total Noncurrent Assets / Liabilities		
19	Totals		
20	State Deferred Income Tax	(579,481)	(1,118,106)
21	Total Deferred Income Tax	$ (32,250,517)	$ (52,727,129)

As explained above, however, because the Examiners have recommended that the September 29, 2009 filing be rejected, the appropriate accumulated deferred income tax expense is the calculation that most closely matches the dates in reflecting adoption of the other rate base components. Accordingly, that figure is $32,250,517. As already noted, the effect is to increase rate base by $20,476,612. Consequently, the increase to the revenue requirement to be recovered from the standard rate classes is $2,538,151.

The City of Houston/Houston Coalition of Cities argued that accumulated deferred income taxes were not correctly calculated and challenged the accumulated deferred income tax associated with the following accounts: (1) Total Miscellaneous Expense (Bad Debt), (2) total employee benefit accruals, (3) total indemnifications and other reserves, (4) Ike Hurricane Deduction/Rate case expense, and (5) total deferred state income taxes.[87]

As is evident from Table 5.7 above, accumulated deferred income taxes can give rise to a credit or a debit. Deferred taxes arise because of timing differences between recognition of certain items for book purposes versus tax purposes.[88] The parties agree that a credit operates

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[87] Although there are two entries related to income taxes for purposes of the proposed adjustment they were treated as one category.

[88] Natural Gas Rate Review Handbook, p. 18.

as a decrease to rate base and that it represents a cost-free source of capital. The parties also agree that a debit represents tax payments that the utility has funded before they are collected from customers.

An example of an accumulated deferred income tax *credit* that is not disputed is the entry for taxes in excess of book depreciation at line 7 of Table 5.7. For ratemaking purposes, the utility collected an amount of depreciation expense and associated taxes from ratepayers. The amount collected is predicated upon the useful life of the asset using the straight-line method of depreciation. On the other hand, for income tax purposes, accelerated depreciation methods are allowed resulting in a utility paying less income tax. Ratepayers pay the income tax rates as if accelerated tax depreciation benefits did not exist. The result is that the company enjoys the benefit of the difference between the actual taxes paid and the amount collected from ratepayers. This in essence, is a cost-free source of capital and is deducted from rate base, as reflected on Table 5.7.[89]

An example of an accumulated deferred income tax *debit* that is not disputed is the entry for accumulated taxes for contributions in aid of construction, at line 8 of Table 5.7, above. Certain ratepayers make contributions to the utility for the construction of specific facilities, which are used to serve that particular customer or customers. The income for contributions in aid construction operates as a reduction to plant costs. The payments from the customers are part of the company's revenue stream and are considered taxable income. As a result, the company was required to pay taxes. Those taxes, however, were not part of the previously approved rates and, in essence, the shareholder was required to provide the funds to pay the taxes. Accordingly, it is included as a debit entry for accumulated deferred income tax. It operates to increase rate base and the company should receive a return on those funds.

(B) Appropriate Treatment of ADIT.

Introduction

The first issue faced by the Commission in this context is the appropriate treatment of accumulated deferred income tax debits. Hugh Larkin, who testified on behalf of the City of Houston/Houston Coalition of Cities, essentially argued that the treatment of debits in five areas by CenterPoint was inappropriate. Those five areas will be discussed in more detail below and the allegation regarding the proper treatment of the entry for accumulated deferred income taxes is similar. The Commission must first evaluate the issues raised regarding the proper treatment of accumulated deferred income tax debits. That determination will guide the Commission's decision regarding the specific entries challenged.

Issues Raised by the Intervenors

Mr. Larkin contended that unless the revenue stream that gave rise to the tax liability has not actually been used or otherwise deducted from rate base, CenterPoint should not be allowed to earn a return on the taxes paid. His basic rationale for this approach is as follows. The

[89] City of Houston/Houston Coalition of Cities Ex. 5, Direct Testimony of Hugh Larkin, p. 3, ln. 5 – p. 4, ln. 15 and CenterPoint Ex. 15, Rebuttal Testimony of David Weaver, p. 5, lns. 8 – 10 & p. 6, lns. 1 – 3.

company received funds from ratepayers. Those funds are in excess of the associated tax liability. Until those funds are consumed or otherwise deducted from rate base the company is not required to provide additional funds in excess of the amounts collected from customers, to pay taxes. Mr. Larkin provided an example using a *Catastrophic Storm Damage Reserve* that has accumulated $50,000,000. Assuming a combined tax rate for that fund of 35%, the tax liability would be $17,500,000. Until those the $50,000,000 are consumed or otherwise deducted from rate base, those funds are available to pay the tax liability of $17,500,000 and the company was not required to provide any additional dollars to meet its tax obligations. In Mr. Larkin's view, including the tax liability in rate base through the accumulated deferred income tax account would result in the ratepayer having to pay a return on funds ($17,500,000) it has supplied. In the case of contributions in aid of construction, Mr. Larkin noted that once those funds are deducted from rate base, it would be appropriate to include the associated taxes as a liability. By matching the use of the funds or reduction to rate base with the associated taxes, the ratepayer will not be required to pay a return on funds the ratepayer has provided.

Mr. Larkin contended that no regulatory authority allows inclusions of an accumulated deferred income tax debit without a deduction from rate base of the associated ratepayer supplied reserve. Instead of arguing that the entire ratepayer supply reserved accrual should be deducted from rate base, he is proposing that only associated debit entered in the accumulated deferred income tax account be deducted. Furthermore, he argued that in a recent proceeding involving CenterPoint the State of Mississippi treated deferred taxes involving in the manner proposed here.[90]

CenterPoint Response

David Weaver, CenterPoint's Vice-President of Tax testified in response to the issues raised by Mr. Larkin. He argued that Mr. Larkin was wrong and asserted that the accumulated deferred income tax debits identified by Mr. Larkin are reflected in the utility's rate base in recognition of the higher current taxable income and higher cash taxes that have been paid to the government. He contended that there is no basis for Mr. Larkin's position, that an ADIT debit should increase rate base only if the corresponding liability has been deducted from rate base. Instead he argued that the company's practice of increasing rate base by accumulated deferred income tax debits that the utility reflects on its accounting books and records is appropriate. The rationale for that practice is that debits are included in rate base because CenterPoint, through its shareholders and through borrowing, has funded the payment of taxes before they are collected from rates.[91]

Examiners' Recommendation

The utility has not established that its practice of including an accumulated deferred income tax debit in rate base is reasonable where the revenue that gave rise to the tax liability has not been deducted from rate base. As stated by Mr. Weaver, accumulated deferred income tax debits are included in rate base because the company, through its shareholder and through borrowing has funded the payment of taxes before they are collected from rates. To the extent that the revenues that gave rise to the corresponding tax liability have not been expended or

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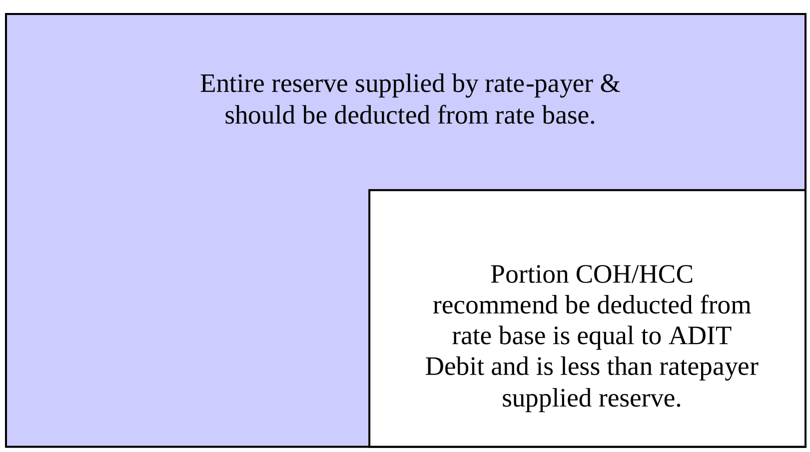
[90] City of Houston/Houston Coalition of Cities, Ex. 5, Direct Testimony of Hugh Larkin, p. 6, lns. 18 – 23.
[91] CenterPoint Ex. 15, Rebuttal Testimony of David Weaver, p. 3, lns. 12,- 15 & p. 5, lns. 17 – 18.

otherwise deducted from rate base, there is no need for the company's shareholder to provide additional funds to pay the tax liability as the ratepayer has provided those funds and they are available to satisfy the tax liability. It is only when those funds are deducted from rate base that the company has a deficit. It is at that moment that the utility must turn to the shareholder or borrow additional revenues to recover the dollars that have been expended.

The utility's argument ignores the fact that the ratepayers have provided the funding necessary to satisfy the corresponding tax liability. Mr. Weaver stated that the company has increased rate base by accumulated deferred income tax debits that the utility reflected on its accounting books and records. This rigid reliance on the entry in the books and records ignores the fact that the funds necessary to pay the corresponding tax liability are available from the ratepayers unless the revenues that generated the liability have been deducted from rate base or otherwise expended. While Mr. Weaver's testimony may be relevant to the entries in the books and records it ignores the fact that funds that ratepayers provided are available to pay the corresponding tax liability.

The City of Houston/Houston Coalition of Cities noted that Mr. Weaver admitted on the cross examination that he was not testifying in this case as to the rate-base treatment of accumulated deferred income taxes. Rather, he was only testifying as to the income tax effect.[92] In many regards several of the issues raised by the Intervenors in this context were not addressed – including Mr. Larkin's allegation that other jurisdictions treat this issue as he described. The fundamental issue raised by Mr. Larkin was never addressed: A deduction from rate base of reserves supplied by the ratepayer has not been made. Mr. Larkin's proposal represents a compromise. Rather than recommending a deduction of the entire ratepayer supplied reserve he is recommending only the deduction of the associated accumulated deferred income tax debit. Figure 5.2 graphically, depicts the result of compromise position of the City of Houston/Houston Coalition of Cities.

Figure 5.2
Representation of Proposed Treatment of
Accumulated Deferred Income Tax Debits



[92] City of Houston/Houston Coalition of Cities' Post Hearing Brief, pp. 12 – 13, citing to Tr. Vol. 3, p. 217. ("I am familiar with the calculation of [accumulated deferred income taxes] from an income tax standpoint. I don't handle how those items are otherwise covered from a rate case or ratemaking perspective.").

Mr. Weaver noted that the Examiners in GUD No. 9869, a case currently pending before the Commission, rejected a similar proposal made by Mr. Larkin in that case. There the Examiners concluded that Mr. Larkin's testimony was not sufficient to allow the Examiners to recommend the Commission's adoptions of his proposed changes.[93] Of course, the evidence presented must be evaluated on a case-by-case basis and an issue-by-issue basis

(C) Total Miscellaneous Expense (Bad Debt)

Introduction

Mr. Weaver testified that CenterPoint accrued a reserve for bad debt expense.[94] CenterPoint included an ADIT debit in the Houston rate base in the amount of $381,034 for taxes associated with the Bad Debt Reserve.[95]

Issues Raised by Intervenors

Mr. Larkin testified that the utility acknowledged that the Bad Debt reserve is not included in rate base and he asserted that the bad debt reserve would operate to reduce rate base. He also asserted that ratepayers have supplied the entire amount for the reserve and the ratepayers have supplied funds to pay the income tax. To include the debit balance for the accumulated deferred income tax while excluding the bad debt reserve from the rate base is not proper matching.[96]

CenterPoint Response

In response, Mr. Weaver argued that bad debts are not deductible when accrued. Rather bad debt accounts are deductible when written off the books and the utility has abandoned efforts to collect the account. Thus, the amounts accrued by the company for bad debts have not been deducted for tax purposes and the company has incurred higher current taxable income and higher cash taxes have been paid to the government.

Examiners' Recommendation

CenterPoint has not established that a debit entry in accumulated deferred income taxes for this account is reasonable. The ratepayer has provided funds for the accumulated reserve. The accumulated reserve has not been reduced from rate base or otherwise expended. As a result funds are available to meet the current tax liability created by the reserve fund. Ratepayers provided those funds. Including a debit entry in accumulated deferred income taxes for this account would have the effect of requiring the ratepayer to pay a carrying charge on funds they have provided that are available to meet the company's current tax liability. The stand-alone impact of this recommendation is to reduce the proposed revenue requirement by $47,231.

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93 CenterPoint Ex. 15, Rebuttal Testimony of David Weaver, p. 14, lns. 10 – 22.
94 CenterPoint Ex. 15, Rebuttal Testimony of David Weaver, p. 9, lns. 18 – 21.
95 CenterPoint Ex. 1, Rebuttal Schedule 2i.
96 City of Houston and Houston Coalition of Cities, p. 9, ln. 1 – p. 10, ln. 2.

(D) Total Employee Benefit Accruals

Introduction

CenterPoint included an accumulated deferred income tax debit of $12,333,100 that has the effect of increasing rate base.[97] The City of Houston/Houston Coalition of Cities have challenged the proposed inclusion of a debit entry as an accumulated deferred income tax item. The figure included in the original filing was $12,408,627 and Mr. Larkin's testimony is directed at the entry included in the original filing, not the rebuttal filing made three working days prior to the commencement of the hearing.[98] Nevertheless, the issues raised regarding the original entry appear to be relevant to the amount included in the rebuttal filing.

Issues Raised by the Intervenors

Mr. Larkin testified that the tax liability identified is the result of the accrual of employee benefits that have not been paid. The accrual was funded by rates collected from ratepayers. He contended that it would be inappropriate for ratemaking purposes to ask the ratepayer to pay a carrying charge on the tax on related accumulated deferred income tax debit balance without simultaneously reflecting the related accumulated liability for accrued but not yet paid employee benefits as on offset to rate base.[99]

CenterPoint Response

Mr. Weaver testified that for tax purposes an accrual is not deductible until an actual payment is made to a participant or a trust funding the benefits. Thus, the amount accrued by the utility for benefits has not been deducted for tax purposes. As a result, he contended that CenterPoint has incurred higher current taxable income and that higher cash taxes have been paid to the government. He asserted that the utility will recover the cash taxes in future periods when benefits are paid to participants or funded into a trust. The impact of this recommendation on the revenue requirement to be recovered from the standard rate classes is $1,528,733.

Examiners' Recommendation

CenterPoint has not established that a debit entry in accumulated deferred income taxes for this account is reasonable. The ratepayer has provided funds for the reserve. The accumulated reserve has not been reduced from rate base or otherwise expended. As a result funds are available to meet the current tax liability created by the reserve fund. Ratepayers provided those funds. Including a debit entry in accumulated deferred income taxes for this account would have the effect of requiring the ratepayer to pay a carrying charge on funds they have provided that are available to meet the company's current tax liability. The impact of this recommendation on the revenue requirement to be recovered from that standard rate classes is $1,528,733.

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[97] CenterPoint Ex. 1, Rebuttal Schedule 2i.
[98] City of Houston/Houston Coalition of Cities Ex. 5, Direct Testimony of Hugh Larkin p. 10, lns. 5 – 6.
[99] City of Houston/Houston Coalition of Cities Ex. 5,Direct Testimony of Hugh Larkin, p. 10, ln. 4 – 11, ln. 2.

(E) Total Indemnifications and Other Reserves

Introduction

CenterPoint included an accumulated deferred income tax debit of $2,863,109 that has the effect of increasing rate base.[100] The City of Houston/Houston Coalition of Cities has challenged the proposed inclusion of a debit entry as an accumulated deferred income tax item. The figure included in the original filing was $2,546,948 and Mr. Larkin's testimony is directed at the entry included in the original filing, not the rebuttal filing made three working days prior to the commencement of the hearing.[101] Nevertheless, the issues raised regarding the original entry appear to be relevant to the amount included in the rebuttal filing.

Issues Raised by the Intervenors

Mr. Larkin inferred that these deferred income tax dollars are related to reserves akin to storm reserves and he noted no deduction from rate base related to those reserves.[102] He concluded that the customers have provided the funds for that reserve and because the funds have not been deducted from rate base it would be inappropriate to impose a carrying charge to the customer for funds they have provided.

CenterPoint Response

Mr. Weaver responded that expenses to build up reserves are not deductible when accrued and that they become deductible when the underlying cost is actually paid. The amount accrued by the company has incurred higher current taxable income and higher cash taxes have been paid to the government. The utility will recover those higher cash taxes in future periods when the underlying expenses related to those reserves are paid. Until that time, additional taxes have been paid to the government.[103]

Examiners' Recommendation

CenterPoint has not established that a debit entry in accumulated deferred income taxes for this account is reasonable. The ratepayer has provided funds for the reserve. The accumulated reserve has not been reduced from rate base or otherwise expended. As a result funds are available to meet the current tax liability created by the reserve fund. Ratepayers provided those funds. Including a debit entry in accumulated deferred income taxes for this account would have the effect of requiring the ratepayer to pay a carrying charge on funds they have provided that are available to meet the company's current tax liability. The impact of this recommendation on the revenue requirement to be recovered from the standard rate classes is $354,893.

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[100] CenterPoint Ex. 1 Rebuttal Schedule 2i.
[101] City of Houston/Houston Coalition of Cities Ex. 5. p. 11, lns. 4 – 15.
[102] *Id*.
[103] CenterPoint Ex. 15, Direct Testimony of David Weaver, p. 11, lns. 1 – 20.

(F) Rate Case Expense

Introduction

CenterPoint included an accumulated deferred income tax debit of $691,158 that has the effect of increasing rate base.[104] The City of Houston/Houston Coalition of Cities has challenged the proposed inclusion of a debit entry as an accumulated deferred income tax item. The figure included in the original filing was $2,547,443 and Mr. Larkin's testimony is directed at the entry included in the original filing, not the rebuttal filing made three working days prior to the commencement of the hearing.[105] Nevertheless, the issues raised regarding the original entry appear to be relevant to the amount included in the rebuttal filing.

Issues Raised by the Intervenors

Mr. Larken asserted that the reserve that imposed the alleged tax liability has been deducted from rate base. He argued that there was no clear explanation of why this accumulated deferred income tax debit balance has arisen nor why ratepayers should be responsible of it.[106] In their Initial Brief, the City of Houston/Houston Coalition of Cities, contended that the analysis provided by Mr. Weaver in rebuttal reveals that the fund related to an over-collection of franchise fees receipts and taxes. The result is that the utility seeks to charge ratepayers an additional amount in rate base additions for an over-recovery of gross receipts tax. They conclude by stating that requesting ratepayers to pay a carrying charge on the tax on an over-recovery the ratepayers have already paid is absurd.[107]

CenterPoint Response

Mr. Weaver's testimony related to this proposed adjustment is related to the $2,547,443 debit entry for accumulated deferred income taxes included in the original filing. He stated that Mr. Larkin's understanding of the rate case expense category is not accurate. The utility's debit related to rate case expense in the original filing is made up of two items that net to $2,547,443: (a) a $3,546,438 accumulated deferred income tax debit to the general ledger account 22118 for over/under recovery of franchise and gross receipts taxes; and (2) a $998,995 accumulated deferred income tax credit related to regular rate case expense in the general ledger account 179030. The balance in general ledger account 221148 represented an over recovery of city franchise tax and Railroad Commission of Texas assessment taxes. He asserted that over recovery is taxable when collected from rate-payers and as a result higher cash taxes have been paid to the government. The utility will recover those higher cash taxes in future periods when the underlying expenses related to those reserves are paid. Until that time, additional taxes have been paid to the government. He concluded that the proposed disallowance "of $2,547,443 for ADIT related to Rate Case Expense accruals should not be made."[108]

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[104] CenterPoint Ex. 1, Rebuttal Schedule 2i.
[105] City of Houston/Houston Coalition of Cities Ex. 5 p. 11, lns. 4 – 15.
[106] City of Houston/Houston Coalition of Cities Ex. 5, Direct Testimony of Hugh Larkin, p. 12, ln. 17 – p. 13, ln. 12.
[107] City of Houston/Houston Coalition of Cities Initial Brief, p. 17.
[108] CenterPoint Ex. 15, Direct Testimony of David Weaver, p. 13, lns. 3 – 5.

Examiners' Recommendation

CenterPoint has not established that a debit entry in accumulated deferred income taxes for this account is reasonable. The ratepayer has provided funds for the reserve. The accumulated reserve has not been reduced from rate base or otherwise expended. In this case, the reserve is the result of over-recovered taxes and the funds are available to meet the current tax liability created by the reserve fund. Ratepayers provided those funds. Including a debit entry in accumulated deferred income taxes for this account would have the effect of requiring the ratepayer to pay a carrying charge on funds they have provided that are available to meet the company's current tax liability. The impact of this recommendation on the revenue requirement to be recovered from that standard rate classes is $1,528,733.

Additionally, the Examiners note that there appears to be some confusion on the part of CenterPoint regarding this adjustment that was generated, in part, by its late rebuttal filing. Namely, Mr. Weaver and the City of Houston and the Houston Coalition of Cities in the initial brief continue to refer to the proposed adjustment as totaling $2,547,443. Mr. Weaver's testimony is directed at establishing the reasonableness of this amount and he discussed figures that were in evidence in support of that calculation.[109] He refers to the two items that make up that make up this amount. A $3,546,438 ADIT debit and a $10,132,681 ADIT credit. These figures can be traced to CenterPoint Ex. 1, Schedule 2i, Workpaper 2i/1 p. 7 of 15. The figure included in the rebuttal is $691,158. No documentation was provided to support the calculation of that contested item and the Examiners are unable to evaluate that figure.

(G) Deferred State Income Taxes

Introduction

CenterPoint included an accumulated deferred income tax debit of $384,142 that has the effect of increasing rate base. CenterPoint also included an accumulated deferred income tax credit of $1,118,106 that has the effect of reducing rate base.[110] The City of Houston/Houston Coalition of Cities has challenged the proposed inclusion of any accumulated deferred income tax amounts related to state income taxes. The figure included in the original filing was $195,914 as a debit and $579,481 as a credit entry to accumulated deferred income taxes. Mr. Larkin's testimony is directed at the entry included in the original filing, not the rebuttal filing made three working days prior to the commencement of the hearing.[111] Nevertheless, the issues raised regarding the original entry appear to be relevant to the amount included in the rebuttal filing. .

[109] CenterPoint Ex. 15, Direct Testimony of David Weaver p. 12, lns. 16 – 18. He refers to the two items that make up that make up this amount. A $3,546,438 ADIT debit and a $10,132,681 ADIT credit. These figures can be traced to CenterPoint Ex. 1 Schedule 2i, Workpaper 2i/1 p. 7 of 15.

[110] CenterPoint Ex. 1 Rebuttal Schedule 2i. .

[111] City of Houston and Houston Coalition of Cities Ex. 5, Direct Testimony of Hugh Larkin p. 11, lns. 4 – 15.

