

Public Utility Commission of Texas

Memorandum

TO: Chairman Donna L. Nelson

FROM: Commissioner Kenneth W. Anderson, Jr.

DATE: August 9, 2013

RE: **Open Meeting of August 9, 2013, Agenda Item No. 11, Docket No. 41233**
Application of Entergy Texas, Inc., ITC Holdings Corp., Mid South Transco LLC, Transmission Company Texas, LLC, and ITC Midsouth LLC for Approval of Change of Ownership and Control of Transmission Business, Transfer of Certification Rights, Certain Cost Recovery Approvals and Related Relief

This case presents significant legal and factual questions for the Commission. Applicants Entergy Texas, Inc. (ETI), ITC Holdings Corp. (ITC), and their respective affiliates (collectively, Applicants) seek approval of a transaction that transfers ownership and control of ETI's transmission assets to affiliates of ITC (the Transaction). Depending on whether and how the Commission approves the Transaction, it may have significant and long term effects on the ratepayers in southeast Texas and other jurisdictions. In their Proposal for Decision (PFD), the Administrative Law Judges (ALJs) recommend that the Commission deny Applicants' proposed Transaction.¹ The ALJs reach this recommendation, first, because the Transaction is inconsistent with policy objectives of the Public Utility Regulatory Act (PURA)² on the basis that it contemplates the divestment of a vertically-integrated utility's transmission assets in an area of the state where customer choice has not been introduced.³ Second, the ALJs conclude that the record evidence does not support a finding that the Transaction is in the public interest because its costs do not justify its benefits, which the ALJs find speculative and difficult to quantify.⁴

Because of the importance and consequences of our decision, I wish to state my position with respect to the PFD. I also wish to emphasize the importance of the parties' due process rights in a matter where a firm decisional deadline limits the time in which those parties may submit evidence in support of their legal positions. This discussion includes my view regarding the ALJs' ruling to strike rebuttal testimony of Christopher Kapfer offered in support of the Transaction. Finally, I want to address the public interest considerations at the heart of the PFD, listing the necessary conditions I would require to reach a determination that the Transaction is in the public interest. I address these issues in turn.

¹ *Application for Approval of Change of Ownership and Control of Transmission Business, Transfer of Certification Rights, Certain Cost Recovery Approvals, and Related Relief*, Docket No. 41223, Proposal for Decision at 2 (July 9, 2013) (PFD).

² Public Utility Regulatory Act, TEX. UTIL. CODE ANN. (Vernon 2007 & Supp. 2012).

³ PFD at 14.

⁴ *Id.* at 54.

I. THRESHOLD LEGAL ISSUES AND DUE PROCESS.

Commission Authority to Approve TSP-only Utilities and Transfer of Transmission Assets: I have reviewed the parties' exceptions to the PFD as well as the replies to those exceptions. Some who oppose the transaction continue to argue that PURA does not permit the certification of a transmission-only utility outside of the Electric Reliability Council of Texas (ERCOT) region. In addition, certain challengers argue that a vertically-integrated utility may not transfer its transmission assets in an area where customer choice has not been introduced.

Having considered these arguments, I remain convinced that the conclusions of my July 18, 2013 memorandum⁵ regarding the Commission's legal authority in this case remain correct. Accordingly, and without restating my previous legal analysis, I would adopt the PFD with respect to its determination that the Commission may certify a transmission-only utility outside of ERCOT. However, I would reverse the PFD's conclusion that Subchapter J of PURA Chapter 39⁶ prohibits a vertically-integrated utility from transferring its transmission assets in an area where customer choice has not been introduced.

Due Process Considerations Regarding Applicants' July 2 and 13 Filings: The evidentiary record in this matter closed on June 13, 2013.⁷ On July 2 and 12, 2013, Applicants filed additional evidence regarding their commitments made in other retail jurisdictions in connection with the Transaction.⁸ These two filings purport to offer material enhancements to commitments Applicants previously made in connection with the Transaction. Importantly, Applicants assert that this new evidence provides enhanced additional rate mitigation benefits that would partially offset the increased costs that would flow from the change in the weighted average cost of capital (WACC) associated with ITC's ownership of the transmission system.

