ORAL ARGUMENT – 11/29/00
00-0816
CITIES OF CORPUS CHRISTI V. PUC
AND
00-0821
POWER CHOICE INC V. PUC

SUSSMAN: Transition charges take money out of our customer's pockets and give it to utilities that are providing them with no services for which they do not otherwise pay. If these utilities are entitled to be reimbursed for the destruction of their investment in generating facilities that have become stranded by the advent of competition, if as they contend such reimbursement serves a public purpose, the legislature should pay for this taking if it is one by appropriating funds from the general revenues raised by taxes imposed on the public at large.

PHILLIPS: It's either a constitutional taking or the PUC had no authority to make this order?

SUSSMAN: That's correct.

PHILLIPS: So there's no middle ground. _____ it wasn't constitutionally required, but it is an acceptable exercise of rate _____?

SUSSMAN: I'm sorry. There is a middle ground. You're right there is a middle ground.

PHILLIPS: I didn't see much of a middle ground in Briggs.

SUSSMAN: It's our position that all citizens who enjoy the benefits of competition, not just those who live within the existing service areas of the utilities that happen to have stranded costs, will benefit from competition. If it's necessary to pay the utilities something to allow competition to proceed, the burden should fall on everyone.

HANKINSON: Why isn't this a policy choice for the legislature to make?

SUSSMAN: It is a question of policy for the legislature except that they are constricted by the constitution. Our arguments is that there is a constitutional restriction here. Their position is, they are entitled by the constitution to recover their stranded costs.

GONZALES: So you're saying that the legislature's policy choice is unconstitutional?

SUSSMAN: That's correct. They can't cite a single case that says that a taking for public purposes should be charged to the pockets of private citizens.

OWEN: You say this is a taking or a tax. Why isn't this just a different form of a rate that's already been authorized by the PUC?

SUSSMAN: It's not a rate, because whether you look at the cases or Black Law dictionary or the Texas statutes, a rate is something that is charged for a service, and it is received by the provider of the service.

OWEN: These costs were already included in the utility's rate base and would be spread across the same consumers but for deregulation. Isn't that correct?

SUSSMAN: That's correct.

OWEN: And so why isn't this really just a mutation of the same rate?

SUSSMAN: Because under deregulation, the customers that are paying these transition charges are not receiving anything from the utilities that are receiving the charges.

OWEN: But they are receiving services from the utility's facilities, the same as they would have under a regulating environment. It's just that there is not another layer of provider in there. Isn't there?

SUSSMAN: There are. But the statute makes very clear that they pay a competitive price for their power for the generation. They pay a transmission fee to the unbundled company that handles transmission. That is to be set by the PUC. It remains regulated, and it's to be sufficient to encourage investment in transmission facilities and to return to those who invested in the facilities what they invested, so that the customer pays for his power and he pays for his transmission. A transition charge can't be a rate because he's not getting anything in addition...

OWEN: They weren't getting anything in addition before in a regulated environment...

SUSSMAN: Oh, they were getting power.

OWEN: Which they are getting now. But they were having to pay for so-called stranded assets from which they were getting no benefit other than...

SUSSMAN: It's not a rate because previously they were getting power from the company that was charging them a rate that included stranded costs.

BAKER: Wasn't that contemplated being part of the use or usefulness of the facility that's part and parcel of furnishing a service as electricity? So why don't you just transfer the same rationale to the transition costs?

SUSSMAN: Because it's no longer a rate. They are stuck with a problem. They have these uneconomic assets. Now to call it a rate to give them their money to deal with this problem is just a fallacy. It doesn't make any sense. They aren't getting anything from these utilities in return for the money. The whole idea of a rate is - I give you a service and I get money in return. Our customers are getting no services from the incumbent utility.

ABBOTT: But isn't one of the purported purposes behind all this to spur competition?

SUSSMAN: It is to spur competition.

ABBOTT: And a hoped for aspect of that competition is going to be reduced prices.

SUSSMAN: It will be reduced prices.

ABBOTT: And so these consumers are who receiving the electrical services are going to be paying less going forward, hopefully?

SUSSMAN: Hopefully that's correct.

ABBOTT: Isn't this basically just a dollar tradeoff? They are going to paying less and during a period of time they are going to be paying these transition costs.

SUSSMAN: That's their argument. Their argument is that the transition charge is the price of competition. And the price of the benefit of competition. Our position is, if that's so, it shouldn't be imposed - it may be a tax - but it shouldn't be imposed - it's not a rate.

ABBOTT: In other words it's kind of a rate tradeoff that's being imposed upon the people who otherwise would be paying a little bit more anyway. In other words, you can call it big a wash couldn't you?

SUSSMAN: Not necessarily, because people benefit from competition. These charges are imposed only on people who are within the service areas of incumbents with stranded costs. And they are only opposed for 15 years. People who live outside of those service areas and people who buy power for more than 15 years certainly benefit from competition. Why don't they have to pay too?

BAKER: Won't they more than likely be subject to the same situation in whatever area they live in, such as in the Dallas/Ft. Worth area you have TXU is the power provider and that company is going through the same thing that your providing here in the CP&L case?

SUSSMAN: Some may and some may not.

BAKER: We actually have the TXU case here, so we know that that's going on.

SUSSMAN: But some of the utilities do not have stranded costs. And some people live within those utility areas and they benefit from competition, too.

OWEN: Aren't we really trying to re-litigate the inclusion of the S. Texas nuclear project in rate base? Isn't that really what we're doing?

SUSSMAN: No, because there was no issue of constitutionality in that case. There was no challenge in that case to the constitutionality of including the rate base, including stranded costs, caused by the regulatory lag into the rate base. That wasn't involved in that case at all.

BAKER: Your task, because you are making a facial constitutional challenge is to show that there is no public benefit or whatever is required on one or more of these sections of the constitution you're relying on. Agree or disagree with this. If the other side shows that they are in fact utility rates, doesn't that cut across all four of your constitutional challenges?

SUSSMAN: No. The strongest challenge I think we have is our takings challenge. Our takings challenge says: money is being taken out of our customers' pocket without them receiving anything of equivalent value in return. Now it doesn't matter whether it's a tax or a rate. It's obviously a takings of their money.