Issues Raised by the Intervenors

Mr. Larkin testified that the State of Texas does not have a state income tax and that even though the net of the two balances favor the ratepayer he has removed the proposed adjustment because there is no state income tax which should be deferred related to any Texas operating expense or accrued liability.[112]

CenterPoint Response

Mr. Weaver rebuttal testimony is again directed at the figures included in the initial filing not at the figures included in the rebuttal filing. He asserted in response to Mr. Larkin's allegation that the State of Texas does not have an income tax that for GAAP financial accounting purposes, that the Texas margin tax is considered an income tax. As an income tax, he asserted the Company was correct to reduce rate base by deferred state income tax credits and to increase rate base by deferred state income tax debits.[113]

Examiners' Recommendation

The Examiners recommend that entry for an accumulated deferred debit as a result of State Income taxes be removed. The CenterPoint witness failed to address what activities resulted in this debit and whether the associated funds that gave rise to the liability have been deducted from rate base. The net impact of this adjustment is to increase the rate request. Thus, the impact of this recommendation on the revenue requirement to be recovered from the standard rate classes is an increase of $85,672

6. Operating Expenses

a. Labor Expenses

Charles Dean Wood, Vice President of Human Resources testified that CenterPoint views compensation plans and levels from a "total compensation" perspective. Thus, the company measures all of the components that make up employees' total compensation. The company benchmarks those components against peer companies to ensure that the compensation plans and levels are adequate. The components of "total compensation" are (1) base pay, (2) short term incentives,[114] (3) long term incentives,[115] and (4) benefits. Mr. Wood testified that additional research is conducted to compare the total compensation offered by CenterPoint with national, regional, and local trends.[116] The same principles apply to executive and non-executive positions.[117]

Employees of CenterPoint and its affiliates are offered the following benefits: (1) Health and welfare, (2) retirement, (3) savings plan, (4) postretirement, and (5) post-

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[112] *Id*.
[113] CenterPoint Ex. 15, Direct Rebuttal Testimony of David Weaver, p. 13, lns. 6 – 16.
[114] CenterPoint Ex. 14, Direct Testimony of Charles Dean Woods, p. 4, ln 19 – p. 6, ln. 10.
[115] CenterPoint Ex. 14, Direct Testimony of Charles Dean Woods, p. 6, ln. 11 – p.
[116] CenterPoint Ex. 14, Direct Testimony of Charles Dean Woods, p. 3.
[117] CenterPoint Ex. 14, Direct Testimony of Charles Dean Woods, p. 4, lns. 1 – 8.

employment.[118] Health and welfare benefits include medical, prescription drugs, dental, vision, life insurance, personal accident insurance; long-term care insurance and long-term disability benefits.

CenterPoint also offers a retirement plan. The expenses for the test-year that ended March 31, 2009, were $863,915.[119] CenterPoint made an adjustment to the test-year expenses for retirement plan expenses. The adjustment was in the amount of $4,459,789.[120] Mr. Wood testified that there are four components of the retirement plan expense: (1) service cost, (2) interest cost, (3) expected return on plan assets, and (4) amortization of prior service cost and actuarial gains and loses.[121] Virtually all aspects of the proposed labor expenses have been challenged by the Intervenors.

(A) Base Payroll Expense - Employee Levels

Introduction

The total calculated test-year level of payroll expense, including merit increases, was $31,029,034. The total base payroll expense requested by the utility in the cost of service was $31,486,917.[122] The parties contend that two adjustments should be made to this figure. One adjustment should be made to base payroll based upon the number of employees and another should be made to reduce the level of merit increases reflected in base payroll.

Table 6.1 below summarizes the relative positions of the parties compared to the test-year levels.

Table 6.1
Test-Year Level of Payroll Expense and Proposed Payroll Expense Level

	CenterPoint	Test Year	COH/HCC	GCCC
Payroll Expense Recommended	$31,486,917	$31,029,034	$29,980,870	$30,768,659
Adjustments Recommended to CenterPoint Proposal				
Adjust Number of Employees			$970,519	$633,251
Adjust Merit Increase			$535,528	$85,007

Each adjustment directly impacts the revenue requirement to be recovered from the standard rate customer and would reduce the revenue requirement by an amount that approximates the requested adjustment.

In order to calculate the requested figure, CenterPoint annualized amounts for the month ending April 2009 and adjusted test-year figures accordingly.[123] The Houston Coalition of

118 CenterPoint Ex. 14, Direct Testimony of Charles Dean Woods, p. 8, lns. 16 – 21.
119 CenterPoint Ex. 1, Schedule 4b, Workpaper 4b/6, p. 1, ln. 1.
120 CenterPoint Ex. 1, Schedule 4b, Workpaper 4b/6, ln. 1 and Schedule 4b, col. (H).
121 CenterPoint Ex. 6, Direct Testimony of Charles Dean Woods, p. 11, lns. 3 – 16.
122 CenterPoint Ex. 1, Workpaper 4b/8, p. 2, col. ("Payroll"), p. 4, col. 6; Workpaper 4b/9, p. 4, col. 6.
123 CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 1, lns. 17 – 22; City of Houston/Houston Coalition of Cities, Ex. 1, Direct Testimony of Jacob Pous, p. 59, ln. 19; and GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 13, lns. 15 – 16.

Cities, through the testimony of Jacob Pous, and the Gulf Coast Coalition of Cities, through the testimony of Constance Cannady, challenged the reasonableness of the amounts included in this expense category. The Commission must determine whether the proposed base payroll expense level is just and reasonable.

Issues Raised by the Intervenors

Mr. Pous recommended an adjustment of $972,840. Mr. Pous argued that the company had not established that the level of payroll included in the cost of service study was reasonable and necessary. He postulated that one method of establishing a reasonable level of payroll expense and testing the reasonableness of the proposed payroll expense would have been to compare the level of vacancies reflected in the April payroll figures with other months. Mr. Pous noted, that the Commission has recognized that payroll expense associated with a normalized level of vacant position should be excluded from the overall reasonable and necessary base payroll expense. Mr. Pous, however, lamented that this could not be accomplished because the company was unable to provide data related to the level of vacancies on a monthly basis.[124]

Mr. Pous attempted to test the reasonableness of the company's proposal to annualize the April 2009 payroll level. He compared additional data, subsequent to the April 2009 data. He reviewed the company's employee termination and hiring reports after April 2009. He found that the data indicated an immediate and constant decline in payroll for the months from May through August of 2009. The result was a net reduction in annual payroll of $972,840. He recommended that payroll expense be reduced accordingly.[125]

Ms. Cannady recommended an adjustment to this amount of $623,741. The adjustment was proposed to reflect the decrease in the number of employees subsequent to the test-year end. Ms. Cannady asserted that she evaluated the number of hires, terminations, and transfers to and from the Houston Division through August 2009. She found an absolute net change in the number of employees. Specifically, at the end of the period she found that there were thirty-one (31) fewer employees.[126]

CenterPoint Response

Mr. Woods argued that annualizing April 2009 payroll is the most accurate measure of actual wage expense at the time the rates will go into effect. He alleged that the payroll expense for September 2009 confirmed the accuracy of the calculations made using the April 2009 data. In response to the contention that the headcount has declined, he noted that a test year is intended to take a "snapshot look" at expenses and that expenses would naturally fluctuate over time. Further, any declines in the number of employees may be offset by other factors.[127] Ms. Gauger testified that the September 30, 2009, payroll levels confirm the reasonableness of the

[124] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 59, ln. 16 – p. 60, ln. 6.
[125] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 60, lns. 8 – p. 61, ln. 4.
[126] GCCC Exhibit 1, Direct Testimony of Constance T. Cannady, p. 13, ln. 1 – p. 14, ln. 17.
[127] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 3 lns. 7 – 16.

utility's request. The utility requested a payroll $31,486,917 and the level for the twelve months ended September 30, 2009, was $31,942,096.[128]

Examiners' Recommendation

The Examiners find that the company failed to establish that its proposed base payroll amount was just and reasonable. In this context, the utility's failure to provide data related to the number of vacancies on a monthly basis limited the ability of the Intervenors to test the reasonableness of the proposal.[129] Thus, CenterPoint has not been able to meet its burden of proof on this issue. The figure provided by the utility for the twelve-month period ended September 30, 2009, also suffers from the same evidentiary infirmity. On the other hand, the reductions suggested by the Intervenors would reduce payroll levels beyond the test-year levels. The proposed adjustments, therefore, are not reasonable. The Examiners recommend that the test-year levels of payroll be adopted and that payroll be reduced to reflect test-year levels. Those levels were disputed because of the amounts associated with merit increases included in test-year payroll expenses.

(B) Merit Increases

Introduction

The parties dispute the reasonableness of two adjustments included in the overall level of payroll expense. The company refers to this adjustment as a competitive pay adjustment whereas the Intervenors challenging this adjustment refer to it as a merit increase.[130] The test year for the cost of service study was the twelve-month period ending March 31, 2009, and the adjustments in dispute are effective April 1st of each year.[131] Thus, the merit increase/competitive pay adjustment provided in 2008 of 4.2% was included in the payroll expense that was part of the cost of service study. The company also included the average merit increase/competitive pay adjustment of 3.22% that was awarded in April 2009, after the conclusion of the test year. The Houston Coalition of Cities, through the testimony of Jacob Pous, and the Gulf Coast Coalition of Cities, through the testimony of Constance Cannady, challenged the reasonableness of the amounts included in this expense category. The Commission must determine whether inclusion of both adjustments is reasonable in the calculation of rates.

Issues Raised by the Intervenors

Mr. Pous recommended that the merit increase in the amount of 3.22% be disallowed, as he believed that the company had not established the reasonableness and necessity of the merit increase. First, in response to the argument by the utility that the adjustment for merit increases were necessary to ensure that competent employees may be retained and recruited, Mr. Pous opined that the company had not established that the test-year level of payroll expense, without

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[128] CenterPoint Ex. 5, Rebuttal Testimony of Kelly C. Gauger, p. 8, lns. 14 – 20, Rebuttal Exhibit KCG-7.
[129] Examiners Exhibit No. 2, Affidavit of Charles Dean Woods; Tr. Vol. 3, pp. 209 – 212.
[130] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 4, lns. 3 – 7.
[131] GCCC Ex. 1, Direct Testimony of Constance Cannady, Attachments and Workpapers, Attachment I (CenterPoint RFI Response COH01-40).

the merit increase component, would hinder the company's retention or recruitment of capable employees. Second, he was critical of the fact that the company had not performed a cost-benefit analysis to establish that the retention of experienced employees was beneficial. Employees with less longevity in the company may provide the same service at a lower cost. Third, Mr. Pous was critical of unsubstantiated assertions made by company witnesses that the total company package approximated the median compensation for the market place. Fourth, the level of merit increase could not be justified in the current economic environment. Fifth, he noted that the company's level of merit increases has far exceeded industry averages during the past five years. The result he argued was that the merit increases resulted in an overall 19.4% increase for an employee over the last five years. This amount exceeded the consumer price index and the employment cost index identified by the Bureau of Labor Statistics during the same period.[132] Mr. Pous recommended a reduction of $535,528.

Ms. Cannady contended that the 4.2% increase was excessive in today's economy. Based on her review of other cases she noted that authorized merit increases have been approximately 3.5% and below. Accordingly, she recommended that the 4.2% increase be reduced to a 3.5% increase prior to the inclusion of the utility's 2009 pay increase. The impact of this recommendation is to reduce the proposed base payroll by $85,007.[133]

CenterPoint Response

Mr. Woods argued that Ms. Cannady incorrectly classified the 4.2% adjustment as a merit increase to non-union employees. He contended that it was a competitive pay adjustment. As a result, he questioned whether Ms. Cannady's assessment was valid as her assessment appeared to be based on merit increases awarded to non-union employees not a competitive pay adjustment awarded to bargaining unit employees.[134]

As an initial point, Mr. Woods testified that the company's overall compensation package represented the mid-point of the market. Thus, the total compensation package was reasonable. As to Mr. Pous' contention that current economic conditions do not support inclusion of the 3.22% of April 2009 adjustment, Mr. Woods argued that the company would be harmed in subsequent years as economic conditions improve. Once a turnaround in the economy is experienced, the utility would be unable to offer the adjustment, as it would not have been included in the calculation of base rates.[135] Mr. Woods also took issue with Mr. Pous' suggestion that retaining employees with several years of experience may not be cost effective. He argued strenuously that such a position was contrary to the requirements of the utility industry.[136]

In response to Mr. Pous' contention that the adjustments exceeded the Consumer Price Index-All Urban Consumers and the Employment Cost Index, Mr. Woods argued that those indices did not provide a relevant point of comparison. He contended that CenterPoint's Human Resource department performed a more relevant analysis and concluded that the

[132] City of Houston/Houston Coalition of Cities, p. 62, ln 6 – p. 64, ln. 22.
[133] GCCC Exhibit 1, Direct Testimony of Constance T. Cannady, p. 15, ln. 1 – p. 15, ln. 12.
[134] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 4, lns. 8 – 20.
[135] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 5, lns. 4 – 10.
[136] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 5, ln. 11 – p. 7, ln. 2.

company's compensation package was within the mid-range of the relevant market. He noted that the underlying data relied upon was provided to Mr. Pous. Finally, in response to the contention that the company should "tighten its belt," Mr. Woods noted that the utility industry is unlike other industries. Namely, while other entities have the option to impose lay offs in the face of rising costs, natural gas utilities must maintain a workforce level that ensures that natural gas is delivered and that the service is safe and reliable.[137]

Examiners' Recommendation

The Examiners find that the merit increases reflected in the test-year level of payroll are just and reasonable and that no further adjustment should be made to reduce, or increase, that amount. Base payroll should be set at test-year levels and CenterPoint has not established that an increase beyond test-year levels is reasonable, nor have the Intervenors established that a base payroll level below test-year levels is appropriate.

(C) Overtime Expense

Introduction

Every year the company incurs a certain degree of overtime expense. CenterPoint requested a test-year level of overtime expense of $3,485,758.[138] The City of Houston/Houston Coalition of Cities and the Gulf Coast Coalition of Cities challenged the level of overtime expense requested. The City of Houston/Houston Coalition of Cities recommended that the request be reduced by $608,328, whereas the Gulf Coast Coalition of Cities recommended that the request be reduced by $547,347. The adjustments recommended are based on an examination of overtime expense over recent years as opposed to adoption of the test-year figure established by the company. Therefore, the Commission must determine whether the proposed level of overtime expense based upon test-year levels is reasonable.

Issues Raised by the Intervenors

Ms. Cannady, who testified on behalf of the Gulf Coast Coalition of Cities, conceded that the company did not propose an adjustment to overtime expense actually incurred during the test year. Rather the company elected to include the test-year amount in the revenue requirement. Ms. Cannady recommended that the expense be based on the average overtime expense per employee for the last four-year period. The recommended adjustment reduced the test year overtime expense of $3,485,758 by $547,347 to $2,938,411. She noted that her recommended overtime expense, as a percentage of the recommended base payroll, was 9.55%. CenterPoint's requested test year overtime expense equated to 11.07% of the utility's proposed base payroll. [139]

Mr. Pous, who testified on behalf of the Houston Coalition of Cities, noted that the level of overtime expense varied from year to year. As evidence of this variation Mr. Pous examined

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[137] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 7, ln. 3 – p. 8, ln. 15.

[138] City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 58, ln. 8; Response to GCCC RFI 5.4.

[139] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 17, ln. 1 – 13.

the overtime expense for the twelve-month period that ended in March for the years from 2005 to 2009, reproduced in Table 6.2 below. He noted that the level of overtime expense during the test year was higher than in previous years.

Table 6.2
Annual Overtime Expense

Twelve-Month Period Ended	Amount
3/2009	$3,485,758
3/2008	$2,048,857
3/2007	$3,097,614
3/2006	$3,683,554
3/2005	$2,184,967

Mr. Pous argued that it would be appropriate to normalize an expense that is necessary for the operations of the system, but which varies from year to year. He maintained that the normalization process attempts to set expenses at the reasonable level that can be expected to occur in a normal year of operation. He recommended a three-year average of the company's overtime expense be included in the revenue requirement. He argued that the Commission has consistently applied a three-year average methodology in the past when the Commission applied a normalization adjustment. His proposed recommendation results in a total overtime expense of $2,877,410 or an adjustment of $608,348 to CenterPoint's request.[140]

CenterPoint Response

Mr. Woods responded that none of the Intervenors offered evidence that the test-year expenses inadequately capture expected levels of future expenses. Additionally, the Intervenors do not support their underlying inference that future overtime expense will approximate past expenses. He contended that, on the contrary, future costs would increase due to wage increases. Thus, an estimate based on historical trends will understate the expected level of overtime expense in the future. Finally, he noted that the use of the test-year expenses is consistent with the Commission's recent decision related to Atmos Energy Corp., Mid-Tex Division in GUD Nos. 9670, 9762, and 9869.[141]

Examiners' Recommendation

The Examiners find that CenterPoint has established that the test-year level of overtime expense is reasonable. The methodology employed is consistent with prior Commission determinations. Furthermore, the argument that an adjustment should be made to test-year figures is inconsistent with a rate setting methodology premised on test-year data. It is understood that all expenses vary. The Intervenors did not point to any factor used in calculating the test-year expense level of overtime expense included in the cost of service that

[140] Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 58, ln. 1- p. 59, ln. 16.
[141] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 9, lns. 1 – 7.

would suggest that the expense level was unreasonable. Indeed, the twelve-month period ended March of 2006 exceeded the test-year level experienced by CenterPoint. That data suggests that the test-year level requested is reasonable. The Examiners recommend that the proposed adjustment be rejected.

(D) Long-Term Incentive and Short-Term Incentive Compensation

Introduction

CenterPoint included $2,394,080 for incentive compensation expense. The amount was divided into two categories of incentive compensation: (1) Long Term Incentive Compensation in the amount of $669,091 and (2) Short Term Incentive Compensation in the amount of $1,724,989.[142]

Issues Raised by the Intervenors

Mr. Pous argued that <u>all</u> incentive compensation should be disallowed. Fundamentally, he cited four reasons for his position. First, CenterPoint admitted that the payment of incentive compensation is not assured. If the company declines to award incentive compensation, the inclusion of this amount in rates operates as a windfall for the company. Second, the performance goals of the incentive compensation plan are tied almost exclusively to the financial performance of the company. As the shareholder is the principle beneficiary of achieving these financial goals, the shareholders should bear the burden of the expense. Third, there are factors outside of the control of the employee that would increase earnings, such as cooler than normal weather, and achieve the company's financial goals. Ultimately these factors provide no benefit to the customer. Fourth, including incentive compensation in base rates shifts all of the risk to the customer and employees.[143]

Mr. Pous noted that the Commission has previously taken action ranging from disallowing all incentive compensation to disallowing only a portion of the requested expense.[144] He also noted two other jurisdictions, in California and Oklahoma that have disallowed incentive compensation from the calculation of rates based upon a similar analysis.[145] Mr. Pous also observed that CenterPoint had specifically removed a customer related goal from the list of goals and objectives. After employees failed to achieve goals tied to improved meter reading accuracy and bill exception backlogs, CenterPoint removed those particular components from the list of goals and objectives.[146]

As to long-term incentive compensation, Ms. Cannady concurs with Mr. Pous. She argued that any award of incentive payments that is based upon financial performance should be the responsibility of the shareholders not the ratepayers. She argued that the long-term incentive compensation was measured exclusively by the achievement of certain financial goals.

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[142] CenterPoint Ex. 1, Schedule 4b, Workpaper 4b/8, p. 2; GCCC Exhibit 1, Direct Testimony of Constance T. Cannady, p. 15, ln. 18 – p. 16, ln. 1 & p. 25, lns. 8 – 12, Attachment Q, CenterPoint Response to COH RFI No. 1-47; City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 52, lns. 1 – 7.

[143] City of Houston/Houston Coalition of Cities Ex., 1, Direct Testimony of Jacob Pous, p. 54, ln. 9 – p. 55, ln. 9.

[144] City of Houston/Houston Coalition of Cities Ex., 1, Direct Testimony of Jacob Pous, p. 52, lns. 9 – 12.

[145] City of Houston/Houston Coalition of Cities Ex., 1, Direct Testimony of Jacob Pous, p. 55, ln. 24 – p. 56, ln. 5.

[146] City of Houston/Houston Coalition of Cities Ex., 1, Direct Testimony of Jacob Pous, p. 53, lns. 12 – 25.

In support of that proposition she listed factors used to determine whether employees are entitled to participate in the goals of the program:

- CenterPoint Total Shareholder Return relative to the S&P Utility Index Subset
- CenterPoint Operating Income
- CenterPoint Cash Flow[147]

As these are all goals that benefit shareholders, Ms. Cannady recommended that test-year expense related to the long-term incentive compensation program not be included in the calculation of base rate. This would result in a disallowance of $669,091 from the proposed revenue requirement.

As to the short-term incentive, STI, Ms. Cannady recommended that STI be allowed only if it is awarded based on performance related to customer service and/or operational safety. Ms. Cannady recommended a reduction to the utility's request of $1,724,989 by $1,385,568. She argued that 80% of STI was based upon the financial performance of CenterPoint. That portion, she contended, should be removed from the company's requested rate increase. Based on a review of the 2008 STI plan, Ms. Cannady concluded that the plan weighted incentive payment 10% for operational performance (including phone response to customers) and 10% for safety issues. The remainder of the weighting for performance was given to core operating income and cash flow. She argued that other regulatory authorities have performed this type of adjustment. Ms. Cannady argued that two PUC proceeding supported the proposition that incentive compensation tied to operational measures was reasonably included in transmission and distribution expense, but that incentive compensation awarded as a result of meeting financial measures should not be included in customer rates.[148]

CenterPoint Response

Mr. Woods responded that CenterPoint in this case seeks to recover incentive compensation consistent with the Commission's recent ruling for the Texas Coast Division in GUD No. 9791. He contended that the Short Term Incentive Plan and the Long Term Incentive Plan are necessary components of the total compensation package necessary to recruit, retain and motivate employees. In response to the criticism that the plans include financial goals as a component of the plan, Mr. Woods argued that corporate and financial goals are consistent with the interests of ratepayers. Mr. Woods also responded to the arguments raised by Mr. Pous regarding certain customer-oriented goals. As discussed above, Mr. Pous was critical of the fact that no payout was made because customer oriented goals were not achieved on certain occasions. Mr. Woods countered that this did not imply a dismissive attitude regarding those goals. Instead, it demonstrated that the company treated goals seriously and is unwilling to reward employees unless goals are met.[149]

The company's witness also responded to issues raised regarding the rulings in other jurisdictions by noting that in one of the cases cited by the Intervenors the state regulatory

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[147] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 25, ln. 8 -

[148] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 15, ln. 13 – p. 16, ln. 16.