However, as the Third Court of Appeals recently and pointedly reminded the Commission in *Oncor Electric Delivery Company LLC v. Public Utility Commission of Texas*, due process requires that "parties must be able to present evidence on the issues to be decided."⁹ Further, "[a]n agency's decision is arbitrary when its final order denies parties due process of law."¹⁰ Commission rules allow parties to introduce evidence that supplements prefiled testimony, but such evidence must be introduced before or during the hearing.¹¹ Further, our rules weigh against introduction of supplemental testimony when opponents do not have an opportunity to respond.¹²

⁵ Memorandum of Commissioner Kenneth W. Anderson, Jr., Docket No. 41223 (Jul. 18, 2013).

⁶ PURA §§ 39.451 – 39.463.

⁷ PFD at 5.

⁸ Informational Filing Regarding Applicants' Relevant Commitments, ITC Exs. A and B (Jul. 2, 2013) and Informational Filing Regarding Applicants' Amended Proposed Commitments, ITC Exs. A and B (Jul. 12, 2013).

⁹ *Oncor Electric Delivery Company LLC v. Public Utility Commission of Texas*, No. 03–11–00233–CV, 2013 WL 3013899, at *12 (Tex. App.—Austin Jun. 14, 2013, no pet.).

¹⁰ *Id.* at *9 (citing *Lewis v. Metropolitan Savings & Loan Association*, 550 S.W.2d 11 (Tex. 1977)).

¹¹ P.U.C. PROC. R. 22.225(c).

¹² P.U.C. PROC. R. 22.225(c).

In this case, the Commission's consideration of Applicants' July 2 and 12, 2013 supplemental filings would necessarily occur after the hearing and close of evidence. Therefore, such consideration would deprive the challengers of an opportunity to respond to the information in the late filings with their own evidence in contravention of the Commission's procedural rules. *Oncor* stands for the principle that the Commission's departure from established rules and practices is a violation of due process when that departure deprives a party of the benefit of reliance on those rules and practices.¹³ Our consideration of the evidence in the late filings without providing the challengers an opportunity to respond to it would violate the due process rights of the challengers. For these reasons, I believe the Commission may not consider the additional evidence presented in Applicants' July 2 and 12, 2013 filings when determining the public interest as it relates to the Transaction.

If this were a typical case, we could delay the procedural schedule and refer the late filings back to the State Office of Administrative Hearings (SOAH) to provide all of the parties with an opportunity to consider and test fully the additional evidence.¹⁴ However, we are not at liberty to do so here because this case is subject to a strict jurisdictional deadline of August 18, 2013.¹⁵ Simply put, we do not have time to allow the parties to appraise and rebut the assertions provided in these or any late filings. Even if Texas ratepayers may benefit from the Applicants' enhanced last-minute commitments, such action by the Commission would leave its final order on the Transaction very likely subject to reversal upon subsequent judicial review for the reasons set forth. Consequently, I believe that the Commission may not consider the late filings in its decision in this matter.

Rebuttal Testimony of Christopher Kapfer: In its rebuttal case, ITC presented testimony of Christopher Kapfer regarding expected savings from economies of scale resulting from expanded transmission business if the Transaction were to occur.¹⁶ The ALJs excluded this testimony after determining that it should have been part of ITC's direct case. In its exceptions to the PFD, ITC requests that the Commission overturn the ALJs' ruling with respect to Mr. Kapfer's testimony.¹⁷ In my view, Mr. Kapfer's testimony constitutes evidence that was required to have been presented in ITC's direct case because it related directly to issues the Commission directed the parties to address in its preliminary order.¹⁸ Specifically, information about savings resulting from economies of scale was germane to the preliminary order's directive that the parties provide evidence of cost savings and benefits, both quantitative and qualitative, associated with the Transaction.¹⁹ Accordingly, I would uphold the ALJs' ruling to exclude the testimony.

¹³ *Oncor*, at *12.

¹⁴ See P.U.C. PROC. R. 22.262.

