

PROJECT NO. 27401

**RULEMAKING AND PROCEEDING TO § PUBLIC UTILITY COMMISSION
ESTABLISH SCHEDULE FOR TRUE-UP §
PROCEEDINGS UNDER PURA §39.262(c) § OF TEXAS**

**ORDER ADOPTING AMENDMENT TO §25.263, RELATING TO TRUE-UP
PROCEEDING, AS APPROVED AT THE JUNE 18, 2003 OPEN MEETING**

The Public Utility Commission of Texas (commission) adopts an amendment to §25.263, relating to True-up Proceeding, with changes to the proposed text as published in the April 4, 2003 *Texas Register* (28 TexReg 2848). The amendment to §25.263 implements the provisions of Public Utility Regulatory Act (PURA) §39.262, which sets forth the requirements for the final true-up of stranded costs. The amendment modifies subsection (d)(1) to establish the true-up filing schedule required by PURA §39.262(c). This amendment is adopted under Project Number 27401.

The commission received written comments and reply comments on the proposed amendment from AEP Texas North Company and AEP Texas Central Company (collectively, the AEP Companies); Centerpoint Energy Houston Electric, LLC and Texas Genco, LP (collectively, Centerpoint); Office of Public Utility Counsel (OPC); Texas Industrial Energy Consumers (TIEC); and TXU SESCO Energy Services Company (TXU SESCO). Additionally, Reliant Resources, Inc. (Reliant) filed initial comments only, while the City of Houston filed reply comments only.

Summary of parties' original comments

TXU SESCO comments

TXU SESCO commented that the only aspect of the true-up proceeding to which it is subject is the retail clawback provision of PURA §39.262(e). However, TXU SESCO pointed out that the first requirement of §39.262(e)—that the price to beat exceeds the market price of electricity—is not likely to be met in its service area. TXU SESCO therefore stated its belief that no retail clawback will be required in its service territory. TXU SESCO indicated that it plans to make a filing with the commission after January 10, 2004 to demonstrate that its price to beat did not exceed the market price of electricity. Because such a filing would not constitute a full-fledged true-up filing in the manner envisioned by the commission's true-up rule, TXU SESCO does not believe that it is necessary to include it in the schedule for true-up filings.

The "retail clawback" provision contained in PURA §39.262(e) requires that, to the extent that the price to beat exceeds the market price of electricity, the affiliated retail electric provider shall credit such differences to the affiliated transmission and distribution utility. Even if TXU SESCO does not believe that its price to beat exceeds the market price in its service territory, the actual determination of this fact will be made by the independent third party described in §25.263(c)(2). Therefore, the commission concludes that it is appropriate to include TXU SESCO in the true-up filing schedule for the limited purpose of fulfilling the provisions of PURA §39.262(e), and establishes January 12, 2004 as TXU SESCO's filing date.

AEP comments

The AEP Companies supported the schedule contained in the proposed rule. The AEP Companies acknowledged that the true-up proceeding for AEP Texas North Company (and Mutual Energy WTU LP) should have as its sole issues the "retail clawback" calculation required by PURA §39.262(e) and the final fuel reconciliation. Because of the comparatively limited scope of the true-up proceeding for these companies, it will likely be less complex than the other cases.

With regard to AEP Texas Central, the AEP Companies commented that the proposed date of September 3, 2004 appears to be reasonable, based on current facts. AEP Texas Central has indicated its intent to sell its generation assets and expects the sale process to be effectively complete by September 2004.

The AEP Companies also expressed support for including in the rule a good-cause provision allowing a company to request an alternative true-up filing date if circumstances so warrant.

The commission generally concurs with the AEP Companies' comments and retains the originally proposed filing date for AEP Texas North Company. For AEP Texas Central Company, in recognition of the indefinite nature of the timing aspect of the sale-of-assets market-valuation method, the commission slightly alters the wording of the rule language to provide enhanced flexibility for the filing date. Specifically, the amendment changes the scheduling language for AEP Texas Central Company to "the later of September 3, 2004, or 60

days following completion of the sale of its generation assets." This slight modification to the language better accommodates the timing uncertainties related to when the sale of AEP Texas Central Company's generation assets will be completed.

The good-cause exception supported by the AEP Companies was included in the proposed rule, and the commission retains this provision on adoption.

Reliant comments

Reliant supported the proposed schedule. Reliant stated that the proposed filing date for Centerpoint is consistent with the time period that will be used for valuing Reliant's option to purchase all the shares of Texas Genco common stock owned by Centerpoint. Reliant did not offer specific comments on the filing schedules of other companies' true-up proceedings other than to agree that the proposed spacing of the filings would allow the commission the opportunity to effectively manage its resources when processing the filings.

Centerpoint comments

Centerpoint provided multiple reasons why it supports the proposed schedule that places it at the beginning of the filing sequence. The major reasons cited by Centerpoint include: 1) a January 12, 2004 filing date is necessary to effectuate Centerpoint's business separation plan as approved by the commission; 2) it has long been expected that Centerpoint would make its true-up filing on January 12, 2004, and there is no reason why Centerpoint should not be allowed to file on that

date; 3) the commission has recently taken action in Centerpoint's final fuel reconciliation case anticipating a January 12, 2004 true-up filing by Centerpoint; and 4) requiring Centerpoint to file for its true-up proceeding after January 12, 2004 would be extremely costly to Centerpoint.

Centerpoint stated that, with regard to the first reason above, its business separation plan envisioned that stranded costs will be quantified using the partial stock valuation method allowed under PURA §39.262(h)(3), and that a key element of that plan is that Reliant Resources has an option, which can be exercised between January 10 and 24, 2004, to purchase the remaining stock of Texas Genco held by Centerpoint Energy. The option price is to be calculated in accordance with the partial stock valuation method prescribed in PURA §39.262(h)(3), including the control premium, if any. Centerpoint commented that the option held by Reliant Resources was an integral part of the business separation plan and that the plan met the requirements of PURA §39.051, which mandated the separation of integrated electric utilities into distinct business units. Centerpoint further commented that the above-described elements of the business separation plan were designed to coordinate the sales price of Texas Genco with the market value used in the stranded-cost true-up. This coordination is appropriate because it allows Centerpoint Energy to recover the book value of the former utility's generating assets—no more and no less. If Centerpoint is not permitted to file for the true-up of stranded costs by mid-January 2004, the market value determined under PURA §39.262(h)(3) could be different from the value used to price the option, and Centerpoint would recover more or less than the book value of the generating assets. Centerpoint stated in its comments that this potential deviation in values would expose it to risks and uncertainty that the approved business separation plan was carefully crafted to avoid.

With regard to the second reason cited by Centerpoint—that it has long been expected that Centerpoint would make its true-up filing on January 12, 2004, and there is no reason why Centerpoint should not be allowed to file on that date—Centerpoint commented that its need to file at the earliest possible date was apparent when Reliant Energy, Incorporated filed its Second Amended Business Separation Plan in August 2000. Centerpoint also pointed out that it specifically asked for a January 12, 2004 filing date in its comments filed July 16, 2001 in the true-up rulemaking proceeding. Given these facts, Centerpoint stated that it has been widely expected for almost two years that it would be allowed to file its case on January 12, 2004, and that assigning Centerpoint to a later date would now be perceived, particularly by the financial markets, as adverse to both Centerpoint Energy, Inc. and Texas Genco, LP. Centerpoint additionally stated that any suggestion that delaying its filing might increase the value of Texas Genco, LP would be pure speculation, and that it is not feasible to "time the market." Centerpoint also commented that there is no reason to delay its filing to allow the market to "mature," as the Legislature determined that scheduling the true-up proceedings two years after the opening of retail choice gave the market sufficient time to mature for purposes of assessing the market value of generating assets. Finally, Centerpoint argued that there is no practical reason why it should not be allowed to make its true-up filing on January 12, 2004, because it *wants* to file on that date. Even if other companies also desire an early filing date, that is still no reason to change Centerpoint's proposed filing date. Centerpoint stated that the true-up filings are important to all companies and, if necessary, the commission should be willing to accept multiple filings on the same date and process them accordingly.

To support its third reason—that the commission has recently taken action in Centerpoint's final fuel reconciliation case that anticipates a January 12, 2004 true-up filing—Centerpoint stated that all elements necessary for its true-up filing will be in place by January 12, 2004. Accordingly, there is no reason why Centerpoint should not be allowed to file on that date.

Finally, with regard to its fourth reason—that requiring Centerpoint to file for its true-up proceeding after January 12, 2004 would be extremely costly to the company—Centerpoint stated that, because carrying costs on true-up balances do not begin to accrue until the date of the commission's final order, it would cost Centerpoint approximately \$35-\$45 million (based on current estimates of Centerpoint's stranded costs) in pre-tax earnings for every month it does not have a final order.