[149] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 9, ln. 8 – p. 12, ln. 9.

agency approved incentive compensation for employees while rejecting executive compensation packages. This, he argued, was consistent with the Commission's recent decision in GUD No. 9791.[150]

Examiners' Recommendation

The Examiners find that the request for recovery of expenses associated with incentive compensation is consistent with the ruling in GUD No. 9791. Furthermore, the utility established that the incentive compensation plans included customer oriented goals related to the following: (1) Phone response, (2) Customer Satisfaction Survey, (3) Resource Utilization, (4) Recordable Incident Rate, (5) Lost Time Incident Rate, and (6) Preventable Vehicle Incident Rate.[151] Furthermore, contrary to the suggestions of the Intervenors, the utility has established that it is serious about improving customer relations. As noted by Ms. Kirk, CenterPoint has increased staff to handle the increased number of calls resulting from an expanding customer base and, at the same time, has reduced the average wait time for callers from over three minutes to under two minutes.[152] Finally, as to short-term incentive pay the requested level of short-term incentive pay is actually below the test-year levels.[153]

(E) Sick Leave

CenterPoint requested $769,461 in sick leave expense during the test year. Mr. Pous argued that the level of sick leave expense can fluctuate from year to year and noted that the level of sick leave expense in the two years prior to the test year was $933,680 and $1,019,697, respectively. He argued that the expenses can, and do, vary from year to year and should be normalized to reflect an average ongoing level of anticipated costs. He recommended that the sick expense be normalized based on the last three years of data, one of which is the test year. His recommendation resulted in a $138,152 increase in the test year revenue requirement. CenterPoint did not respond to this proposed adjustment. The Examiners recommend that the proposed adjustment be rejected and that the level of sick leave be adopted at test-year levels.

(F) Payroll Adjustments Flow Through: Benefits and Savings Plan

Introduction

The City of Houston/Houston Coalition of Cities and the GCCC argued that certain other adjustments flowed from adjustments to payroll. One adjustment related to payroll taxes, which are addressed in the next section. The other adjustment is related to the level of benefit expenses, proposed by the City of Houston/Houston Coalition of Cities and savings expenses, proposed by GCCC.

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150 CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 11, ln. 15 – p. 12, ln. 9.

151 CenterPoint Ex. 6, Direct Testimony of Charles Dean Woods, p. 5, ln. 9; CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 10, lns. 10 – 22; and, GCCC Ex. 1 Direct Testimony of Constance T. Cannady, Attachment J (Response to RFI GCCC01-20).

152 CenterPoint Ex. 16, Rebuttal Testimony of Mary A. Kirk, p. 5, lns. 7 – 11.

153 CenterPoint Ex. 1, Schedule 4b, Workpaper 4b/8.

Issues Raised by the Intervenors

Mr. Pous argued that an adjustment to payroll expenses should be made because of the proposed reduction to payroll expense. His calculated adjustment is $280,178. He argued that employee benefits averaged 28.8% of salaries. Thus, the adjustment to payroll expense he proposed of $972,840 results in a savings of $280,178 in employee benefits expenses.[154] Ms. Cannady argued that an adjustment to savings plan expenses should be made as a result of her adjustment to payroll expenses. Specifically, she recommended a reduction of $141,181 to the utility's requested savings plan benefits expense.[155]

CenterPoint Response

In response to Mr. Pous' proposed employee benefits expense adjustment, Mr. Woods argued that adjustment results in a double-counted reduction. The derived percentage used by Mr. Pous included Retirement Plan expense. Mr. Pous made a separate adjustment to post retirement expense. Accordingly, an additional adjustment here duplicated an adjustment that had been previously made.[156] In response to Ms. Cannady's proposed adjustment to savings plan benefits Mr. Woods stated that since he disagreed with the payroll adjustment, the savings plan adjustment should be disregarded as well.[157]

Examiners' Recommendation

The Examiners find that if payroll expenses are reduced, due to a reduction in the number of estimated employees or merit increases, a corresponding adjustment should be made to the benefit expenses related to the employee level. The Examiners find that the proposed adjustment of the City of Houston/Houston Coalition of Cities results in a duplicate reduction and would not be reasonable. As a result the proposed adjustment overstates the savings from the lower level of payroll expenses and is not reasonable. GCCC's adjustment focused on the savings plan expenses and, while it may understate the total employee benefit savings from a lower level of payroll expenses, it is a reasonable estimate. The Examiners find that if payroll expenses are reduced, a reduction should be made to the savings plan expense to reflect savings that may flow from a lower number of employees than anticipated. Ms. Cannady's methodology, corrected and reflected in the attached Examiners' Schedule No. 5, provides a reasonable estimate of the savings and the Examiners recommend that the adjustment be made if payroll expenses are reduced. As the Examiners recommended a reduction to payroll expenses the Examiners find that a corresponding adjustment to the savings benefit expense is just and reasonable.

154 City of Houston /Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 65, lns. 1 – 17.
155 GCCC Ex. 1, Direct Testimony of Constance T. Cannady, p. 25, lns. 1 – 7.
156 CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 13, lns. 12 – 21.
157 CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 28, lns. 1 – 7.

(G) Wages and Payroll Tax Adjustments

Introduction

The City of Houston/Houston Coalition of Cities and GCCC each proposed adjustments to payroll taxes that were a direct result of the proposed payroll adjustment.[158] The City of Houston/Houston Coalition of Cities proposed an adjustment based upon a tax rate of 7.65% and the GCCC proposed an adjustment based upon 7.97%. The Commission must first determine whether a flow through adjustment is required if an adjustment is made to payroll expenses. If the Commission determines that such an adjustment is appropriate, the Commission must determine the appropriate rate.

Issues Raised by the Intervenors

Mr. Pous proposed that the adjustment be based upon a tax rate of 7.65%. Although no testimony was provided regarding the basis for the tax rate it is presumably derived from the FICA tax rate of 6.20% and the Medicare tax rate of 1.45%.[159] Ms. Cannady derived the tax rate algebraically by simply dividing the total proposed payroll taxes ($2,646,912) by the total payroll expense proposed ($33,211,906). The resulting quotient, 7.97%, was the tax rate she applied in calculating the payroll tax adjustment.

CenterPoint Response

Mr. Woods, who testified on behalf of CenterPoint opposed any adjustment. He did not contend that a flow-through adjustment to payroll tax was not required if an adjustment to payroll was made. Instead, he simply stated that because a payroll adjustment should not be made he did not believe a payroll tax adjustment was appropriate.[160]

Examiners' Recommendation

The Examiners find that if an adjustment is made to the base payroll a corresponding adjustment to payroll tax is also required. The Examiners find that Mr. Pous' proposed methodology understates the applicable tax rate because it does not reflect the State and Federal Unemployment tax that Ms. Cannady attempted to capture. The Examiners recommend that to the extent a payroll adjustment is made, that the applicable payroll tax rate to apply to calculating the flow through adjustment is 7.97%.

(H) Medical Benefits

Introduction

CenterPoint's costs of service schedules allege that the test-year expense for medical benefits was $3,837,386. CenterPoint requested an increase over this amount of

[158] City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 97, lns. 8 – 13.
[159] CenterPoint Ex. 1, Schedule 4b, Workpaper 4b/8, p. 7 of 115, col. (7) & (8).
[160] CenterPoint Ex. 1, Rebuttal Testimony of Charles Dean Woods, p. 12, lns. 9 – 18.

$1,430,421over the test year expense.[161] The adjustment for health and welfare was determined by comparing Houston Division pro-forma year expense to the test year health and welfare expense. The pro-forma year was determined by applying the trend rates to benefits in the 2009 plan as follows: 6% for medical, 5% for dental and 2.4% for other health and welfare benefits.[162] The proposed adjustment is based on an averaging of the last three months of the test year (January – March 2009), using that average for nine months, and projecting a slight increase for three months.[163] The Gulf Coast Coalition of Cities did not challenge the test-year amounts. The GCCC did not challenge the company's contention that test-year amounts should be adjusted upward. The GCCC challenged the methodology employed to determine a proposed adjustment to test-year. The Commission must determine whether the proposed adjustment to the test-year amount was reasonably calculated.

Issues Raised by the Intervenors

Ms. Cannady argued that use of the first quarter data for 2009 to annualize expenses inappropriately inflated expenses. Her assessment of data indicated that medical expense for the first quarter of the year was consistently higher from 2006 through 2009. After the first quarter, the company has usually experienced a drop in monthly expense of approximately eighteen percent (18%).[164] Thus, the company elected to make its adjustment based upon a calculation that annualized the period within the year that has the highest medical expenses.[165] Ms. Cannady proposed that any adjustment be based on the sum of the average quarterly medial benefits expense for the period from January 2006 through June 2009. Ms. Cannady proposed that pension expenses be adjusted to allow an increase of $418,191 to test-year expenses associated with medical benefits.[166]

CenterPoint Response

Mr. Woods maintained that the amount of health and welfare expense requested was reasonable. Mr. Woods argued that the methodology of predicting future expenses based upon past expenditures is fundamentally flawed because it ignores the upward trend of expenses. He argued that a simple average simply did not take into account inflationary costs of health care.[167]

Examiners' Recommendation

The Examiners find that CenterPoint has not established that the proposed *adjustment* to test-year medical benefits expenses the utility proposed is just and reasonable. The parties do not dispute the test-year level of expenses related health and welfare benefits. That figure was

[161] CenterPoint Ex. 1, Schedule 4b, Workpaper 4b/6, ln. 4 and Schedule 4b, col. (K). CenterPoint Ex. 1, Schedule 4b, Workpaper 4b/6, p. 1, ln. 4.
[162] CenterPoint Ex. 6, Direct Testimony of Charles Dean Woods, p. 10, lns. 8 – 7, and Workpaper 4b/6: Pro Forma Benefits Adjustment.
[163] CenterPoint Ex. 1, Schedule 4b, Workpaper 4b/6, p. 10, GCCC Direct Testimony of Constance Cannady, p. 21, lns. 7 – 9.
[164] GCCC Ex. 1, Direct Testimony of Constance Cannady, Attachment P., CenterPoint Response to GCCC01-08. Benefits expense by line item for the period from 2005 – 2009.
[165] GCCC Ex. 1, Direct Testimony of Constance Cannady. p. 21, lns. 10 – 17.
[166] GCCC Ex. 1, Direct Testimony of Constance Cannady. p. 22, lns. 1 – 8.
[167] CenterPoint Ex. 1, Rebuttal Testimony of Charles Dean Woods, p. 14, lns. 1 – 16.

$3,837,386. The dispute centers upon the upward adjustment requested by CenterPoint – $1,430,421. This represents a 37% increase over the test-year amounts. In order to arrive at this figure, CenterPoint focused on the highest monthly data of three months encompassed by the test year. Ms. Cannady ascertained that fact by evaluating annual medical expense data from 2006 to 2009.[168] Once Ms. Cannady established the unreasonableness of the company's proposed methodology, instead of requesting that the adjustment be simply rejected, Ms. Cannady computed an alternative increase to the test-year figure based on the historical average from January 2006 to June of 2009. The Examiners find that the alternative methodology is reasonable and recommend that the proposed adjustment to the test-year medical benefits expense level of GCCC be adopted in the amount of $418,191.

(I) Retirement Plan – Pension Expense

Introduction

The company's retirement plan is a defined benefit pension plan and, generally, all employees are eligible to participate in the plan. Mr. Woods testified that the plan expense was determined based upon the actuarial expense amount required by generally accepted accounting principles under Statement of Financial Accounting Standards No. 87 "Employees' Accounting for Pensions" ("SFAS No. 87").[169] The test-year expense associated with the retirement plan was $836,915, for the test year that ended March 31, 2009.[170] CenterPoint seeks an adjustment to this amount of $4,549,789. Thus, the total cost of service expense associated with this item is $5,413,704.[171] Mr. Woods argued that the adjustment was necessary for several reasons. First, a large decline in the value of plan assets was experienced in 2008. He argued that the decline was due to the worldwide turmoil in the securities market. Second, plan amendments increased the retirement expense. Third, a reduction in the long-term expected rate of return also contributed to the decline.[172]

The City of Houston/Houston Coalition of Cities and the Gulf Coast Coalition of Cities disputed the necessity of the $4,549,789 adjustment. They did not dispute that a pension deficit had arisen nor did they dispute the cause of the deficit. Instead, they disputed the amount of the adjustment. The Commission must determine whether an adjustment is required and, if so, whether the adjustment proposed by CenterPoint is reasonable.

Issues Raised by the Intervenors

Mr. Pous recommended a more modest adjustment to the test-year figure. Instead of a $4,549,789 adjustment to the test-year pension expense of $839,915, Mr. Pous suggested an increase in the amount of $940,214. He argued that the company's proposed $4,549,789 adjustment was an overreaction. He did not dispute that a pension liability existed on December 31, 2008, nor did he dispute the cause of that liability. Instead, he argued that the company's $4,549,789 adjustment was an attempt to quickly correct the deficit that had developed. The

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[168] GCCC Ex. 1, Direct Testimony of Constance Cannady, Attachment P (CenterPoint Response to RFI GCCC01-08.
[169] CenterPoint Ex. 6, Direct Testimony of Charles Dean Wood, p. 10, lns. 17 – p. 11, ln. 2.
[170] CenterPoint Ex. 1, Schedule 4b, Workpaper 4b/6, p. 1, ln. 1.
[171] *Id*.
[172] CenterPoint Ex. 6, Direct Testimony of Charles Dean Woods, p. 12, ln. 18 – p. 13, ln. 5.

company ignored fundamental changes in the market in recent months that would operate to dampen the deficit. Indeed, Mr. Pous suggested that it might be appropriate to reject the proposed adjustment as premature. He also noted that other entities that have experienced similar losses have taken more tentative steps than what is proposed by the utility. Those entities are relying, in part, on corrections that will become apparent as the market improves. His recommendation is a reduction over the level requested by CenterPoint but an increase over the test year level of pension expense.[173]

Ms. Cannady pointed out that the proposed adjustment represented an increase of over 525% over the test-year per-books amount.[174] She did not concur with the proposed adjustment for three reasons. First, although the plan assets significantly dropped during the 2008 period, it appears that the plan assets have recently experienced a marked increase in value through August 2009. This increase is consistent with recent observed market trends. Second, the company appears to place the entire burden of the loss in the plan on the ratepayer. To her, this was particularly unjustified as the ratepayers provided the funds that were originally in the pension plan. Investing the dollars that have been provided by ratepayers into the pension plan, and then losing those funds in the market, does not entitle the company, to come back to the ratepayers to make-up the total loss. CenterPoint shareholder should burden some of the loss occasioned while the company managed the plan. Third, the increase in pension benefits provided, at a time when the pension plan experienced such a severe decline, further compounded the problem. She explained that after the plan assets had experienced a decline, the company increased the pension benefits to employees. At the time CenterPoint acknowledged that the increase would significantly increase CenterPoint's total cost of benefits. The ratepayer should not shoulder all the burden of the ill-timed pension increase.[175] Ms. Cannady proposed that the loss experienced in the pension fund be shared between the ratepayer and the shareholder. Accordingly she recommended a pension expense adjustment of $1,208,913. This results in an increase of 140%.[176]

Ms. Cannady also proposed a corresponding pension expense adjustment to Corporate Support Services post-test-year adjustment. The company's adjustment to Corporate Services expense was $1,385,540 and this amount was due to the perceived increase in pension expense.[177] As with her other pension expense adjustment Ms. Cannady recommended an adjustment that reflected a lower increase in the amount of $368,148.

CenterPoint Response

In rebuttal, Mr. Woods reiterated many of the issues raised in his direct testimony.[178] Mr. Woods observed that both Intervenor witnesses relied on historical costs that he contended

[173] City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 65, ln. 19 – p. 69, ln. 13.
[174] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 17, ln. 18.
[175] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 17, ln. 14 – p. 19, ln 19; GCCC Ex. ___ Attachments to Direct Testimony of Constance Cannady, Attachment O (CenterPoint Response to GCCC05-03, Memo from David M. McClanahan to CenterPoint Employees, pp. 1 - 2).
[176] GCCC Ex. 1, Direct Testimony of Constance Cannady. p. 19, lns. 1 – 18.
[177] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 26, lns. 4 – 5.
[178] CenterPoint Ex. 13 Rebuttal Testimony of Charles Dean Woods, p. 15, ln. 12 – p. 17, ln. 9 to CenterPoint Ex. 6, Direct Testimony of Charles Dean Woods, p. 10, ln. 20 – p. 13, ln, 10.

were not useful indicators of future costs.[179] He responded to Mr. Pous assessment of the plan loss by noting that the actually experienced loss was 23.1% not a 30% "expected investment loss" as alleged by Mr. Pous.[180] A level that was consistent with the loss experienced by other entities. Mr. Woods also responded to Ms. Cannady's contention regarding an allegedly "ill-timed" pension increase that propounded the company's pension deficit. Mr. Woods explained that the decision to provide the increase was part of a decision made in September 2007 – well before the downturn in the market. That decision was generated, in part, by a reevaluation, initiated in 2006, of the company's retirement plan. Mr. Woods also argued that the statement in the internal memorandum, noting that the change in the retirement plan would "significantly increase CenterPoint's total cost of benefits," was intended as a motivational statement to employees. It emphasized CenterPoint's efforts to retain workers and provide a competitive package of pay and benefits.[181] Mr. Woods contended that recent increases in the value of plan assets in 2009 were insufficient. Furthermore, in his opinion both Mr. Pous and Ms. Cannady ignored changes that would operate to increase retirement plan expense in the future.[182] Finally, Mr. Woods maintained that the company performed a benchmark analysis and found that the contributions towards savings and retirement for CenterPoint were consistent with industry average.[183]

Examiners' Recommendation

The Examiners find that the company has not established that the proposed adjustment is just and reasonable. The company witness conceded that the pension liability identified was the result of the *projected* benefit obligations relative to the value of the plan assets as of December 31, 2008. While conceding that "there is no reason to think that the economy will not improve during the time these rates are in effect," the company's analysis appears to ignore this fact in the calculation of the projected benefit obligations relative to the value of plan assets.[184] Furthermore, the company's proposal places the burden of the loss of the funds previously provided by the ratepayers, and managed by the utility, <u>entirely</u> on the ratepayer. Management decisions of the company had an impact on the funds as Mr. Woods conceded that when the market was at its lowest, the benefit committee elected to increase pension benefits.[185] The company witness conceded that when the market was at its lowest it would have been reasonable to delay the change to the pension plan that was adopted in August of 2008. The company acknowledged that this change would "significantly increase CenterPoint Energy's total cost of benefits." The Examiners recommend that the adjustment proposed by the Gulf Coast Coalition of Cities be adopted. Thus, the test-year figures established by the company for pension expense would be adjusted upward by $1,208,913 not $4,549,789. This represents an increase of 140% instead of a 525% increase. Likewise the Examiners recommend that the pension expense adjustment related to Corporate Support Services be reduced from $1,385,540 to $368,148.

[179] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 15 lns. 2 – 11.
[180] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 17, lns. 4 – 15.
[181] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 19, ln. 18 – p. 21, ln. 21.
[182] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 17, ln 1 – p. 18, ln. 6.
[183] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 22, lns. 1- 9.
[184] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 5, ln. 6 ("First, there is no reason to think the economy will not improve during the time these rates will be in effect.").
[185] Tr. Vol. 1, p. 113, lns. 3 – 10 and Tr. Vol. I, p. 114, lns. 3 – 13.

The Examiners note that the testimony on the change in plan benefits appears contradictory. In the direct testimony Mr. Woods specifically listed three events that contributed to the increased retirement expense. The first item on the list was the state of the economy in 2008. The second item was the "plan amendments that increased the retirement expense by approximately 11%."[186] This was repeated in the rebuttal testimony.[187] He later appears to argue, however, that the overall impact of the change, when combined with a reduction in the savings plan expense, was "relatively small."[188] Furthermore, Mr. Woods argued that the changes were implemented in part to retain employees and prevent an exodus of employees who would leave CenterPoint and begin fresh accruals of retirement benefits with new employees. CenterPoint has not established that it has experienced a higher level of departures than other entities. The evidence in the record established that the average length of employment was 14.8 years.[189] Indeed, as CenterPoint does not track the number of vacant positions, it would be difficult for the company to establish a trend in employment statistics that would operate to harm the company.[190]

Finally, Mr. Woods' contention that the company's contributions to savings and retirement is consistent with industry standards does not address the issue of who ultimately bears the burden of the expenses related to the savings and retirements. CenterPoint places that burden almost entirely on the ratepayer. In the context of the adjustment proposed here, CenterPoint proposed placing the burden of any loss experienced in the market entirely on the ratepayer. The statistics provided by Mr. Woods provide no insight regarding the distribution of the expense burden. Thus, while it provides a useful measure, a key component relevant to the determination of the adjustment proposed here is not provided.

(J) Post Retirement Expense

Introduction

Post retirement benefits are primarily health and welfare benefits provided to retired employees, their beneficiaries and covered dependents. This includes benefits to surviving spouses and dependents of retired employees. Employees are eligible for post retirement benefits at age fifty-five with five years of experience after age fifty.[191] The company's test-year analysis established expenditures for this expense were $2,084,924 for the test year ended March 31, 2009.[192] The company proposed a test-year adjustment to this amount of $528,153.[193] The Gulf Coast Coalition of Cities does not challenge the test-year amount. Instead, Ms. Cannady, who testified on behalf of the Gulf Coast Coalition of Cities challenged the proposed post test-year adjustment. The Commission must decide whether the company has established that the proposed post test-year adjustment is just and reasonable.

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186 CenterPoint Ex. 6, Direct Testimony of Charles Dean Woods, p. 12, lns. 21 – 22.
187 CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 16, lns. 10 – 11.
188 CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 22, lns. 10 – 18.
189 City of Houston/Houston Coalition of Cities Ex. 1, p. 32, ln. 19 – p. 33, ln. 1.
190 Examiners Exhibit No. 2, Affidavit of Charles Dean Woods; Tr. Vol. 3, pp. 209 – 212.
191 CenterPoint Ex. 6 Direct Testimony of Charles Dean Woods, p. 16, lns. 2 – 14.
192 CenterPoint Ex. 1 Schedule 4b, Workpaper 4b/7, Pro Forma Adjustment for Post Retirement Expense, p. 1, ln. 21 & Pensions and Benefits FERC 9260 Test Year, p. 6, ln. "518030", col. "Total."
193 CenterPoint Ex. 1 Schedule 4b, Workpaper 4b/7, Pro Forma Adjustment for Post Retirement Expenses, p. 1, ln. 22.

Table 6.3
Proposed Adjustments to Post Retirement Expense

	Test-Year Level	CenterPoint Request	GCCC
Level Requested	$2,084,924	$2,613,077	$2,230,730
Adjustment to Test Year		$528,153	$145,806

Issues Raised by the Intervenors

Ms. Cannady pointed out that *pro-forma* adjustment to post retirement benefits expense is based upon an actuarial study using trends analysis, and based on a “pay as you go” methodology. She analyzed the reasonableness of the proposed increase by comparing the average monthly expense produced by the requested amount to the historical average experienced by the company from April 2005 through June 2009. She noted that the adjusted monthly level requested had not been realized since March 2006. This included the period recorded for the test year and beyond to June 2009. She concluded that the company’s computation yielded an unreasonable result. She proposed an adjustment that would result in a more modest increase to the post test-year amount of $145,806. Thus, the total postretirement expense recommended by the Gulf Coast Coalition of Cities was $2,230,730.[194]

CenterPoint Response

Mr. Woods asserted that the post retirement expense level requested was reasonable. He stated that it was calculated based upon actual pay-as-you go claims for the test year trended forward to the *pro-forma* year. He was critical of the approach suggested by Ms. Cannady for two principle reasons. First, he suggested that the approach she used to calculate her proposed adjustment was contrary to a prior commission ruling in GUD No. 8399. Second, he argued that simply averaging actuarial expense over a historical period of time is no indicator of what those expense levels are going to be in the future.[195]

Examiners’ Recommendation

The company has not established that the post test-year adjustment is reasonable. The adjustment is not known and measurable. Ms. Cannady established that the levels suggested by the proposed adjustment had never been reached in the past. The level had not been reached during portions of the test year. Further, it had not been achieved during the period from April through June subsequent to the test year. These facts established that the proposed adjustment was not reasonable. Nevertheless, Ms. Cannady attempted to calculate a posttest-year adjustment that would increase the level of test-year expense. Her proposed methodology was reasonable and provides a result consistent with the empirical evidence she evaluated.