BAKER: If I understand their argument, there is a benefit which equates to the adequate compensation requirements under the takings. And that the benefit to the ratepayers is that they get to pay lesser fees over the 15 years of the transition involved because the cost of refinancing these assets is less by this securitization process than it is the way it's set up now. That's their argument. Now what's wrong with that argument?

SUSSMAN: It would justify imposing a charge like this whenever an industry is deregulated. Whenever competition comes on an industry it would justify imposing a charge, a competition subsidy charge on the beneficiaries of competition in that industry. It's a tax and it is a taking. And the mere fact that no case has ever said that it's sufficient compensation that you simply get the benefits of competition, in general, the constitution has a revision against monopolies. Competition should be the way of life in this state, not the exception to the rule.

BAKER: I guess we can say that our legislature took 25 years to figure that out, but they are now going from a monopoly regulation system to a competitive system.

SUSSMAN: And if that is a benefit to people it should have been obtained by either a constitutional amendment, or it should have been handled by a general appropriation by taxes imposed on everyone, not by this tax that is imposed on our customers. People who move into the

area, people who self-generate power all have to pay this transition charge even though they are also paying - the statute says that they pay for the power and they pay for the transmission. So what else is there left for them to pay for? A simple answer is, Well the benefits of competition. There is not a single case that said that the benefits - I mean that would allow you to take someone's property for a road and say, Well I'm not going to pay them for the property because they are going to use the road, too. They are drivers.

* * *

ENOCH: How does the pass-through of this transition charge work? If I'd picked Power Choice to provide my electricity, would their bill contain this itemized transition charge and then they would pass it on through to the utility from whom they purchased the power, or like in a separate bill from Central Power & Light, as an example, for a transition charge?

PORTER: The first.

ENOCH: So it would be a pass-through then?

PORTER: Exactly.

ENOCH: And so as far as the customer is concerned, the bill would look substantially identical to the bill they would get from Central Power & Light back when they were forced to buy it from CP&L, which would include within the rate some amount of money for the stranded cost?

PORTER: The design of the bill, I don't think has been decided by the commission as to this point. But you're correct in your assumption that the charges that customers will get from their retail electric providers, such as Power Choice will include the transition charges and other charges...

ENOCH: Even though the statute reads the way it does, would it be fair to say that in allowing Power Choice to buy power from CP&L to give it to the customer, CP&L is entitled to pass through to Power Choice those stranded costs?

PORTER: Right. It's the retail electric providers that will be receiving the bill from the transmission and distribution utility, such as CP&L, for the costs of transmitting and distributing electricity, as well as the stranded costs at issue here and in the current pending cases before the PUC.

HECHT: On the SFAS 109 assets, do you argue that they were not included in the statutory definition of regulatory assets, or do you argue only that they may have been but they didn't benefit consumers, and that's another overlay in securitizing them?

PORTER: Yes. Our argument depends upon the requirements of §39.301, that the securitization of the assets benefit customers economically.

HECHT: But apart from that, you agree that those assets are within the definition of regulatory assets?

PORTER: Yes.

HECHT: So it comes down to whether it also has to benefit the consumer?

PORTER: Exactly. In order to securitize, the regulatory asset must be included into the definition of regulatory asset as you suggest. But it also must meet the statutory requirement founded in 39.301 that they are tangible and quantifiable benefits to customers. As we argue in the brief, we believe that the commission cannot show this, has not shown this with regard to the SFAS 109 assets, because those assets currently earn a zero rate of return. Customers are paying zero percent carrying charges. By securitizing these assets, that carrying charge will not decrease as the statute contemplates, but increased up to 8.75%. Clearly, mathematically, securitization of the SFAS 109 asset...

BAKER: But in this case, the PUC made those decisions based on an aggregate basis as opposed to what they did in the TXU case where they _____ classification _____. So doesn't that make a difference in your argument, or should it?

PORTER: It makes a difference, but in this instance it's a violation of the statute. The commission should have...

BAKER: Well there is some indication in the financing order that if those 109's weren't taken into account now that some way or the other they will be at the next round when a second financing order is requested.

PORTER: Yes.

BAKER: In fact, it's already in the works isn't it for some $361 million?

PORTER: Yes. And that was going to be one of my points. When Cities' appeal talks about disallowance of the amount that the commission is authorized to securitize, please understand it's not a disallowance. The statute allows a company to collect all stranded costs. Regulatory assets are simply a subset of stranded costs.

If you agree with Cities' appeal in these cases, the utility will have an opportunity to collect those regulatory assets through the competition transition charge. Our point

in this case is it should not be - first of all I should say securitization is simply a method of collecting stranded costs. And the statute is very clear about what assets qualify for securitization. The problem here is, that securitization of these assets result in a transition charge that is in effect for 15 years and cannot be changed by the commission, and the statute sets out the legislature's promise to bond holders that these charges will not be impaired, will not be reduced.

Our point is that setting these transition charges, setting the level of assets to be securitized, the commission must be very careful because this is a charge that will remain in effect for 15 years and cannot be reduced. That's not the case with the competition transition charge. Another method for the utilities to collect its stranded costs and if disallowed here the regulatory assets.

ABBOTT: Was it essential to getting this bill passed that this particular provision allowing the collection of stranded costs be included?

PORTER: I suggest that there would be no bill if the utilities had not been allowed to collect the stranded costs.

ABBOTT: And more pointedly, how important was it to the passage of a bill to allow the securitization of assets?

PORTER: I'm unfamiliar with that. I could not answer that.

ENOCH: The securitization of the assets, there are provisions throughout the _____ about a trued-up on an annual basis where you can do it by 2004. And that played some sort of role in all of this. And you've argued that we've got to be very careful up front because we are tied into a 15 year bond that's out there. Explain to me how you understand this true-up works? I'm assuming the utilities up front will securitize as much of their debt as possible. What is left to be trued-up at the end of the year or at the end of 4 years, or whatever? What's anticipated would happen?

PORTER: The true-up provisions are designed to reconcile the amounts that the commission allows the utilities to recover and the actual stranded costs incurred and measured in the year 2004. In other words, there will be market based measurements of these utilities actual stranded costs in the year 2004. At that time, the commission will go back in and they will have the ability to go in and amend the competition transition charge to ensure that the utility collects its stranded costs but no more. The statute specifically prohibits an over-collection of stranded costs. The commission will use its true-up to ensure that there have not been an over-recovery of those stranded costs.