OPC comments

The central focus of OPC's initial comments was that Centerpoint's true-up filing should be delayed until later in 2004. OPC stated that allowing Centerpoint to file its true-up case first in the filing sequence will likely increase stranded costs because Reliant's option to purchase 81% of Texas Genco stock creates uncertainty for the 19% of traded stock used for the stranded-cost determination. OPC commented that the existence of the option has major consequences for the long-term prospects of Texas Genco because it will determine whether Texas Genco is associated with an affiliated retail electric provider and will also have implications for Texas Genco's future dividend policy. If the option is not exercised, it is possible that Texas Genco will be spun off into a separate independent entity or sold to another corporation. OPC pointed

out that uncertainty about the long-term future of the enterprise translates into risk and thus exerts downward pressure on the stock price. However, OPC argued, the uncertainty regarding the option and any distorting effects on Texas Genco's stock price resulting therefrom could be eliminated if the stock price used for valuation of Texas Genco's assets reflects a period after the option has expired. OPC therefore argues that the commission should set a filing date for Centerpoint that is 30 to 60 days after the expiration of Reliant's option to purchase the shares of Texas Genco held by Centerpoint.

OPC also commented that, despite the fact that Centerpoint will likely be the most litigated of all the true-up filing and will therefore require the greatest amount of resources, those required resources will be the same regardless of the timing of Centerpoint's filing. Additionally, OPC noted that the existence of Reliant's option may raise significant issues as to whether stranded costs were adequately mitigated by Centerpoint. OPC stated that if a schedule is adopted that allows stock trading for the post-option period, it is possible that a contentious issue could be obviated or reduced, thus requiring less litigation time.

OPC additionally provided an alternative to Centerpoint filing first by suggesting that Texas-New Mexico Power Company (TNMP) be moved to the first position. OPC noted that TNMP has already sold its assets and, given the apparent lesser amount of stranded costs, its proceeding could perhaps be resolved more quickly than the other cases.

TIEC comments

Like OPC's comments, TIEC's comments were principally directed to the issue of Centerpoint's filing date. TIEC argued that, for a number of reasons (discussed below), Centerpoint should file its true-up case no earlier than May 28, 2004. With regard to the proposed filing schedule in general, TIEC essentially argued that the filing dates of Centerpoint and WTU should be switched—that is, WTU would file on January 12, 2004, and Centerpoint would file on May 28, 2004.

The first reason TIEC provided for its recommended schedule is that the Centerpoint filing will be extremely complicated and that consideration of the issues in the WTU and TNMP cases will benefit the consideration of the Centerpoint case. TIEC suggested that lessons learned in the administration of the earlier cases may enhance settlement possibilities.

The second reason TIEC provided is that the South Texas Project (STP) Unit 1 is currently out of service, and the market valuation of Texas Genco will be negatively impacted because of concerns about the plant's status. TIEC commented that if the coolant leak issue is not fully and favorably resolved prior to Centerpoint's filing, issues regarding the prudence of STP's operation and maintenance could become a part of the true-up case. Additionally, TIEC commented that the circumstances surrounding the leak problem have the potential to depress the stock price of Texas Genco, so it is appropriate to delay Centerpoint's true-up filing to increase the likelihood that STP Unit 1 will be returned to full service by the time of the filing and any negative impact on the stock price will have been reduced or eliminated.

The third reason cited by TIEC for moving Centerpoint's filing to a later date is that the capital markets for energy-related stocks are currently depressed relative to historical levels. A delay of Centerpoint's filing for several more months would allow the markets more time to return to more rational and historically normal levels, thus minimizing stranded costs. TIEC also pointed out that valuing assets during a time of historically low stock prices may raise a question regarding the commercial reasonableness of the valuation method, and TIEC provided recent examples of how some energy companies that have attempted to sell assets and/or stock in the current market have decided to withdraw their proposal once they determined that the current market is not attractive. TIEC commented that its recommendation that the commission allow more time for capital markets to improve is not a simple attempt to time the market, but rather, it is a request to follow the commercially reasonable practice of maximizing asset value by postponing a valuation until the markets have returned to more historically reasonable levels.

The fourth reason cited by TIEC for moving Centerpoint's filing to a later date is that Reliant's option to purchase Centerpoint's shares of Texas Genco has never been approved by the commission, and this creates uncertainty and likely increases stranded costs. TIEC commented that although the commission approved Reliant Energy, Incorporated's business separation plan, *it never approved the stock option* (emphasis in TIEC's comments). TIEC further stated that the commission found that approving the business separation plan does not preclude a review of whether Reliant Energy, Incorporated pursued commercially reasonable means to reduce stranded costs, raising the implication that the granting of the option may not have been commercially reasonable. Similar to OPC's comments, TIEC stated that the option creates

uncertainty, and this uncertainty has a negative impact on the value of Texas Genco's stock because of stockholder concern that Texas Genco will be majority owned by Reliant, whose liquidity problems are common knowledge. Because of the option, TIEC argues that the current market value of Texas Genco stock is not based on its stand-alone value, but rather is heavily tied to the value of Reliant's stock.

The fifth reason provided by TIEC to delay Centerpoint's filing date is that such a delay will not create uncertainty regarding the full recovery of stranded costs. TIEC stated that stranded costs are not known and measurable until a filing is made under substantive rule §25.263. This rule—and the statute—provides that the market value of the common stock will be determined based on a 30-day period chosen by the commission out of the last 120 consecutive trading days before the filing. TIEC argues that it is irrelevant that Centerpoint granted Reliant an option the value of which is based on the 30-day average stock price out of the last 120 consecutive trading days prior to January 9, 2004. TIEC reiterated its comment that the commission never explicitly approved the option, and the fact that the valuation derived from the option may be different from the valuation conducted pursuant to PURA §39.262(h)(3) is a risk that Centerpoint alone has chosen to bear. Ratepayers should not have to bear this risk.

Summary of parties' reply comments

OPC replies

OPC replied to Centerpoint's comments regarding the use of Reliant's option as part of Centerpoint's approved business separation plan by stating that if Centerpoint files its true-up case prior to the conclusion of the option exercise period (January 10 - January 24, 2004), this will increase uncertainty surrounding the 19% of traded stock used for valuation purposes. OPC further replied that a more accurate valuation of Texas Genco's assets may be possible if the stock prices include the period after the option period has expired, thus reducing the possibility that uncertainty regarding the option has distorted the stock price.

Regarding Centerpoint's comments that "[i]t has long been expected that Centerpoint would make its filing on January 12, 2004," OPC replied that such an expectation is based upon false assumptions, and that Centerpoint alone expected to file on that date. With respect to Centerpoint's comments that the commission recently moved the date of the interim hearing for Centerpoint's final fuel reconciliation to allow sufficient time to conclude that proceeding before January 12, 2004, OPC replied that moving up that hearing simply means that Centerpoint's final fuel reconciliation will be completed prior to the filing of the true-up case, regardless of when in 2004 such filing occurs.

The final point in OPC's replies was that it is incorrect for Centerpoint to claim that moving its filing date beyond January 12, 2004 would be extremely costly to Centerpoint. OPC stated that the Austin Court of Appeals recently affirmed that part of the true-up rule which states that true-up balances do not begin to accrue interest until the date of the commission's final order in the true-up case. OPC stated that because Centerpoint does not legally have any carrying costs until

the date on which the commission decides that it has stranded costs, Centerpoint is precluded from arguing that delaying its true-up filing will increase its carrying costs.

TIEC replies

TIEC replied to Centerpoint's comments by stating that while PURA §39.051(b) mandated the separation of integrated electric utilities into three separate units, it did not mandate that one of the separated businesses provide an option to purchase the stock of one of the other businesses. Therefore, TIEC asserted, the option is irrelevant to both the approved business separation plan and the filing date of Centerpoint's true-up proceeding. TIEC further replied that, based upon the commission's statements in its final order for Reliant's business separation plan, Reliant had satisfied the statutory standards for business separation regardless of the presence of the stock option. Furthermore, TIEC stated that it is indisputable that the commission never approved the stock option.

TIEC also reiterated its comments that the presence of the stock option creates a cloud on the Texas Genco stock price that could result in higher levels of stranded costs. TIEC strongly expressed its belief that the truest market valuation of Texas Genco will occur only if the stock option lapses. TIEC stated that, through the use of the stock option, Centerpoint is attempting to create a new stranded cost valuation method not contemplated in PURA. TIEC argued that, given that Centerpoint has chosen the partial stock valuation method to determine the value of its generation assets, any payments that Centerpoint receives from an affiliate pursuant to a stock option are irrelevant to the stranded cost equation. Moreover, because the stock option had not

yet been reduced to writing at the time the commission approved the final business separation plan, there has been very little, if any, regulatory review of the option. Therefore, TIEC argued, it is inappropriate to order that Centerpoint file its stranded cost true-up case in January so as to give effect to an option that has never been approved by the commission.