[194] GCCC Ex. 1, Direct Testimony of Constance T. Cannady, p. 23, ln. 10 – p. 24, ln. 16.
[195] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 28, ln. 9 – p. 29, ln. 20.

(K) Post Employment Benefits

Introduction

Post employment benefits are primarily health and welfare benefits provided to certain inactive employees, their beneficiaries and covered dependents after employment, but before retirement. This would include benefits to surviving spouses and dependents of active employees and employees approved for long-term disability benefits who are no longer in rehabilitation.[196] The test-year level of post-employment benefits is $176,950. CenterPoint proposed a *pro-forma* adjustment of $514,974.[197] The Gulf Coast Coalition of Cities does not challenge the test-year level of post-employment benefits. The GCCC challenged, however, the post-test-year adjustment of $514,974.

Table 6.4
Post Employment Benefits

	Test-Year Level	CenterPoint Request	GCCC
Level Requested:	$176,950	$691,924	$234,398
Increase Test-Year Level By:		$514,974	$57,488

Issues Raised by the Intervenors

GCCC challenged this adjustment. Ms. Cannady explained that the company's adjustment was based upon costs incurred during the first three months of 2009. Once those costs were calculated, the amount was annualized to determine the adjustment. Ms. Cannady argued that the first three months of the year have, on average, the highest expenses for post employment benefits of any quarter of the year. In order to establish this fact, Ms. Cannady reviewed the monthly expense for this category of expenses from January 2006 through June 2009.[198] Ms. Cannady opined that a longer period should be used to determine a normalized level of expense and she recommended that the post-employment benefit expense be based on the sum of the quarterly averages for the period from January 2006 through June 2009. She testified that the impact of the proposed adjustment was to reduce the proposed expense by $457,526. The result of this recommendation is to include a post employment expense of $234,398 instead of $691,924.[199]

CenterPoint's Response

Mr. Woods responded by contrasting post-employment benefits, primarily related to health and welfare, with retirement plan expenses, which are related to pension benefits. He argued that averaging a component of these expenses is a reasonable method for predicting future costs of this component as these health and welfare claims tend to be relatively constant

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196 CenterPoint Ex. 6, Direct Testimony of Charles Dean Woods, p. 17, lns. 12 – 17; and, Rebuttal Testimony of Charles Dean Woods, p. 30, lns. 1 – 8.
197 CenterPoint Ex. 1, Schedule 4b, Workpaper 4b/6, p. 1, ln. 3.
198 GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 22, ln. 16 – 18, Attachment P, CenterPoint Response to GCCC RFI No. 1-08.
199 GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 23, ln. 18 – p. 23, ln. 4.

on a year-to-year basis. In response to Ms. Cannady's claim that the company used the quarter with the highest level of expense, he stated that these expenses are primarily for individuals who are disabled and that the types of claims made by these individuals are consistent throughout the year.[200]

Examiners' Recommendation

The Examiners find that CenterPoint has not established that its pro-forma adjustment to the test-year figure of $514,974 is just and reasonable. Once again, the issue was not the test-year level of expenses. The issue raised was the proposed adjustment to an expense which was precisely known and measurable. The fact that the adjustment was based on the quarter of the year that has exhibited a consistently higher level of expense for the period from January 2006 through June 2009 undermines the reasonableness of the company's analysis. Rather than request that the adjustment be rejected, the Gulf Coast Coalition has calculated an adjustment that would increase $57,448. The Examiners find that the proposed adjustment is reasonable.

b. Hurricane Ike Restoration Expense

Introduction

The utility has requested recovery of Hurricane Ike restoration expenses. Specifically, CenterPoint included expenses in the amount of $2,571,915. The company proposed that those amounts be amortized over a period of three years, which would result in an annual amortization expense of $857,305.

Issues Raised By the Intervenors

The City of Houston/Houston Coalition of Cities recommended that the entire amount associated with the amortization expense be denied. Mr. Pous argued that expenses associated with Hurricane Ike are abnormal and nonrecurring expenses. As a result, he concluded, the expenses should be excluded in the revenue requirement. Further, he noted that while the legislature had created a specific statutory mechanism for recovery of those expenses by electric utilities a similar mechanism was not available for gas utilities. Mr. Pous noted that the utility has sought reimbursement of those expenses through its insurance and as of the date of his prefiled testimony the insurance proceeds were unknown. Thus, he concluded that the request is premature.[201]

Ms. Cannady testified that CenterPoint should be allowed to recover certain Hurricane Ike recovery expenses. She argued, however, that any expenses that are included should be adjusted to reflect amounts recovered from any of the company's insurance claims. Ms. Cannady argued that certain adjustments should be made to the claimed expense of $2,571,915. She specified four adjustments. First, all expenses for expenditures related to repairs already contracted prior to the hurricane should be removed. These expenditures totaled $13,163. Second, expenditures for fuel deliveries and waste management in the amount of $145,317 appeared to be based on normal operations and should also be removed. Third, a disallowance

[200] CenterPoint Ex. 6, Rebuttal Testimony of Charles Dean Woods, p. 30, ln. 1 – p. 32, ln. 8.
[201] City of Houston Ex. 1, Direct Testimony of Jacob Pous, p. 48, ln. 6 – p. 50, ln. 17.

in the amount of $9,094 for vendor profit markups as the profit was already built into the labor rates. Fourth, Ms. Cannady recommended disallowance of $763,568 for internal labor costs. She argued that normal work with a reasonable amount of overtime is recovered through base rates and should not be recovered again through amortization of Hurricane Ike Expenses. Ms. Cannady did not, however, recommend disallowance of all overtime expenses incurred during this period. She acknowledged that the event required a significant amount of overtime, which would not have occurred during the normal course of events. Finally Ms. Cannady recommended a five-year recovery period for this expense item.[202]

CenterPoint Response

Responding to Mr. Pous' contention that the expenses should be excluded, Kelly Gauger asserted that these expenses were incurred to respond to and repair the damage to the system that was caused by the hurricane and the expenses are not included elsewhere in the filing. She also pointed to the testimony of Constance Cannady, testifying on behalf of GCCC, who agreed with the company that the overtime expenses should be allowed as recoverable costs.[203]

As to the roofing expenses, Kelly Gauger acknowledged that certain invoices were incorrectly coded as Hurricane Ike charges, and a correction of $4,388 was made to reduce the amount of Hurricane Ike expense to be amortized. Ms. Gauger testified that the fuel deliveries and waste management expense in the amount of $145,317 was, in fact, for hurricane Ike related expenses. The purchase orders related to fuel expenses indicated that the purchase was for use in Emergency Operations Procedures noted as "EOP" on the purchase orders and purchase orders related to waste management referenced Hurricane Ike. As to the markup, Ms. Gauger testified that the mark-up was part of the negotiated contract and the $9,904 requested for Hurricane Ike recovery should be allowed.[204]

As to the labor expense, Ms. Gauger argued that the labor employed was part of the total storm restoration costs required to respond to and repair damage to the system. She argued that the employees labor was focused on responding to and repairing damage to the system in the wake of Hurricane Ike and they were not performing their normal functions. She stated that the employees were focused on damage repair and normal day-to-day operations and maintenance activities were put aside in an effort to make the system safe as quickly and safely as possible.[205]

As to the claim made by Mr. Pous that the claim in this proceeding is premature and that Ms. Cannady's assertion that any insurance proceeds should offset this expense, Ms. Gauger noted that if a COSA is approved, any insurance proceeds may be applied to the expenses included in the subsequent filing. Without a COSA the ratepayer would receive the benefit of the insurance proceeds in the company's next rate filing.[206]

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[202] GCCC Ex. 1, Direct Testimony of Constance T. Cannady, p. 10, lns. 1 – 13 & p. 32, ln. 8 – p. 36, ln. 6.
[203] CenterPoint Ex. 13, Rebuttal Testimony of Kelly C. Gauger, p. 9, lns. 18 – 23 & p. 13, lns. 1 – 8.
[204] CenterPoint Ex. 13, Rebuttal Testimony of Kelly C. Gauger, p. 9, ln. 15 – p. 9, ln. 6.
[205] CenterPoint Ex. 13, Rebuttal Testimony of Kelly C. Gauger, p. 11, ln. 7 – p. 13, ln. 8.
[206] CenterPoint Ex. 13, Rebuttal Testimony of Kelly C. Gauger, p. 13, ln. 9 – p. 14, ln. 8.

Examiners' Recommendation

CenterPoint has established that it should be able to recover expenses related to this event. Additionally, the Examiners find that the adjustments proposed by Ms. Cannady are not warranted. The Examiners also find that prompt recovery of just and reasonable recovery expenses after a hurricane event is reasonable.

The Examiners recognize that the total expenditure is not yet fully known due to the fact that some amounts may be recovered through insurance. Accordingly, the Examiners recommend adoption of a separate tariff to allow the utility the ability to recover those expenses promptly. The Examiners recommend that the tariff allow a true-up for any amounts recovered through insurance. The result is a reduction to the base rate of $2,571,915, an amount that would be recovered through the separate tariff. The text of the proposed tariff is set out in Figure 5.1, below

Figure 6.1
Examiners' Proposed Hurricane Ike Tariff

APPLICATION OF SCHEDULE

The Hurricane Ike Surcharge ("IKE") rate as set forth in section (B) below is for the recovery of losses incurred by the Company as a direct result of Hurricane Ike and not recoverable from any other source. These losses include insurance deductibles under the property damage and business interruption policies. The IKE rate shall apply to the following gas sales rate schedules of Centerpoint Energy Texas Gas Houston Division Environs currently in force in the Company's service area: R-2079, GSS-2079, and GSLV-610.

(B) IKE RATE

The following rate will be added to the applicable Rate Schedule Cost of Service rate per Ccf for each monthly billing period:

Residential and Commercial Customers: $ per Ccf per month

EFFECTIVE DATES

Ike Rider to be effective for meters read on or after _______________ 2010.

This rate will be in effect until all approved and expended Hurricane Ike costs are recovered under the applicable rate schedules. This Rider does not limit the legal rights and duties of the Cities and is subject to all applicable laws and orders and the Company's rules and regulations of file with the regulatory authority.

This rate will be in effect for approximately 36 months until all approved Hurricane Ike charges are recovered from the applicable customer classes as documented in the compliance filing on Hurricane Ike Surcharge for GUD 9902. This tariff expires upon collection of $2,585,078* which is estimated to be a three-year period ending in March of 2013.

COMPLIANCE

The Company will file quarterly, due on the 10th of each April, July, October, and January, a report with the RRC Gas Services Division. The report shall detail the monthly collections for the IKE surcharge and show the outstanding balance.

Upon final settlement with the insurance company, Centerpoint shall file a copy of the final settlement statement from the insurance company regarding claims for Hurricane Ike.

*Initial amount established in GUD No. 9902.

c. Gasoline Expense

Introduction

The Intervenors observed that CenterPoint purchased a significant amount of gasoline for its vehicles and equipment. During the test year the company purchased 635,555 gallons of gasoline.[207] The total fuel expense was $2,006,279.[208] The test year average price for diesel paid by the company was $3.46 per gallon. The average price for unleaded gasoline was $2.79 per gallon.[209] The City of Houston and GCCC recommended adjustments to this amount.

Issues Raised by the Intervenors

Mr. Pous argued that gasoline prices hit an all time high during 2008. Mr. Pous noted that the price of gasoline has declined since 2008. The average cost of diesel and unleaded gas during the first nine months of 2009 are $2.22 and $2.08, respectively. He contended that there is a continued trend towards even lower gas prices. Mr. Pous argued that an adjustment should be made to the price of gasoline purchased during the test year. Specifically, he contended that the price of gasoline should be reduced by $600,203.[210]

Ms. Cannady raised similar issues regarding expenses for fuel recorded during the test year. She developed an adjustment based on the fuel expense for the five month period from May 2009 to September 2009, reported at http://texasahead.org/economy/trackingtables.html. Based upon her analysis of the economic indicators reported, she computed an adjustment of $384,333 to fuel expense.

CenterPoint Response

In response Ms. Gauger stated that the Commission should not ignore actual test-year gasoline expenses incurred by the utility. Any adjustment to test-year figures should be known and measurable. The Intervenors proposal to substitute this expense is speculative because it is based upon the average cost of gas in 2009, which is not yet known and measurable. She concluded that the amount of fuel cost in the filing is the only fuel expense that is truly known and measurable.[211]

Examiners' Recommendation

The Examiners find that the test-year level of expense identified for fuel expense was just and reasonable. As Ms. Gauger noted, no one challenged the necessity of the expense. The issue before the Commission is whether the test-year figures should be adjusted for a known and measurable change or otherwise normalized. The Examiners find that while GCCC presented a known basis upon which to make the adjustment, there is no method for

[207] City of Houston and Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 50, ln. 24.
[208] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 28, ln. 18.
[209] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 28, lns. 17 – 18, Attachment T, CenterPoint Response to RFI No. COH 2-4.
[210] City of Houston Ex. 1, Direct Testimony of Jacob Pous, p. 50, ln. 19 – p. 51, ln. 19.
[211] CenterPoint Ex. 13, Rebuttal Testimony of Kelly C. Gauger, p. 19, ln. 15 – p.

determining the future price of gasoline. Furthermore, while future consumption of gasoline cannot be predicted, it is likely to increase. The Examiners find that Houston Division continues to grow and expand and this will likely necessitate a higher consumption of gasoline.[212]

d. Injuries and Damages

Introduction

CenterPoint included as part of its cost of service an amount for general liability, auto liabilities, and injuries and damages. For the test year that ended March 31, 2009, that figure was $988,088.[213] No party disputes this figure. The dispute centers around the company's efforts to normalize the test-year figure. That adjustment totaled $1,851,792.[214] GCCC challenged the methodology for calculating that adjustment and the State of Texas contended that one component of that adjustment should not be included in the cost of service calculation as it is not paid by the company.

Issues Raised By Intervenors

Ms. Cannady recommended a reduction of $460,026 to CenterPoint's proposed general liability, a reduction of $77,518 to workers compensation, and a reduction of $111,596 to auto liability.[215] GCCC alleged that the projected general liability, auto liability, and injuries and damages expenses were based on a ten-year average of incurred claims adjusted upward to reflect what the utility anticipated as its ultimate liability. Ms. Cannady contended that a more accurate methodology was to compute a 4.25 year average of the reported accruals for general liability and workers compensations and a 4.25 year average of the actual claims for auto liability.

In its closing brief, the State of Texas argued that CenterPoint had not established that expenses for injuries and damages related to workers compensation claims should be included in this case. Specifically, the State of Texas contended that it appeared that part of the costs, in the amount of $319,401, that the utility seeks, are for payment of benefits that are actually incurred by its insurance carrier, and not by the utility. The contention is that pursuant to the provisions of the Labor Code, workers compensation insurance coverage is the exclusive remedy for work-related injuries.[216]

During the hearing Kelly Gauger, Director of Financial Accounting, was asked about an entry entitled "HOU Paid WC Claims" and an entry entitled "HOU WC premiums."[217] She confirmed the entry entitled "HOU WC Premiums" confirmed that CenterPoint paid for workers compensation insurance. Charles Dean Woods, Vice-President of Human Resources confirmed

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[212] CenterPoint Ex. 11, Direct Testimony of Matthew Troxle, p. 4, Table 1, GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, p. 6, Table 1.
[213] CenterPoint Ex. 1, Schedule 4a, ln. 48, col. (B).
[214] CenterPoint Ex. 1, Schedule 4a, ln. 48, col. (C).
[215] GCCC Ex. 1, Direct Testimony of Constance Cannady, 29, ln. 6 – p. 30, ln. 16.
[216] State of Texas Initial Brief, p. 15 – 17.
[217] Tr. Vol. 1, p. 93, ln. 10 to p. 95, ln. 9.

that employees of the Houston Division are covered by a workers compensation policy.[218] Ms. Gauger conceded that if the workers compensation insurance company is paying the claims there would be no reason to consider how those claims are paid out by the insurance company and no reason to consider them as a cost to Centerpoint.[219] Mr. Woods also agreed that the insurance company is responsible for paying those claims and the company does not undertake to pay any of those benefits itself.[220] Consequently, the State of Texas requested that the expense item for workers compensation be removed.

CenterPoint Response

Ms. Gauger asserted that the utility's approach is actuarially based and the company has used the history of those claims to determine the cost of claims incurred in the current period. She contended that using claim payments made in the current period, as Ms. Cannady has done, may have no relation to the actual incident giving rise to claims in the current period. Injury and damage claims often take many years to be resolved. The period recommended by Ms. Cannady is not a sufficiently long period of time and it does not allow for a normalization of costs by taking into account the years required to fully develop the claims.[221] CenterPoint responded to the allegations of the State of Texas by alleging that issue was raised for the first time in briefing and that it was based on the false assumption that CenterPoint's insurance carrier pays all workers compensation expenses.[222]

Examiners' Recommendation

The Examiners find that CenterPoint has not established that an adjustment to the test-year level of expense related to injuries and damages is necessary. As stated by Mr. Woods, the point of the test year is to take a snapshot look at expenses that may change over time.[223] Nevertheless, GCCC did not dispute the necessity of an adjustment, and the Examiners do not recommend that an adjustment not be made. The Examiners find, however, that it is not necessary to include in the calculation of this adjustment expenses that are recovered from the insurance provider for workers' compensation. Therefore, the Examiners find that it is just and reasonable to remove those expenses from the calculation of the proposed adjustment to the test-year figures. The issue was placed squarely before two company witnesses and each one conceded that expenses related to workers compensations claims are paid by the insurance carrier. Neither witness offered any explanation as to why those figures should be included in the *pro-forma* adjustment to the test-year figures. The company has not established that a ten-year period is necessary for calculating the proposed *pro-forma* adjustment and the Examiners find that the adjustment proposed by GCCC is just and reasonable.

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[218] Tr. Vol. 1, p. 115, ln. 17 – ln. p. 116, ln. 25.
[219] *Id*, p. 96, lns. 1 – 8.
[220] *Id*, p. 116, lns. 18 – 25.
[221] CenterPoint Ex. 13, Rebuttal Testimony of Kelly C. Gauger, p. 14, ln. 9 – p. 16, ln. 3.
[222] CenterPoint Reply Brief, pp. 19 – 20.
[223] CenterPoint Ex. 14, p. 3, lns. 7 – 8.

e. Legal Expense

Ms. Cannady noted that a correction should be made for an error related to legal expenses. CenterPoint acknowledged the error and as stated by Ms. Gauger the error related to legal expenses has been deducted from the utility's request in the rebuttal filing. The Examiners find that no further adjustment is required.[224]

f. Bad Debt Expense

Introduction

CenterPoint initially calculated its bad debt expense based upon a bad debt write-off of .77%. That ratio was determined based upon three years of uncollectible expense data. The Commission, in GUD No. 9791, directed the utility to apply five years of data. The company determined that a three-year period was appropriate because of two anomalous events. First, due to the conversion to a new customer billing system ("CCS") in November 2005, account write-offs stopped until the conversion was completed. Second, the write-off period decreased from 150 days in the old system to ninety days in the new CCS.[225] GCCC concurred with this rationale. GCCC, however, recommended adjusting the bad debt write-off based upon a three-year average ratio of .74%. In its rebuttal testimony, CenterPoint agreed and amended the applicable write-off ratio to .74%. The City of Houston/Houston Coalition of Cities argued that the company should use data spanning five years.

Issues Raised by the Intervenors

In its closing brief, GCCC re-urged its position regarding the use of a .74% even though the utility apparently adopted its position.[226] The City of Houston/Houston Coalition of Cities contended that the utility should have normalized uncollectible expense over five years.[227] The State of Texas argued that uncollectible expense should be removed altogether. As the company factors its accounts receivable prior to those accounts becoming uncollectible, the company is never burdened by an uncollectible expense.[228] The Intervenors agree that if the gas cost portion of the uncollectible expense is to be recovered through the Purchase Gas Adjustment Clause an adjustment should be made to remove the gas cost portion from the uncollectible expenses included in Account 904.

CenterPoint Response

CenterPoint concurred with GCCC's recommended change. In response to the assertion of the City of Houston, CenterPoint presented data showing the annual percentage of annual bad debt write-offs to revenues.

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[224] CenterPoint Ex. 5, Direct Testimony of Kelly C. Gauger, p. 21, lns. 3 – 10; GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 31, lns. 1 – 4.
[225] GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, p. 14, ln. 1 – p. 15, ln. 18.
[226] GCCC Initial Brief, pp. 24 – 25.
[227] City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 10, lns. 5 – 15.
[228] State of Texas Initial Brief, p.

Table 6.4.
Annual Percentage of Bad Debt Write-Offs to Revenue
Twelve Months Ending March 31st

Year	Percentage
2005	0.38%
2006	0.22%
2007	0.83%
2008	0.75%

The two unusual events account for the anomalous results seen in 2005 and 2006.

Examiners' Recommendation

The Examiners find that an adjustment should be made to account for the fact that CenterPoint factors accounts receivable. The adjustment proposed by the State of Texas has the potential of overstating the effect of factoring. As the Examiners have recognized a 27.35% level of factoring in the context of cash working capital the Examiners recommend that a corresponding adjustment be made to calculation the uncollectible expense.

g. Affiliate Expenses

i. Introduction

GURA requires that affiliate expenses meet the following two criteria: (1) that they are reasonable and necessary, and (2) that the price charged to the gas utility be no higher than the prices charged by the supplying affiliate to its other affiliates or divisions, or to a non-affiliated person for the same item or class of items.[229] Issues regarding affiliate transactions were raised by the Steering Committee of Cities ("SCC") and by the Gulf Coast Coalition of Cities ("GCCC").

ii. Affiliate Expenses – Generally

Introduction

Mary A. Kirk testified that affiliate expenses are included in the test-year cost of service. Specifically, during the test year services were provided to the Houston Division by CenterPoint Energy Services Company ("Services Company"), CenterPoint Energy Houston Electric, LLC, and other divisions of the gas operations of CenterPoint Energy Resources Company.[230] Services Company provides oversight and managerial functions CenterPoint Energy, Inc. and its business units. Services Company is divided into four functional areas: Corporate, Information Technology, Business Support Services, and Regulated Operations and Management. Those four functional areas provide services related to finance, law, corporate compliance, records, human resources, government affairs, executive management, corporate

[229] Tex. Utils. Code Ann. § 104.055.
[230] CenterPoint Ex. 7, Direct Testimony of Mary A. Kirk, p. 4, ln. 1 – 21.

communications, and audit services. Total billing from Service Company to the Houston Division during the test year was $34,700,000.[231] SCC argued that CenterPoint had not established that these expenses meet that statutory affiliate standard.

