

ORAL ARGUMENT – 02-18-04
03-0396
CENTERPOINT ENERGY V. PUC

LAWYER: There is no serious dispute in this case that interest or carrying costs are required when stranded costs are recovered over time. The CA agreed with that and correctly held that interest or carrying costs is an element of stranded cost. But the court fell into error when it said that those stranded costs are not created until the end of the true up proceeding later in 2004. We believe that's wrong.

The core issue in this case is when stranded costs come into existence.

OWEN: I'm not sure I understand the statutory scheme totally. What statutory mechanism, if any, was there in place to allow utility - like a generating facility that was above market price? In other words, the book value was higher than market value. And they've got operating costs - debt service and all this between 2002 and 2004. Was there any mechanism under the statutory scheme to recover those debt service operating costs?

LAWYER: The mechanism contemplated by the statute to recover the carrying costs, the interest on the generation investments is interest. If carrying costs are not allowed from the date stranded costs are created, and interest does not begin to accrue until 2004 or later, then under what we call the regulatory compact, the utilities will have lost the opportunity to recover a return on those generation investments for that extended period.

OWEN: What about the true up for the capacity auction. Will that compensate you at all for these - the debt service and all those?

LAWYER: No. The capacity auction idea or argument that it compensates is a myth. In the first place, the commission never found any such thing. It's an ad hoc appellate argument. The CA instead specifically found that the capacity auction is an independent, separate calculation that has nothing to do with stranded costs.

OWEN: But doesn't it sort of approximate a stream of income?

LAWYER: No. Its purpose is to set a stabilizing baseline for the price of power during 2002 and 2003. There was lots of concerns at the legislature as to what might happen when this competitive market opened 1/1/02. Are you going to have utilities coming in and charging very high prices for power, taking advantage that the competition didn't really exist. Or on the other hand, are you going to have competitors coming in that drive the price of power down so low that you would have an unstabilized market.

So the legislature in its wisdom said we want the commission to project a

power price. And we're going to true up then to that projection up or down depending on which way it goes.

BRISTER: If the wholesale power price is lower explain what happens at the auction.

LAWYER: If the capacity auction prices are higher than projected, that is if the utilities are able to recover more during this period, then they are going to have to refund or reduce back to the projected level. And the flip side of that is if they are lower than projected, the utility would be entitled to an...

PHILLIPS: That refund is with interest from Dec. 31, 2001?

LAWYER: There is no provision for interest in the capacity auction. We argued for interest below, and it was denied on the theory that the capacity auction is an independent factor that has nothing to do with stranded costs. Interest on stranded cost is based on the statutory requirement that we be able to recover all verifiable stranded costs. And as I say, the CA has held that when stranded costs are recovered over time, you have to have interest in order to have full recovery.

OWEN: There's an income stream that the generation company gets for this 2-year period. It's based on the power that they actually sell and it's an E-com price, which is not market based. So they are guaranteed that e-com price on the power they sell for those two years.

LAWYER: The guarantee works both ways. There is a true-up to a projected price, and that was \$43 in Centerpoint's case.

OWEN: But when all is said and done what the generation company gets to keep is the ECOM price.

LAWYER: That's true.

OWEN: And is that projected price an approximation of what the generation company's operating costs would be or not?

LAWYER: It has nothing to do with operating costs. All it has to do is with a stabilizing market price for the first 2 years of competition when no one knew what the effect of going into competition would be.

OWEN: As a surrogate for the market price that's how the generation company would have otherwise have recouped its carrying costs, operating costs, or not?

LAWYER: That would be the true up level. But I think the killer to this issue is, that the stranded cost amount under the statute can be positive, negative, or zero and that has no impact whatsoever on these capacity auction power costs projections. It has nothing to do with stranded

costs recovery.

What we do have here is an argument that I think is helpful. That if you say that stranded costs don't exist until they are quantified in 2004, that would be an argument that prejudgment interest in a civil case is not appropriate because no damages exist until a judgment that determines the amount of the recovery.

O'NEILL: Are we bound by law of the case from equating those two? In other words, if the appellate court has held that you can't make them up to make any determination of stranded cost, and that issue has not been appealed to us, are we bound as law of the case to that proposition?

LAWYER: I would state it differently, that all parties accepted the decision of the CA.

O'NEILL: In other words, if we accept that decision could we then accept your opposing counsel's argument that we can take that into account in determining stranded costs?

LAWYER: Whether you can or should, my argument is that even if you consider it it makes no difference. It's an entirely independent consideration. It's not a mistake that the CA made.

O'NEILL: I understand that, and I didn't mean to imply that. My understanding of the premise of the court of appeals decision in that regard was that it is entirely different. And do we then as a matter of law of the case accept that premise and not even get into it?

LAWYER: I believe you should. But in saying that, I'm not concerned about your examining it, because I think under the statute you would necessarily come to the same conclusion. This is an opportunistic argument presented by the other side. Now it appears that the true up would run in the utility's favor.