TIEC also replied that concern by Centerpoint about differences in timing between the true-up filing date and the option exercise could be resolved by an agreement between Centerpoint and Reliant to amend the option to provide for a different strike date. TIEC averred that Centerpoint granted Reliant the option at its own risk, and ratepayers should not be asked to bear the risk of a business decision between affiliated companies. Accordingly, TIEC argued, the stock option has no bearing on the timing of Centerpoint's true-up filing.

TIEC also stated in its replies that if the option lapses, regulatory complexity will be reduced. TIEC stated that, in the true-up case, the commission has full authority to determine whether the granting of the option was commercially reasonable and a normal business practice. TIEC stated that if Centerpoint's schedule is moved to May, as TIEC suggested, there is a greater chance that the stock option will not be exercised, and factual and legal arguments regarding the meanings of "commercially reasonable" and "normal business practices" as they apply to the stock option will not need to be a part of Centerpoint's case.

Regarding Centerpoint's comments that "it has long been expected" that Centerpoint would make its true-up filing on January 12, 2004, TIEC replied that TIEC has not expected such an outcome, nor apparently has OPC or the City of Houston. TIEC pointed out that,

notwithstanding representations by Centerpoint, Reliant, and Texas Genco, there has never been certainty that Centerpoint's true-up filing would occur on January 12, 2004. TIEC further replied that the blame for any adverse impact—such as a negative perception by the financial markets—that would result from the commission setting a later filing date for Centerpoint would fall entirely on Centerpoint for making overly optimistic statements. Accordingly, the potential reaction of Wall Street, which does not consider the public interest, should not dictate to the commission when it should determine the market value of Texas Genco stock.

City of Houston replies

City of Houston filed reply comments only, and basically supported the comments filed by TIEC and OPC. City of Houston stated that Centerpoint's true-up proceeding will likely be the most complicated and contentious true-up case at least partially because the stock valuation method will be used as the basis for quantifying stranded costs. City of Houston added that the complexity of Centerpoint's case will be increased because several issues—involving hundreds of millions of dollars—relating to its final fuel reconciliation have been postponed for consideration until the true-up proceeding. City of Houston argued that, because TNMP's case is expected to involve a considerably lesser amount of stranded costs, it is more reasonable to schedule TNMP first in the filing sequence. Additionally, because of the expected less complex nature of TNMP's proceeding, any issues arising in that case that may be common in all true-up proceedings could be afforded more attention.

City of Houston stated that the more important reason to delay Centerpoint's filing is because of increased risk associated with uncertainty regarding whether Reliant will exercise the option to purchase Centerpoint's shares of Texas Genco. Like OPC and TIEC, City of Houston argued that delaying the filing date for Centerpoint until later in 2004 would allow additional trading days after the option is exercised or not exercised, and would allow additional time for the financial markets to return to more rational and historically normal levels. City of Houston also argued that delaying the filing date for Centerpoint would allow more time for the resolution of issues related to the service concerns of STP Unit 1. For the foregoing reasons, City of Houston recommended that the commission schedule TNMP's true-up proceeding first, followed by Centerpoint later in 2004.

AEP replies

The AEP Companies replied to TIEC's and OPC's comments by stating that while the AEP Companies have no position on the matter of moving the Centerpoint filing date, the commission should reject TIEC's effort to argue substantive issues regarding the scope of the true-up cases in this procedural rulemaking. The AEP Companies stated that TIEC's arguments are premature and unnecessary at this stage. Furthermore, the AEP Companies argued, TIEC's comments contain a critical legal error. To the extent that TIEC seeks to have the commission question the market valuation that results from one of the valuation methods provided for in PURA §39.262(h) or (i), it is seeking to indirectly do what PURA §39.252(d) says the commission cannot do directly—substitute its judgment for a market valuation of generation assets. The AEP Companies also replied to TIEC's comments regarding the shifting of AEP Texas North

Company to January 2004 by reiterating their support for the filing schedule as originally proposed, but acknowledging that AEP Texas North could be ready for filing at the earlier date if the commission finds that to be in the public interest.

Centerpoint replies

Centerpoint replied to TIEC's and OPC's comments by stating two basic points: 1) no utility, affiliated power generation company, affiliated retail electric provider, combination of those entities, municipal regulator, or nonaffiliated retail electric provider objected to the proposed schedule, and 2) only TIEC and OPC argued for a change in the schedule, and the basis for their arguments is the unsupported speculation that a delay in Centerpoint's filing might result in higher prices for the shares of Texas Genco.

Centerpoint replied that the bottom line is that TIEC and OPC seek a three- to five-month delay in Centerpoint's filing in an ill-advised effort to "time" the market, and that the benefits claimed by TIEC and OPC are entirely speculative because the Texas Genco stock price is as likely to fall as it is to rise during that time. However, Centerpoint argues, its economic damage is not speculative—the delay sought by TIEC and OPC will cost Centerpoint from \$100 million to \$200 million in lost carrying costs.

Centerpoint stated that TIEC and OPC have not presented any reason that justifies changing the proposed date for Centerpoint's filing in the true-up schedule, and the commission should not set dates based on speculation as to what might occur in markets affected by a variety of factors,

including long term excess generating capacity, specific generating plant operations, fuel prices, and interest rates. Though most of these factors can and probably will change over time, what will not change in the near future is the factor that may have the largest impact on the value of generating assets in ERCOT—the fact that ERCOT will have generating capacity in excess of 15% until at least 2007. Any delay of a few months will not change the impact this excess capacity has on the value of Texas Genco stock.

Centerpoint included in its replies the argument that, in adopting a rule, a governmental agency must apply sound reasoning, and explain how and why it reached the conclusions it did. That is, the agency must summarize the evidence it considered, state a justification for its decision based on the evidence before it, and demonstrate that its justification is reasoned. The agency's explanation of the facts and policy concerns it relied upon when it adopted the rule must demonstrate that the agency considered all the factors relevant to the objective of the agency's delegated rulemaking authority and that it engaged in reasoned decision-making. Centerpoint argued that, in short, the commission cannot delay Centerpoint's filing based on TIEC's and OPC's speculation that delay might result in lowering stranded costs without hard evidence that such delay is more likely to lower than to increase costs and that the benefits of delay will outweigh the harm to Centerpoint the delay will cause.

Centerpoint further argued in its replies that no one can predict whether delaying Centerpoint's filing will reduce stranded costs; it is equally likely that delay will increase stranded costs. Centerpoint stated that what TIEC is actually seeking is to have the commission speculate on stock prices while imposing on Centerpoint additional carrying costs of \$35-40 million per

month for at least four and a half months. This speculation could result in stranded costs being higher or lower and is as likely to harm customers as it is to help them.

Centerpoint pointed out in its replies that when the Legislature passed the Texas Electric Choice Act (Senate Bill 7, Act of May 21, 1999, 76th Leg., R.S., ch. 405, 1999 Tex. Gen. Laws 2543) in 1999, it was determined that there would be a two-year period after the opening of retail choice before proceedings were conducted by the commission to calculate and true-up stranded costs. This established a neutral "test period" for determining the value of generation because no one could accurately project in 1999 what the generation market in ERCOT would be by January, 2004. Centerpoint argued that when the Legislature gave the commission the authority to set the schedule for the true-up filings, it intended to give the commission the ability to manage its resources, not to have the commission manipulate the legislatively determined test period or try to "time" the stock market.

In response to TIEC's comments that recent attempts to sell generating assets were unsuccessful, Centerpoint replied that TIEC ignores the fact that a number of sales and stock issuances (the data for which Centerpoint provided) of generating assets have occurred in recent months. In response to TIEC's argument that its recommendation for delay is "not a simple attempt to time the market," but rather a "request to follow the commercially reasonable practice of maximizing asset value," Centerpoint replied that a delay for the purpose of "maximizing asset value" is precisely an "attempt to time the market," but that TIEC ignores the illogic of its own statement.

Centerpoint also replied to TIEC's statement that "[t]he capital markets for energy-related stocks are currently depressed relative to historical levels." Centerpoint stated that TIEC never specifies the "historical levels" and does not explain how or when the markets will return to those levels. Centerpoint adds that the more important question, however, is the very real question of whether it is logical to expect that investors' long term perceptions of the ERCOT market for generation, which is expected to have a surplus of capacity for at least four *years*, will materially change during a delay of four and a half *months* (emphasis in Centerpoint's reply comments). Centerpoint argued that it is purely speculative to say that the market for Texas Genco stock will change dramatically in that short of a time period, and the commission should not engage in such speculation.