Issues Presented by the Intervenors

SCC argued that CenterPoint did not establish that the affiliate expenses were (1) reasonable and necessary, and (2) that the price charged to the gas utility is no higher than the prices charged by the supplying affiliate to its other affiliates or division, or to a non-affiliated person for the same item or class of items. SCC argued in briefing prior to the hearing that there is no evidence in the record to assure that the Houston Division customers are not paying more than their appropriate share of expenses related to services provided by the Services Company.[232]

CenterPoint Response

Ms. Kirk explained that CenterPoint developed a careful allocation methodology to assure that the statutory standards were met. At the time that Services Company was established, January 1, 2004, CenterPoint engaged an independent, third-party exert (Maximus, Inc.) to assist in establishing the allocation process, methodology and factors in order to balance the interests of both the regulated and non-regulated affiliates. Furthermore, the operations of Services Company have been reviewed by the Securities and Exchange Commission.[233] Ms. Kirk also outlined the evidence that was provided with the Statement of Intent to establish the reasonableness of these expenses and compliance with the requisite statutory standard:

- Direct Testimony
- Thirteen exhibits attached to that testimony
- Diagram of Houston Affiliate Relationships
- Diagram and Summary of Affiliate Services
- NARUC Guidelines for Cost Allocations and Affiliate Transactions
- Gas Operations Service Level Agreements
- Corporate, Information Technology, Regulated Operations, and Business Support Services

[231] CenterPoint Ex. 7, Direct Testimony of Mary A. Kirk, p. 5, lns. 14 – p. 6, ln. 14; p. 7, lns. 18 – 21; and, p. 12, lns. 10 – 12
[232] SCC's Statement of Position (October 19, 2009), pp. 2 – 4.
[233] CenterPoint Ex. 16, Rebuttal Testimony of Mary A. Kirk, p. 8, lns. 1 – 14, see also, CenterPoint Ex. 7, Direct Testimony of Mary A. Kirk, p. 15, lns. 9 – 23.

Additionally, she outlined the documents provided in response to several requests for information:

- Maximus study reviewing billing methodologies and suggesting changes to ensure a fair and equitable distribution of Service Company costs to business units
- SEC letter approving Composite Ratio Formula
- Service Company procedures for updating SKF's quarterly
- Calculation of SCFs used in 2nd Quarter 2008
- Calculation of SCFs used in 3rd Quarter 2008
- Calculation of SCFs used in 4th Quarter 2008
- Calculation of SCFs used in 1st Quarter 2009
- List of objects on which Service Company initially incurs costs ultimately billed to affiliate business units
- Test-year amounts objects that are charged to business units.
- Service Company test year billing by Functional Area and business units
- Service Company procedures for updating SKF's quarterly
- Calculations of SKF's used in 2nd Quarter 2008
- Samples of cost objects allocating on the various SKFs for June 2008
- Sample showing Business Support Services Insert Operations cost center billings for June 2008
- Sample showing Information Technology Mainframe CPU Utilization cost center billing for September 2008.

Examiners' Recommendation

SCC never clearly stated what adjustment, if any, it was proposing. Instead, SCC merely asserted a general concern regarding the $34,700,000 allocated from Services Company to the Houston Division. The Examiners can only assume the SCC was arguing that the entire $34,700,000 should be reduced because of the general perception held by SCC that CenterPoint had not met the statutory affiliate transaction standards. The Examiners note that SCC did not challenge any specific affiliate transaction nor did SCC challenge the allocation factors developed for allocating costs. The Examiners find that CenterPoint has amply satisfied that standard and recommend that the utility be permitted to include those costs that are not otherwise adjusted, as part of its calculation of rate base. Ample documentation was provided to the Intervenors and the Examiners regarding the affiliate transactions. Further, the utility established that only 8.24% of the total billings, excluding billing from the Regulated Operations Management function, from Services Company were allocated to the Houston Division.[234] The allocation methodology proposed is consistent with the allocation methodology approved in GUD No. 9791.

In conclusion, no adjustment should be made based on the allegation that CenterPoint has not met the affiliate transaction standard. The Examiners find that (1) the affiliate charges from CenterPoint Services are reasonable and necessary, and (2) that the price charged to the

[234] CenterPoint Ex. 16, Rebuttal Testimony of Mary A. Kirk, p. 11, lns. 9 – 10.

gas utility be no higher than the prices charged by the supplying affiliate to its other affiliates or divisions, or to a non-affiliated person for the same item or class of items.

iii. Corporate Services

Introduction

In addition to the test-year expense for Corporate Services, CenterPoint proposed to adjust amounts allocated from Corporate Support Services by an additional $1,385,540.[235] GCCC raised two issues with regards to Corporate Services. The first issue was related to pension expenses and was addressed in Section 6(I), above. The second issue relates to FERC Account 903.

Issues Raised by the Intervenors

Ms. Cannady noted that corporate services charges for FERC Account 903 had increased from $14.5 million to $21 million from 20056 to the end of the test year – an average annual increase of approximately $2 million. Based on responses to request for information Ms. Cannady concluded that the costs were attributable to CenterPoint's decision to centralize its call center. She contended that the increase in call volumes alone could not account for the increase in expenses.[236]

CenterPoint Response

Ms. Kirk testified that it was not clear on what basis Ms. Cannady claimed that the proposed increase to FERC Account 203 was due to the fact that the call centers were centralized. She explained that the two main factors that drive call center costs are call volume and the average length of calls. Both components have increased over time. Regarding the first component, Ms. Kirk noted that the volume of calls has increased from 1.15 million in the twelve months ended March 2006 to 2.34 million in the test year. This represents an increase of 103.5%. The increase in call volume is explained by customer growth and the impact of the economic downturn. Additionally, CenterPoint documented the increase in call volume. As to the second component, Ms. Kirk asserted that there was a sharp increase in the length of calls from 4.1 minutes in the twelve months ended March 2006 to approximately to 5.1 minutes in the test year – an increase of approximately 16%. The combined effect of the two components has been to increase the total number of call minutes from 5 million in 2006 to 11.9 million in the current test year. Finally she noted that there was a decrease in the number of abandoned calls and in the average wait time from over three minutes to under two minutes. The costs were impacted because in order to achieve these goals the utility increased staff, utilized third-party support, improved training and increased supervision.[237]

[235] CenterPoint Ex. 1, Schedule 4b, col. P; Schedule 4b, Workpaper 4b/11, p. 1, ln. 6.
[236] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 27, ln. 3 – p. 28, ln. 12.
[237] CenterPoint Ex. 16, Rebuttal Testimony of Mary A. Kirk, pp. 3, ln. 1 – p. 6, ln 8.

Examiners' Recommendation

The Examiners find that CenterPoint has established that the expenses related to FERC Account 903 are just and reasonable. Although the yearly levels of increases appear rather high, CenterPoint established that there was a tremendous increase in volume and the average length of call. The Examiners note that the evidence presented by the Intervenors challenging the expenditure in this account was somewhat hazy and appeared to be based on the generalized assumption that "customer service information charges should somewhat track the increase in the number of customers."[238] While it is a reasonable presumption, the witness did specifically identify specific expenditures that were questionable. Based on the challenge presented, CenterPoint has established that the general presumption underlying the challenged category of expenditure was flawed. Accordingly, the Examiners do not recommend that any adjustment be made to this expenditure.

7. Depreciation Expense

Introduction

A depreciation study was prepared to support the depreciation and amortization rates requested by Centerpoint for distribution and general plant assets in the Houston Division. The *pro-forma* year depreciation expense is $28,086,044[239]. The straight-line, equal life group (ELG) remaining-life depreciation system was employed to calculate annual and accrued depreciation. The ELG remaining-life depreciation system was also used to develop the depreciation rates currently in place for the CenterPoint Houston Division. Account level depreciation rates were developed based on depreciable property recorded on the Company's books as of December 31, 2008.[240] Non-depreciable property and property that is amortized were excluded from the study.

The study recommended a decrease of $85,000 in annual depreciation expense for accounts booked directly to the Houston Division and an increase of $800,000 in annual depreciation expense for accounts booked at a Centerpoint Energy Entex corporate level or $493,000 when allocated to the Centerpoint Houston Division.[241]

The Commission must determine whether the proposed depreciation rates and resulting depreciation expense are reasonable.

Issues Raised by the Intervenors

<u>Transportation Depreciation – 392</u>. Ms. Cannady testified on behalf of the Gulf Coast Coalition of Cities. She disputed the transportation depreciation rate of 23.17% that resulted in an average life of less than five years.[242] Ms. Cannady recommended an eight-year life for this group of assets. Her recommendation was based upon the Office of Management and Budget's

[238] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 28, lns. 2 – 3.
[239] CenterPoint Ex. 5, Direct Testimony of Kelly G. Gauger, p. 15, ln. 11.
[240] CenterPoint Ex. 5, Direct Testimony of Dane Watson, p. 6, lns. 27 – 29.
[241] CenterPoint Ex. 5, Direct Testimony of Dane Watson, Exhibit DAW-1, 2.
[242] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 31, lns. 8 – 9.

Circular No. A-76, which recommended expected useful lives for a variety of equipment, including vehicles and trucks. [243] An eight-year life equates to a depreciation rate of 12.5% for this group of assets, which are accounted for in FERC account no. 392, versus 23.17% recommended by Centerpoint. This 10.67% decrease in the depreciation rate results in a reduction to transportation depreciation expense of $1,344,597.00 and an increase in plant in service of $98,063 for a net change of $1,246,534.[244]

The City of Houston/Houston Coalition of Cities also raised issues with regards to this account. Mr. Pous disagreed with the net salvage and life parameters in the formula used by the Company[245] He contended that Centerpoint did not present a basis for its proposal of a five-year life for account 392. Mr. Pous testified that Centerpoint's life analyses is the only basis in the filing and, it cannot support a five-year average service life.[246] Contrary to CenterPoint's request of a 23.17% depreciation rate for this account, Mr. Pous recommended an 11% depreciation rate. His recommendation results in a $1,520,446 reduction to revenue requirements.[247]

Mr. Pous believed more current data and the trend in data indicated at a minimum an average service life of eight years[248] He asserted that this account dropped to a balance of $7,500 in 1995 compared to the balance of $13.1 million currently. Because of this fluctuation Centerpoint should rely on a SPR analysis with a five to ten year observation band, rather than the longer observation bands that Mr. Watson presented.[249] His position is that analysis with fifteen-year or longer observation bands incorporate data associated with investment that was retired prior to Centerpoint's reinvestment in vehicles beginning in 1995 and relies on life patterns dealing with vehicles built as far back as the mid 1970s which is not representative of today's quality and expected useful life.[250]

<u>Miscellaneous Intangible Software – 303.01</u>. Mr. Pous challenged two of the four plant categories where Centerpoint has proposed 20% and 10% amortization rates. He contended that the utility has no basis for its proposal and the company asserted that the rate "is their best estimate at this point in time."[251] Mr. Pous also maintained that the Company did not provide a single reason why the investment in software could not be expected to last 12 or even 15 years.[252] He concluded that unsupported guesses do not rise to the level of credible evidence and recommends extending the overall amortization period by 5 years which results in a $456,867 decrease to amortization expense.[253]

<u>Intangible SAP Software – 303.02</u>. Mr. Pous challenged Centerpoint's decision to amortize its SAP software over a ten-year period. He believed Centerpoint failed to justify its

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[243] GCCC Ex. 1, Direct Testimony of Constance Cannady, p. 31, lns. 11 – 14.
[244] GCCC Ex. 1, Direct Testimony of Constance Cannady, Schedule CTC-18.
[245] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 73, lns. 27 – 28.
[246] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 78, lns. 4 – 4.
[247] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 80, lns. 17 – 20.
[248] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 78, ln. 8.
[249] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 78, lns. 14 – 17.
[250] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 78, lns. 23 – 27.
[251] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 81, lns. 9 – 12.
[252] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 81, lns. 23 – 24.
[253] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 82, lns. 19 – 20.

decision to use a five-year life for software and a ten-year life to SAP software. The vague statement that this was done due to the nature of the software and that it is their best estimate at this point in time is insufficient to explain why a ten-year period is appropriate or why a longer period would not be appropriate.[254] He also contended that this proposal is accelerated depreciation that would cause intergenerational inequity and recommended a fifteen-year amortization period resulting in a $655,120 reduction to annual revenue requirements.

Centerpoint Response

Transportation Depreciation – 392. Mr. Watson stated that Mr. Pous' recommendation regarding transportation depreciation would create a situation where Centerpoint would retire assets prior to those assets being fully depreciated. He also stated that Ms. Cannady's adjustment to transportation depreciation from five to eight years does not accurately reflect Centerpoint's plant data and she does not provide any evidence that an eight-year life for account 392 is representative of Centerpoint's actual retirement experience.[255]

Miscellaneous Intangible Software – 303.01. Mr. Watson stated that Mr. Pous' recommendation regarding intangible miscellaneous software would create a situation where Centerpoint would retire assets prior to those assets being fully amortized. Mr. Watson stated that Centerpoint is proposing a 20% depreciation rate for one small planning software package with an installation cost of $168,975 and is requesting a 10% rate for the remainder of the software account. He asserted that it is commonly accepted practice for utilities to amortize small software assets over a 5-year period and large software assets over a 10-year period.[256] He details the account showing that "approximately 85% of the investment in this account is 3 years old or less and has 7 years or higher remaining life under a 10-year amortization period."[257] Mr. Watson asserts that the recommended 10-year life is supported by the Company's actual experience with assets in this account and that practical reality is that software systems become quickly outdated.

Intangible SAP Software – 303.02. Mr. Watson stated that $8.9 million dollars is original installation costs of the SAP software from 2002. This original cost has four years remaining amortization and that the remaining $1.2 million is from additions from 2003 through 2007 with a remaining amortization of five to nine years. He contended that Mr. Pous did not have any evidence or historical retirement data supporting the proposition that any asset in this account has experienced a fifteen-year service life. Also, under GAAP the Company is required to assign a life to its intangible software assets that represent the Company's "best estimate of the expected life of the asset".[258] He pointed out that the Commission in GUD No. 9791 agreed that a ten-year service life for this account is reasonable and appropriate.

[254] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 83, lns. 19 – 21.
[255] CenterPoint Ex. 18, Rebuttal Testimony of Dane A. Watson, p. 3, lns. 4 – 11.
[256] CenterPoint Ex. 18, Rebuttal Testimony of Dane A. Watson, p. 4, lns. 4 – 5.
[257] CenterPoint Ex. 18, Rebuttal Testimony of Dane A. Watson, p. 4, lns. 16 – 17.
[258] CenterPoint Ex. 18, Rebuttal Testimony of Dane A. Watson, p. 7 lns. 16 – 20.

Examiner' Recommendation

Transportation Depreciation – 392. In response to certain questions raised by the Examiners during the hearing it was established that that Centerpoint did not group assets in FERC acct. 392 according to FERC instructions. Centerpoint accounts for trailers in FERC acct. 396. Booking trailers in the proper account, account 392, would most likely increase the overall life for account 392.[259] As a result, CenterPoint has not established that the proposed depreciation rates are just and reasonable for this account. GCCC established that the eight-year service life, resulting in a 12.5% depreciation rate is reasonable. This adjustment reduces revenue requirement by $1,246,534. Additionally, the Examiners recommend that Centerpoint be directed to correctly book trailers' dollars from acct. 396 to 392 prior to the next filing.

Miscellaneous Intangible Software – 303.01. The Examiners find that the software amortization rate of five years used by Centerpoint is just and reasonable. Furthermore, that rate is consistent with Commission's determination in GUD 9791. No adjustment is recommended.

Intangible SAP Software – 303.02. The Examiners find that the software amortization rate of ten-years used by Centerpoint is just and reasonable. Sufficient evidence was not presented to establish that a suitable service life for software is fifteen years. Furthermore, CenterPoint's request is consistent with Commission ruling in GUD 9791. As a result no adjustment is recommended.

8. Excess Accumulated Depreciation

The City of Houston/Houston Coalition of Cities argued that on several accounts CenterPoint overcharged customers for depreciation well beyond the level of gross plant cost and the impact of net salvage. Mr. Pous contended that the company arbitrarily elected to reverse excess accumulated depreciation in those accounts. He contended that the utility eliminated the excess accumulated depreciation through an accounting entry and customers did not receive a refund on their overpayment. He contended that those excess amounts should be recognized and returned. He proposed that the amounts be amortized and returned to customers.[260]

CenterPoint responded to this issue through the testimony of Ms. Gauger. Ms. Gauger stated that depreciation rates reflected in the cost of service filed in the 2003 Houston Division rate case were based upon a 2001 study. Those rates were adopted in a settlement with the municipalities. At that time, the company reversed excess depreciation expense and it was expressed as a reduction to rate base.[261] Additionally, CenterPoint argued that the proposed adjustment represented prohibited retroactive ratemaking.[262]

[259] Tr. Vol. 3, p. 175.
[260] City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 43, ln. 1 – p. 48, ln. 4.
[261] CenterPoint Ex. 13, Rebuttal Testimony of Kelly Gauger, p. 5, ln. 12 – p. 6, ln. 13.
[262] CenterPoint Reply Brief, p. 20.

Examiners' Recommendation

The Examiners find that the proposed adjustment is retroactive ratemaking. The company recovered depreciation expense based on rates approved in the last rate proceeding. To make the adjustment requested at this juncture is to true-up the previously approved rates.

9. Ad Valorem Taxes

CenterPoint estimated its *ad valorem* taxes through 2010 based on estimated plant and gas inventory values. GCCC contended that this was not appropriate and recommended a reduction to the requested levels of *ad valorem* taxes in the amount of $837,021. Ms. Cannady contended that using estimates of potential tax liability as well as estimates for future annual changes does not result in a known and measurable change to test-year expense.[263]

CenterPoint responded that the testimony of Ms. Gauger. Ms. Gauger testified that the determining factor in the valuation of the taxable value of the company's assets, and the resulting property tax expense, is the appraiser's opinion of the future net operating income that will be earned by the distribution system. All appraisers look closely at the previous three and five year history and make projections based upon the trends indicated in historic figures. She contended that this was the process used by the company. She was also critical of the methodology Ms. Cannady applied to determining her adjustment.[264]

Examiners' Recommendation

The Examiners find that CenterPoint has not established that the proposed adjustment is just and reasonable. As noted by Mr. Woods in other contexts, the point of a test year is to take a snapshot look at expenses that may change over the course of time.[265] Or as stated by Ms. Gauger adjustments to test year expenses should be known and measurable with reasonable accuracy and speculative assumptions should not be substituted based on average costs.[266]

10. Rate of Return

a. Introduction

In setting a gas utility's rates, the regulatory authority shall establish the utility's overall revenues at an amount that will permit the utility an opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public in excess of its reasonable and necessary operating expenses. The regulatory authority may not establish a rate that yields more than a fair return on the adjusted value of the invested capital used and useful in providing service to the public.

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[263] GCCC Ex. 1, Direct Testimony of Constance T. Cannady, p. 36, ln. 7 – p. 37, ln. 4.
[264] CenterPoint Ex. 13, Rebuttal Testimony of Kelly C. Gauger, pp. 16 – 18.
[265] CenterPoint Ex. 14, Rebuttal Testimony of Charles Dean Woods, p. 3.
[266] CenterPoint Ex. 13, Rebuttal Testimony of Kelly C. Gauger, p. 19 – 20.

As noted by the Austin Court of Appeals in *Railroad Commission of Texas v. Lone Star Gas Company,* to achieve the rate of return that a utility should be allowed to earn, the regulatory agency should consider the cost to the utility of its capital expressed as follows: (1) interest on long-term debt; (2) dividends on preferred stock; and (3) earnings on common stock.[267] As stated by the United States Supreme Court, the annual rate that will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties . . . . The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and business conditions generally.[268]

In this case the dispute has centered around the company's proposed capital structure and the cost of equity. CenterPoint, the City of Houston/Houston Coalition of Cities, the State of Texas, and Staff of the Railroad Commission each presented witnesses on issues related to the appropriate rate of return. GCCC stated that in order to reduce rate case expense and avoid duplication of effort, GCCC concurred with and relied upon the recommendations of the witness for the City of Houston/Houston Coalition of Cities regarding rate of return.[269]

b. Capital Structure

Introduction

CenterPoint proposed a hypothetical capital structure composed of 44.40% long-term debt and 55.60% common equity.[270] Although Staff is in agreement with the proposed capital structure, Staff's basis differed. Staff argued that the capital structure of the parent company is the relevant basis. On the other hand, the City of Houston/Houston Coalition of Cities argued that a different capital structure should be applied.

Issues Raised by the Intervenors

Bertram Soloman, who testified on behalf of the City of Houston/Houston Coalition of Cities argued that a review of CenterPoint's balance sheet for the last several years demonstrated that it consistently and regularly relied on short-term debt to fund its assets.[271] As

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267 *Railroad Commission of Texas v. Lone Star Gas Company*, 599 S.W.2d 659 (Tex. App. C Austin 1980).
268 *Bluefield Water Works and Improvements Co. v. Public Serv. Comm'n of West Virginia*, 262 U.S. 679 (1923), see also, *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1942).
269 GCCC Initial Brief, p. 26.
270 CenterPoint Ex. 8, Direct Testimony of Robert B. Hevert, p. 49, ln. 4 – 50, ln. 10.
271 City of Houston/Houston Coalition of Cities, Ex. 3, p. 4, ln. 15 – p. 6, ln. 21.

a result he proposed a capital structure of 47.42% long-term debt, 3.09% short-term debt, and 49.49% common equity. Staff agreed that the actual capital structure of the parent company is the relevant starting point. In this case, Staff argued that the actual capital structure of a utility should be used in preference to a proxy-derived average. In the case of a subsidiary such as the Houston Division, Staff noted that the Rate Review Handbook provides that "the Commission generally looks at the parent corporation's consolidated capital structure."[272]

Staff's conclusion, however, was that there was no short-term debt. Instead, Mr. Tomicek examined the capital structure of CenterPoint Energy Resources Corporation and concluded that a capital structure of 44.61% long-term debt and 55.39% common equity was reasonable. This was based on an examination of 10-Q and 10-K filing of CenterPoint Energy Resources Corporation. This average happened to coincide with the capital structure that Mr. Hevert derived from the proxy companies of 44.4% debt and 55.6% equity.[273] Thus, Staff is in agreement that the proposed capital structure by the utility is appropriate in this proceeding. Staff did not arrive at this conclusion by application of the methodology employed by Mr. Hevert.