HECHT: In the 2004 true up, not the capacity auction, when market value of the utilities assets are determined, is that - I take it that determination is made as of the day it's made. In other words, the 2004 true up determines market value as of whatever date in 2004 or 2005, not as of 2002. Is that true?

LAWYER: Not entirely. I think the market value transactions can occur over a very extended period of time. Anytime after 1999, the utility can sell at a stock transaction whatever. So you have these market values that can be determined in a series of transactions. And the purpose of the 2004 true up is to take those market values, compare them to 12/31/01 book value, and decide whether you have stranded costs.

HECHT: Usually when you think about market value, you think about it in a point in time, because things are changing. And they are certainly changing in this industry. And everybody agrees that natural gas prices, and weather, and other factors can influence market value. So when that market value is determined to compare it to the Dec. 31, 2001 book value, what date is being

used to determine the market value?

LAWYER: The date of the transaction that the utility entered into.

HECHT: Whether it's the sale of assets in Aug. 2004?

LAWYER: Yes.

BRISTER: Which could have been anytime from 1999 to 2004.

LAWYER: That's what the legislature decided. Nobody knows what these market values are going to be. So utilities would be given an opportunity to engage in these market transactions. And the ones that are now operative are close to the 2004 true up to sell, exchange, have stock offerings that would determine this market value. And as the legislative history indicates, that would provide a period of 2 years during which utilities would have an opportunity to test the market.

HECHT: Here is a statement in the Texas Industrial Energy Consumer's brief - respondent if you would: The market value of a utility's assets established in the 2004 true up proceeding is in no way indicative, reflective or tied to the market value those same assets had in 2002. What's your response to that?

LAWYER: I think that to say in no way it is, is incorrect. I think what the legislature decided, we don't want everybody to go out and sell everything 1/1/02. We want to have a period of time for these transactions. Then you take the transaction as long as it meets the statutory requirement, compare it to 12/31/01 book value.

PHILLIPS: How long can this go on?

LAWYER: Well it can't go on past the true up in 2004.

PHILLIPS: And the true up is at a definite date. Is that right?

LAWYER: No the true up has to be filed at some time after Jan. 10 of this year.

PHILLIPS: Until when?

LAWYER: That's all the statute says. There have been filings. The statute goes on to say that the commission is supposed to complete the hearing within 150 days. So the true up final order will not be until late 2004, maybe even later than that.

HECHT: But if AEP sale doesn't happen in August, if it gets delayed till Nov., then the true up might occur in 2005?

LAWYER: The information necessary for the true up would have to be available when AEP files for the true up. And I don't think there's any game playing here about people waiting forever to file.

PHILLIPS: Have Centerpoint and AEP filed? Either or both of them filed yet?

LAWYER: I think Centerpoint has filed.

PHILLIPS: I'm groping to understand. When Centerpoint files it's not going to be the value as of the date of that filing? It's some continuum over a 5 year period.

LAWYER: Centerpoint uses a partial stock offering as allowed by the statute. That stock offering has been going on for sometime. It has to exist for 1 year. The commission then has the opportunity to go back and pick a 30 day period of stock prices. Those are then used.

BRISTER: Within the last 4 months?

LAWYER: Yes.

BRISTER: So Centerpoint is going to be comparing stock valuation in Spring 2004 to book value in Jan 2002?

LAWYER: That's correct.

BRISTER: On the 2002 recovery, everybody has several options. You can switch depreciations. When was the earliest - could you switch all your depreciation as of Jan. 2002?

LAWYER: As Jan, 2002 depreciation is immaterial. You're now in a competitive environment. You don't recover depreciation as an expense anymore.

BRISTER: You could reduce stranded costs by shifting depreciation from the transmission distribution to the generation.

LAWYER: These mitigation efforts, you have to continue to use the tools that the statute provided earlier than 1/1/02. Once you're into the competitive environment you have to use good business judgment to try to reduce stranded costs.

BRISTER: So when could you switch depreciation to the generation assets?

LAWYER: But that would not have any affect on book value. Book value is...

BRISTER: When could you switch depreciation from the transmission to the generation? Before 02?

LAWYER: Before 2002 you were directed to do so by the legislature, but the commission said we're not going to have any stranded costs so you need to reverse it.

BRISTER: So you could have done that before 2002?

LAWYER: We could have and did.

BRISTER: And the same thing with securitization. That could have taken place before 02?

LAWYER: That's correct.

BRISTER: And under both of those the stranded costs book value would be reduced, stranded costs reduced, the ratepayers in the case of depreciation shift or the investors in the case of securitization would be paying back, I guess principal plus interest in both cases. Right?

LAWYER: Yes. The utility in that event would have the money. But in that event book value would be reduced, so stranded costs would be reduced. There would be no recovery of that amount.

BRISTER: So if they hadn't undone in 2002 the depreciation transfer, we wouldn't be here because carrying costs would have been eliminated and it would have been shifted to the ratepayers?