In response to OPC's comments, Centerpoint replied that there is no evidence that the Texas Genco option decreases market value or that a more accurate value for Texas Genco's generating assets will be achieved by delaying Centerpoint's true-up filing. Centerpoint disagreed with the thrust of OPC's comments that the option held by Reliant to purchase the shares of Texas Genco held by Centerpoint creates uncertainty and thereby creates risks and exerts downward pressure on the shares of Texas Genco. Centerpoint stated that TIEC raises the same contention but goes a step further by asserting that the stock price of Texas Genco is artificially low because of the capital markets' negative perception of Reliant. Centerpoint replied that OPC's and TIEC's arguments, distilled to their essence, are simply that a control premium exists that should be applied to the Texas Genco stock because there is the possibility that Reliant could own the majority of Texas Genco stock rather than Centerpoint Energy, Incorporated or another party. Centerpoint stated that is an issue for the true-up proceeding and will be decided by the

commission after a determination by a panel of experts in accordance with the specific procedures in PURA §39.262(h)(3). Accordingly, Centerpoint believes that none of OPC's or TIEC's contentions provide a basis for delaying Centerpoint's filing beyond January 12, 2004.

Regarding Reliant's option, Centerpoint replied that TIEC mischaracterizes the commission's actions regarding the option. Centerpoint stated that the commission approved Reliant's option when it approved Reliant Energy, Incorporated's business separation plan, and pointed out that Finding of Fact No. 52 in that Order on Rehearing stated:

The commission finds that Reliant's proposed separation meets the requirements of PURA § 39.051 whether the stock option is exercised or allowed to lapse. Consequently, there is no need for the commission to approve the stock option *as a separate matter*. The proposed stock option *is an integral part of the Second Amended Plan*, which the commission finds in this Order meets the separation requirement in PURA § 39.051 (emphasis in Centerpoint's replies).

Centerpoint further argued that, contrary to TIEC's assertion, the commission's Order on Rehearing does not imply that the granting of the option may have been commercially unreasonable. Centerpoint stated that in the Open Meeting in which the commission approved the business separation plan, Chairman Pat Wood stated that "[o]n its own, the buy-back—or the stock purchase option does not trigger any higher burdens on the Company to rebut than any other normal business practice issue," and Commissioner Walsh stated, "I think we're saying the option is okay. We're not going to second guess that." Centerpoint argued that second-guessing

the Reliant option is exactly what OPC and TIEC want the commission to do when they argue for delaying Centerpoint's filing date for its true-up proceeding.

Centerpoint also argued in its replies that OPC's and TIEC's arguments claim that the value of the Texas Genco stock will increase after the conclusion of the option period, but neither OPC nor TIEC offers any support for that claim. Centerpoint stated that TIEC attempts to tie the value of Texas Genco stock to Reliant stock and casts aspersions on the value of Reliant stock in order to conclude that "[b]ecause of Reliant's financial problems, the presence of the stock option has a negative effect on the current price of Texas Genco." Centerpoint states that while it disagrees with TIEC's view of Reliant and the effect of the option on the value of Texas Genco stock, ultimately TIEC is defeated by its own argument. Centerpoint argues that if the Reliant option reduces Texas Genco's stock price, as TIEC claims, the stock will decline even more when Reliant exercises its option and makes Reliant ownership of the majority of the stock a reality, rather than just a possibility. Consequently, Centerpoint argues, if TIEC really believed its own contentions, TIEC would argue against any delay in Centerpoint's true-up filing.

Centerpoint stated in its replies that Reliant is the logical strategic buyer for Texas Genco because Reliant serves a significant load in the Houston area and therefore needs a significant amount of power in the geographical region where most of Texas Genco's generation is located. Thus, there is no reason to believe that the existence of the Reliant option exerts downward pressure on the stock of Texas Genco. Centerpoint points out that those utilities that did not separate into two separate holding companies as Centerpoint and Reliant have done have the same situation that the option was designed to achieve—an alignment of generating assets with

the loads that the assets were traditionally used to serve. Therefore, there is no basis for assuming that the option creates any less value for Texas Genco's generating assets than if the assets were placed in Reliant to begin with. In short, Centerpoint argues, the existence of the Texas Genco option provides no basis for delaying Centerpoint's filing. Centerpoint again pointed out that, as discussed in the preamble and in Centerpoint's initial comments on the proposed rule, with regard to stranded costs, allowing Centerpoint to file its true-up case on January 12, 2004 will allow it to recover the book value—no more, no less—of the former utility's generating assets.

In response to TIEC's comments, Centerpoint stated that consideration of the WTU and TNMP cases before Centerpoint's will not benefit the consideration of Centerpoint's filing nor facilitate settlement. Centerpoint expressed its belief that these proceedings will be fact-specific cases involving different utilities that have chosen different valuation methodologies, and it is unlikely that decisions on the issues in the WTU and TNMP cases will be of any benefit in the consideration of Centerpoint's filing. Centerpoint believes that, in fact, it is more probable that the opposite of what TIEC suggests is true: processing a larger, more complicated case first could facilitate expedient consideration of the cases with fewer issues. Centerpoint also replied to TIEC's argument that for "settlement to be a viable possibility, key precedential issues need to be resolved." Centerpoint replied that TIEC never explains what are the "key precedential issues" applicable to Centerpoint that can be resolved in the WTU and TNMP cases. Centerpoint also argued that TIEC's statement that "parties must have time to process the complicated filings and to run and rerun revenue studies and rates" is shorthand for TIEC's saying that it will not even be in a position to consider a settlement until Centerpoint makes its

filing, regardless of when Centerpoint makes the filing. Centerpoint therefore argued that taking TIEC's statements at face value, the chances of settlement are not affected by allowing Centerpoint to file its case on January 12, 2004.

With regard to TIEC's comments that the current outage of STP Unit 1 has the potential to depress the price of Texas Genco common stock, Centerpoint replied by first pointing out that STP Unit 1 represents less than 3.0% of Texas Genco's generating capacity. Centerpoint also argued that a number of factors go into the pricing of Texas Genco stock and that TIEC's arguments unrealistically assume that investors in generating assets will focus only on short-term operational issues at one generating unit. Centerpoint argued that there is no reason to believe that investor perceptions of the risks associated with Texas Genco's ownership interest in STP will be higher or lower if Centerpoint's filing is delayed. Centerpoint reiterated its argument that TIEC has provided no evidence that factors affecting STP Unit 1 will cause the market price of Texas Genco's stock during any 30 consecutive trading days in the 120 trading days before May 28, 2004 (TIEC's suggested date for Centerpoint's filing) to be better than the 30 consecutive trading days chosen by the commission from the 120 trading days before January 12, 2004.

Commission response

Most of the parties' comments and replies in this rulemaking proceeding focused on the issue of Centerpoint's filing date. The filing schedule has specific valuation implications for Centerpoint, because Centerpoint's stranded costs will be determined primarily on the basis of the prices at which Texas Genco stock trades during the 120 trading days prior to filing. With regard to the

majority of arguments that were offered by TIEC, OPC, and the City of Houston that Centerpoint's filing should be delayed, the commission is not persuaded that such arguments are well-founded. While the possibility exists that the amount of stranded costs could be reduced if the schedule were altered on the basis of these arguments, it is also possible that stranded costs could be increased. To a large degree, therefore, many of the arguments for delaying Centerpoint's filing are speculative in nature. For example, TIEC, OPC, and the City of Houston all argued that delaying Centerpoint's filing date would allow for a longer period of time to pass during which the stock of Texas Genco could be expected to become more favorably valued. A delay in the scheduling of Centerpoint's filing for the purpose of waiting for a more favorable stock value is ultimately the common denominator of the arguments relating to both the suggestion that stock valuation levels should be allowed an opportunity to return to "historically normal" levels and the impact of the leak at STP Unit 1. In response to these points, the commission agrees with Centerpoint that the essence of such arguments is an attempt to "time the market," with the ultimate outcome of such attempts being inherently unpredictable. As Centerpoint argued, delaying the filing is as likely to result in lower stock prices that would be used in valuing Centerpoint's generation assets as higher stock prices. Consequently, the commission refrains from relying upon such arguments as justification for changing the proposed true-up filing schedule.

Other arguments offered by TIEC, OPC, and the City of Houston relate to learning-curve advantages that might be achieved by processing TNMP's case first and the facilitation of a settlement that could possibly be realized by delaying the filing of Centerpoint's case. The commission, however, agrees with Centerpoint that few critical issues, if any, will be common

between the TNMP and Centerpoint cases primarily because the two companies will be relying upon different market-valuation methodologies. TNMP has sold its generating assets and will therefore be relying upon the sale-of-assets method for the determination of stranded costs, while Centerpoint will be using the partial stock valuation method. Moreover, the TNMP case will not include the issues of the capacity auction true-up and the control-premium determination. Consequently, there are not likely to be any meaningful efficiencies gained on these major, potentially controversial issues simply by having TNMP file first. Similarly, the commission agrees with Centerpoint's comment that any settlement in its case is unlikely to happen until *after* Centerpoint makes its filing, regardless of when that filing occurs.