ENOCH: The transition costs is something that will fluctuate depending on taking the

whole picture of securitization and stranded costs and _____ so that 2004 if they put too much in the debt that they've got the bond in, they might reduce some of the transition pass through or _____. Am I right or am I comparing apples to oranges?

PORTER: You're right in one respect. You keep saying transition charges, and that's the distinction I'm trying to make. The transition charges that are set in this case will not be impaired or reduced or will not fluctuate. What can fluctuate are the utility's distribution of transmission rates and the competition transition charge, which is different than the transition charge they set in this case.

BAKER: Does the first part of §307 in the true-up standard have to do with over and under collection? Is that correct?

PORTER: The true-up provisions that are at issue in this case do indeed affect the...

BAKER: But you're not complaining about the standard true-up provisions are you?

PORTER: Actually, the next two speakers will be discussing the true-up provisions and how these costs are allocated to customers.

BAKER: You represent the Cities. Are the Cities complaining about the standard of the true-up procedure?

PORTER: We have not appealed or addressed that in the brief. We agree with the brief of the Office of Public Utility council.

HANKINSON: Are the findings made by the PUC in this case sufficient for this court to review the issues that you present, or should this go back to the PUC for additional findings?

PORTER: That's a huge problem in this case that I hope to get into. By adopting a contested settlement, the commission essentially declined to address all three of the issues that are before this court on appeal by the Cities. What you will see in reviewing the financing order, you will not find inclusions of law, discussions or even a decision with regard to the very issues that are before this court in the Cities' appeal. Instead, the commission simply adopted the non-unanimous stipulation that several parties entered into.

HANKINSON: So what should we do?

LAWYER: We should reverse the commission's order, remand it to the commission for a fair hearing, that includes cross-examination and a decision on finding on the issues that the parties have raised.

HANKINSON: What prevents us from reviewing the current state of the record?

PORTER: The problem the court is going to have is you have various theories offered by the appellee as to what the commission did and why they did it, because they simply refused to simply decline to address our issues.

* * *

LAWYER: I represent the Texas Industrial Energy Consumers, otherwise, known as TIEC. This group is a group of large industrial consumers in the CPL service area, including DuPont, Union Carbide and other petro chemical primarily manufactured. We are very concerned about our rates.

HECHT: Do you agree with the Cities due process arguments or not?

LAWYER: No, I do not.

HECHT: You join the stipulation _____?

LAWYER: Yes. Our concern in this case first relates to rate design, or what are generally characterized as rate design issues. And in that regard, there are two specific statutory requirements which we believe the commission has ignored in its final order, and has ignored what we believe is the plain and ordinary meaning of those statutory provisions. We understand the court's reluctance to enter into the rate design area. We understand the discretion that the commission has in this arena, and we understand the presumptions that the interpretations given these statutes by the PUC are generally given by the courts. In this instance, however, and we understand even given the heavy burdens, we submit that the commission has ignored the plain, the ordinary meaning of two important statutory provisions in implementing the transition charges. Once the constitutional issues are resolved, once the question of how much is to be securitized, then comes the problem of how these transition charges are to be designed and placed on customer's bills, as previous questions have underlined.

We submit that in this case the commission has misallocated by failing to take into account an important exemption which the legislature provided in the deregulation statute. Co-generation, which is simply the process of producing electricity in concert with industrial processes so you don't lose the waste heat has been given a preference in state statute as well as federal statute. When a large industrial concern produces electricity and uses the waste heat for chemical processes, for example, you have very important energy conservation results, and very important air pollution abatement results. And accordingly the legislature when it passed this bill, it said: If certain industries meeting certain criteria have generation, their own generation built by a certain date, they are exempt subsequently from the transition charges.

BAKER: Does your group of clients already qualify as a co-generator? In other words, are you just like everybody else as far as this first financing order is concerned, that your group is included for a percentage that table shows for transition charges?

LAWYER: Yes.

BAKER: But some time later on, you might be out because you become a co-generator, or because your part dropped more than 40% under _____ things?

LAWYER: That question really hones in on the issue. The evidence reflects and the AG on behalf of the commission contends, however, that we failed to demonstrate that there were already substantial numbers of not all of the TIEC members, but substantial numbers who had already qualified for this exemption. That's reviewed in our reply brief. We believe the evidence demonstrates incontrovertibly that certain customers, particularly Oxi Chem had already left the system. No question about it. And if you will look at the rely brief, some of our members had left. This question relates to what happens to those who are still on the system within that class? The answer of the commission was, Do not make any adjustment in the billing units; don't take into account that these members have left and have qualified instead leave those remaining members within that class holding the bag. And that's the problem.

BAKER: Isn't the nonstandard true-up the solution to what you're just complaining about and don't you benefit tremendously from that?

LAWYER: We do. And as the briefs reflect, we support the nonstandard true-up.

BAKER: Well I can understand why.

LAWYER: The problem is, that the nonstandard true-up in our judgment was not a wholly sufficient correction. It is essential in order to avoid the spiraling diminishment of usage by this class. You start raising these rates by 70 and 80%, your usage goes down, and pretty soon you don't have any members in the class. And for all the reasons stated in the brief, we certainly do support the nonstandard true-up. But that nonstandard true-up provides...

BAKER: If I understand where you're going as each one of your members goes out because it becomes a co-generator or for some other reason, or its part drops, you go out of the mix for being charged, and the nonstandard true-up will take your part and put it on another class that's still there. Isn't that correct?

LAWYER: The nonstandard true-up after there has been a 10% of the imposition falls upon the remaining members of that class and then thereafter it is spread to the entire system.

BAKER: But if you're out of it, you're not part of the system anymore when that true-up occurs?

LAWYER: That's our position. Our position is, that the adjustments should have been made...

BAKER: On this financing order?

LAWYER: That's correct.

BAKER: So how many members do you have that you represent?

LAWYER: I believe there are nine members in our group.

BAKER: So your argument is, that maybe only 7 should be included in the mix for this financing order, and two of them should have been left out for the reason that you are arguing?