CenterPoint Response

Mr. Hevert asserted that Mr. Solomon has ignored the typical financing cycle for utilities and selected a fiscal quarter for which much of the short-term debt was likely used to finance current, rather than permanent assets. Mr. Solomon's short-term debt calculation failed to recognize that natural gas distribution companies have a seasonal pattern to short-term debt balances, with the winter and "shoulder periods requiring higher levels of short-term debt to finance seasonal net working capital requirements. The company also noted that the capital structure proposed is consistent with several recent Commission decisions: GUD Nos. 9400, 9670, and 9762.

Examiners' Recommendation

The Examiners find that the capital structure proposed by the company is just and reasonable. The Examiners find that the appropriate method of determining capital structure is based upon the actual capital structure of the company and that there is evidence in the record that established that the actual capital structure was 44.40% long-term debt and 55.60% short-term debt. This is based on year-end capital structures reported in the company's 10-K filings from the year 2000 forward to the end of 2008.

c. Cost of Debt

The cost of debt is a directly observable component of the rate of return calculation. No party disputed CenterPoint's proposed cost of debt of 6.334%.[274] Accordingly, the Examiners find that the cost of debt is just and reasonable and recommend that it be approved.[275]

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[272] Railroad Commission Staff Ex. 1, Direct Testimony of Frank Tomicek, p. 5, ln. 17 – p. 6, ln. 3 citing to Railroad Commission of Texas, Natural Gas Rate Review Handbook, p. 2.

[273] Railroad Commission Staff Ex. 1, Direct Testimony of Frank Tomicek, p. 6, ln. 5 – p. 7, ln. 9.

[274] Railroad Commission Staff Ex. 1, Direct Testimony of Frank Tomicek, p. 7, lns. 11 – 15.

[275] CenterPoint Ex. 1, Schedule 3, ln. 12, col. (C).

d. Return on Equity

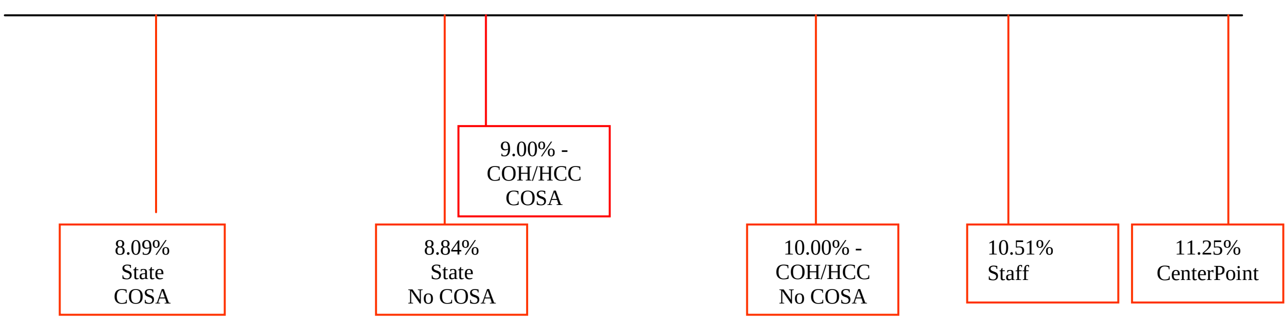
(A) Introduction

The parties, however, have vastly differing recommendations regarding the cost of equity. Unlike the cost of debt, the cost of equity is not directly observable and must be estimated.[276] Table 10.1 below summarizes the relative positions of the parties in this proceeding and Figure 10.1 graphically represents the relative positions of the parties.

Table 10.1
CenterPoint and Intervenors ROE Requests/Recommendations

State COSA	State Without COSA	COH/HCC/GCC COSA	COH/HCC/GCC Without COSA	Staff	CenterPoint
8.09	8.84	9.00	10.00	10.50	11.25

Figure 10.1
CenterPoint and Intervenors ROE Requests/Recommendations



(B) Proxy Group

Mr. Hevert relied on a proxy group to perform his analysis. The proxy group included the following entities: (1) AGL Resources, (2) Laclede Group, (3) Nicor, Inc. (4) Northwest Natural Gas, (5) Piedmont Natural Gas, (6) South Jersey Industries, (7) Southwest Gas Corp., and (8) WGL Holdings, Inc.[277] A proxy group is reasonable because in this proceeding the Commission is estimating the cost of equity for an entity that is not publicly traded. Mr. Hevert also pointed out that the Commission has adopted the use of a proxy group in the past.[278]

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[276] CenterPoint Ex. 8, Direct Testimony of Robert B. Hevert, p. 24, lns. 11 – 15. Railroad Commission Staff Ex. ___, p. 4, lns. 13 – 15.

[277] CenterPoint Ex. 8, Direct Testimony of Robert B. Hevert, p. 22, lns. 4 – 15.

[278] CenterPoint Ex. 8, Direct Testimony of Robert B. Hevert, p. 18, lns. 17 – 29 & p. 21, ln. 21 – p. 22, ln. 2. Citing to Tex. R.R. Comm'n, *TXU Gas Company Statement of Intent to Change Rates in the Company's Statewide Gas Utility System*, Docket No. 9400 (Gas Utils. Div. May 25, 2004) (Final Order granting application) ("GUD No. 9400") and, Tex. R.R. Comm'n, *Petition for De Novo Review of the Reduction of the Gas Utility Rates of Atmos Energy Corp., Mid-Tex Division,*

Further, this methodology has been used by the Federal Energy Regulatory Commission and affirmed by the Court of Appeals for the District of Columbia.[279] He also noted that a benefit of using a proxy group is that it serves to attenuate the effects of anomalous events that may be associated with any one company.[280]

In selecting the proxy group, Mr. Hevert imposed five restrictions. First, he began with a group of twelve companies currently classified as Natural Gas Utilities by Value Line. Second, he eliminated companies that were not covered by at least two utility industry equity analysts. Third, he eliminated proxy companies that did not have senior bond and/or corporate credit ratings of BBB- to AA by Standard and Poor's. Fourth, he eliminated companies that did not have a recent history of not paying dividend or that did not have positive earning growth projections. Fifth, he attempted to select companies that were primarily regulated gas distribution utilities.[281] No party disputed the members of the proxy group:

- AGL Resources
- Laclede Group
- Nicor, Inc.
- Northwest Natural Gas
- Piedmont Natural Gas
- South Jersey Industries
- Southwest Gas Corp.
- WGL, Holdings, Inc.[282]

Mr. Hevert testified that in arriving at the recommended Return on Equity he applied three methodologies: (1) Discounted Cash Flow (DCF) Model, (2) CAPM, and (3) a Bond Yield plus Risk Premium analysis. He argued that this was consistent with relevant literature regarding cost of equity analysis.[283] All parties agreed that the DCF model is an appropriate methodology to apply.

(C) Economic Conditions

Mr. Hevert, Mr. Tomicek, Mr. Solomon, and Dr. Miravete all addressed the current economic conditions. With the exceptions of Mr. Solomon, all rate of return witnesses analyzed current economic conditions and appear to generally agree that current and expected economic conditions affect the cost of raising funds to finance operations, investments, acquisitions, and

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by the Cities of Blue Ridge, Caddo Mills et al.; Atmos Energy Corporation Statement of Intent to Change Rates in the Atmos Energy Corp., Mid-Tex Division Gas Utility System; Petition for Review from Actions of Municipalities Denying Rate Request (Gas Utils. Div. June 16, 2007) (Final Order on Rehearing) ("GUD No. 9670").

279 CenterPoint Ex. 8 Direct Testimony of Robert B. Hevert, p. 19, ln. 10 – p. 20, ln. 6. Citing to *Petal Gas Storage v. FERC*, 496 F.3rd 695 (D.C. Cir. 2007).

280 CenterPoint Ex. 8, Direct Testimony of Robert B. Hevert, p. 16, lns. 3 – 5.

281 CenterPoint Ex. 8, Direct Testimony of Robert B. Hevert, p. 21, lns. 3 – 19.

282 CenterPoint Ex. 8, Direct Testimony of Robert B. Hevert, p. 22, lns. 6 – 14, Railroad Commission Staff Ex. 1, Direct Testimony of Frank Tomicek, p. 5, lns. 13 – 15 & p. 10, lns. 2 – 6.

283 CenterPoint Ex. 8, Direct Testimony of Robert B. Hevert, p. 24, lns. 21 – 25. ("[M]any finance texts recommend using multiple approaches when estimating cost of equity. Copeland, Koller and Murrin, for example, suggest using the CAPM and Arbitrage Pricing Theory Model, while Brigham and Gapenski recommend the CAPM, DCF, and "bond yield plus risk premium" approaches.)

gas purchases.[284] Dr. Miravete argued that relative to other industries, regulated utilities benefit from risk-averse investors.[285] Mr. Hevert, who testified on behalf of CenterPoint, and Mr. Tomicek, who testified on behalf of Staff of the Railroad Commission appear to agree that the current economic conditions aversely affect a utility's ability to attract capital.[286] Mr. Hevert provided compelling testimony on this point citing to several recent decisions and announcements of several utilities:

- Michigan Public Service Commission: "Balancing the needs of ratepayers in just and reasonable rates against the need of Detroit Edison to continue to attract capital from the financial markets, the Commission concludes that there is ample justification for maintaining Detroit Edison's ROE at 11.00%."

- Public Service Company of Oklahoma: "The Commission recognizes that the uncertainty of the economic markets for at least the near future may have a negative impact on expectations of investors."

- Florida Public Service Commission: "We have also taken into account TECO's proposed construction program and its need to access the capital markets during this potentially challenging period."

- Great Plains Energy, Inc.: ". . . the Board's decision to reduce the dividend is prudent in order to strengthen our earnings, cash flow, and credit position so that we can be in a position to better weather the current and anticipated economic and financial market conditions.

- UIL Holdings Corp: "Accordingly, the Company must reduce capital expenditures until access to equity capital can be achieved at reasonable terms."

The Examiners agree that regulated utilities generally benefit from concerned investors in search of safe havens. The Examiners conclude, however, that substantial evidence was presented that indicated that the current economic environment has adversely affected the utility industry. Thus it is reasonable to recognize that fact as the Commission determines the appropriate rate of return.

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[284] State of Texas Ex. 1, Direct Testimony of Eugenio J. Miravete, p. 7, lns. 17 –26; CenterPoint Direct Testimony of Robert B. Hevert, Ex. 8, pp. 2 – 18 & p. 8, lns. 17 – 18 ("The current state of the financial markets has led to a general decrease in the availability of, and an increase in, the cost of both debt and equity capital for all market sectors, including utilities.); Railroad Commission Staff, Direct Testimony of Franck Tomicek, p. 17 ln. 10 – p. 18, ln. 14. ("The role of current economic conditions must also necessarily influence any discussion of equity returns . . . . Under these conditions, it's argued that stocks need to offer additional return in order to attract relatively risk averse investors . . . .").

[285] State of Texas Ex. 1, Direct Testimony of Eugenio Miravete, p. 7, ln. 29 – p. 8, ln. 5.

[286] CenterPoint Direct Testimony of Robert B. Hevert, Ex. 8, pp. 2 – 18, Railroad Commission Staff, Direct Testimony of Franck Tomicek, p. 17, ln. 10 – p. 18, ln. 14.

(D) DCF Analysis

Introduction

Application of the DCF Model requires that several variables be established. There is no single method of identifying the variables and quantification of the variable requires a certain degree of judgment. In this proceeding, the dispute centered on two variables: (1) The appropriate dividend yield and (2) an estimate of the future earnings growth.

DCF Evaluation

In his direct testimony, Mr. Hevert identified a range for the cost of equity from 8.17% to 11.35%. The dividend yield for Mr. Hevert's DCF model was based upon the proxy companies' current annualized dividend and average closing stock prices over the thirty and ninety-trading days that ended July 15, 2009. The input for the growth estimates used by Mr. Hevert were (1) Zacks consensus long-term earning growth estimates, (2) Value Line earning per share growth estimates, and projected Retention Growth Estimates.[287] A table presented by Mr. Hevert summarizing that range is set out below:

Table 10.2:
CenterPoint Mean DCF Results[288]

	Mean Low	Mean	Mean High
30-Day Average	8.17%	9.75%	11.25%
90-Day Average	8.27%	9.85%	11.35%

Mr. Hevert then applied a flotation cost adjustments to his estimate of the dividend yield. Flotation costs are the costs associated with the sale of new issues of common stock. These costs include out-of-pocket expenditures for the preparation, filing, underwriting, and other costs of issuance of common stock. Mr. Hevert contended that flotation costs should be considered in setting an appropriate level of return.[289] After applying that factor, Mr. Hevert determined a revised DCF range of 8.37% to 11.54%. The ultimate return on equity recommended, after applying the CAPM analysis, his risk premium analysis and evaluation of other market factors, was 11.25%. That was within Mr. Hevert's initial DCF range. Mr. Hevert updated the DCF analysis in his rebuttal testimony and identified a range of 8.45% to 11.16%.[290] Mr. Hevert continued to recommend a return on equity of 11.25% based upon his CAPM and Risk Premium analysis.

The dividend yield employed by Mr. Tomicek, who testified on behalf of the Railroad Commission, was based upon the recent month share price and ninety-day share prices. The inputs for the growth estimates applied by Mr. Tomicek on behalf of Staff of the Railroad

[287] CenterPoint Ex. 8, Direct Testimony of Robert B. Hevert, p. 29, ln. 21 – p. 30, ln. 3.
[288] CenterPoint Ex. 8, Direct Testimony of Robert B. Hevert, p. 30, lns. 19 – 20.
[289] CenterPoint Ex. 8, Direct Testimony of Robert B. Hevert, p. 42, ln. 10 – 45, ln. 14.
[290] CenterPoint Ex. 19, Rebuttal Testimony of Robert B. Hevert, p. 12, lns. 1 – 3.

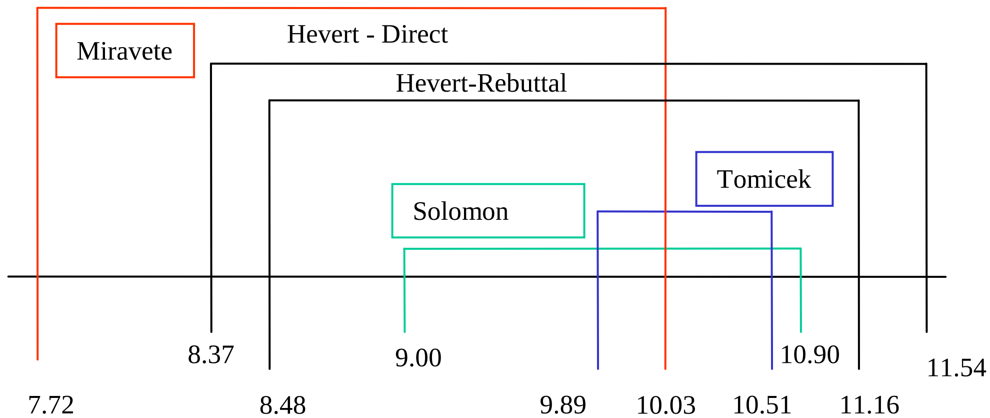
Commission were taken from Zack's and Morningstar, Inc.[291] Mr. Tomicek did not recommend any adjustment based upon flotation costs. He noted that the Commission has not previously included a specific adjustment for flotation cost in any previous return on equity determination. He also noted that the Rate Review Handbook stated that the dilution of existing shareholder equity from such costs is not significant enough to warrant adjustment in overall return on equity. Mr. Tomicek developed a DCF range of 9.89% to 10.51%. After evaluating his CAPM analysis, Risk Premium Analysis and other market factors, Mr. Tomicek ultimately recommended a return on equity of 10.50%. That recommendation was within his DCF range.

Mr. Soloman, who testified on behalf of the City of Houston/Houston Coalition of Cities used monthly average high and low prices along with the contemporaneous annualized dividends to calculation low and high average dividend yields for the six months ending September 2009. The growth rates he used were based upon Value Line, Zacks, Thompson Financial. Mr. Solomon did not apply a flotation cost adjustment. He contended that flotation costs are normally allowed when there is specific evidence of expected new issuances of common stock by the applicant or its parent during the time rates are expected to be in effect. Additionally, he asserted that the flotation cost adjustment should only be applied to that portion of equity capital expected to come from the identified new issuance, whereas Mr. Hevert has applied this adjustment to the full equity base. Finally, he argued that natural gas utility stocks and that of the company's parent, CenterPoint Energy, Inc. are selling at more than book value, thus eliminating the possibility of dilution as a result of any failure to include a flotation cost adjustment in the allowed return on equity.[292] Based upon his DCF analysis and a review of average return on equities allowed for other natural gas utilities, Mr. Solomon recommended a return on equity of 10.00%.

In order to establish the dividend yield to use in his DCF analysis, Dr. Miravete, who testified on behalf of the State of Texas, computed the daily average closing price of the stocks of the utilities in the proxy group for the ninety days ending on September 30, 2009. In order to determine the growth rate Dr. Miravete employed the most recent forecast available from Value Line. He established a DCF range of 7.72% to 10.03%. Based upon his CAPM analysis and consideration of other market factors he concluded that a return on equity of 8.84% was reasonable. This recommendation was within his DCF range. He did not include the impact of flotation costs as he concluded that flotation costs are unlikely to influence the return on equity required by CenterPoint to attract sufficient capital. He also concluded that flotation costs are not contemplated by the Rate Review Handbook since, as noted by Mr. Tomicek, the handbook concludes that the dilution to existing stockholders' equity from such costs is inconsequential. He noted that the Examiners in GUD NO. 9869 recently confirmed this treatment.[293] Figure 11.1, summarizes the relative DCF ranges identified by the witnesses in this proceeding.

[291] Railroad Commission Staff Ex. 1, p. 10, lns. 7 – 20.
[292] City of Houston/Houston Coalition of Cities, Ex. 3. p. 19, lns. 7 – 18.
[293] State of Texas, Ex. 1, Direct Testimony of Eugenio J. Miravete, p. 11, ln 12 – 9. 14, ln. 11.

Figure 10.2
DCF Ranges Identified



Examiners' Recommendation

The Examiners find that the updated DCF range identified by Mr. Tomicek of 9.89% and 10.51% is reasonable. This range excludes flotation costs. The Examiners find that the Commission has not historically allowed for the inclusion of flotation costs in determining a utility's cost of equity. Of course, whether to allow the inclusion of such a factor is a policy determination. The Examiners do not recommend that the Commission approve the inclusion of flotation costs. As stated in the Rate Review Handbook the dilution of existing shareholder equity from such costs is not significant enough to warrant adjustment in overall return on equity. The Examiners find that a flotation cost adjustment should only be applied to that portion of equity capital expected to come from the identified new issuance and that natural gas utility stocks and that of the company's parent, CenterPoint Energy, Inc. are selling at more than book value, thus eliminating the possibility of dilution as a result of any failure to include a flotation cost adjustment in the allowed return on equity.

e. CAPM

Introduction

Mr. Hevert, Dr. Miravete, and Mr. Tomicek also performed an analysis using the Capital Asset Pricing Model (CAPM). Mr. Solomon did not employ a CAPM analysis to arrive at his ultimate recommendation. The CAPM model is a forward looking methodology that measures the cost of equity as the sum of a risk free return plus a risk premium to compensate investors for systemic risks associated with that security.[294] As with the DCF Model the CAPM requires selection of several variables. Mr. Hevert also proposed several adjustments to the traditional CAPM analysis, which were challenged by the parties.

[294] State of Texas, Ex. 1, Direct Testimony of Eugenio J. Miravete, p. 14, ln 15 – 17; CenterPoint Ex. 8, Direct Testimony of Robert B. Hevert, p. 31, lns. 1 – 5; Railroad Commission Staff Ex. 1, Direct Testimony of Frank Tomicek, p. 12, lns. 5 – 15.

CAPM Analysis

The yields on Treasury bonds are commonly accepted measures of the risk-free asset in the CAPM method.[295] Mr. Hevert advocated the use of long-term Treasury securities for the estimate of a risk free rate. Specifically, he advocated the use of 30-year Treasury Bonds. Mr. Hevert also advocated adjusting the initial CAPM results by using a Sharpe Ratio, which is the ratio between risk premium and market volatility. The CAPM result ultimately identified by Mr. Hevert is 10.64%.

Dr. Miravete advocated the use of 10-year Treasury Bonds. He disputed Mr. Hevert's use of a 30-year treasury bond noting that the concern with the use of long-term bonds is that bonds, which take so long to mature, include a risk premium component that is not acknowledged by Mr. Hevert. Furthermore, in GUD No. 9762 the Examiners accepted the yield of 10-year Treasury bonds as an appropriate measure of the risk-free return for purposes of the CAPM method and rejected the use of the 30-year Treasury bond as it include a risk premium component.[296] Dr. Miravete finds that the application of a Sharpe Ratio is unjustified and rejects the notion that the CAPM analysis should be revised using that ratio.[297] The CAPM result ultimately identified by Dr. Miravete is 8.98%.[298]

Mr. Tomicek provided two return on equity estimates based on CAPM methodology. One was based on the historical risk premium reported in the Ibbotson 2009 SBBI Valuation Yearbook (SBBI) and the other was based upon the 10-year Treasury Bond. Mr. Tomicek concurred with Dr. Miravete regarding the use of a 10-year Treasury Bond. The CAPM result ultimately identified by Staff was 9.64%.[299]

As noted, Mr. Solomon did not advocate application of the CAPM analysis as he believed that the CAPM methodology was fraught with problems of practical application as a reliable means of determining an allowable return on equity. He concluded that it was not reasonable to place any reliance on that methodology or the risk premium analysis.[300]

Examiners' Recommendation

The Examiners find that a CAPM methodology premised upon a 10-year Treasury Bond and/or SBBI is just and reasonable. The use of a 30-year Treasury bond is not reasonable and is not consistent with Commission precedent. Accordingly, the Examiners find that a CAPM result of 9.64% is reasonable.

f. Return on Equity Recommendation

Mr. Hevert and Mr. Tomicek each performed an additional Risk Premium Analysis. The State of Texas and the City of Houston/Houston Coalition of Cities opposed this approach.

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295 State of Texas Ex. 1, Direct Testimony of Dr. Eugenio J. Miravete, p. 15, lns. 11 – 12.
296 State of Texas Ex. 1, Direct Testimony of Dr. Eugenio J. Miravete, p. 15, lns. 8 - 21.
297 State of Texas Ex. 1, Direct Testimony of Dr. Eugenio J. Miravete, p. 18, lns. 7 – 8.
298 State of Texas Ex. 1, Direct Testimony of Dr. Eugenio J. Miravete, p. 17, lns. 23 – 27.
299 Railroad Commission Staff Ex. 1, Direct Testimony of Frank M. Tomicek, p. 12, ln. 4 – p. 14, ln. 18.
300 City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of J. Bertram Solomon, p. 9, ln. 12 – p. 15, ln. 7.

Mr. Hevert also proposed consideration for the "small size effect." The City of Houston/Houston Coalition of Cities, Staff of the Railroad Commission, and State of Texas opposed this. Application of this adjustment is not consistent with Commission precedent, is not warranted by the current economic conditions, and is not appropriate to a division that is not publicly traded whose parent company certainly does not suffer from any small size effect.