LAWYER: That's correct. If it had not been for the reversal of the EMC's and the reversal of the depreciation that the commission ordered, stranded costs would now be a lot lower. And in that respect, we are presenting the EMC issue in the alternative. Because if we receive as we believe we are entitled to receive interest on stranded cost back to 1/1/02, that takes care of the EMC problem.

OWEN: Centerpoint and AEP seem to be in different positions on the EMC. Is that correct, because Centerpoint is no longer appealing whether that was proper or not but AEP is?

LAWYER: That's correct, but not in this case. But in the contested case proceeding AEP still has that issue preserved. After this court's New Year's Eve opinion on the EMC's, Centerpoint went to DC and was assured that this matter would be taken care of at the true up. And the district judge said any prohibition against recovering interest on the EMC's was premature.

Now we are faced with a rule, however, that flatly says no interest on EMC's and no interest on anything until the true up in 2004. When we say with good reason that stranded costs were created 1/1/02.

OWEN: They could be different impacts on you and AEP depending on what happens

in the EMC?

LAWYER: In the long term in the other case, but there's no difference between the two companies in this challenge to the rule.

OWEN: If we were to say that you were entitled to interest on the EMC's, and AEP pursued all the way through the courts, it's right to say the EMC's were improper? That could all be washed out at AEP's case ultimately.

LAWYER: And it would apply in Centerpoint's case as well. Because the district judge in Centerpoint said it was premature to decide the interest issue now.

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RESPONDENT

BARRON: What I would like to do is to frame the issue for the court, then address the capacity auction questions that were asked by the court, and then address at what point in time does the market value of these assets, and then finally clarify the question of the scheduling for the true up that the court asked.

To frame the issue. Everyone agrees that the legislature nowhere actually instructed the commission to award interest back to 2002 if stranded costs are found to exist in 2004.

HECHT: Or not to?

BARRON: Or not to exist.

BRISTER: Or after 2004?

BARRON: Or after is when the legislature cut it off. In fact, in the rule making proceeding Centerpoint urged that the commission's rule should provide for interest prospectively beginning June 2004. And in its rule making comments, it also recognized that the capacity auction true up was the proper mechanism to address the 2002, 2003 period.

OWEN: Is a copy of those comments appended anywhere to the briefs or is it part of the record?

BARRON: It's part of the record. It's record item 7 at pages 28 to 29. Record item 16 at page 4, and then record item 45 at pages 97 to 98. But the argument here, nevertheless, is that the legislature implicitly intended to award interests as of 2002. And the argument is that on that day, the first day of competition, stranded costs were created, and in consequence the utilities lost all ability to earn a reasonable return over that ensuring 2002, 2003 period.

The commission disagrees that stranded costs were created on that date.

OWEN: What about the argument that there is a two year gap in there where they've got debt service and all of that?

BARRON: That ultimately is the crux of it. Because no matter how you come away with deciding when stranded costs were created, it's clear that the legislature put mechanisms in the statute, chief in point, but not solely the capacity auction true up to ensure that the utilities have what they are promised under the regulatory regime, a reasonable opportunity to earn a return on the investment.

OWEN: Explain to me how the capacity auction true up covers their debt service and operating costs during that two year period?

BARRON: The capacity auction true up is addressed for the court's reference in subsection (i) of the rule. And basically what it is, is truly an unprecedented wholesale revenue guarantee to the utilities that they will recover fully what the commission estimated to be, not only fuel costs, but also the fixed costs of operating their plants over that two year period.

HECHT: But unrelated to stranded costs isn't it?

BARRON: I think that it is entirely compatible with the commission's position to view stranded costs on one side as addressing - if there were stranded costs in 2004 you recover them; and that separately the legislature provided as the CA has ruled that the capacity auction revenue guarantee among other things provides the kind of opportunity for these utilities who still have the assets and can sell power in the market, to get revenues during the 2002, 2003 period.

HECHT: But is it true as petitioner says that whether the stranded costs were positive, negative, or zero that would have no effect on the capacity auction?

BARRON: That's absolutely correct.

HECHT: How are they related?

BARRON: The question for the court is - the sole justification for saying we want interest back for the 2002, 2003 period, is not that we won't recover the full amount that the commission finds, but that we were deprived of the use, the opportunity to earn a return during that interim period.

The commission believes that it was entitled to look at the statute and say among other things that these utilities still have these assets, they are selling in the market, they have expanded - the legislature recognized that there are expanded market opportunities to earn a return during that period. It wasn't like they were left to the dogs on that date. Plus, we, the legislature,

are going to guarantee that...

OWEN: But how is there an expanded right for the generating entity to have expanded opportunities? Because even if they did better in the market, or whatever, they are brought back down to the ECOM model. There was no upside or downside.

BARRON: First, brought back down I think is a misconception. The numbers are in on this. It hasn't been litigated before the commission. They sold power in the market. And Centerpoint anticipates that it will get \$1.2 billion...

OWEN: They got ECOM. Where was the opportunity to get more or less than ECOM?

BARRON: By having these assets participating in the market. Two sections that I think are worthy of the court's consideration to show that the legislature understood that there were opportunities in the market to bring a return...