LAWYER: Our position is, that the state statute, which I haven't had an opportunity to discuss, clearly requires that the adjustment be made to the billing units to take into account those who have qualified for the exemption. And that the remaining members of the class should not have imposed upon them, because they have certainly not caused any increase, it should be spread system-wide.

* * *

ROURKE: I represent the office of Public Utility Council. The Office of Public Utility Council appeals from the commission's financing order in this case, because the order includes the nonstandard true-up.

BAKER: How would you deal with that if we X-out the nonstandard true-up?

ROURKE: If you x-out the nonstandard true-up, there are other means and we suggest this in our reply brief and a little bit in our appellant's brief as well, that there are other possible kinds of accounts, such as the over-collateralization account which already is provided for in the financing order.

BAKER: Over or cross collateralization?

LAWYER: It would be collateralization within the specific classes. For instance, if there is a deficiency in the industrial class transition charge, then the over-collateralization accounts which would have to in effect take more money from the industrial class before they are depleted, before

their members are depleted or their customers are depleted, would then make up for any sort of deficiency that might occur later on. But it's our point that the non-standard true-up as the financing order includes violates §39.253 and 39.303(c). Particularly it's important for the court to recognize that subsection 39.253(i) very clearly and very directly and forcefully states the legislature's intent with respect to each class bearing its own obligation for its allocated amount of transition charges that is determined according to the formula in §39.253.

HECHT: But if there is evidence that non-firm users and other industrial users will leave the system and that that will jeopardize the entire securitization process, doesn't something like the nonstandard true-up have to be in the financing order?

ROURKE: I do not believe that is the case. I believe that as I mentioned a moment ago, there are other kinds of financial mechanisms. There could be some sort of bond insurance. There could be some other kinds of mechanisms...

HECHT: But your saying, yes the bonds will fail...

ROURKE: No, not necessarily. The bonds would not necessarily fail. There would be special accounts provided for as the financing order already provides for: additional over collateralization accounts and other kinds of accounts that could address this kind of issue. We don't even know what the size of the issue is at this point.

HECHT: But if it's small, then who cares?

ROURKE: Well if it's small there's still the fact that the legislature intended that each class bear its own obligation. This is particularly important to residential small commercial because the growth that is expected in these classes are going to be needed to reduce transition charges so that there is margin for potentially competing retail electric providers.

ENOCH: Do you disagree that there is a risk under your _____ that as users drop out of the system, you disagree that that would place such an inordinate burden on the remaining members of the class that it would accelerate their leaving the system that would produce catastrophic effects on the viability of this program?

ROURKE: That is correct. The industrial user's transition charges is much small than for instance commercial class transition charges. I would think the possibility of the commercial class leaving the system would be more likely. But it's basically that the industrial class...

HECHT: Where are they going to get electricity?

ROURKE: If they leave the system altogether, they could get it through the 39.262(k)

provision, which provides for small co-generation as well as the large co-generation.

* * * * * * * * * *

APPELLEES

GONZALES: If we find that the securitization provisions are invalid, what is the practical effect upon existing bonds?

BARRON: The bonds have not yet been issued. They are awaiting the outcome of this litigation principally.

BAKER: Has the legislature ever allowed stranded costs recovery in the other deregulated industries, such as gas and telecommunications?

BARRON: In the natural gas area stranded costs recovery has been allowed. It's been principally at the federal level by the federal energy regulatory commission.

BAKER: But not the state?

BARRON: Not to my knowledge at the state level. But the fact that it's been done at the *Firk(?)* level is discussed in some detail in the very recent decision issued by the DC circuit that we cite in our brief, *Transportation Policy Access Group v. Firk(?)*

BAKER: But you rely on those to show that it's been done elsewhere, but it's not been done by our legislature in any other deregulated industry?

BARRON: Not that I am aware. On the facial constitutional challenge, the transition charge that appears as a part of a customer's monthly electric bill is not an unconstitutional coercive exaction of money to enrich private interest wholly unrelated to any public purpose. CP&L is not just a utility. It is a public utility that has had for years a statutory express duty to provide continuous and adequate service to every customer in its certificated...

HECHT: And after this goes into effect, when the fellow gets the bill, the homeowner gets the bill and there is a transition charge on there, what's he paying for?

BARRON: He is paying for two things. And this is in response to that he's not getting anything question. One, they've got something. They got past-service, such as _____ accounting costs that were used to provide and generate and distribute electric service.

HECHT: He hadn't quite paid for last month's bill...

BARRON: When the commission sat rates, when the nuclear plants were built, it said it was unreasonable under our just and reasonable requirement to make the ratepayers for them all at once. So there is an extended recovery period, and these regulatory assets concern legitimate costs that were incurred in connection with providing past service. The second...

OWEN: How do you justify imposing that on new co-generation entities that come in to the system that would never have used a traditional utility?

BARRON: I believe if a co-generation facility comes in and never gets on the system that it would not be covered by this statute. This talks about the non-bypassability requirement. And the statute talks about the requirement that a customer - a CP&L customer cannot escape paying his or her share of costs by moving to another retail competitor.

ABBOTT: If I understand her question correctly, I don't think you answered it. You're saying that putting this costs on the consumers is okay because arguably what could have happened in the past is that the consumers could have been obligated to pay for it more up front?

BARRON: Plus, as the courts have recognized, it's legitimate to continue to charge customers even though they may be new customers.

ABBOTT: That's the point. Because the new customers obviously wouldn't have been obligated to pay for it in the past?

BARRON: They would. The point that's recognized in *Southwestern Bell v. PUC*, 615 S.W.2d, albeit in a footnote, but the basic point is that when a new customer comes in, moves in to Texas, he takes service, that the purpose of the rate regulatory system is not to adjust individual debits and credits to make sure that one customer is paying exactly costs that were used to provide service to that particular house or business. It is part of a system, and it's not an individual debit adjustment. And that's a legitimate part of rates.

ABBOTT: Let's put this under the _____ of a taking. And that is, that I could see in some fashion how you could argue it's not a taking of somebody's property because all they are paying is what they would have been obligated to pay for anyway; however, for a new consumer it's nothing that they would have been obligated to pay for and, therefore, for new consumers it is a taking.

BARRON: Well it's no more taking than it has been under the traditional regulatory system when a new customer comes in. You are obligated to pay the regulated rate in the area that the agency has found to be just and reasonable. And the legislature itself has made the judgment in this instance, not just the PUC.