CenterPoint has not established that its proposed return on equity is just and reasonable. CenterPoint's proposed return on equity is outside the updated DCF range prepared by its own witness, Mr.Hevert. The Examiners find that in light of current economic conditions it was reasonable to perform the additional risk premium analysis to assist in identifying the exact return on equity to approve in this proceeding. As noted above, the Examiners find that a reasonable range for the return on equity in this case is between 9.89% and 10.50%. Based upon the results of the risk premium analysis and taking into account the effect of current economic conditions, the Examiners find that a return on equity of 10.50% is just and reasonable.

11. Service Charges

Introduction

The utility proposed the addition of a service charge of $47.00 for after-hours service calls. GCCC argued that an adjustment should be made to the cost of service study to reflect the added revenues from the service charges.

Issues Raised by the Intervenors

Mr. Nalepa objected to CenterPoint's failure to include any revenues for the proposed service charges. Mr. Nalepa attempted to calculate potential revenues from this new charge based upon a survey of other utilities and also based upon data provided by CenterPoint related to the number of reconnection service calls during the twelve-month period ending March 2009. Based on this analysis he increased test-year miscellaneous service revenue by $57,380.[301]

As regards the miscellaneous service charges Mr. Brock, on behalf of Staff of the Railroad Commission, proposed a specific change to the language, to replace "Plus other related costs," with "Plus other related costs to disconnect service at the main. Other related costs will be at cost to Entex and contain no mark-up of any kind." Staff argued that these type of expenses do not normally include a mark-up, and that it has been the policy of the Commission that these charges are at the utility's cost and do not include a mark-up.[302]

CenterPoint Response

Mr. Troxle stated that it would be inappropriate to impute income without the corresponding expense and CenterPoint has not included the expenses related to this proposed

[301] GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, p. 7, ln. 13 – p. 8, ln. 11.
[302] Railroad Commission Staff Ex. 2, Direct Testimony of Mark Brock, p. 20, ln. 20 – p. 22, ln. 22.

service charge. He further argued that it is not appropriate to include miscellaneous service charges in base revenues. CenterPoint did not oppose the language requested by Staff.[303]

Examiners' Recommendation

The Examiners find that CenterPoint has not established that failure to include some estimate of the revenues to be generated under the proposed miscellaneous service charge was reasonable. The Examiners recommend that any estimated revenues be included as part of the calculation of base rates. The Examiners also find that the unopposed language proposed by Staff of the Railroad Commission is reasonable and recommend that it be included in the miscellaneous service charge tariff.

12. Allocation

a. Introduction

Once the cost of service is determined, the regulatory authority must determine the appropriate allocation of costs among the various customer classes. CenterPoint provided a cost allocation and rate design proposal through the testimony of Matthew Troxle. As explained by Mr. Troxle, the cost allocation study allocates the operating and maintenance expenses, depreciation, taxes, return, and all rate base elements to each class of customer.[304] The cost allocation study classified costs into one of four categories:

- Capacity – These costs are fixed costs that do not vary with consumption.
- Customer – These costs are fixed costs that do not vary with consumption.
- Commodity – Costs are variable costs that vary with consumption.
- Revenue – Costs are variable that vary with revenues.

Once the costs were classified, CenterPoint allocated those costs among the various customers. Capacity costs were allocated based on relative peak demands for each class, customers costs were allocated based on the number of customers within each class, commodity costs were allocated based upon the usage by each class and revenue costs were allocated based on the revenue responsibility of each class.

[303] CenterPoint Ex. 20, Rebuttal Testimony of Matthew Troxle, p. 17, ln. 11 – p. 18, ln. 22.
[304] CenterPoint Ex. 11, Direct Testimony of Matthew Troxle, p. 20, lns. 3 – 4.

Table 12.1
Classification/Allocation

	(1)	(2)	(3)	(4)
Classification:	Capacity	Customer	Commodity	Revenue
Allocation Basis:	Peak Demand	Number of Customer	Usage by Class	Revenue Responsibility
Allocation Percentages				
Standard Customers:	95%	99.9%	78%	
Contract & Industrial:	5%	.01%	22%	

Expenses in some accounts may be classified as capacity, customer, and commodity. For example, costs associated with the Account 367, Mains Account, in the amount of $165,266,357[305] are classified as both capacity and customer costs. In other words it is a function of both the number of customers and the peak demand of the customers. In order to determine the customer component of the mains account, CenterPoint employed a minimum system study for the Houston Division. Based upon that study, CenterPoint concluded that 66% of mains costs, in the amount of $112,939,677,[306] are customers-related and 34% of mains costs in the amount of 58,037,331[307] are capacity-related. The Standard Rate Classes, the regulated customers, will bear approximately 99.9% of the customer-related costs or $112,826,737, and approximately 95% of the capacity related costs or $55,135,464.

The Intervenors challenge two aspects of the allocation methodology proposed by CenterPoint. First, the Intervenors challenge the minimum system study used to allocate costs between capacity and customer related classes for certain accounts. Second, the Intervenors peak demand methodology for determining the allocation of capacity related costs.

b. Allocation: Minimum System Study

Introduction

In order to classify costs as either capacity or customer costs, CenterPoint relied on a minimum system study.

Issues Raised by the Intervenors

Mr. Pous argued that the minimum system study was flawed. Specifically, he explained that underlying premise for relying on a minimum system approach for estimating customer classification percentages is that it costs less per linear foot to install smaller size pipe. He argued, however, that in the case of the Houston Division this underlying premise is violated. He contended that in the Houston Division the cost of installing three-inch pipe is less than the cost of installing 2-inch pipe. He claimed that the company's data revealed that it cost more per

[305] CenterPoint Ex. 20, Direct Testimony of Matthew Troxle, CARD Exhibit HD 6, ln. 9, col, (E).
[306] CenterPoint Ex. 20, Direct Testimony of Matthew Troxle, CARD Exhibit HD 8, ln. 6, col. (D) & CARD Exhibit HD 9, ln. 6.
[307] CenterPoint Ex. Ex. 20, Direct Testimony of Matthew Troxle, CARD Exhibit HD 8, ln. 6, col. (E) & CARD Exhibit HD 10, ln. 6.

linear foot to install ½ - inch pipe, ¾ - inch pipe, and one-inch pipe than it costs to install two-inch pipe. He concluded that the underlying data related to costs was flawed and that a normalization adjustment on the costs should be imposed. He recommended reliance on a average cost per foot for one, two, and three – inch pipe as a more appropriate approach.[308]

He contended that reliance on a normalized two-inch minimum system calculation resulted in a 53.6% customer classification compared to the utility's proposed 66% value. Correspondingly, the normalized two-inch system would result in a 46.4% capacity component compared to the utility's proposed 34% capacity estimate. The proposed adjustment would reduce the revenue requirement of the standard rate classes by $535,542 and would reduce the revenue requirement of the residential class by $2,053,946.[309]

Mr. Nalepa contended that CenterPoint misapplied the minimum system methodology. He argued that the minimum system methodology should be based upon a skeleton system adequate to supply a usable pressure to customers. He argued that data supplied by CenterPoint revealed that the utility has over 5,525,801 feet of installed mains with a diameter of 1¼ inches. These facilities can reasonably represent the skeletal system required to deliver an adequate supply of gas to customers at a usable pressure. Using a 1 ¼ - inch pipe as representative of the minimum system results in a customer-related component of approximately 38% of the cost of distribution mains. Mr. Nalepa did not, however, recommend adoption of minimum system based upon 1 ¼ -inch pipe. Instead, he recommended a customer related percentage of 50% be used for the allocation of the customer component of distribution mains.[310]

CenterPoint Response

Mr. Troxle argued that a minimum system based upon 2-inch pipe has been approved in several other dockets. He also responded by noting that 2-inch main is by far the most prevalent sized main used to connect a customer to the distribution system. The 2-inch main grouping represents 65.34% of all linear footage of main for the Houston Division. He pointed out that a minimum system based upon 2-inch mains is the same methodology that the utility has employed and the Commission has approved in past dockets. In response to the Mr. Pous' proposed re-pricing of the minimum system, Mr. Troxle contended that it was not reasonable to average the price of the 2-inch minimum system with the cost of installing other pipe sizes that represent such comparatively small proportion of the Houston Division. Finally, he contended that Mr. Pous has not correctly calculated the proposed adjustment.[311]

Examiners' Recommendations

The Examiners find that the proposed methodology is consistent with well established precedent. The Examiners further find that a minimum system based upon 2-inch pipe is reasonable given the facts of the Houston Division. That size represents the predominant pipe in the system and a system based upon 2-inch diameter pipe meets the definition of a skeletal system. Finally, the Examiners find that it would be unreasonable to normalize the cost used in

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[308] City of Houston/Houston Coalition of Cities Ex. 1,irect Testimony of Jacob Pous, p. 99, ln. 1 – p. 100, ln.2.
[309] City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 101, lns. 4 – 16.
[310] GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, p. 19, ln. 1 – p. 21, ln. 4.
[311] CenterPoint Ex. 20, Rebuttal Testimony of Matthew Troxle, p. 11, ln. 11 – p. 17, ln. 11.

determining the cost of the 2-inch minimum system with pipe that composes such a small part of the overall system within the Houston Division. Accordingly, CenterPoint has established that the proposed minimum system methodology is just and reasonable.

c. Allocation: Design Day

CenterPoint proposed an allocation methodology for capacity related costs based upon a peak design day methodology. The method assumes that the costs associated with the maximum load should be divided among the customers creating such a maximum peak load regardless of the magnitude of their demands at other times of the day, month or year or how duration of the demand. The result was that 95% of the costs are allocated to the regulated customers and only 5% are allocated to the contract and transportation customers. The City of Houston/Houston Coalition of Cities and the GCCC objected to the use of an allocation methodology based upon a peak design day.

Issues Raised by Intervenors

Mr. Nalepa and Mr. Pous objected to the use of a peak design day methodology. They raised four principle contentions. First, reliance on a single point estimate of peak allocation methodology resulted in a disproportionate amount of costs being allocated to the residential and commercial customers. Second, the appropriateness of such apportionment depends upon whether off-peak operations result from control by the customer or the utility, or whether it results from natural usage characteristics. Third, this method does not appropriately recognize the allocation of costs of utilities with a significant industrial or transportation load. Fourth, the Commission found in GUD Nos. 9670 and 9400 that an allocation based equally on design day and average throughput was reasonable. Each witness proposed a similar alternative and maintained that the alternative proposed was consistent with the Commission's prior ruling in those cases.[312]

In essence the Intervenors proposed adoption of the Seaboard methodology that was originally developed by the Federal Power Commission. The Seaboard methodology blends capacity of the system with system throughput and results in an allocation factor that reduces the amount of costs allocated to the regulated customers. Mr. Nalepa and Mr. Pous developed an allocation factor of approximately 88% instead of 95%.[313]

CenterPoint Response

Mr. Troxle pointed out that CenterPoint has simply applied the same methodology that was approved in several recent Commission Decisions: GUD Nos. 9533, 9534, and 9791. In GUD Nos. 9533 and 9534 the Commission specifically accepted the utility's methodology, which is the same methodology applied proposed here. In support of the results of the proposed methodology Mr. Troxle contended that the residential class in the Houston Division has historically been highly subsidized by the other customer classes. Mr. Troxle also stated

[312] City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p. 101, ln. 18 – p. 103, ln. 5; GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, p. 16, ln. 8 – p. 18, ln.15.

[313] City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous p. 102, ln. 16; GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, p. 18, ln. 12.

that it is the peak demand that determines the ultimate size of pipe necessary in the distribution system.[314]

Examiners' Recommendation

The Examiners find that CenterPoint has established that its proposed cost allocation methodology is appropriate. It is clearly consistent with Commission precedent and the methodology applied in other jurisdictions. Further, the Examiners find that a reasonable basis for determining cost allocation is the cost driver for the size of the system. It is the peak demand that determines the ultimate size of pipe necessary in the distribution system. Accordingly, a peak demand methodology is reasonable.

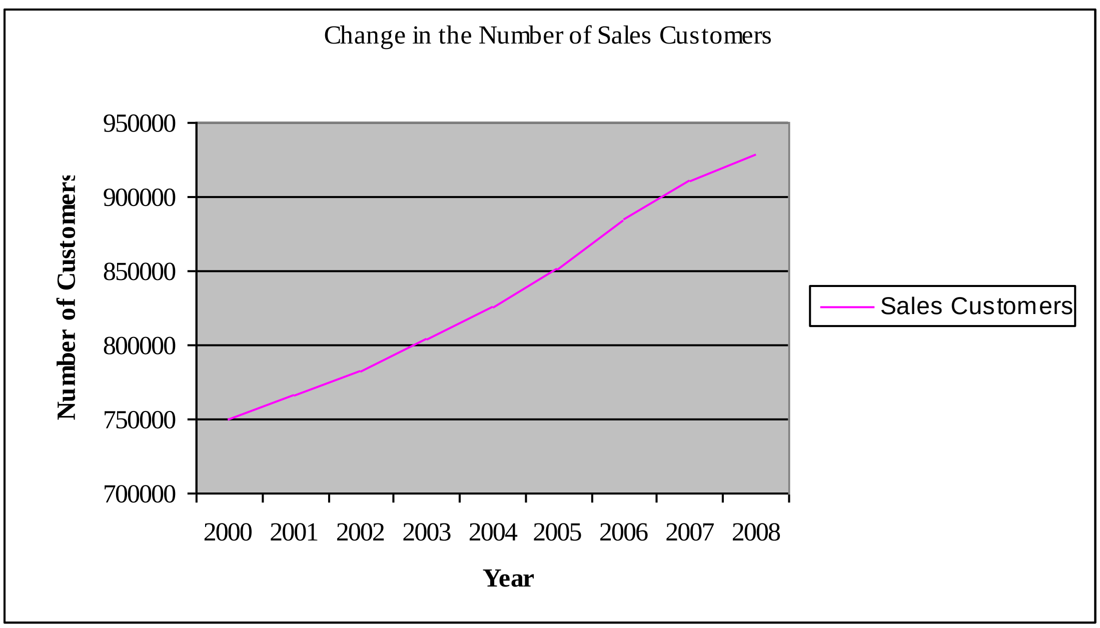
13. Rate Design

a. Billing Determinants

Introduction

Billing determinants are the number of customer bills and sales or transportation volumes (Mcf, Ccf, or MMBtu) to which rates are applied.[315] CenterPoint's filing reflected that the number of customers for the residential and small commercial classes is based, in part, on the average number of customers within each class over the twelve-month test year ended March 31, 2009. The company established that since 2000 the number of sales customers has increased every year:

Figure 13.1[316]



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[314] CenterPoint Ex. 20, Rebuttal Testimony of Matthew Troxle, p. 3, lns. 9 – 17 & p. 10, ln. 1 – p. 12, ln. 10.
[315] CenterPoint Ex. 20, Direct Testimony of Matthew Troxle, p. 3, lns. 7 – 8.
[316] CenterPoint Ex. 20, Direct Testimony of Matthew Troxle, p. 4, Table 1.

Mr. Troxle performed a customer adjustment that projected the total number of customers for the period ending March 31, 2010. He testified that he factored the change in customer growth downward because he observed a decrease in number of customers for the first three months of 2009. He noted that the residential average monthly increase over the previous year for 2007, was 29,936 customer and for 2008, 20,020 customers. For the first three months of 2009, however, the average increase was 16,384. GCCC disputed this downward adjustment.

Issues Raised by the Intervenors

Mr. Nalepa, who testified on behalf of GCCC, and Mr. Pous, who appeared on behalf of the City of Houston and the Houston Coalition of Cities, argued that the proposed adjustment was unreasonable given the observed trends.[317] They contended that CenterPoint provided no studies or economic forecasts that would support the downward adjustment. Instead, he asserted that the adjustment appeared to be based upon subjective determinations. He prepared the chart, reproduced as Table 10.1, focused upon the number of residential and small commercial customers and argued that there was no reason to adjust the growth rate downward.

Table 13.1
Residential and Small Commercial Customer Changes in the Houston Division[318]

	Residential	Small Commercial	Residential %	Small Commercial %
2000	709,190	37246	-	-
2001	724,815	37941	2.20%	1.87%
2002	739,617	39,424	2.04%	3.91%
2003	758,180	41,233	2.51%	4.59%
2004	779,670	41,484	2.83%	0.61%
2005	805,570	42,163	3.32%	1.64%
2006	838,062	42,472	4.03%	0.73%
2007	861,056	45,216	2.74%	6.47%
2008	881,076	44,021	2.33%	2.65%
Compound Growth Rate			2.44%	1.87%

CenterPoint Response

Mr. Troxle conceded that the downward adjustment applied was an estimate used to adjust historical growth to growth expected in the projected year. He noted, however, that the actual residential customer class growth in the Houston Division experienced through September 2009 suggested an even lower downward adjustment than the adjustment he developed.[319] He concluded that eliminating the customer growth adjustment as proposed by the Intervenors would cause the customer count for the residential customer class to be grossly overstated and would not afford the utility a reasonable opportunity to collect its revenue requirement. Finally he noted that the Commission has approved similar adjustments in GUD Nos. 9533, 9534, and 9791.[320]

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[317] GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, p. 5, ln. 1 – p. 7, ln. 11, City of Houston/Houston Coalition of Cities, Ex. 1, Direct Testimony of Jacob Pous, p. 105, lns. 1 – 14.
[318] GCCC Ex. 1 Direct Testimony of Karl J. Nalepa, p. 6, Table 1.
[319] CenterPoint Ex. 20 Rebuttal Testimony of Matthew Troxle, p. 5, lns. 8 – 21.
[320] CenterPoint Ex. 20 Rebuttal Testimony of Matthew Troxle, p. 6, lns. 3 – 5.

Examiners' Recommendation

CenterPoint has established that the proposed downward adjustment to the projected customer growth is reasonable. It is important to note that this proposed billing determinant still suggests that the number of customers are increasing from year to year. The adjustment simply reflects that the *rate of the increase* is not as high. Table 10.2, sets out the change in residential customer growth from year to year since 2000, based on the data provided by GCCC's witness, reproduced in Table 10.1 above. A downward trend in the year-to-year change occurs in 2006 and it appears to persist for two years. The GCCC proposed billing determinant suggests that the trend has reversed. The evidence appears to be to the contrary.

Table 13.2
Year-to-Year Change in Number of Residential Customers

Year	Residential	Change from Prior Year
2000	709,190	
2001	724,815	15625
2002	739,617	14802
2003	758,180	18593
2004	779,670	21490
2005	805,570	25900
2006	838,062	32492
2007	861,056	22994
2008	881,076	20020
Billing Determinant		Change Projected Based Upon Billing Determinant
CenterPoint	891,121	10,045
GCCC	903,401	22,325

As noted above, Mr. Troxle observed that the average increase for the first three months of 2009 was lower than the average increase in 2008. The trend is more noticeable when graphs of the data in Table 10.2 are compared. Figure 10.2 below shows the effect of adjusting the billing determinant as proposed by GCCC. The proposed determinant suggests a change contrary to the trends established in the two prior years. On the other hand, Figure 10.2, which includes the effect of the company's proposed billing determinant for residential customers, is consistent with the previously observable trend.

Figure 13.2

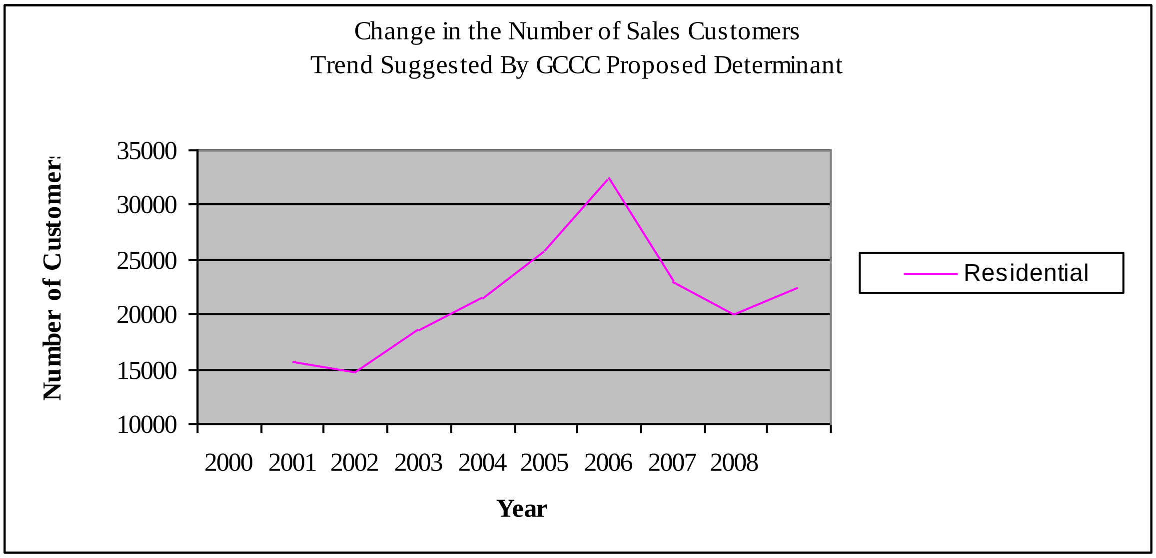
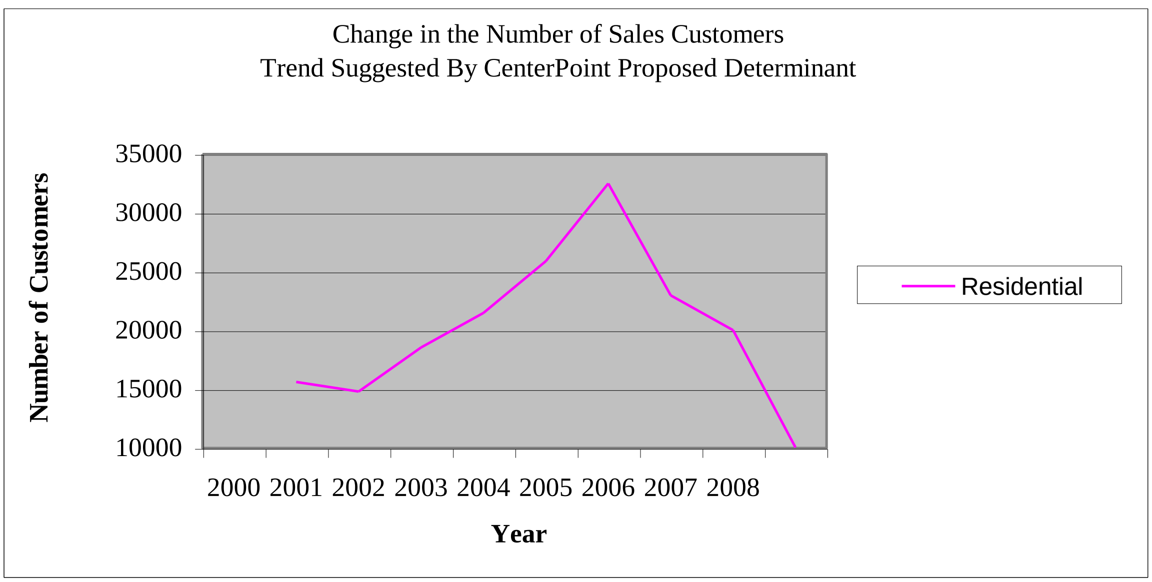


Figure 13.3



Accordingly, the Examiners find that CenterPoint has established that the proposed billing determinants are just and reasonable and recommend that the Commission adjust the determinants proposed by the utility.