The foregoing notwithstanding, the commission finds that, based on the extensive initial and reply comments with regard to the existence of Reliant's option to purchase the 81% of Texas Genco stock held by Centerpoint, sufficiently credible arguments have been put forth to justify a change in the order in which the companies will make their true-up filings. Specifically, the principal rationale underlying the commission's decision to alter the filing schedule relates to the uncertainty created by the existence of the Reliant option and the impact of this uncertainty on the price of Texas Genco stock. The commission believes that the existence of an unexercised option results in a stock price on the true-up filing date that is a less accurate proxy for the value of Texas Genco's assets than if the option had expired or had been exercised sufficiently in advance of the filing date. The commission concludes, however, that the magnitude and direction of the effects of this uncertainty cannot be determined in advance. Reasonable arguments can be made about whether the effect of the option on the price of Texas Genco Stock is large or small and even whether it is positive or negative—that is, it is conceivable that the

option has a propping-up effect on the stock price of Texas Genco, a depressing effect, or little meaningful effect at all. Presumably, investors in Texas Genco assign some value to the quality of management and financial condition of the company that owns 81% of its stock, and presumably they are aware that Reliant has an option to acquire that 81%. In assessing the value of the stock, they can be assumed to have factored in some measure of likelihood that Reliant will acquire 81% of the Texas Genco stock, but they cannot be certain that the option will be exercised. Inevitably, there is a degree of uncertainty about who will be the majority owner of Texas Genco, who will manage it, the effectiveness with which it will be managed, and the financial condition of the majority owner. Thus, the removal of some of this uncertainty by the expiration or exercise of the option may result in a change in the value of the stock.

Therefore, in view of the uncertain impact of the Reliant option, the commission concludes that it is prudent to schedule the timing of Centerpoint's true-up filing on a date that enables the 120-day trading period used in the partial stock valuation methodology to encompass time periods both before *and* after the exercise date of the option. Accordingly, the commission is adopting true-up filing dates for TNMP and Centerpoint that are the reverse of the dates that were originally proposed for these companies. The true-up filing date for TNMP is scheduled to be not earlier than January 12, 2004 and not later than ten days thereafter, and the filing date for Centerpoint is scheduled to be not earlier than March 31, 2004 and not later than ten days thereafter. Because the Reliant option exercise period is January 10 - 24, 2004, scheduling Centerpoint's filing approximately two and one-half months thereafter, namely, on March 31, 2004, allows the 120-day valuation period that will be used in the true-up proceeding to span the time period before and after the exercise period of the option. Thus, if the existence of the

option does in fact have an impact (in whichever direction) on the price of Texas Genco stock, the commission will have the discretion of using whichever time period provides the higher valuation for purposes of determining stranded costs, so as to minimize the costs to electric customers.

With regard to Centerpoint's claims that the commission's order in Docket Number 21956, *Application of Reliant Energy, Inc. for Approval of Business Separation Plan* effectively approves the option, the commission concludes that the order acknowledges the option as part of Centerpoint/Reliant's Second Amended Business Plan, but does not say anything about giving specific consideration to the option at the time of true-up, and certainly nothing about the option influencing the *scheduling* of the true-up filings. While the finding of fact that Centerpoint relied upon in its reply comments addresses the option from the perspective of the approval of an unbundling plan, it does not address the option from the perspective of valuing stranded costs. In fact, the commission did not "approve" the stock-purchase option as an independent transaction in the business separation plan proceeding. When taken as a whole, the business separation plan order makes it clear that the commission only evaluated the stock option as it related to the business separation findings, and decided that the business separation was adequate. The business separation plan order further finds that approval of the separation plan does not preclude a reasonableness review of certain business practices in the 2004 true-up proceeding. This is highlighted by the fact that the stock purchase option was not yet finalized and reduced to writing at the time of the business separation plan order. Accordingly, the commission finds that the statements in the Docket Number 21956 order regarding the option are

not directly relevant to this rulemaking and that the establishment of the true-up filing schedule is not controlled by any findings in the final order in that proceeding.

With regard to Centerpoint's argument that any delay in its filing will be extremely costly to the company, this issue is tied to Centerpoint's claim that they have counted on the January filing date for some time. Regardless of Centerpoint's expectations, the statute clearly says the true-up proceedings will be filed on a schedule established by the commission. The commission has never promised or guaranteed Centerpoint that it can file in January. Centerpoint has requested that date, but for reasons explained in this preamble, the commission has now chosen a different date. Centerpoint has presented no evidence that the stock purchase option agreement was conditioned either upon any regulatory condition to exercise or any conditions precedent based on the actions of, or approval by, this commission, particularly with respect to the filing date for the true-up proceeding. Additionally, given the timing of the execution of the stock purchase option agreement, Centerpoint could not have relied upon the commission's schedule as contained in the published version of this rule, which set the Centerpoint true-up filing date in January 2004, as this rule was published more than two years after the option was executed. Nor does the commission find any commitment in the business separation plan order to schedule Centerpoint's true-up proceeding in January 2004. The regulatory risk Centerpoint faces regarding the scheduling of its true-up filing is present for any company whose filing is later in the sequence. If the legislature had intended for companies to be compensated for this regulatory lag, it could have explicitly done so, but it did not.

Moreover, PURA §39.262(c) grants the commission broad authority to set a schedule for the true-up proceedings. The fact that the commission is charged with preparing a schedule clearly indicates that the legislature intended that different companies subject to true-up proceedings would make their filings at different times during 2004. Centerpoint's argument that its true-up should be filed in January because scheduling it later in the year will allegedly result in the imposition of carrying costs runs counter to the principles of setting a schedule. If, in fact, incurring carrying costs is a sufficient reason to schedule Centerpoint's true-up case no later than January, then the logical extension of that argument would be that any company scheduled after January might incur these costs and therefore they should likewise be scheduled in January—thus eliminating the need for any schedule.

The commission also notes that Centerpoint and Reliant in February 2003 agreed to an amendment to the option that provides an extension of time—up to 45 business days—in which Reliant can rescind its exercise of the option if it is unable by that date to secure financing for its purchase of the Texas Genco shares on terms reasonably acceptable to Reliant, despite the exercise by Reliant of commercially reasonable efforts to obtain such financing. Setting Centerpoint's true-up filing date on March 31, 2004 allows the 45-day period to pass, and eliminates or at least reduces any uncertainty related to a possible rescission by Reliant that may be reflected in Texas Genco's stock price.

Finally, with regard to the scheduling, the commission notes that TNMP is the first company to have completed the sale and apparent market valuation of its generation assets. TNMP has thus for some time been prepared for and ready to file its true-up application. Moreover, the true-up

proceeding for TNMP can be reasonably expected to be less controversial than later filings by Centerpoint and AEP Texas Central Company because the amount of TNMP's apparent stranded costs is considerably smaller and because, as previously noted, the particulars of TNMP's case do not include other potentially controversial true-up issues such as the capacity auction true-up and the control-premium issue. As a result, the resolution of the TNMP true-up case is likely to be more readily and expeditiously achieved than Centerpoint's case, thus freeing up additional staff resources if needed for the more complex Centerpoint case.

This amendment is adopted under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (Vernon 1998, Supplement 2003) (PURA), which provides the Public Utility Commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction; and specifically, PURA §39.262, which requires the commission to conduct a true-up proceeding for each investor-owned electric utility on a schedule and under procedures to be determined by the commission.

Cross Reference to Statutes: Public Utility Regulatory Act §§14.002, 39.252 and 39.262.

§25.263. True-up Proceeding.**(a) Purpose.**

- (1) The purpose of the true-up proceeding is to quantify and reconcile the amount of stranded costs, the differences in the price of power obtained through the capacity auctions and the power costs used in the excess costs over market (ECOM) model; the results of the annual reports; the level of excess revenues, net of nonbypassable delivery charges, from customers who continue to pay the price to beat (PTB); the reasonable regulatory assets not previously approved in a rate order that are being recovered through competition transition charges (CTCs) or transition charges (TCs); and the final fuel balances. The purpose of the true-up proceeding is also to provide for the recovery of regulatory assets not already approved for securitization that were to be considered in future proceedings pursuant to a commission financing order in a securitization case.
- (2) An electric utility, together with its affiliated retail electric provider (AREP), its affiliated power generation company (APGC), and its affiliated transmission and distribution utility (TDU), shall not be permitted to over-recover stranded costs through the application of the measures provided in the Public Utility Regulatory Act (PURA), Chapter 39, or under the procedures established in PURA §39.262 and this section.

- (b) Application.** This section applies to all investor-owned transmission and distribution utilities established pursuant to PURA §39.051, their APGCs, and their AREPs. In

addition, the reporting requirements of subsection (j)(6) of this section apply to all retail electric providers (REPs) serving residential and small commercial customers.