HANKINSON: You started off in response to an earlier question, you mentioned that there were two items that you wanted to tell us about that justify the transition charges being made to the customers. The first one was the deferred cost. What's the second one?

BARRON: The second one is a transition charge and is defined to be payments for the use or availability of electric service. Prospectively, this is part of the legislature's judgment that is in the public interest as part of a regulatory transition to competition to provide customers with the availability of getting service at rates that have now been frozen and when customer choice begins will be dropped 6%. So it seems to me it's a benefit, customers are getting something by getting prospectively the benefit of reduced costs and even an additional prospect of reduced costs through securitization, as the commission found by refinancing and making the opportunity that these costs should be lower.

OWEN: Are there going to be any set of customers who could have come in that is not residential, not commercial, but a set of customers who could have come in to Texas under the old regulated environment and not ever have been part of this grid, as it were the regulated grid who are now paying transition costs?

BARRON: If a customer under the old system just moved in, just pure co-generated and didn't subscribe to CP&L service, they wouldn't pay.

OWEN: Are those customers now paying a transmission charge?

BARRON: Not if they move in now and decide to co-generate. The specific exemption that is raised by TIEC concerns the requirement to show that existing customers on CP&L system qualify for a specific exemption because they are going to turn now...

OWEN: Is it fair to say that under this regulatory scheme that everybody that's going to pay the transition charges would have been a CP&L customer under a regulated environment?

BARRON: Yes. So the bottom line, I think, on the constitutional issue is that you are getting something. That this is a reasonable exercise of the legislature's police power to continue to allow these costs that have been used to provide service, that will give a benefit in terms of availability of choice in the future in reduced rates. Customers are getting something. And it's a perfectly legitimate public purpose.

HECHT: But it is true that the consumer is paying the new REP for his electricity, the actual stuff, and a transmission utility for providing utility?

BARRON: Yes.

BAKER: What's a little confusing is the answer to the takings question. And what is the adequate compensation that a ratepayer receives to prevent this from being a taking, and how does that work, because it seems like all that the ratepayer is doing is getting more debt put on them but paid out over a period of time?

BARRON: No more or less debt, and no more nor less a taking than under the preexisting scheme where a customer comes in to the system, has to pay as part of the rate for these costs that have been authorized by the legislature.

BAKER: Do the incumbent utilities continue to have the opportunity to depreciate the generation assets?

BARRON: They do. And that goes to a point raised by Cities...

BAKER: At the same time they're still getting paid in full for them when you issue the bonds? Is that what happens when you issue the bonds?

BARRON: No. When you issue the bonds the amount that have been securitized come off the books. There will be a...

BAKER: For instance, CP&L gets the whole amount of money that's generated from the sale of the series of bonds. Isn't that correct?

BARRON: Yes.

BAKER: So they've now been paid for a generation asset, which is now going to be passed on through the transition charges based on the system that the statute sets up?

BARRON: There will be no double recovery in that sense as reflected in the commission's finding of facts...

BAKER: Well I understand money under the transition charge ends up in the hands of the bond holders.

BARRON: Yes. But the transition charge while the rates - once it's issued if you stay a CP&L customer, the transition charge comes out of the bundled rates, so there is no double collection. The commission provided for that, made findings on that, finding of fact #79, an order in paragraph 7 in approving the tariff.

BAKER: On page 25 of your brief, you say that this is a proper way to do this because the transition charges apply equally to all ratepayers in the service area regardless of whether they

choose to stay in or switch.

BARRON: Yes.

BAKER: How does that stack up with the non-standard true-up? Does that system affect that statement? If I understand when you have a nonstandard true-up, you're taking somebody out of the system and reallocating. So it seems to me that it's changing the equal application of the payment of these transition charges.

BARRON: To the extent that a customer qualifies for exemption under 39.262(k), the legislature has specifically said: You're out; it's okay...

BAKER: The other part of it is they have to collect all of these charges. So somebody else gets to pay it, the people that are left.

BARRON: Yes. And the big debate between the Cities and TIC is, Who pays? And what the commission decided is that there is insufficient evidence of individual TIC customer exemptions to justify giving those specific exemptions based on this record. And that was made very clear.

BAKER: When we read these findings of facts in the financing order many of them are conclusory. And so the question is, Did the commission do the job they are required to do when they make findings of fact to allow an effective appeal and allow this court to understand how they reached that decision? And one of the main questions is, is on the non-unanimous stipulations. All they just say is, We agree that what they've done reaches the result of it's a benefit in defining a fact. So is it our job to go in to this record and see well there is substantial evidence to support it, or as your brief says, nobody's arguing the underlying fact that there is not substantial evidence to support that finding of fact?

BARRON: There certainly is substantial evidence to support it, and we've done that. But the commission has made adequate findings. Under the APA, the commission is required to make the statutory findings and have supporting underlying findings. And I think if you look at the order you will see that the commission made the necessary findings on specific points.

BAKER: Well I have looked at it, that's why I'm asking the question. It just says, We find that that's okay. That's it. And they don't say we find that's okay because, and then go 1, 2, 3 4. It's not there.

BARRON: Well they do. This was a 90-day deadline for the commission...

BAKER: I understand, but it's a 72-page order, so somebody _____.

BARRON: But the findings are there. On the investment tax credits, finding of fact 20 is where the commission made its finding on substantive issue, first and last sentences of that finding, on the substantive issue one of Cities. Finding of fact 25, is where the commission made its finding along with appendix C and appendix F on the SFAS 109...

BAKER: So your answer is, when you look at that No. 25, it refers to C, then you go look to appendix C and see what that...that's the supporting evidence?

BARRON: Those are the supporting findings in the order.

BAKER: What if that appendix C happens to be exactly what the non-unanimous stipulation said, This is what you ought to do.

BARRON: And then the question is whether the evidence...

BAKER: Which is exactly what it is, isn't it?

BARRON: Yes. But the stipulation was based on the evidence before the commission that was already put in. And the due process issue...

BAKER: I know, but the Cities say, That's not fair to find that, hold it without giving us the opportunity to appear for a full hearing in response to that.

BARRON: There is no due process requirement to reopen an evidentiary record unless there are new disputed fact issues.