OWEN: For the generating...

BARRON: Yes. For the generator.

OWEN: What are those?

BARRON: One is in §252(d). The legislature said that before the commission determines stranded costs in 2004, utilities are in the market, and have a duty to do what they can to use commercially reasonable means to reduce their potential stranded costs, including things like re-negotiating contracts. In the price to beat adjustment, which is 202(l), that allows the retail affiliate to request a fuel adjustment twice a year over the 2002, 2003 period. In a way that acts as a price umbrella basically to raise the retail price of power, which in turn can provide increased selling opportunities for the utilities.

I want to come back to this capacity auction true up, because it really is so unique and important and was specifically geared to the 2002, 2003 period. The numbers are in. If those numbers are indeed what the utility will get, it will reflect well above what the regulated return would have been for these utilities. \$1.3 billion is what Centerpoint believes it's owed, and \$450 million is what AEP believes that it's owed.

HECHT: As I understand the basis of the petitioner's position, it's that the legislature meant for them to have that anyway and that they are entitled to the interest. We're going to get an apple no matter what. What we want is an orange.

BARRON: I think the better way to look at the statute is that the legislature looked at these two separate periods and said, we've got this transitional two year period. Here's what we're going to do about that. We understand that market value fluctuates and we can't know whether

stranded costs exist or not while you are in the market selling. And for 2004, we will decide if stranded costs exist or not, and if you have them, you get them. And you don't get them all at once. If the number is real large you get it over time, you get interest appropriately.

OWEN: Let's say I have \$1 billion generating plant and I've got lots of day service. And this capacity auction is not going to make me whole. And the statute says I get it anyway. But it's not going to make me whole because the market value of this generating plant is only \$200 million. So I've got \$800 million in stranded costs of which I've been carrying the debt service for 2 years and the operating costs, which the operating costs are above market. How do I ever get that back?

BARRON: The \$800 million you get.

OWEN: And I've been paying debt service for two years on the \$1 billion.

BARRON: The legislature looked at it and said you get...

OWEN: But I get that anyway.

BARRON: You get that anyway. The legislature wasn't intending to give more than one could reasonably expect under the statute of the prior regulatory...

OWEN: They wanted me to get my stranded costs down, and I might have done it had the commission not stepped in. I didn't get it down. Now under the statutory scheme I get what I was supposed to get. Under the capacity auction I have no opportunity to recoup my debt service and these other costs.

BARRON: The question of whether you have stranded costs in 2004 is a question of what the revenues will be on a going forward basis. It doesn't address the question of whether you had a reasonable opportunity during this transitional period to earn a return, which is all this debate is about.

OWEN: What is the justification for the commission to say we recognize that going forward you have to get these carrying costs? For this two year period, we're saying you don't get them.

BARRON: Two reasons. One is, once you have a debt that's firm, you either pay up now or you pay over time and you should appropriately be awarded interest. And the second reason that the commission said this way, but not backwards is that the legislature put in these mechanisms to address this transitional period. These utilities have not lost the time value of money. They have been in the market, selling power, and now claiming large amounts of money that more than surpass what a regulated return would have been for this period.

O'NEILL: What if we get into all of this and disagree, and we find they are two different _____. Do you lose?

BARRON: No. If you conclude - there are two steps to the issue. One is whether the legislature put in mechanisms to get a reasonable opportunity to...

O'NEILL: And let's say...

BARRON: That's one side. The threshold question that's necessary to the argument is that stranded costs were indeed created on that first day.

O'NEILL: Or couldn't it be that they were created just some time before. Because by saying it's only from the true up proceeding forward, that's an arbitrary determination. So if there's any indication that stranded costs could be recoverable from a certain point in time. Let's say the assets are sold before 2004, and you know that number beforehand. The rule arbitrarily says you don't collect it till after the true up proceeding would seem to be just by definition arbitrary.

BARRON: What the rule does is it actually establishes a specific schedule for the utilities to do a true up following when they have completed their market transactions. It will be in March when stock transaction period finishes for Centerpoint.

O'NEILL: Then what about the 150 days? The order comes out on the 150th day...

BARRON: The legislature spoke to that issue. The legislature said we recognize that there is a time factor in here. And in 262(j), the legislature said, Commission, you have 150 days to get the job done to grant the thing. And on the other hand it gave at the front-end the commission express discretion to do appropriate scheduling. What the legislature did not do in addition to saying here is your 150 day limit, do it quickly. It didn't say and you should get interest for that period, as it did in Ch. 36.

O'NEILL: Presume that's the case. Isn't that arbitrary? If you're determining it as of the date of filing, even 150 days why is that not time value _____ loss of money?

BARRON: That's a traditional regulatory lag kind of concept. That the risk is traditionally borne by a utility when rates are awarded on a prospective basis unless the legislature has stepped in specifically as it did in ch. 36 and didn't do in ch. 39 to say, Well you can set temporary rates to be applicable during the time it takes to the proceeding. And if the legislature didn't do that, there's no statutory right to get it.

HECHT: When is market value determined as of?