(c) **Definitions.** The following words and terms, when used in this section, shall have the following meanings unless the context indicates otherwise:

- (1) **Capacity auction total price of power (\$/MWh)** — The total (fuel plus non-fuel) capacity auction revenues for entitlements to capacity for the years 2002 and 2003 divided by the total capacity auction energy (expressed in MWh) scheduled to be delivered for those entitlements over the same time period.
- (2) **Independent third party** — The party designated by the commission to perform the duties described in subsection (j) of this section.
- (3) **Mitigation** — The total excess earnings and redirected depreciation applied to generation assets pursuant to PURA §39.254 and §39.256 or a commission order issued after 1996 that approved a utility's transition case.
- (4) **Net mitigation** — Any mitigation that has not been reversed or refunded as of the date of the final order in the true-up proceeding.
- (5) **Net value realized** — All compensation paid by a buyer for generation assets, including the buyer's assumption of debt, less any costs of sale such as legal fees, broker fees, and other reasonable transaction costs.
- (6) **Projected stranded costs** — The value produced by the ECOM model and approved by the commission in the proceeding conducted pursuant to PURA §39.201.

- (7) **Regulatory assets** — The generation-related portion of the Texas jurisdictional portion of the amount reported by the electric utility in its 1998 annual report on Securities and Exchange Commission Form 10-K as regulatory assets and liabilities, offset by the applicable portion of generation-related investment tax credits permitted under the Internal Revenue Code of 1986.
- (8) **Residential market price of electricity** — The volume-weighted average price, less average nonbypassable charges (each expressed in cents per kilowatt-hour (kWh)), calculated by the independent third party for residential electric service provided by non-affiliated retail electric providers and non-provider of last resort (POLR) service providers competing in the TDU region. The price determined by the independent third party shall be based upon pricing disclosures pursuant to §25.475(e) of this title (relating to Information Disclosures to Residential and Small Commercial Customers) and other information provided to the independent third party.
- (9) **Residential net price to beat** — The average residential PTB rate (expressed in cents per kWh) less the average nonbypassable charges (expressed in cents per kWh) applicable to residential customers.
- (10) **Small commercial market price of electricity** — The volume-weighted average price, less average nonbypassable charges (each expressed in cents per kWh), calculated by the independent third party for small commercial electric service provided by non-AREPs and non-POLR service providers competing in the TDU region. The price determined by the independent third party shall be based upon

pricing disclosures pursuant to §25.475(e) of this title and other information provided to the independent third party.

- (11) **Small commercial net price to beat** — The average small commercial PTB rate (expressed in cents per kWh) less the average nonbypassable charges (expressed in cents per kWh) applicable to small commercial customers.
 - (12) **Transferee corporation** — A separate affiliated or non-affiliated company to whom an electric utility or its APGC transfers generation assets.
 - (13) **Transmission and distribution utility (TDU)** — A transmission and distribution utility that, pursuant to PURA §39.051, is the successor in interest of an electric utility certificated to serve an area.
 - (14) **Transmission and distribution utility region (TDU region)** — The affiliated transmission and distribution utility's service territory.
- (d) **Obligation to file a true-up proceeding.**
- (1) Each TDU, its APGC, and its AREP shall jointly file a true-up application pursuant to subsection (e) of this section according to the following schedule.
 - (A) Texas-New Mexico Power Company and First Choice Power, Inc. — not earlier than January 12, 2004, and not later than ten days thereafter;
 - (B) TXU SESCO Energy Services Company — not earlier than January 12, 2004, and not later than ten days thereafter;
 - (C) Centerpoint Energy Houston, LLC, Reliant Energy Retail Service, LLC, and Texas Genco, LP — not earlier than March 31, 2004, and not later than ten days thereafter;

- (D) AEP Texas North Company and Mutual Energy WTU, LP — not earlier than May 28, 2004, and not later than ten days thereafter;
 - (E) AEP Texas Central Company and Mutual Energy CPL, LP — the later of September 3, 2004, or 60 days following completion of the sale of its generation assets.
 - (F) Notwithstanding the schedule in subparagraphs (A) – (E) of this paragraph, the commission may allow a company, upon a showing of good cause, to file its true-up application on a different date.
- (2) Each TDU that is a successor in interest of any utility that was reported by the commission to have positive ECOM, denoted as the "base case" for the amount of stranded costs before full retail competition in 2002 with respect to its Texas jurisdiction in the April 1998 Report to the Texas Senate Interim Committee on Electric Utility Restructuring entitled "Potentially Strandable Investment (ECOM) Report: 1998 Update," and such TDU's, APGC's, and AREP's, shall file the true-up application as required by subsections (f) – (k) of this section.
 - (3) All TDUs not described in paragraph (2) of this subsection, their APGCs, and their AREPs shall file the applications required by subsections (h) and (j) of this section.
- (e) **True-up filing procedures.**
- (1) Each TDU, APGC, and AREP shall file all testimony and schedules on which they intend to rely for their direct case in accordance with the true-up filing package prescribed by the commission.

- (A) Within 20 calendar days of the filing of a true-up application, commission staff or any intervenor may file a motion stating that the filing is materially deficient. Any such motion shall include a detailed explanation of the claimed material deficiencies.
- (B) If the presiding officer determines that an application is materially deficient, the TDU, APGC, and AREP shall correct the deficiencies within 30 calendar days. The deadline for final commission order shall be extended day for day from the date of initial filing until the corrections are filed with the commission.
- (2) At least 90 days prior to the filing of the first true-up application scheduled by the commission, a utility's APGC shall file a notification of intent with the commission if it intends to utilize PURA §39.262(i) to determine the amount of its stranded costs for nuclear assets.
- (3) The commission may initiate a generic proceeding to determine true-up issues that are common to multiple TDUs, APGCs, and AREPs. This proceeding may include updates to the ECOM model required by subsection (f)(2)(B) of this section, in the event a notification of intent is filed pursuant to paragraph (2) of this subsection. The commission may order further updates to any order approved in a generic proceeding pursuant to this section for any utility whose customers are not offered competition on January 1, 2002.
- (4) As part of the true-up proceeding, the commission shall make a determination with respect to whether the TDU, the APGC, and the AREP have complied with PURA §39.252(d). If the commission finds that the TDU, the APGC, or the

AREP have failed, individually or in combination, to fully comply with their obligations under PURA §39.252(d), the commission may reduce the net book value of the APGC's generation assets or take other measures it deems appropriate in the true-up proceeding filed under this section. In making a determination as to compliance with PURA §39.252(d), the commission shall not substitute its judgment for a market valuation of generation assets determined under PURA §39.262(h) or (i).

- (5) The State Office of Administrative Hearings shall employ expedited procedures during discovery in the true-up proceedings.
 - (6) The commission shall issue the final order for each proceeding filed under this section not later than the 150th day after the filing of a complete, non-deficient application. Notwithstanding the foregoing, however, the 150-day deadline may be extended by the commission for good cause.
- (f) **Quantification of market value of generation assets.**
- (1) Market value of generation assets shall be quantified using one or more of the following methods:
 - (A) Sale of assets method. If an electric utility or its APGC sells some or all of its generation assets after December 31, 1999, in a bona fide third-party transaction under a competitive offering, the total net value realized from the sale shall establish the market value of the generation assets sold. Within 30 days of closing, the utility or its APGC shall provide to the commission a detailed explanation, which may be filed confidentially, of

the transaction and a description of the generating unit, property boundaries, fuel and parts, emission allowances, and other general categories of items associated with the sale, including any ancillary items related to the assets.

(B) Stock valuation method. The following method of market valuation without using a control premium may be used to value generation assets.

(i) If, at any time after December 31, 1999, an electric utility or its APGC has transferred some or all of its generation assets, including, at the election of the electric utility or the APGC, any fuel and fuel transportation contracts related to those assets, to one or more separate affiliated or nonaffiliated corporations, not less than 51% of the common stock of each corporation is spun off and sold to public investors through a national stock exchange, and the common stock has been traded for not less than one year, the resulting average daily closing price of the common stock over 30 consecutive trading days chosen by the commission out of the last 120 consecutive trading days before the true-up filing required by this section establishes the market value of the common stock equity in each transferee corporation.

(ii) The average book value of each transferee corporation's debt and preferred stock securities during the 30-day period chosen by the commission to determine the market value of common stock shall be added to the market value of its stock.

- (iii) The market value of each transferee corporation's assets that is determined as the sum of clauses (i) and (ii) of this subparagraph shall be reduced by the corresponding net book value of the assets acquired by the transferee corporation from any entity other than the affiliated electric utility or APGC.
 - (iv) The market value of the assets determined from the procedures required by clauses (i), (ii), and (iii) of this subparagraph establishes the market value of the generation assets transferred by the affiliated electric utility or APGC to each separate corporation.
- (C) Partial stock valuation method. The following method of market valuation using a control premium may be used to value generation assets.
 - (i) If, at any time after December 31, 1999, an electric utility or its APGC has transferred some or all of its generation assets, including, at the election of the electric utility or the APGC, any fuel and fuel transportation contracts related to those assets, to one or more separate affiliated or nonaffiliated corporations, at least 19%, but less than 51%, of the common stock of each corporation is spun off and sold to public investors through a national stock exchange, and the common stock has been traded for not less than one year, the resulting average daily closing price of the common stock over 30 consecutive trading days chosen by the commission out of the last 120 consecutive trading days before the filing

establishes the market value of the common stock equity in each transferee corporation.