BAKER: Well isn't it true that this final non-unanimous stipulation was reached after the hearing?

BARRON: Yes it was.

BAKER: And so can't they make a valid argument: If you decided something after the hearing when we appeared, and it's not what we saw before, we are still entitled to a full hearing to take our shot at the now new evidence.

BARRON: The Cities are entitled to a full opportunity to present their issues and...

BAKER: And how did they get that opportunity?

BARRON: They submitted briefs on the legal and policy questions that arose. There were no new factual issues that would required the record to be open. So they had their due process

opportunity.

* * *

CP&L Company

SCHENKKAN: The assets being securitized in this financing order are regulatory assets. And one of them, I think, a brief discussion of it will help answer a number of the questions that have been asked.

A large regulatory asset that's part of this securitization is something called a Mirror CWIP. What happened was, that the PUC using its authority under prior law in 1990, said: Putting in our current rates the full actual costs of providing this service would be too much. It would cause rate shock. For the next 5 years, 1991-1996, we will reduce your rates below what they need to be to recover your costs by $361 million, and spread that out over 40 years. So you ultimately get paid in full. But for 5 years you don't get paid in full.

ENOCH: The basis for doing this was because of construction costs of the...just as an example the South Texas project. And that project was projected to provide power for a number of years into the future, and the PUC says, It would not be fair to require the customers using the service today to pay for the service that customers 20 years from now would be getting the benefit of. And so we will spread out the payment for this service, this construction over a longer life of that facility.

SCHENKKAN: It's historically correct that the South Texas project was what occasioned this rate shock problem. The $361 million was for full services, the integrated utility services.

ENOCH: But for that historically if the utilities went out and spent several hundred million for a new electric plant, they would be entitled to recover that cost immediately from the consumers?

SCHENKKAN: No. For all long life physical assets like that, the recovery is in the form of an amortization depreciation charge. It's included in the rates over whatever the estimated use of the life is.

ENOCH: I thought you said because of this particular rate shock, they did something differently.

SCHENKKAN: They did both. They spread out the physical costs to the plant as always, and they also said, Even though your total costs of service, including this year's depreciation charge on the new power plant, is so large to avoid rate shock we're going to spread it out over a much longer period of time. And in answer to your question Justice Gonzales, that's the policy choice the

legislature made. They were free constitutionally, and no one contends otherwise, to leave that regulatory system in place forever. In which case, CPL's ratepayers, everyone who takes power off CPL's wires, whether they arrived in 1997, the year 2000 or the year 2010 would be paying their share of that $360 million, as well as their share of the physical costs to the power plant through the amortization.

HECHT: If the stranded costs recovery is unconstitutional, is it severable from the rest of the statute?

SCHENKKAN: No. It's clearly central to the entire statutory scheme. Recognized in advance of the passage of the statute by the PUC and the reports to the legislature that the previous legislature commissioned and required as the crucial transition issue.

BAKER: But there are three other methods available under the statutory scheme. Is that correct?

SCHENKKAN: Yes. But the constitutional arguments apply equally to them. They are not special to the securitization of them.

BAKER: But nobody's raised the question about any of the other three methods.

SCHENKKAN: No. I understand Power Choice's argument to be a facial challenge to the constitutionality of stranded costs recovery if the same legal arguments apply.

HECHT: And if the whole thing is unconstitutional, where does that leave the utilities? Back where they were.

SCHENKKAN: It leaves everybody back where we were under the existing rate regulation system. The question is...

HECHT: So is this don't throw me in the briar patch?

SCHENKKAN: No. We support the compromise. We recognize as I hope everyone candidly does, that it is an experiment. It is not guaranteed that the legislature's policy decisions to say, We will continue utility rate regulation of the delivery of electricity, the transmission, the distribution, the wires. We will de, or re, or partially deregulate the retail sales in generation and we will continue the regulation of the stranded costs portion. That may or may not work.

ENOCH: In response to Mr. Sussman's argument then, if a portion of the stranded costs is not for the capital improvements, but is simply for - it costs us $5 to produce this piece of electricity today. But we're only - the regulators say, We are not going to let you recover that $5.

We're going to make you recover it 5 years from now. Then the new customer that comes on is being asked to pay a portion of the cost that the other customer is the one who used. Why isn't that a taking without a - isn't that exactly what Mr. Sussman says it is? It's a taking without a benefit.

SCHENKKAN: Because that's the way utility rates work. Because utility rates are not taking. You take an enormous number of people with many people moving in and many people moving out and many people moving around, and we say we're going to have one set of rates and we are going to make the rules recognizing that the investments have to be made on a long-term basis, and the power is going to have to be delivered on a long-term basis. And every once and awhile we create a property right, which is what we did here, a receivable from ratepayers.

ENOCH: So if the regulator refuses to allow the utility to recover its full costs, and then all of a sudden the regulation stops, and now anybody can come in and fight a cost, the legislature is free to say we're going to allow this utility to recover its loses by creating the charge to the new customer?

SCHENKKAN: I would rephrase it. I would say we are going to allow the utility to continue to recover the costs that we promised it would be allowed to recover, we, the state, until it has completely recovered the property right that we, the state, created in 1990 by our order to spread this out.

OWEN: Let's suppose that the legislature had come up with a different scheme and decided, Well we're not going to completely deregulate, but we're going to let more competitors in the market. So they allow two new utilities into CP&L's market. But they said, We recognize our competition problems, so we're going to adjust, basically take some of these costs out of CP&L's rate base and base load it into these new utilities rate base. Could they constitutionally do that?

SCHENKKAN: I guess it may depend on what the mechanics of the scheme are. If we're really talking about two new utilities in the traditional sense, universal service rate regulation full service: the wires, the generations sales, the whole 9 yards, yes, I think they probably could. They could make sure that even though the new utility was coming in that the total costs of serving all the ratepayers off of somebody's wires were spread around _____.

OWEN: Would it make a difference if they just allowed the new utilities to come in and provide the transmission portion of it and the retail sales, and not the hardware basically? Could they take part of CP&L's rate base and transfer it essentially over to these new utilities to say so you have to include this as part of your cost of service to even out the _____ ,level the playing field more or less?

SCHENKKAN: I think the answer is, yes. But I guess it's the complexities of the existing scheme we're under that make it hard to be sure without knowing the details of that scheme.

