

PROJECT NO. 29478

**PROCEEDING TO AMEND PUC RULE § PUBLIC UTILITY COMMISSION
RELATING TO VALUATION PANEL IN §
A TRUE-UP PROCEEDING, § OF TEXAS
SUBSTANTIVE RULE §25.263(f) §**

**ORDER ADOPTING AMENDMENT TO §25.263, RELATING TO TRUE-UP
PROCEEDING AS APPROVED AT THE MAY 13, 2004 OPEN MEETING**

The Public Utility Commission of Texas (commission) adopts an amendment to §25.263, relating to True-Up Proceeding, with no changes to the proposed text as published in the April 9, 2004 *Texas Register* (29 TexReg 3585). 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 deletes the conflict-of-interest provisions in subsection (f) of the rule, relating to the employment of a valuation panel to ascertain the existence and value of a control premium for any power generation company that uses the partial stock valuation method to determine the market value of its generation assets, in connection with determining the company's stranded costs. The commission will instead consider appropriate conflict-of-interest standards in selecting persons to serve on the valuation panel. This amendment is adopted under Project Number 29478.

A public hearing on the amendment was held at commission offices on Tuesday, April 13, 2004 at 9:30 a.m. Representatives from CenterPoint Energy Houston Electric, LLC (CenterPoint); Texas Industrial Energy Consumers (TIEC); and Clark, Thomas & Winters (CTW) attended the hearing and provided comments. To the extent that these comments differ from the submitted written comments, such comments are summarized herein.

The commission received one set of written comments on the proposed amendment jointly filed by the City of Houston, Coalition of Cities, Office of Public Utility Counsel, Texas Industrial Energy Consumers, Gulf Coast Coalition of Cities, Houston Council for Health and Education, and State of Texas (collectively, “Ratepayer Advocates”).

Summary of Comments at Public Hearing

CenterPoint commented at the public hearing that with regard to potential conflicts of interest, the banks that are eligible to serve on the valuation panel also perform work for some of the major intervenor groups. CenterPoint noted that, therefore, the concerns relating to conflicts of interest in the selection of a valuation panel are not completely one-sided.

Summary of Ratepayer Advocates’ Written Comments

Ratepayer Advocates noted in their written comments that the stated purpose of the proposed amendment is to attract “a broader group of persons who would be eligible to serve on the valuation panel and a more accurate determination of the market value of stranded costs.” Ratepayer Advocates additionally noted that the commission’s initial Request for Proposal (RFP) in this project did not elicit any responses, and that they appreciate the commission’s efforts to broaden the prospective panel for valuation of the control premium pursuant to PURA §39.262(h)(3). Ratepayer Advocates expressed concern, however, that the proposed amendment may not adequately address the intent of the legislature that the panelists be “independent,” and may not be sufficient to elicit an adequate number of responses because of the strong disincentives for “sell-side” investment banks to participate. Ratepayer Advocates suggested that the foremost intent of the Legislature was that the participating investment bankers remain

independent. To the extent that a potential panelist is not independent, this would clearly violate the intent of the Legislature in enacting PURA §39.262. Therefore, the Ratepayer Advocates urged the commission to expressly include appropriate conflict-of-interest standards in the rule.

Ratepayer Advocates noted that banks and similar sell-side intermediaries, which include mergers and acquisitions firms, make their money from commissions on the issuance of new securities, commissions on the sales and trading of existing securities, and from transaction fees involving mergers, acquisitions and divestitures. Even a relatively small offering (*e.g.*, \$200 million) can generate three to five million dollars in fees for the intermediaries involved. Consequently, Ratepayers Advocates noted, it cannot be assumed that any large investment bank would be willing to jeopardize this lucrative business in order to participate in a commission valuation panel that yields relatively little compensation and that has the potential to alienate future clients. Ratepayer Advocates averred that it may be that it was this disincentive, rather than the direct prohibition of conflicts of interest, which kept any of the top ten investment banks from bidding on the last RFP. If this is the case, Ratepayer Advocates submitted, then the recently approved amendment to the rule may not be sufficient inducement for these firms to bid on any future RFP.

Ratepayer Advocates also commented that, to the extent that any large investment bank does intend to issue securities for CenterPoint or related entities, it is hard to see how any such panelist could be considered independent. It cannot be assumed that an investment bank would ignore its own financial gain in issuing securities, and jeopardize further engagement with CenterPoint, to issue a valuation opinion unfavorable to CenterPoint in this case. Ratepayer

Advocates therefore requested that the commission consider alternatives which Ratepayer Advocates believe are viable options under PURA. Specifically, the Ratepayer Advocates requested that the commission seek to fulfill the legislative intent underlying PURA §39.262 by issuing an RFP that would seek responses from alternate groups of independent financial experts, including “buy-side” analysts who do not make their money through transaction fees and trading commissions. Ratepayer Advocates noted that although PURA §39.262(h)(3) states that the valuation panel must consist of financial experts, chosen from the top ten nationally recognized investment banks, there is a very real possibility that the commission will not be able to convene an independent valuation panel in accordance with this language. Thus, Ratepayer Advocates suggested that it may be impossible for the commission to follow the exact letter of the statute should it choose to convene a valuation panel. Ratepayer Advocates averred that Texas law is clear that the commission has the authority to consider alternatives necessary to fulfill legislative intent if the plain language of the statute cannot be followed or following the plain language of the statute would lead to an absurdity.