¹⁵ PURA §§ 39.262(m) and 39.915(b) require that the Commission make a determination regarding the Transaction not later than 180 days after the filing date of the application.

¹⁶ PFD at 41, n. 60.

¹⁷ ITC Holdings Corp. and ITC Mitsouth LLC's Exceptions to the Proposal for Decision at 24 (Jul. 22, 2013).

¹⁸ *Application for Approval of Change of Ownership and Control of Transmission Business, Transfer of Certification Rights, Certain Cost Recovery Approvals, and Related Relief*, Docket No. 41223, Preliminary Order (Mar. 29, 2013).

¹⁹ *Id.* at 5.

Lastly, I wish to comment on the relatively tight deadline in this case as it applies to evidentiary matters. At the outset, the Commission identified the importance of this matter and sought to clarify precisely the issues and evidence the parties were expected to address.²⁰ The parties were on notice that the 180-day deadline would likely impose constraints requiring that evidence be gathered, organized, and ready for administrative proceedings.²¹ In the wake of *Oncor*, I again wish to emphasize the necessity of preparing complete and responsive direct evidentiary materials in a timely fashion to allow all parties to respond to evidence submitted in SOAH proceedings in accordance with our rules.

Should the Commission uphold the ALJ's recommendation with respect to the "public interest finding", I would note that nothing prevents the Applicants from submitting another Transaction application with a complete presentation of evidence, including the excluded testimony of Mr. Kapfer in Applicants' direct case, as well as information provided in Applicants' filings of July 2 and 12, 2013. The inclusion of those materials in evidence would go a long way in providing firmer support for a finding that the Transaction is in the public interest.

II. PUBLIC INTEREST CONSIDERATIONS.

The PFD recommends denial of the Transaction application because the ALJs find that the Applicants have not met their burden of proof that the Transaction is in the public interest. With the record evidence as admitted by the ALJs, I am inclined to agree with the ALJs recommendation. However, if my colleague disagrees with the ALJs' recommendation on this issue, I am willing to consider a different finding if we impose all of the conditions set forth below. However, I would require that any order approving the Transaction with these conditions must include a mechanism whereby all of the Applicants, and their respective successors and assigns, explicitly agree to be bound by all conditions notwithstanding their rights under applicable federal law within 30 days of entry of the order approving the Transaction. These conditions are as follows:

Rate Proceeding and Cost Recovery Conditions

- All transmission-related cost increases by ITC that would ultimately flow through to Texas wholesale and retail customers through ETI as a result of the Transaction, including without limitation any increased costs attributable to the WACC of ITC, shall first be approved by the Commission upon a showing that the quantifiable Transaction benefits equal or exceed such costs.
- Applicants shall not seek to recover compensation paid to any party to settle any part of this case or any part of Docket No. 40346²² from Texas ratepayers.

²⁰ Open Meeting Tr. at 17:22-25 (Mar. 28, 2013).

²¹ See *id.* at 27:20-24.

²² *Application of Entergy Texas, Inc. for Approval to Transfer Operation Control of its Transmission Assets to the MISO RTO*, Docket No. 40346.

- Applicants shall agree to delete section 5.13 of their Merger Agreement, which prohibits ETI from opposing, contesting, or challenging any proposed ITC rate increase in a Federal Energy Regulatory Commission (FERC) proceeding for a period of five years.
- Applicants shall provide a rate mitigation plan that is no less favorable than has been or will be provided to any of the ratepayers of any of Entergy's operating companies other retail jurisdictions on account of the Transaction.
- If any Entergy, ITC or any of their respective operating companies commits to provide rate discounts or concessions to customers in any other jurisdiction in which Entergy operates, ETI and ITC shall offer substantially the same concession to customers in Texas.
- Applicants shall not seek to recover any costs incurred to effectuate the Transaction from their customers.
- ITC shall not recover costs from Texas ratepayers for the upgrade or replacement of the facilities being purchased from ETI without the prior approval of the Commission. If ITC plans to recover such costs, then ITC shall evaluate the condition of the facilities and provide a detailed cost and description of the facilities' conditions and associated explanations of the upgrade replacements and costs to the Commission before it can seek recovery of the costs.
- ITC and its affiliates shall agree not to seek any incentives for new transmission projects allocable to Texas, regardless of the location of the facilities, and to seek prior Commission approval for any new transmission costs allocable to Texas regardless of the location of the facilities, for a period of ten years.
- ITC shall not request from FERC a return on equity (ROE) or capital structure for the transmission assets it acquires from ETI different from ETI's current Commission-approved ROE and capital structure for a period of five years.