HECHT: Why isn't TIEC right about taking the co-generation people out of the class in the first instance rather than using the nonstandard true-up?

SCHENKKAN: The nonstandard true-up clearly covers the bulk of the problem. It ensures that we won't have the cascading load loss that once we actually know who the departing customers are and how many of them there are, that will be reflected. The concern that we need to make the adjustment on the front-end, which my company shared in the proceedings at the PUC, the reason that that adjustment was not ultimately accepted by the PUC was simply they didn't think we had proven it adequately. We didn't have non-hearsay, nonconfidential evidence adequate to show with sufficient certainty that there was this quantity of load that had already left. Behind the TIEC tab of the notebook that I have, there is the excerpt of the transcript of the hearing in which PUC Chairman Wood and Commission Walsh were _____ about this issue and were identifying the practical problem they had, but they just didn't feel they knew well enough what the numbers were at that point to make the confident decision about that. And they felt that since the nonstandard true-up would take place on an annual basis beginning after the securitization, that that would take care of the problem. The company shares that view.

BAKER: On page 16 of your brief in the Power Choice case, you state in response to their constitutional argument that these transition charges are utility rates. And then you state that these charges reflect the legislature's unquestioned power to regulate businesses affected with the public interest. Which I don't guess we would disagree with on the surface. Then you say, and it's constitutional duty recognized in our cases and US SC to ensure that the owner of a private property devoted to utility service has a reasonable opportunity to recover all of its expenses and all of its investment together with a reasonable return on that investment. That sounds like an argument that our constitution requires the legislature as a constitutional duty to guarantee that CP&L gets all of its investment back plus a profit. Is that your position?

SCHENKKAN: They cannot make the rules in a way that prevent the owner of a utility who spent his money on that property from having a reasonable opportunity to fully recover the operating expenses, the depreciation...

BAKER: But doesn't your statutory scheme not only go past a reasonable opportunity, but guaranteed that CP&L not only recovers a reasonable return on its capital investment, but it gets its whole capital investment back? Don't the transition costs when it's all said and done at the end of the 40 year _____, they've been paid back every cent that they have put in to building the nuclear plant or whatever, paid back, not just a return on that?

SCHENKKAN: They will have been paid back with the reduced return provided through securitization. Yes. In full. That's what the legislature decided that the utility is entitled to recover all the _____ verifiable stranded cost.

BAKER: Does Power Choice get that same deal? If it has some capital assets sooner or later it's going to get those paid back too?

SCHENKKAN: No, because they are not going to be coming in on a utility basis. The rules under which they are coming in are not the rules that CPL came in under, and which we had to spend the money to provide service to any customer whether it was a profitable customer or an unprofitable customer, universal service, and we weren't free to charge...

BAKER: But as any other investor, whether it's a utility or private, that premise then was that you're entitled to a return on your investment, not that we're also going to give it back to you in whole so that you have zero involved and you're just making money from then on except for operating costs.

SCHENKKAN: It's not my understanding of the prior utility law. The constitutional law, the federal due process law that this court adopted in the *Alvin* case is, you get the expenses which include your depreciation expense, the recovery of your original investment, plus a reasonable opportunity to earn...

BAKER: But depreciation is not the same thing as money. You will agree with that won't you? I'm not going to get my investment back by depreciating it, thereby saving on income taxes. But if I can do that plus get somebody else to pay me back the dollars that I put in, I'm in pretty good shape.

SCHENKKAN: But that's what utility rates do. They repay the utility for the depreciation expense...

BAKER: So basically is it a correct statement that this securitization process is absolutely vital to any public electric utility in the same position as CP&L to survive and meet the competitive market that's supposed to exist by 2004?

SCHENKKAN: Stranded costs recovery is vital for all the reasons that all of the jurisdictions that have addressed this issue have concluded. Securitization is not as vital. It is one alternative means of stranded costs recovery that is especially useful for things like regulatory assets, where we don't have to fight over estimating the dollar amount. We know what it is. Because it allows us to get them off the books of the utility and out of the way of the competition issue faster and at a lower carrying cost.

OWEN: Let's assume that this court were to decide that in some areas at least, we don't have adequate findings from the commission to conduct a proper review. As a practical matter, what's the effect if we were to remand this case for additional findings in specific areas?

SCHENKKAN: Delay in the process leading to an order that is sufficiently final to where the bonds can be issued. And if the ultimate result is an affirmance anyway, then the loss to he ratepayers of the time value of the money in the meantime.

OWEN: I'm not sure I follow that.

SCHENKKAN: If you hold that the findings are inadequate, there would be a remand. The commission would have to do something to change the findings and then we would have an appeal process about the new findings, which however expedited it would be, would take additional time beyond where we are now. So very much on that basis I hope you can conclude as Mr. Barron has argued my brief fully, the findings here meet this court's Charter Medical standard. The commission in its findings that began at finding 28, made the findings that the securitization subchapter requires. There are specific words in the statute about upon a finding that, the commission shall issue a financing order. The commission made those findings. They are in that section, that set of findings, and they are all that is required into this court's Charter Medical standard for what findings must be in the order. And as a practical matter, they are perfectly clear on what happened. We know exactly what happened. SFAS 109 assets hotly litigated were included in the pack...

OWEN: That's one question. SFAS 109 assets, apparently the commission did not explain why it made it's decision. It just said they are in. But we don't know - you offer several arguments or someone does in the briefs as to why they would have done that, but we don't know why the commission did that.

SCHENKKAN: We do know. The findings that are included that the commission did make that meet the statutory tests are that the total amount of securitization, which includes, the SFAS 109 assets listed and by dollar amount, meet the statutory test. That's why they said this is alright, because this securitization including these designated assets with this offset for the ADIT present value, one form of a tax issue, but not the generation related ITCs. That's what we find meets the statutory test and therefore that's what we are approving for securitization.

BAKER: That's another area - the ITC's I think the finding of fact just says that we've allowed all the "applicable ITCs" but there's no explanation to answer the Cities' argument: Well but they all should have been there. What's applicable and what's not applicable, and how can we tell from the findings of fact on this record what if any ITCs were applied in this first financing order?

SCHENKKAN: We know that none were found applicable because when you look at the appendix C and appendix F...