BARRON: By way of example, last week the publically traded stock of Centerpoint's power generation company jumped 10% in a single day. It will go up. It will go down. It's been

going up. It's been going down. The legislature said for purposes of when market value is determined if you're going to do this publically traded stock route, that it has to be traded in the market when the utility chooses the time to go to the market for at least 1 year period. And then the commission has authority to pick, set the schedule for when the application will be filed by the utility and the commission has authority to look back over the last 120 day period and pick an appropriate 30 day period for purposes of valuation.

So for Centerpoint, the market valuation will occur by looking at a market segment sometime over the Feb/March period. For AEP they are selling assets. In August is when they do that. And so we just don't know what it is...

BRISTER: But either of those could have been in 2003 or 2002?

BARRON: Could have been, but weren't. And I think what's important is when the utility has the statutory right to choose, they have chosen by nature, inherently you decide whether or not you have stranded costs by comparing the appropriate time for when market value is established. And we know that's 04. And you compare that to book value. Under 262 the utilities have had a duty to reduce their book value using commercially reasonable means straight through to the true up. Which is why our view is that stranded costs are created when those two variables stop and you know that the culmination of events has stopped and you make that determination in 04, not in 02.

HECHT: When the utilities were ordered to give EMC's and pay interest going forward, if it is determined that that was improvident and those EMC's should not have been ordered and they come back, does the interest that was paid become a part of the corpus that comes back to the utility or not?

BARRON: Yes. Because it won't get _____ paid at once, the utilities will get prospective interest, not even just at the 7.5%, but in a 9-12% range.

HECHT: They were giving the EMC's and paying 7.5% interest over time. So that total number comes up to be the EMC plus the interest. And so when they recover that do they get back the EMC plus the interest?

BARRON: That is my understanding.

O'NEILL: They are out that interest which they could have been earning interest. So that in a sense becomes part of the corpus?

BARRON: You're right. If the commission was wrong to have ordered that, then they ought not just to get the corpus and the 7.5% interest, but they ought to get that lost time value of money. But that's not an issue in this case.

O'NEILL: And it has nothing to do with the rule?

BARRON: That's our position.

OWEN: Are we, or are we not looking at fixed interest rate, or are we looking at an individual company's actual carrying costs?

BARRON: I think we're looking at weighted costs of capital, which will vary by utility.

OWEN: So it's not just a set rate that the commission fixed. They look at the actual company's - what their actual expenses would have been during this...

BARRON: They are not going to do a new proceeding. They are going to look back to what happened under the regulatory regime last go around. And I think it's in the range of 9-12. It's utility specific. In both cases it's in excess of the 7.5%.

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DAY: I represent TIEC. TIEC is about 30 large consumers of electricity, including refiners: Exxon, Mobile, Shell and others, Petro chemical manufacturers, Oxy and others, as well as major hospitals in the Texas Medical Center. These are users of large amounts of electricity. We are deeply concerned about the implications of this case on our rates. I don't think there's any significant disagreement among the intervener ratepayer groups. And so our comments really represent a common view point among all ratepayers. We have the City of Houston, residential customers, commercial customers, the State of Texas, and a number of others who have expressed a strong interest in this case.

Let me begin with an agreement with Mr. Barron, and that is, there is no dispute in this case that as of the determination by the commission in a final order of what stranded costs are, a utility is entitled to that amount, plus its carrying costs going forward. Ratepayers recognize that that's the regime that the legislature established. That's not what we're talking about here. What we're talking about is the effort by the utilities to ask this court to go back and add to that amount an additional amount which is characterized...

O'NEILL: Not really. My understanding of what we are supposed to do here is just determine whether this rule is arbitrary or not. And if we do that, the commission can then hear evidence and decide in a particular case whether interests or carrying costs went back before that. It sounds like we're being asked to do a lot of advisory sort of things when really all we need to do is determine whether this only true up forward calculation is just arbitrary.

DAY: And in that respect, that reflects our client's viewpoint. The rule is not arbitrary insofar as it establishes that carrying costs are applicable from the date of the true up forward. No one contests that that is a reasonable provision in the rule. What the utilities want is

to have this court inject into the rule a further provision, a requirement without any of the facts in this case. We've had discussions about the capacity auction true up, how much had the utilities recovered during this two year period. What they are saying is they want the court to rule that they are entitled as a matter of law to an additional amount when the facts about what the utilities have actually realized during this time period are not before the court.

OWEN: But we're testing the rule. We can make assumptions high, low, middle to test the rule. Would it be arbitrary and reasonable under these circumstances. Regardless of whether they ever occur, we are just testing the rule.

DAY: We know and it's recited in our brief that these utilities have already reported to the SEC that they are entitled to non-cash earnings. The case of Centerpoint \$1.35 billion attributable to the capacity auction true up. That is based upon a market assumed price pursuant to the ECOM model that includes within it the investment in generating facilities, the operating costs and all of the other elements. The utilities claim that the ECOM model has made a market prediction that is much too high. Keep in mind that the capacity auction true up delivers to the utilities a difference between that price, which they claim is much too high and what they've actually received. This commission has not ruled that these utilities will not earn a reasonable return in 2002 and 2003. This commission has not heard the evidence. It has not heard anything about whether or not the capacity auction true up has actually operated in a reasonable fashion, what the earnings have been in terms of their operations of their generating plants. None of that has been determined by the commission. And the commission has not yet ruled...