Regulatory and Oversight Conditions

- ITC shall submit to the Commission a report on the analysis of the transmission system formerly owned by ETI and any related plan to improve the transmission system in Texas before such improvements are undertaken. ITC shall work in conjunction with the Commission to consider and pursue transmission projects recommended by the Commission and consistent with ITC's planning criteria.

- The Commission shall maintain input on transmission planning activities of ITC, and Applicants shall support an oversight group similar to the existing Entergy Regional State Committee (ERSC).
- ETI shall keep the Commission apprised of ITC Transaction activities in other jurisdictions in which Entergy operating companies operate, and Applicants must provide all Transaction-related orders, updates, studies, reviews, reports, and analyses as required under the orders of the other jurisdictions.
- ITC shall provide to the Commission any periodic filings required by other regulatory jurisdictions related to transmission system safety and reliability.
- ITC shall conform with the State of Texas Operation Center guidelines and provide full support to the transmission facilities pursuant to such guidelines at all times.
- ITC shall designate an employee whose main work location and residence is in Texas to be a liaison to the Commission on behalf of ITC.
- ITC shall propose and support in the Midcontinent Independent System Operator (MISO) planning process those transmission projects identified in any MISO study that are expected to reduce congestion in a cost-effective manner.
- ITC shall make a presentation to Commission staff of the MISO transmission planning process as it relates to the Texas market annually and provide the projects, solutions, and mitigation plans. ITC shall also include annual presentations of operations and maintenance procedures and provide Commission staff with a report of the challenges faced and solutions performed during the year.
- ITC shall make a detailed presentation to Commission staff regarding any proposed rate increase before it files a rate case with the FERC.
- Applicants shall provide to the Commission an emergency response plan that reflects coordination and communication between Applicants, the Commission, local governmental authorities, and applicable emergency responders. Applicants must submit to an independent audit of their storm response by an auditor chosen by the Commission and paid for by ITC and ETI in equal shares. If the auditor finds that storm response could have been undertaken more quickly or efficiently then Applicants must agree to compensate their customers for the delays in an amount the Commission determines to be reasonable.
- ITC shall agree that the certificate of convenience and necessity (CCN) it obtains through the Transaction applies only to the existing transmission it acquires from ETI and does not authorize ITC to own, construct, operate or maintain additional transmission, including transmission outside the ETI service area without first obtaining a

Commission-approved amendment to the CCN allowing such ownership, construction, operation, or maintenance.

Transmission System Maintenance Conditions

- ITC shall provide the Commission a transmission-related vegetation management plan to ensure continued maintenance of the Texas transmission system. The vegetation management plan must show allocations of expenses and responsibility among ETI and ITC.
- ITC shall provide the Commission staff a detailed root cause analysis with solutions when any damage to the system results in loss of power to customers.
- ITC shall file with the Commission its proposal for hardening of the transmission system to mitigate the damage caused by storm or other factors.
- ITC shall provide to the Commission the procedures and associated resources that it will make available in the event of a hurricane or other disaster. Applicants shall provide to the Commission the names and contact information of ITC personnel so that Commission staff has complete, 24 hour communication with applicable personnel regarding the repair of facilities because of a hurricane or other natural disaster. ETI and ITC shall conduct joint storm drills at least one time per year.

Miscellaneous Conditions

- The Transaction shall not be consummated before ETI and the various Entergy operating companies are successfully integrated into the MISO transmission system.
- ITC shall assume all liabilities for unfunded retirement or other obligations such as historical transmission storm damage.

I look forward to discussing these issues with you at the open meeting.