BAKER: With all due respect, that appendix is nothing more than a repeat of the nonunanimous stipulation isn't it?

SCHENKKAN: No. The appendix C lists the amount that were agreed to in the stipulation, but the Appendix F, which is the calculation of meeting the statutory test was not part of the stipulation. It is a calculation made as the findings state according to the methodology testified to by the staff earlier in the hearing applied to those assets and showing that they meet those assets. This is the way the PUC does rate cases.

BAKER: Justice Owen asked some questions about the bonds that are issued as a result of this financing order. Do I understand from what I read in that that you don't have to ask for and issue the whole $800 million of transition bonds to cover the transition charges and the one-time deal at the front, that they can be issued in series over a period of time?

SCHENKKAN: I believe that is correct.

BAKER: Would it be a correct statement, too, that even though you may have omitted certain assets in this calculation for this financing order, that for instance there's a application for the $361 million of generation costs that at a later date will also be securitized, so that you're getting back up to the $1.2 billion that you started out with in the first place?

SCHENKKAN: No, that's not correct. It is correct that the statute permits more than one securitization within 90 days after Sept. 1999, at any time after that. So there can be repeated financing order requests. But I believe the $361 million you're referring to is the process by which the generation costs, the bricks and mortar costs, not these receivables from ratepayers, _____ these being estimated and it may or may not be securitized.

BAKER: Aren't those costs part of the transition charges?

SCHENKKAN: They are not.

BAKER: Never?

SCHENKKAN: If a later request is made to recover those stranded costs through securitization they would have their own transition charges.

BAKER: By definition aren't stranded costs included in the transition charges under the statutory scheme?

SCHENKKAN: The ones that are being securitized. In this case, the regulatory assets.

BAKER: Are you saying you can't securitize the $361 million?

SCHENKKAN: No. I'm saying that no decision has been made as to whether those would be

recovered through the securitization and the transition charges...

BAKER: If you can issue these bonds in a series, this process will take longer than 14 years as is _____ throughout the briefing because of the 15 year deadline stated in the statutory scheme, but that deadline is based on when you issue the bonds isn't it?

SCHENKKAN: I believe I must be in error over the repeated issuance, because clearly the 15-year deadline is statutory.

BAKER: The PUC says, Well we're not worried about whether we're under-collected at the end of the 15-year period, because we can take legal action or go through judicial process to recover that. How can that occur if you have to cut it off at 15 years with all the true-up provisions in there?

SCHENKKAN: The 2004 true-up is the legislature's decision as to how all of the adjustments will be made, including the adjustments for the securitization, the excess earning annual report provision, and the bricks and mortar costs that have not yet been specially provided for, and it may be provided for by securitization or may be by a different kind of transition charge to all the CTC.

When we get to 2004, all of the books will be cleared is the theory.

* * * * * * * * * *

REBUTTAL

LAWYER: Every lawyer you have heard today concedes that the transition charge is a taking. The question is, Is the person who pays it receive anything in return? Only one answer has been suggested today by counsel. The answer is, Past service. In the first place, they cannot find a single case that says that the government doesn't have to pay for a taking, because sometimes in the distant past it provided something of value to the victim of a taking.

OWEN: Is it fair to say that everyone who will be paying these transition costs would be a CP&L customer if we maintained a regulated _____?

LAWYER: Yes. I think that's right. And that's the answer. Mr. Schenkkan's answer was "because that's the way utilities work." Mr. Barron's answer was, "it's a taking but no more of a taking than it was in the past." The problem is, I don't have to tell you the Texas constitution - we're dealing with the constitution. Our constitution has unique provisions. That's why we have so many amendments.

ABBOTT: Does the current method of charging consumers money for electricity constitute a taking?

LAWYER: It has never been challenged on constitutional grounds. And one could argue that it is a taking.

ABBOTT: Because I'm being charged electrical rates...

LAWYER: For something that you didn't have any - you just began to get buying power this week, and you were being charged for some failure to recover costs 5 years ago.

ABBOTT: Are we all potential members of a class action?

LAWYER: You could be. But this has never been - I mean the recovery of stranded costs has never been validated as a matter of constitutional law.

BAKER: But there are federal cases that have approved this same...

LAWYER: There's never been a challenge.

BAKER: So that's why they do it unchallenged?

LAWYER: As long as you can disguise the taking as a rate. Because under a utility regime, under a rate regime, when I pay a rate I am getting something. I'm getting power from the person I'm making the payment to. Now maybe I'm paying too much to it. And maybe there is an inequality between the value of what I give and the value of what I get, but it's hard to characterize that as a naked taking. But under this regime, which is not the utility regime, this is not the old regime, you can't say I'm getting - the new customer is getting, he's never gotten anything from the incumbents, he never will get anything from the incumbents that he isn't separately required to pay for under the statute, and so now it's hard to say that what he's paying is a rate. Now we don't have to kind of: Well is he paying too much for what he's getting? He's not getting anything for what he's paying.

OWEN: But if we continue regulation, he would be getting service from CP&L, and he would be paying these _____ costs as part of the rate base?

LAWYER: Yes. And he could theoretically bring the contest while paying too much for too little. But he's getting something. It would be a difficult case I think under taking jurisprudence to make. What makes this case so easy to make under taking jurisprudence, is that they admit there is a taking. And when you ask them, What do I get in return? They say past service. And when you ask them why is it fair for a new customer who's never been their customer to pay for past service? There answer is that's the way it was, that's the way it's always been. It's no worse than it was ever. They ignore the constitution. And that's the problem with their argument.

Justice Enoch asked a question that I want to respond to. He said, is the transition fee a passthrough of stranded costs when CPL provides power for example to Power Choice, and is simply passing on to Power Choice the stranded costs? And the answer to that, I think, was yes. But the answer should have been no. Because even if Power Choice is buying its power from someone out of the state or in the state who does not have stranded costs and buying it at a competitive rate, it's customers still are required to pay a transition fee. So it's not a passthrough of something CPL is selling in that circumstance. I mean, it's just a tax. It's a tax to subsidize a cause. And they say it's a good cause, and it may be a good cause but let them either go to the public and get an amendment of the constitution to allow it, or go to the legislature and get the legislature to set up a fund for their benefit and tax everyone generally and let everyone pay the benefits of competition.