HECHT: That's the troublesome thing that they have not heard all of that and haven't ruled, but they have ruled no interest except going forward.

DAY: What they ruled is that interest will go forward. But what they haven't been called upon yet to do is to say, taking into account the capacity auction true up and all other elements potential interest on the ECOM, the returned amounts, what are the utilities entitled to.

HECHT: What if they think after they hear all of that and look at those numbers, that they really should have had interest for the 2-year period?

DAY: They have enormous flexibility at the commission. They have to set just and reasonable rates. Our position is, that what...

OWEN: They don't set those for the generation _____.

DAY: They do in the sense that they are entitled to make a determination of stranded costs. And they have a determination to be made about what is a reasonable resolution based upon the capacity auction true up and the earnings of these companies. What we're concerned about is that if the court should hold - Yes. Interest is required. We are going to engraft that into the statute...

O'NEILL: I don't understand that we need to do that in order to rule their way. If we just were to say that this does appear to be a fairly arbitrary date, the commission wants to hear all the evidence can determine when the interest shall run. I don't understand that we have to totally buy hook, line and sinker the accrual argument in order to say the rule appears to be arbitrary.

DAY: First of all, I want to say unhappily it is a given in the context of deregulation that there has to be an arbitrary date when stranded costs are determined. And it is just in the nature of the process that the curtain has to fall for each of these utilities at a point in time.

PHILLIPS: And is that the date they file or the date the commission chooses from within their filing?

DAY: We've had a discussion about the various methodologies. Certainly a key ingredient is the date of their application. For this utility based on the formula, that is Centerpoint, the 30 day moving average of the stock, the curtain will fall on that date, and then the commission will have some discretion about selecting that 30 day evaluation period.

So we have to have a date. And then the question is, Well has the commission made a reasonable determination of stranded costs based on the facts and circumstances, based on the methodology selected and all of those other considerations. The separate issue is, what has been the results during this 2002, 2003 time period? And what we are very, very strongly concerned about is that the utilities - and I agree with you. I think the court has the discretion not to say, which they would like for you to do is say, we're entitled to not interest, that's a misnomer, it's a guaranteed rate of return. It's their average cost of ...**SIDE A RUNS OUT.**

SIDE B

...It's characterized as interest but that's what they want. They want a guaranteed rate of return from Jan. 1, 2002 until a final order in this case. That's not what they indicated to the commission. I want to emphasize what Mr. Barron said neither of these utilities told this commission at the time this rule was adopted that they thought they were entitled to a guaranteed rate of return back to Jan 1, 2001. Look through the record. Look at the comments of these utilities. Neither one of them said Boo about this. To the contrary. Centerpoint said, We think interest should accrue from approximately June 1, 2004 until whatever date there's a final order in the case.

OWEN: Was the rule adopted before the EMC's were ordered or after?

DAY: I don't know.

OWEN: It all seems so intertwined to me. I'm having trouble sorting it out because it seems like the generating companies are kind of caught in traffic that was not of its own making. It wanted to reduce its stranded costs. They did the appreciation. All of that to get stranded costs down. And then the commission came along and reversed all of that, so that its stranded costs are

now high. It would have had this fixed stream of income, and now the commission through the EMC's have kept stranded costs way up there. They've had to do the debt service on that and all of that, and they have no way to recoup it, where they would have mitigated a lot of this had the commission not interfered. So now the commission is saying we got you both ways.

DAY: These utilities are entitled to their stranded costs and they are going to get them. What they are asking here is for this court...

OWEN: Haven't they had higher carrying costs in the interim because of the commission's actions?

DAY: No.

BRISTER: In other words, they would have gotten the stranded costs returned earlier, but for the EMC's?

DAY: Right. And it is not clear that there are going to be any stranded costs. The court should not assume...

OWEN: Again we're looking at the rule of how it could operate. And it casts whether it's arbitrary or not. And let's assume the state facts to go into J. Brister's question.

DAY: It is accurate. If stranded costs are determined to exist, then if they had not refunded in the form of excess mitigation credits, they have lost the use of that money during the time period. The commission pursuant to the DC ruling, the commission has the discretion to determine, at least in our view, that interest is due on that during that time period. They can give that money back to them if that's what they want to do. What they want this court to do is to make a ruling - without any of the facts they want rigged rulings that we get interest from Jan. 1, 2002, and we get interest on the EMC's without knowing any of the facts relative to what stranded costs might be.

O'NEILL: Are you saying that the commission has the discretion to award interest before the true up proceeding judgment on the EMC's?

DAY: Not before the true up. This is all going to come down at the time of the true up.

O'NEILL: At the true up could they award interest before the true up?