Ratepayer Advocates noted that The Texas Supreme Court has long recognized that “the intention of the legislature in enacting a law is the law itself, and must be enforced when ascertained, *although it may not be consistent with the strict letter of the statute.* Courts will not follow the letter of the statute when it leads away from the true intent and purpose of the legislature and to conclusions inconsistent with the general purpose of the act.” (Ratepayer Advocates’ emphasis)

Ratepayer Advocates cited the directive in PURA §39.262(a) that an electric utility “may not be permitted to overrecover stranded costs through the procedures established by this section or through the application of the measures provided by the other sections of this chapter.” They opined that the Legislature could not have intended that a control premium be avoided simply because the top ten independent investment banking firms with demonstrated experience in the electric utility industry failed to respond to a RFP. To the extent that an independent valuation panel cannot be convened, and a control premium exists for a particular stock, then a utility would overrecover stranded costs by the measures set forth in “this section”—PURA §39.262—if the control premium is not adopted. Ratepayer Advocates therefore argued that not convening an independent panel, simply because of a failure to receive responses from the top ten independent investment banking firms, would lead to a result that directly contravenes PURA.

Ratepayer Advocates commented that the commission has ample experience to select a fair valuation panel consisting of financial experts chosen from among the most nationally recognized firms with demonstrated experience in the United States electric industry. Ratepayer Advocates opined that such a selection by the commission would comply with the intent of PURA, which is the supreme law, although it may not be possible to comply with the strict letter of the law. Accordingly, Ratepayer Advocates requested that the commission issue an alternative RFP that is consistent with the legislative intent behind PURA §39.262, while using the commission’s expertise to ensure compliance with the Legislative intent in selecting qualified financial experts to serve on the panel. Ratepayer Advocates strongly urged the commission to consider alternative panels to analyze the need for a control premium, as the case

law strongly supports such options when it is impossible to follow the exact letter of the statute, while still complying with legislative intent.

The commission understands Ratepayer Advocates' concern to be that the amended rule will not attract a sufficient number of independent, qualified respondents. Ratepayer Advocates' concern is premature. As reflected in the filings in this Project, the commission has received several responses from apparently qualified RFP respondents. As the Ratepayer Advocates note, one of the chief concerns with respect to independence is the prospect that serving on the valuation panel would impair a company's future business prospects with CenterPoint or a related company. The RFP contains clear restrictions on performing current or post-agreement work for either CenterPoint Energy Houston Electric, LLC, or Texas Genco, LP, and despite this prohibition, the commission received several responses to the RFP. The Ratepayer Advocates in their comments did not specifically suggest that the commission change the proposed rule, and the commission is not making any changes in response to these comments. The commission shares Ratepayer Advocates' concern that it be able to select independent, qualified persons to serve on a valuation panel, and it intends to make every reasonable effort to select such a panel.

With regard to CenterPoint's comments at the public hearing, the commission acknowledges that to the extent that the same investment banks eligible for the valuation panel also conduct business with certain of the intervenor groups, this would have the effect of mitigating concerns about conflicts with CenterPoint or Texas Genco. Similar, however, to its conclusions regarding Ratepayer Advocates' comments, the commission is

not making any changes in response to these comments because CenterPoint did not specifically suggest that the commission change the proposed rule.

This amendment is adopted under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (Vernon 1998, Supplement 2004) (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) - (e) (No change.)

(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) - (B) (No change.)

(C) Partial stock valuation method. The following method of market valuation using a control premium may be used to value generation assets.

(i) - (iii) (No change.)

(iv) 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%.

(v) The costs and expenses of the panel, as approved by the commission, shall be paid by each transferee corporation.

(vi) 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.

(vii) 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.

(viii) 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.

(ix) The market value of the assets resulting from the procedures required by clauses (i) - (viii) of this subparagraph establishes the market value of the generation assets transferred by the electric utility or APGC to each transferee corporation.

(D) (No change.)

(2) (No change.)

(g) - (m) (No change.)

(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 in 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) (No change)

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 no changes to the text as proposed.

SIGNED AT AUSTIN, TEXAS the 13th day of May 2004.

PUBLIC UTILITY COMMISSION OF TEXAS

JULIE PARSLEY, COMMISSIONER

PAUL HUDSON, CHAIRMAN

BARRY T. SMITHERMAN, COMMISSIONER