- (ii) The commission may accept the market valuation to conclusively establish the value of the common stock equity in each transferee corporation or convene a valuation panel of three independent financial experts to determine whether the per-share value of the common stock sold is fairly representative of the per-share value of the total common stock equity or whether a control premium exists for the retained interest.
- (iii) Should the commission elect to convene a valuation panel, the panel must consist of financial experts chosen from proposals submitted in response to commission requests from the top ten nationally recognized investment banks with demonstrated experience in the United States electric industry, as indicated by the dollar amount of public offerings of long-term debt and equity of United States investor-owned electric companies over the immediately preceding three years as ranked by the publication "Securities Data" or "Institutional Investor."
- (iv) None of the financial experts chosen for the panel shall have participated, or be employed by an investment house or brokerage house which has participated, in the business separation, securitization, or other activities related to the implementation of

PURA Chapter 39 on behalf of the utility for which the market valuation is being determined.

- (v) If the panel determines that a control premium exists for the retained interest, the panel shall determine the amount of the control premium, and the commission shall adopt the determination, but may not use the control premium to increase the value of the assets by more than 10%.
- (vi) The costs and expenses of the panel, as approved by the commission, shall be paid by each transferee corporation.
- (vii) The determination of the commission, based on the finding of the panel and other admitted evidence, conclusively establishes the value of the common stock of each transferee corporation.
- (viii) The average book value of each transferee corporation's debt and preferred stock securities during the 30-day period chosen by the commission to determine the market value of common stock shall be added to the market value of its stock.
- (ix) The market value of each transferee corporation's assets shall be reduced by the corresponding net book value of the assets acquired by the transferee corporation from any entity other than the electric utility or its APGC.
- (x) The market value of the assets resulting from the procedures required by clauses (i) - (ix) of this subparagraph establishes the

market value of the generation assets transferred by the electric utility or APGC to each transferee corporation.

- (D) **Exchange of assets method.** If, at any time after December 31, 1999, an electric utility or its APGC transfers some or all of its generation assets, including any fuel and fuel transportation contracts related to those assets, in a bona fide third-party exchange transaction, the stranded costs related to the transferred assets shall be the difference between the net book value and the market value of the transferred assets at the time of the exchange, taking into account any other consideration received or given.
- (i) The market value of the transferred assets may be determined through an appraisal by a nationally recognized independent appraisal firm, if the market value is subject to a market valuation by means of an offer of sale in accordance with this subparagraph.
 - (ii) To obtain a market valuation by means of an offer of sale, the owner of the asset shall offer it for sale to other parties under procedures that provide broad public notice of the offer and a reasonable opportunity for other parties to bid on the asset. The owner of the asset shall provide to the commission copies of all documentation explaining and attesting to the utility's sale proposal.
 - (iii) The owner of the asset may establish a reserve price for any offer based on the sum of the appraised value of the asset and the tax impact of selling the asset, as determined by the commission.

- (iv) Within 30 days of closing, the utility or its APGC shall provide to the commission a detailed explanation, which may be filed confidentially, of the transaction and a description of the generating unit, property boundaries, fuel and parts, emission allowances, and other general categories of items associated with the transfer, including any ancillary items related to the assets.
- (2) **ECOM Method.** Unless an electric utility or its APGC combines all its remaining generation assets into one or more transferee corporations pursuant to paragraph (1)(B) or (C) of this subsection, the electric utility shall quantify its stranded costs for nuclear assets using the ECOM method.
 - (A) The ECOM method is the estimation model prepared for and described by the commission's April 1998 Report to the Texas Senate Interim Committee on Electric Restructuring entitled "Potentially Strandable Investment (ECOM) Report: 1998 Update." The methodology used in the model must be the same as that used in the 1998 report to determine the "base case."
 - (B) As part of the filing specified in subsection (d) of this section, the electric utility shall rerun the ECOM model using updated company specific inputs required by the model, updating the market price of electricity, and using updated natural gas price forecasts and the capacity cost based on the long-run marginal cost of the most economic new generation technology then available, as approved by the commission pursuant to

subsection (e)(3) of this section. Natural gas price projections used in the model shall be forward prices of Houston Ship Channel natural gas.

- (C) Growth rates in generating plant operations and maintenance costs and allocated administrative and general costs shall be benchmarked by comparing those costs to the best available information on cost trends for comparable generating plants.
- (D) Capital additions shall be benchmarked using the 1.5% limitation set forth in PURA §39.259(b).

(g) Quantification of net book value of generation assets.

- (1) For purposes of this section, the net book value of generation assets shall be established as of December 31, 2001, or the date a market value is established through a market valuation method under subsection (f) of this section, whichever is earlier.
- (2) Net book value of generation assets consists of:
 - (A) The generation-related electric plant in service, less accumulated depreciation (exclusive of depreciation related to mitigation), plus generation-related construction work in progress, plant held for future use, and nuclear, coal, and lignite fuel inventories, reduced by:
 - (i) net mitigation;
 - (ii) the net book value of nuclear generation assets if quantification of ECOM related to those nuclear generation assets is determined pursuant to PURA §39.262(i); and

- (iii) any generation-related invested capital recoverable through a CTC, exclusive of related carrying costs, projected to be collected through the date of the final order in the true-up proceeding.
- (B) Above-market purchased power costs arising from contracts in effect before January 1, 1999, including any amendments and revisions to such contracts resulting from litigation initiated before January 1, 1999.
 - (i) The purchased power market value of the demand and energy included in the purchased power contracts shall be determined by using the weighted average costs of the highest three offers from a bona fide third-party transaction or transactions on the open market.
 - (ii) The bona fide third-party transaction or transactions on the open market shall be structured so that the above-market purchased power costs are determined pursuant to subclause (I) or (II) of this clause.
 - (I) A transaction may be structured so the electric utility pays a third party to assume the utility's obligations under the purchased power contract. The weighted average of the three highest offers received in the transaction establishes the above-market purchased power costs.
 - (II) A transaction may be structured so a third party pays the utility to take power under the purchased power contract. The difference between the net present value of obligations

under the existing contracts at the utility's cost of capital and the weighted average of the three highest offers received in the transaction establishes the above-market purchased power costs.

- (C) Deferred debits, to the extent they have not been securitized, related to a utility's discontinuance of the application of SFAS No. 71 ("Accounting for the Effects of Certain Types of Regulation") for generation-related assets if required by PURA Chapter 39.
- (D) Capital costs incurred before May 1, 2003 to improve air quality to the extent they have been approved by the commission pursuant to §25.261 of this title (relating to Stranded Cost Recovery of Environmental Cleanup Costs).
- (E) Any adjustments resulting from the commission's review of the TDU's, APGC's, and AREP's efforts pursuant to subsection (e)(4) of this section.

(h) True-up of final fuel balance.

- (1) An APGC shall reconcile the former electric utility's final fuel balance determined under PURA §39.202(c).
- (2) The final fuel balance shall be reduced by any revenues collected by the AREP under any commission-approved fuel surcharge, from the date of introduction of competition to the utility's customers through the date of the true-up filing under this section, so long as the fuel surcharge is associated with fuel costs incurred during the time period covered by the final reconcilable fuel balance.

- (3) If an electric utility or its TDU or APGC is assessed by another utility in Texas a fuel surcharge after 2001 for under-recoveries occurring through the end of 2001, the surcharged utility shall add the amount of surcharges and any associated carrying costs paid after 2001 to its final fuel balance.
 - (4) The final fuel balance, as adjusted by paragraphs (2) and (3) of this subsection, shall include carrying costs on the positive or negative fuel balance equal to:
 - (A) the weighted-average cost of capital approved in the company's unbundled cost of service (UCOS) proceeding, if the period until the date of the final true-up order is greater than one year; or
 - (B) the rate approved in §25.236 of this title (relating to Recovery of Fuel Costs) if the period until the date of the final true-up order is one year or less.
- (i) **True-up of capacity auction proceeds.**
- (1) For purposes of the true-up required by PURA §39.262(d)(2), and as provided for under §25.381(h)(1) of this title (relating to Capacity Auctions), the APGC shall compute the difference between the price of power obtained through the capacity auctions conducted for the years 2002 and 2003 and the power cost projections for the same time period as used in the determination of ECOM for that utility in the proceeding under PURA §39.201. The difference shall be calculated according to the following formula: (ECOM market revenues – ECOM fuel costs) – ((capacity auction price x total 2002 and 2003 busbar sales) – actual 2002 and 2003 fuel costs). For purposes of this paragraph:

- (A) "ECOM market revenues" shall be the sum of rows 12 through 14 for the years 2002 and 2003 in the "Plant Economics" worksheet of the ECOM model underlying the commission-approved ECOM estimate in the company's UCOS proceeding;
 - (B) "ECOM fuel costs" shall be the sum of rows 33 through 35 for the years 2002 and 2003 in the "Cost Partition" worksheet of the ECOM model underlying the commission-approved ECOM estimate in the company's UCOS proceeding;
 - (C) The "capacity auction price" shall be the APGC's total capacity auction revenues derived from the capacity auctions conducted for the years 2002 and 2003 divided by that APGC's total MWh sales of capacity auction products for the years 2002 and 2003.
- (2) If, as a result of not having participated in capacity auctions pursuant to §25.381(h)(1) of this title, an APGC is unable to determine a company-specific capacity auction price, the APGC may request in its true-up application a method using prevailing capacity auction prices from other APGCs for the calculation in paragraph (1) of this subsection.
- (j) **True-up of PTB revenues.** This subsection specifies how the PTB will be compared to prevailing market prices pursuant to PURA §39.262(e). For purposes of this subsection, the term "small commercial customer" does not include unmetered lighting accounts unless such an account has historically been treated as a separate customer for billing purposes.