DAY: I think they have that discretion.

O'NEILL: Their argument is going to be the rule does not allow that.

DAY: The rule says you get interest on stranded costs from the date of the order forward. It doesn't say and you get no other interest, you don't ever get any other interest. It says what you are entitled to, to which we have agreed.

O'NEILL: How do you square the CA's opinion on inability to net up against stranded costs, the capacity auction true ups because they are a different thing?

DAY: Keep in mind that the CA ruled that the interest was not due from Jan 1, 2002. The CA never addressed the implications of its opinion that the capacity auction true up is not a stranded cost on the question of the entitlement of the utilities to a reasonable return during this time period. They never reached that question. Yes. They did say the capacity auction true up is not a stranded cost. They said there is a close nexus. Our view is, and it's stated in our brief, that it's impossible to separate all this. We are moving from a regulatory regime to an unregulated regime. And yes, there is this interim period that the CA identified. And yes, the court said you can't net between these various items. But the court never reached or stated in any way what the implications were vis a vis, the return or the protection of these companies during this interim period.

We are not opposed to these companies earning a reasonable return. What we are very afraid of, and the reason we are here is that they want to stack interest and capacity auction true up. And what they are going to get is a return vastly in excess of what they would have received in a regulated regime, including all of their costs, the return, and so forth. And what they want this court to do is put the utility commission in a straightjacket so they have to award more during this time period than they would have been entitled to in a regulated...

O'NEILL: So you would be fine if we said, we're not going to answer the question of whether they are entitled to it back to the beginning of competition. If we just said the rule does appear to be arbitrary, the commission can award interest as it sees fit in the hearings. Your concern is that we make the affirmative statement that it's recoverable back to competition?

DAY: That is our principal concern because we believe that if you should make a direction to the commission that they must award interest, what will happen is ratepayers will be severely damaged because these companies will get more than they are entitled to.

O'NEILL: Not that they must award interest, but just that this statute - the commission to do what it deems appropriate in its discretion as to interest but that this statute is arbitrary. And it just throws it to the commission to determine.

DAY: I submit to you the rule is not arbitrary. And what the utilities want you to do is to say the rule should have additional elements in it, and they want you to go into it without the facts before you.

OWEN: What happens if the true ups occur for the stranded costs before there is a final decision in the courts about the propriety of the EMC's? Can you go back and undo the true up if

the courts would ultimately say the EMC's were incorrect? How do you undo all of that?

DAY: Money is fungible and with taking into account the time value of money, I am certain that between the commission and the courts if it is determined that excess mitigation credit should not have been awarded, there is a mechanism whereby interest can be provided to make the utilities whole. They have lost...

OWEN: Do you go back and restore the credits and then redo the true up? What do you do? How do you ever get back...

DAY: You just assume that, which is what the utilities have asked this court to direct. They want you to rule here in an opinion that they were entitled to this interest from the date of the excess mitigation credits. They can be made whole for the time value of money.

OWEN: I'm just asking you how this works in your view. Do you go back and redo the true up if it's determined that the excess mitigation that the utilities were doing were proper and the commission had no statutory authority to stop it. How do you go back and put the genie back in the bottle and figure out true up costs?

DAY: The excess mitigation credits are attributable to excess earnings, everybody agreed to that. These utilities were allowed to collect excess earnings. Earnings over and above a reasonable rate of return. And they put them to the side and they said, We're going to credit that against potential stranded costs. At a later time the commission came in and said, Well it doesn't look like there is going to be any stranded costs so we are going to start refunding. They haven't refunded all those excess earnings. I believe it was laid out over a regime of 5 years, perhaps 7. And they have refunded for a certain period of time. In order to make them whole if it is subsequently determined that there are stranded costs and that they were entitled to offset, you can give them the value of the money back to the date that the credits were issued.

OWEN: What about the depreciation switch. What do you do about that?

DAY: I don't believe at this point that the depreciation switch can be - I'm less clear about that. I want to be candid with you. I don't believe all the depreciation shift can be remedied at this point because it affects the TND Utility's rates, because the rates that they have been entitled to collect so that is a much more difficult matter. But keep in mind that under a securitization regime once stranded costs are determined they are in a position to realize in cash the full amount of the stranded costs as a single payment. The whole regime is based on that. So I don't think the court needs to be concerned that they are going to be disadvantaged in this circumstance.

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REBUTTAL

LAWYER: Let me begin by straightening out the capacity auction. The projected price

that the commission came up with is based on the assumption that the market would be driven by a most efficient, combined cycle gas plant. That's what will drive a competitive market. The marginal unit that will drive the market and produce the most efficient price. That gas plant price almost by definition is not sufficient to recover the unrecovered costs in a nuclear plant.

So the idea that the capacity auction has anything to do with stranded costs is a myth. The commission estimated what the competitive market price would be after 1/1/02 based on a gas plant. And that's the whole idea of competition. Gas plants perhaps can provide power more efficiently than big old nuclear and coal plants.