(b) Customer Charge

As the recommendation proposed by the Examiners results in a smaller increase overall the Examiners find that the proposed rate design and customer charge resulting from the model is just and reasonable.

14. COSA Rate Schedule

Introduction

Centerpoint requested the implementation of a proposed COSA Rate Schedule (COSA or COSA-4) that provides for an annual review by the applicable regulatory jurisdiction of the company's expenses, revenues, and plant investment, and a corresponding adjustment to the company's rates to reflect annual changes, increases or decreases, in these categories. Centerpoint claimed that the proposed COSA Rate Schedule will provide greater rate transparency by providing regulators with an annual review of the company's revenues and expenses. It will also serve the purpose of reducing the effects of regulatory lag and reducing the significant costs of preparing rate cases, which are ultimately recovered from the company's customers.[321]

The Commission approved COSA-3 for the CenterPoint's Texas Coast Division in Gas Utilities Docket No. 9791. In a recent District Court decision, the 345th District Court determined that the Commission lacked the authority to create the COSA-3 established in GUD No. 9791. While that decision may be appealed, and a final determination may be in the future, the Examiners recommend that the Commission not establish another COSA tariff at this juncture.[322]

If COSA-4 is not approved as proposed, in the alternative, Centerpoint requested approval of, a new Pension Cost Recovery Adjustment Rate Schedule (PCR Rate Schedule) and a new Integrity Assessment and Management Adjustment Rate Schedule (IAM Rate Schedule).[323] Centerpoint stated that it has recently experienced significant increases in pension expense and anticipated significant cost increases associated with pending pipeline and distribution integrity assessment and management requirements at both the state and federal levels. Given these factors, CenterPoint is concerned that a cap on the amount of any increase will not allow the utility to fully recover its operating costs and provide a reasonable opportunity to earn a fair return on its investment. The company instead argued that the COSA Rate Schedule should provide for full recovery of actual costs, subject to appropriate regulatory review.[324]

The proposed PCR Rate Schedule provides for an annual adjustment to the company's rates either up or down to ensure recovery of the appropriate level of pension expense. The IAM Rate Schedule likewise provides for an annual rate adjustment to allow for timely recovery of increased costs that the company incurs resulting from new government regulations at both the state and federal levels related to pipeline and distribution assessment and management.[325] Mr. Zapalac states, "although these proposed new rate schedules are obviously not as comprehensive as the COSA Rate Schedule, in the event that the COSA Rate Schedule is not adopted, they will at least help to mitigate and possibly delay the need for a future general rate

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321 CenterPoint Ex. 4, Direct Testimony of Richard A. Zapalac, p 10, lns 10-13

322 *Texas Coast Utilities Coalition v. The Railroad Commission of Texas*, No. D-1-GN-09-000982 (353rd Judicial District Court Travis County, Tex. Dec. 18, 2009) (Letter Re Intended Ruling).

323 Center Point Ex. No. 4, Direct Testimony of Richard A. Zapalac, p 7, lns 2-5.

324 Center Point Ex. No. 4, Direct Testimony of Richard A. Zapalac p 11, lns 5-11.

325 Center Point Ex. No. 4, Direct Testimony of Richard A. Zapalac, p 11 lns 17-23.

case with all of its attendant costs that must ultimately be recovered from the Company's customers."[326]

15. Pension Cost Recovery Adjustment Rate Schedule and Integrity Assessment and Management Adjustment Rate Schedule

Introduction

If the COSA is not approved, or if the Commission determines that a cap is appropriate, Centerpoint has proposed two new rate schedules: (1) Pension Cost Recovery (PCR) and (2) Integrity Assessment and Management (IAM). The company asserted that it is expecting changing levels of expense in these areas over the next several years.[327] The PCR is intended to recover the Company's pension expenses. The IAM is intended to recover costs resulting from new government regulations related to pipeline and distribution assessment and management.[328] The IAM costs are to be recovered volumetrically and the PCR is to be recovered as part of the customer charge. The Company also proposed annual filings to true up and adjust the PCR and IAM rates.

Issues Raised by the Intervenors

<u>The City of Houston/Houston Coalition of Cities</u>. Mr. Pous asserted that Centerpoint is seeking to implement piecemeal ratemaking and the request is inappropriate and should be denied. He says the legislature has already provided the limits of special regulatory relief afforded gas utilities through the GRIP provision of GURA.[329] He cited a request by TXU LSP for integrity and safety assessments, GUD No. 9304:

> The Commission finds that it cannot establish the incremental rate requested by TXU LSP without establishing the utility's reasonable and necessary operating expenses and appropriate rate of return on its invested capital. There is no statutory authority granting the Commission the power to set an incremental rate for the sole purpose of allowing additional marginal revenue to the utility designed to recover additional rates of return on capital and additional operating expenses on margin. The establishment of the incremental rate proposed by TXU LSP is outside the statutory authority of the Texas Utility's Code.

<u>Railroad Commission Staff</u>. Regarding the IAM rate schedule, Mr. Brock stated that Centerpoint provided no evidence or testimony that demonstrated that this rate schedule is necessary or any evidence to establish that a state or federal mandate has predisposed a calculated amount to be spent.[330] He recommended denial of the IAM because Centerpoint has not met its burden of proof and has not provided the evidence necessary for Commission Staff to recommend approval.

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[326] Center Point Ex. No. 4, Direct Testimony of Richard A. Zapalac, p 12 lns 1-5.
[327] Center Point Ex. No. 11, Direct Testimony of Matthew Troxle, p 18 lns 8-10.
[328] Center Point Ex. No. 4, Direct Testimony of Richard A. Zapalac, p 11, ln 18, p 12, ln 1.
[329] City of Houston/Houston Coalition of Cities Ex. 1, Direct Testimony of Jacob Pous, p 124, lns 13-15.
[330] Railroad Commission Staff Ex. 2, Direct Testimony of Mark Brock, p 29, lns 18-20.

Mr. Brock reviewed the PCR rate schedule and stated that the rate schedule appeared to remove risk associated with the securities market for Centerpoint's pension fund and the RRC Staff has a fundamental issue with the concept of placing the success of the pension fund squarely on the back of the ratepayers. Staff opined that company's proposal would diminish the inherent obligation of management to conduct business in a manner that enhances the fund.[331] He recommended denial of the PCR rate schedule.

State of Texas. Mr. Novak argued that the automatic adjustment clauses encourage wasteful and imprudent spending. The proposed PCR revealed that only Commission Staff is allowed to dispute or question the calculation of the annual filing. Intervenors are eliminated from reviewing or commenting while under the current process Intervenors have the right to dispute the expense within the context of a rate case. The proposed IAM does not contemplate a process for review by the regulators or Intervenors and allows new rates to go into effect without review or notice to customers. The proposed rate schedules do not specify how disputes regarding recorded costs are to be resolved. He recommended both rate schedules be denied and the review of these expenses continued to be considered only within the structure of a properly filed rate case as required by GURA.[332]

Gulf Coast Coalition of Cities (GCCC). Mr. Nalepa opposed the two proposed rate schedules and asserted that the utility envisioned that its annual filings would simply true-up and adjust the PCR and IAM rates. There would be no rate proceedings and he anticipated no review or participation by municipalities.[333] As with the recovery of uncollectible gas costs in the PGA, there would be no incentive to control these costs. He found this particularly important because in this proceeding, GCCC witness Cannady proposed significant adjustments to the company's requested pension expense.[334]

He also stated that the riders anticipated no participation by the municipalities and that any adjustment under the PCR or IAM must be recognized as a rate proceeding under GURA, and adequate notice and a sufficient review period including all affected parties should be established.[335] Mr. Nalepa also contended that if approved these charges should all be applied volumetrically and that Centerpoint's risk reduction should be reflected in their rate of return.

The Steering Committee of Cities (SCC) Statement of Position. SCC's argued that the proposed IAM and PCR riders should be rejected and the additional pension recovery and integrity assessment and management cost items should remain in base rates if the Commission accepts the COSA with a 5% cap and any increase in pensions and integrity assessment costs may be recovered through the COSA.[336]

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[331] Railroad Commission Staff Ex. 2, Direct Testimony of Mark Brock, p 31 lns 20-22.
[332] State of Texas Ex. No. 1, Direct Testimony of William H. Novak direct, p 11 lns 13-15.
[333] GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, attachment D (CNP Response to GCCC RFI No. 3-23).
[334] GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, p 44 lns 1-4.
[335] GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, p 45 lns 1-3.
[336] SCC position statement, p 6.

CenterPoint's Response

Mr. Troxel asserted that he did not believe the IAM and PCR schedules constituted "piecemeal ratemaking." Further he maintained that they are allowed by GURA. He maintained that pursuant to the terms of the proposed tariffs the regulatory authorities may review and confirm the filings. Further, the true-up mechanism guaranteed the costs will not be over-recovered from the consumers.[337] In response to Mr. Brock's concern regarding the need for IAM, Mr. Troxle testified that if the anticipated increases in costs have occurred as a result of compliance with Commission-mandated programs, then the company should be able to include those costs in rates. The utility is trying to anticipate a problem and implement ratemaking tools that will allow it to make rate adjustments necessary without the need for traditional rate case and all of the attendant costs that such a case entails.[338]

Mr. Troxle also addressed Mr. Brock's recommendation to deny the PCR because Centerpoint is no different than any other company. He claimed that the statement ignored the difference that non-regulated companies are free to increase revenue by modifying their prices. Centerpoint must utilize the regulatory process and request relief as it has done in this case.[339]

Examiner's Recommendation

In a recent District Court decision, the 345th District Court determined that the Commission lacked the authority to create the COSA-3 established in GUD No. 9791. While that decision may be appealed, and a final determination may be in the future, the Examiners recommend that the Commission not establish any similar tariff at this juncture.[340] Nevertheless, even if the tariff is distinguishable from COSA, the Examiner's recommend denial of the PCR and the IAM riders. Keeping the costs in base rates provides the incentive to maintain cost at reasonable levels and operate efficiently.

16. Tax Adjustment Rate Schedule – Franchise Fees

CenterPoint proposed that its Tax Adjustment rate schedule and the Franchise Fee Adjustment Rate Schedule be modified to recover revenue related taxes imposed, or caused to be incurred by various jurisdiction, from customers located in those jurisdictions. Currently the company collects revenue related taxes on a division average basis. Staff of the Railroad Commission supported this proposal. The proposal is consistent with the Commission's recent decision in GUD No. 9791.

The City of Houston/Houston Coalition of Cities, GCCC, and SCC opposed the proposal. They argued that revenue related taxes should be collected on a division-wide basis from all customers and contended that municipal franchise fees benefit all customers. The

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337 Center Point Ex. No. 20, Rebuttal Testimony of Matthew Troxle, p. 27, lns 2-5.

338 Center Point Ex. No. 20, Rebuttal Testimony of Matthew Troxle p. 27, lns 11-15.

339 Center Point Ex. No. 20, Rebuttal Testimony of Matthew Troxle, p. 28, lns 11-15.

340 *Texas Coast Utilities Coalition v. The Railroad Commission of Texas*, No. D-1-GN-09-000982 (353rd Judicial District Court Travis County, Tex. Dec. 18, 2009) (Letter Re Intended Ruling).

proposed change would impose a higher burden on municipal customers. In fact, they contended that the franchise fees paid by municipal customers would nearly double.

The Examiners find that CenterPoint has established that its proposed tax adjustment rates schedules are just and reasonable and recommend approval of those schedules. The proposal ensures that CenterPoint will recover the exact amount required to pay the franchise fees. Further, as noted by Staff of the Railroad Commission, the Tax Code provides that municipal taxes are to be assessed from business done in an incorporated city or town.

17. Purchase Gas Adjustment Clause

Introduction

CenterPoint requested three changes to the purchase gas adjustment clause. First, CenterPoint seeks to recover carrying costs for its investment in storage gas through the purchase gas adjustment clause. Related to that the company requested that the carrying charge be set at the pre-tax rate of return established in this docket. Second, the company is also proposing to recover its gas-related uncollectible expense through the purchase gas adjustment clause. Third, CenterPoint seeks to change the carrying cost on the over/under recovery of gas cost expense to six percent.[341]

Issues Raised by the Intervenors

<u>Carrying costs for its investment in storage gas</u>. Mr. Nalepa, who testified on behalf of GCCC, agreed that the company is entitled to recover a return on gas storage inventory. He proposed that the balance of gas costs be returned to base rates. He contended that this was consistent with traditional rate making and cited the treatment of materials and supplies and that the Commission's Natural Gas Rate Review Handbook supported this classification. He also argued that rent on inventory items is not appropriate for recovery through the purchase gas adjustment clause. Finally, he argued that there was the possibility of a double recovery.[342]

Conversely, the City of Houston/Houston Coalition of Cities concurred with the removal of gas costs from base rates and agreed that the company should recover the carrying costs through the purchase gas adjustment clause. As to the carrying cost, Mr. Pous contended that the appropriate rate was the cost of debt.[343] The State of Texas, through the testimony of Mr. Novak argued that this issue should be addressed via rulemaking.[344]

Staff did not oppose the recovery of carrying costs through the purchase gas adjustment clause. Staff contended, however, that the cost should be set at six percent. Mr. Brock argued that by using a pre-tax rate of return it made it appear that storage inventory is not gas supply but investment and suggested that perhaps storage gas costs should not be included in the purchase gas adjustment clause if considered an investment.[345]

[341] CenterPoint Ex. 11, Direct Testimony of Matthew Troxle, p. 16, lns. 1 – 16.
[342] GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, p. 24, ln. 8 – p. 25, ln. 12.
[343] City of Houston/Houston Coalition of Cities, Direct Testimony of Jacob Pous, p. 20, ln. 21 – p. 22, ln. 5.
[344] State of Texas Ex. 2, Direct Testimony of William H. Novak, p. 13, lns. 1 – 20.
[345] Railroad Commission Staff, Direct Testimony of Mark Brock, p. 17, ln. 16 – p. 19, ln. 7.

<u>Recovery of the gas-cost portion of uncollectible expense</u>. Mr. Nalepa posited three arguments in opposition to the proposal. First, he argued that the proposal eliminates the incentive to minimize uncollectible expenses by allowing the company to automatically recover the gas cost portion of uncollectible expense through the purchase gas adjustment clause. Second, he opined that the proposal may lead to double recovery of these expenses. Third, he observed that the company's ability it calculate gas cost is limited to an estimate of those costs. Staff of the Railroad Commission agreed that as a general proposition it was reasonable to include the gas-cost portion of uncollectible expenses in the purchase gas adjustment clause. In this case, however, Staff was opposed because CenterPoint had not established an ability to control gas cost.[346] Mr. William Novak, who testified on behalf of the State of Texas argued that CenterPoint had not established that it has the ability to provide the adequate reporting necessary for regulatory authorities to properly segregate its gas costs from each of its uncollectible accounts. He noted that the amounts are currently only provided in total along with the base rate portion of uncollectible expense and that to accurately segregate gas costs from each uncollectible account the company must be able to identify the purchase gas adjustment rate that was applied on a cycle basis to each customer. The ability to accomplish this task has not be established.[347] The State of Texas, through briefing, also agued that this proposal should be rejected. The State of Texas contended that the proposed changes also failed because of the company's factoring arrangements and the fact that the company does not recognize the effects of factoring on uncollectible expenses.[348]

<u>Carrying cost on the over/under recovery of gas cost</u>. Mr. Nalepa argued that the carrying cost on the over/under recovery balance of gas cost should not be changed. The current carrying charge on the deferred gas cost balance in the company's purchase gas adjustment charge is equal to the Commission's customer deposit interest rate. He contended that as the company added more components to the purchase gas adjustment clause it is more likely that the deferred gas cost balance would increase. This he concluded would be unreasonable. Finally, he contended that the company has offered no reasons to support the increase.[349] Staff of the Railroad Commission did not oppose the change and, in fact, argued that the current charge of 2.09% is not reasonable.[350]

CenterPoint Response

<u>Carrying costs for its investment in storage gas</u>. Mr. Troxle indicated that the company's proposal coincided with the City of Houston/Houston Coalition of Cities position that storage gas costs should be removed from rate base. As to the carrying charge Mr. Troxle explained that the carrying charge established in GUD No. 9791 was the pre-tax rate of return. He noted that this treatment is consistent with the carrying cost the company would earn on its investment in storage gas if that investment were reflected in rate base. He also observed that

[346] Railroad Commission Staff, Direct Testimony of Mark Brock, p. 13, ln. 14 – p. 15, ln. 22.
[347] State of Texas Ex. 2, Direct Testimony of William H. Novak, p. 13, lns. 11 – 22.
[348] State of Texas Initial Brief, p. 15.
[349] GCCC Ex. 2, Direct Testimony of Karl J. Nalepa, p. 31, ln. 9 – p. 32, ln. 13.
[350] Railroad Commission Staff, Direct Testimony of Mark Brock, p. 16, ln. 14 – p. 15, ln. 22.

there is an opportunity cost associated with storage inventory that is lacking with other gas cost recovered through the purchase gas adjustment clause.[351]

Recovery of the gas-cost portion of uncollectible expense. Mr. Troxle disagreed that recovering the gas-cost portion of uncollectible expenses through the purchase gas adjustment clause removed the company's incentive from recovering those costs. He argued that even if the company recovers the gas cost portion through the purchase gas adjustment clause, the company still has a large amount of un-recovered bad debt not associated with gas cost. Thus, when the company seeks collection for the base rate portion of the bill, it will automatically be seeking collection on the gas cost portion of the bill. In response to Mr. Brock's contentions, Mr. Troxle argued that Mr. Brock has taken an inconsistent approach. On the one hand, he argued that recovery of the gas-cost portion of uncollectible expense through the purchase gas adjustment clause may be reasonable. On the other hand, he concluded that the company should not be made whole for those expenses. Finally he urged that the company can establish that it can control gas costs and he alleged that it accomplished this through the testimony of Mr. Coogler and DePeña.[352]

Carrying cost on the over/under recovery of gas cost. As to the carrying cost on the over/under recovery of gas cost, Mr. Troxle argued that the request of the company is consistent with the Commission's recent decision in GUD No. 9770 and Staff supports the request.

Examiners' Recommendation

Carrying costs for its investment in storage gas. The Examiners find that CenterPoint has established that it is just and reasonable to recover carrying costs for its investment in gas storage through the purchase gas adjustment clause. The carrying costs for its investment in gas cost is part of the cost of gas as it is part of the opportunity cost of maintaining gas storage inventories. Furthermore, this treatment is consistent with the treatment of gas costs approved by the Commission in GUD No. 9791. Finally, the Examiners find that the appropriate carrying cost is the pre-tax rate of return established in this case which is consistent with GUD No. 9791.

Recovery of the gas-cost portion of uncollectible expense. The Examiners find that CenterPoint has not established that the proposed change is just and reasonable. First, the company failed to establish that it has proper reporting requirements in place to accurately track the gas cost portion of uncollectible expenses. More troubling, however, is the fact that the company steadfastly refuses to acknowledge the effect of factoring on account receivables and its impact on uncollectible accounts. The Examiners express no opinion on whether this proposal should be rejected based upon the company's ability to control gas costs. The Commission has reserved that issue for consideration. The Examiners observe, however, that it may not be necessary to address that issue if the Commission finds that the proposal should be rejected for the reasons set forth herein.

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[351] CenterPoint Ex. 20, Rebuttal Testimony of Matthew Troxle, p. 28, ln. 16 – p. 30, ln 16.

[352] CenterPoint Ex. 20, Rebuttal Testimony of Matthew Troxle, p. 32, ln. 3 -

Carrying cost on the over/under recovery of gas cost. The Examiners find that CenterPoint has established that its request is reasonable. It is consistent with recent Commission determinations and a carrying cost of 2.09% is not reasonable.

CenterPoint has opted to discontinue hedging, but has requested that the language related to hedging be maintained to allow for recovery of expenses pursuant to existing hedging contracts. The Examiners recommend that the language related to the recovery of expenses related to hedging be modified to limit the recovery of expenses related to hedging to contracts that are in effect as of the date of this order. Further, the Examiners recommend that CenterPoint be required to refile its tariff to reflect the removal of the language related to hedging expenses no later than January 31, 2011. Additionally, CenterPoint is directed to continue filing its annual report outlining its Gas Procurement Plan and an annual report analyzing its results from its hedging practices.

18. Gas Cost

Prior to this proceeding a discovery dispute arose regarding the discovery related to the company's gas costs. The Commission allowed discovery on all gas cost issues and directed the Examiners to reserve deliberation of all gas cost issues for the Commission to consider directly. Accordingly, under separate cover, the Examiners are forwarding portions of the transcripts where gas cost issues were addressed, all pre-filed testimony related to gas cost issues, evidence presented at the hearing, and copies of all briefing on this issue.

The Examiners observe that with regard to the calculation of base rates the parties have not proposed any adjustment as a result of their evaluation of gas cost issues. In the context of the proposed tariff, it appears that only one party has raised the issues of gas costs. The Staff of the Railroad Commission argued that the proposal to recover the gas cost portion of uncollectible expenses to the purchase gas adjustment clause because CenterPoint has not demonstrated an ability to control its gas costs. That issue is reserved for the Commission to determine directly. The Examiners note that the Examiners have recommended that the request be denied on other grounds. Namely, CenterPoint has not reflected the effect of factoring on its uncollectible accounts. If the Commission affirms that recommendation the issue raised by Staff of the Railroad Commission, in this limited regard, is moot.

19. Conclusion

CenterPoint initially requested a base revenue requirement to be recovered from regulated customers in the amount of $216,361,949. In its rebuttal filing CenterPoint reduced its requested revenue requirement to $210,206,600. That would signify an increase over prior rates of $20,351,747. It represents a 10.72% increase over prior revenues. The Examiners recommend a revenue increase of $5,693,227 and that represents an increase of 3.0% over prior revenues. The Examiners have recommended that Hurricane Ike expenses be recovered through a separate tariff. Thus, the base rate increase is $4,838,711, or 2.11%. The Examiners find that CenterPoint has established the reasonableness of expenses related to Hurricane Ike in the amount of up to $2,571,915 and agree that recovery of those amounts should be accomplished over a three-year period. That would result in a recovery of approximately $857,305. The total amount, however, has not been established, as proceeds from insurance claims have not been fully determined. Accordingly, the Examiners recommend that a tariff be approved that allows recovery of those actual expenses and direct that they be adjusted for any insurance proceeds recovered.

Respectfully submitted,

Gene Montes	Rose Ruiz
Hearings Examiner	Technical Examiner
Office of General Counsel	Gas Services Division