- (1) An AREP is not required to perform the reconciliation described in PURA §39.262(e) for the residential or small commercial customer class if the commission has determined that the AREP has reached the applicable 40% threshold requirements prior to January 1, 2004, pursuant to filing requirements listed in §25.41(l) of this title (relating to Price to Beat) applicable to that class.
- (2) If an AREP has not reached the applicable 40% threshold requirements prior to January 1, 2004, for either the residential or the small commercial class, or both, the net PTB for each such class must be compared to the market price of electricity for that class in the TDU region for the period January 1, 2002 through January 1, 2004 as provided in paragraphs (3) and (4) of this subsection.
- (3) The independent third party shall compute the difference between the residential net PTB and the residential market price of electricity on the last day of each calendar-year quarter for the years 2002 and 2003. The price differential for each quarter shall be multiplied by the total kWh consumed by residential PTB customers of the AREP for that quarter. The results shall be summed over the eight quarters within the period from January 1, 2002 through January 1, 2004.
- (4) The independent third party shall compute the difference between the small commercial net PTB and the small commercial market price of electricity on the last day of each calendar-year quarter for the years 2002 and 2003. The price differential for each quarter shall be multiplied by the total kWh consumed by small commercial PTB customers of the AREP for that quarter. The results shall be summed over the eight quarters within the period from January 1, 2002 through January 1, 2004.

- (5) For each of the residential and small commercial classes, the AREP shall credit the TDU the lesser of the amounts calculated in subparagraphs (A) and (B) of this paragraph:
- (A) \$150 multiplied by (the difference between the number of residential or small commercial customers, as applicable, in the TDU Region taking PTB service from the AREP on January 1, 2004 and the number of residential or small commercial customers, as applicable, outside the TDU region being served by the AREP on January 1, 2004, provided that such customers are not receiving POLR service from the AREP); or
- (B) the total differential between the net PTB and the market price of electricity calculated for the applicable class under paragraph (3) or (4) of this subsection.
- (6) All REPs shall provide information to the independent third party as needed for the performance of calculations set forth in paragraphs (3) and (4) of this subsection. All data used in the calculations performed by the independent third party will remain confidential but shall be subject to audit by the commission.
- (7) The functions of the independent third party shall be funded by the AREPs through one or more assessments made by the commission.
- (k) **Regulatory assets.** To the extent that any amount of regulatory assets included in a TC or CTC exceeds the amount of regulatory assets approved in a rate order which became effective on or before September 1, 1999, the commission shall conduct a review during the true-up proceeding to determine any such amounts that were not appropriately

calculated or that did not constitute reasonable and necessary costs. In addition, to the extent that any amount of regulatory assets approved for securitization in a commission financing order was not subsequently included in an issuance of transition bonds, that amount of regulatory assets shall be included in the TDU/APGC true-up balance under subsection (l) of this section.

(l) **TDU/APGC True-up balance.**

(1) The formula to establish the true-up balance between the TDU and APGC is shown in the following table. TDUs described in subsection (d)(3) of this section and their APGCs shall insert zero for all inputs in this equation except the input entitled "Final fuel balance calculated pursuant to subsection (h)."

<u>Calculation of True-up Balance</u>	
	Net book value calculated pursuant to subsection (g)
-	Market value calculated pursuant to subsection (f)(1)
+/-	Value calculated by ECOM model pursuant to subsection (f)(2)
+/-	Final fuel balance calculated pursuant to subsection (h)
+/-	Capacity auction true-up calculated pursuant to subsection (i)
+/-	<u>Regulatory asset amount calculated pursuant to subsection (k)</u>
=	TDU/APGC True-up Balance

(2) For TDUs described in subsection (d)(2) of this section, the TDU/APGC true-up balance shall be compared to projected stranded costs as provided in subparagraphs (A) – (C) of this paragraph. For TDUs described in subsection (d)(3) of this section, the TDU/APGC true-up balance shall be treated as provided in subparagraph (D) of this paragraph.

- (A) If the TDU/APGC true-up balance is positive, and greater than projected stranded costs, then the commission shall increase the CTC (or establish a CTC, if no CTC has previously been approved for the utility), extend the time for the collection of the CTC, or both, to enable the TDU to collect the TDU/APGC true-up balance. The utility may seek to securitize any or all of the amounts determined under this subparagraph under PURA Chapter 39, Subchapter G.
- (B) If the TDU/APGC true-up balance is positive, but less than projected stranded costs, then the commission shall reduce nonbypassable delivery rates in the amount of the difference by:
- (i) reducing any CTC established under PURA §39.201;
 - (ii) reversing, in whole or in part, the depreciation expense that has been redirected under PURA §39.256;
 - (iii) reducing the TDU's rates; or
 - (iv) any combination of clauses (i), (ii), and (iii) of this subparagraph.
- (C) If the TDU/APGC true-up balance is negative, then
- (i) any CTC established under PURA §39.201 shall be eliminated;
 - (ii) net mitigation shall be reversed until exhausted or until a zero true-up balance is achieved, and the amount of net mitigation reversed shall be returned to ratepayers by the APGC through an excess mitigation credit; and
 - (iii) if net mitigation is exhausted and some amount of the negative true-up balance remains, then for companies that have securitized

regulatory assets, a negative CTC shall be established based upon the lesser of the absolute value of the remaining negative true-up balance or the securitization amount on which any TCs are based. If the company has been issued a financing order by the commission authorizing the securitization of regulatory assets but securitization has not yet occurred, then the negative CTC will be implemented at the time the securitization bonds are issued. If the company has not received a financing order from the commission authorizing securitization of regulatory assets, then no negative CTC shall be established for purposes of this subsection.

- (D) If the TDU/APGC true-up balance is positive, then a CTC shall be imposed to enable the APGC to recover any positive fuel balance. If the TDU/APGC true-up balance is negative, then a fuel credit shall be implemented to return the over-recovered fuel balance to ratepayers.
- (3) The TDU shall be allowed to recover, or shall be liable for, carrying costs on the true-up balance. Carrying costs shall be calculated using the utility's cost of capital established in the utility's UCOS proceeding, and shall be calculated for the period of time from the date of the true-up final order until fully recovered.
- (m) **TDU/AREP true-up balance.** The TDU shall bill the AREP for, and the AREP shall remit to the TDU, the amount calculated pursuant to subsection (j) of this section, plus carrying costs. Carrying costs shall be calculated using the utility's cost of capital established in the utility's UCOS proceeding, and shall be calculated for the period of

time from the date of the true-up final order until fully recovered. The commission may reduce the TDU's rates to reflect the amounts due from the AREP.

(n) **Proceeding subsequent to the true-up.**

- (1) The TDU shall file an application to adjust its rates within 60 days following the issuance of a final, appealable order on its true-up proceeding. In the proceeding, the commission may adjust the TDU's rates and any CTC, in accordance with PURA §39.262(g), and any excess mitigation credit. The commission may also allocate the recovery responsibility for such rates and any CTC to the TDU's customer classes.
- (2) In the proceeding, the commission shall also consider adopting remittance standards, if necessary, with respect to the credits or bills as among the TDU, the APGC, and the AREP.

This agency hereby certifies that the rule, as adopted, has been reviewed by legal counsel and found to be within the agency's authority to adopt. It is therefore ordered by the Public Utility Commission of Texas that §25.263, relating to True-up Proceedings, is hereby adopted with changes to the text as proposed.

ISSUED IN AUSTIN, TEXAS ON THE 17th DAY OF JULY 2003.

PUBLIC UTILITY COMMISSION OF TEXAS

Chairman Rebecca Klein

Commissioner Brett A. Perlman

Commissioner Julie Parsley