HECHT: Would you respond to the respondent's statements that Centerpoint's position before the commission was different?

LAWYER: This is a rule-making. This is not a contested case. In these rule-makings you have workshops, you have discussions, there is no ex parte prohibition. You simply come in and discuss the rule. Then you have a statutory right after the rule is promulgated to challenge the validity of the rule. That's what both ADP and Centerpoint have done.

OWEN: Going back to the capacity auction. The ECOM model, it's company specific isn't it? He mentioned something about your debt service was in there.

LAWYER: No. The debt service isn't in there.

OWEN: He said your average cost of cap...

LAWYER: He said a lot of things I don't agree with. The only thing I agree with is his statement that the only way the utility can be made whole is to take into account the time value of money.

OWEN: Explain to me what goes in to the ECOM model and how that translates into the capacity auction, and what is taking into account?

LAWYER: One of the factors in the ECOM model is to determine a projected price of power, wholesale price.

OWEN: But it's different for each company. Right?

LAWYER: No. I don't think so. It could be in each rate case. But the standard is no different. You determine what the price of power is likely to be in a competitive environment, and that price is dictated, driven by a combined cycle gas plant.

OWEN: So what is the company's specific data that goes into all this?

LAWYER: I don't know that there is company specific data on that. It's an abstract insert into a computer model. And they projected that at a level which turned out to be too high even for gas plants. But it's very difficult for me to sit here and hear these people argue that that was intended to recover the costs of a nuclear plant. It wasn't. That's what competition is about. Competition will produce prices lower than the utility will be able to recover in terms of the fixed costs, the unrecovered costs of nuclear power plants that the commission and everybody else said was _____ to build when they were built.

O'NEILL: Is there anything in the proceedings to indicate that somehow the capacity auction true up amounts were intended to mirror any sort of return on generation investment?

LAWYER: Absolutely not. And again, as I said at the outset, this is an ad hoc appellate argument that was raised after the CA's decision.

OWEN: What about Mr. Day's statement that you would get in return vastly in excess of what you would have earned in a regulatory environment?

LAWYER: That's simply wrong, and it's indicated by the point I'm trying to make about the gas price and the capacity auction true up being based on an assumption that the competitive prices will be driven by gas plants. And that's the whole idea. Those competitive prices are going to be lower than the price that would have to be charged to recover the stranded costs in a nuclear plant. It's just as simple as that.

So the capacity auction has nothing to do with stranded costs.

O'NEILL: I'd like to know about the 150 day lag. Do you agree that that's just generally regulatory authority - that you're not entitled to - if we were just looking at the 150 day hearing period.

LAWYER: We're not a utility anymore. It says that. We are entitled to recover all of our verifiable stranded costs.

O'NEILL: And if...

LAWYER: The only way that can be done is to go back to when they were created, 1/1/02 and allow interest from that day.

O'NEILL: But if we did not apply that line of authority that says that's just part of the regulatory lag, and determine based upon the definition of stranded costs and the premise that you are required to recover carrying costs on that amount, the interest on just 150 days would be something that is intended to be recovered. Wouldn't that be enough to make the rule itself arbitrary?

LAWYER: This is an important point. This rule is arbitrary. There is no doubt about it. But this is a competition rule that the legislature said the commission should announce in advance before the 2004 true up, so that the commission in the true up would be bound by the rule, like a statute. And this court has said many times that when you've got a rule, the commission has to follow it. So what we're faced with now is the commission in the true up having to follow a rule, no matter how you read it, that says no interest.

O'NEILL: I guess that's my point. We don't have to decide that interest should start to run on stranded costs from the date of competition.

LAWYER: I would suggest that you do. Because otherwise it's going to go back to the commission. The commission - Lord knows what they will decide, but they open to decide that they don't have to allow interest back to 1/1/02. And the only way for this process to move forward free of years of litigation, repeated arguments in the CA and in this case, appeals from the true up proceedings, is to establish now what the ground rules are.

PHILLIPS: But it sounds like you do agree with Mr. Day that on the state of the record and the commission's rule they could decide that you could get interest on stranded costs.

LAWYER: I think it would be a violation of the rules for them to say that. Mr. Day is not speaking for the commission.

PHILLIPS: I suppose that waiting for a SC opinion is not one of the grounds that they could extend making their final decision on a true up correct?

LAWYER: I have trouble with that. I think the purpose of the appeal of a rule is to decide whether the rule constitutes a valid implementation of the statute. And I think that this court needs to decide that this rule is not only arbitrary, but that it fails to follow the statute because it does not provide for interest from 1/1/02.

OWEN: From your perspective what does the timing of all this mean? If the commission does the true up before this court issues an opinion, would that make this all moot or should we expedite this?

LAWYER: Certainly it should be expedited if that fits the court's resources and schedule. These proceedings are going to drag on. The 150 days is directory. These true up proceedings will last possibly for weeks or months. This is February. A decision by this court clarifying the law in this area, not simply sending it back because this rule didn't quite do it, but making it clear that interest is due from 1/1/02 would simplify the whole process enormously.