

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair
Commissioner
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In the Matter of an Inquiry into Possible Effects
of the Financial Difficulties at Reliant Energy,
Inc. on Reliant Energy Minnegasco and its
Customers

ISSUE DATE: April 8, 2003

DOCKET NO. G-008/CI-02-1368

ORDER REQUIRING FILINGS TO
PROTECT MINNESOTA RATEPAYERS

PROCEDURAL HISTORY

On August 29, 2002, the Commission met to determine whether it should 1) require Reliant Energy (now CenterPoint) officials to provide additional information, 2) pursue an investigation, and/or 3) take other actions to help ensure that Minnegasco (then a division of Reliant and now a division of CenterPoint) provides safe, adequate, and reliable service at reasonable rates, in light of the financial problems of Reliant Energy, Inc. (Reliant Energy) and Reliant Resources, Inc. (RRI). Following the Commission meeting, the Department compiled Minnegasco's oral responses to the questions contained in the briefing papers and requested that Minnegasco file the responses with the Commission.

Effective August 31, 2002, Reliant Energy completed a restructuring transaction that resulted in a new holding company (CenterPoint Energy, Inc.) that generally replicates all of the principal corporate characteristics of Reliant Energy.

On October 11, 2002, Minnegasco filed, in written form, the responses that it had provided orally during the Commission's August 29, 2002 meeting.

On November 20, 2002, the Residential and Small Business Utilities Division of the Office of the Attorney General (RUD-OAG) filed comments.

On December 6, 2002, the Minnesota Department of Commerce (the Department) filed comments.

On December 23, 2002, CenterPoint Energy, Minnegasco, filed reply comments.

On January 13, 2003, Minnegasco filed supplemental reply comments.

The Commission met on March 13, 2003 to consider this matter.

FINDINGS AND CONCLUSIONS

I. THE COMMISSION'S CONCERN

The Commission's concern is for Minnegasco, a division of CenterPoint Energy¹, and its ability to continue to provide safe, reliable natural gas service at reasonable rates to its customers in Minnesota. The specific focus of concern is the potential impact on Minnegasco of the financial condition of CenterPoint Energy, Inc. and Reliant Resources, Inc. (RRI).

II. TRACKING THE CONCERN THROUGH RESTRUCTURING

Prior to restructuring on October 1, 2002, Minnegasco was a rate-regulated division of Reliant Energy Resources Corp (RERC), which itself was a subsidiary of Reliant Energy, Inc. On October 1, 2002, Reliant Energy, Inc. was split into two portions:

- 1) CenterPoint Energy, Inc. (CenterPoint Energy), which contains both rate regulated and non-rate regulated operations; and
- 2) a fully non-regulated portion, Reliant Resources, Inc. (RRI).

Prior to the restructuring, Reliant Energy, Inc. was a holding company that owned both regulated and non-regulated subsidiaries. One of Reliant Energy, Inc.'s regulated subsidiaries was Reliant Energy Resources Corp. (RERC) and one of RERC's divisions was Reliant Energy, Minnegasco (Minnegasco).

In the restructuring, RERC has been succeeded by CenterPoint Energy Resource Corp. (CERC) and, just as RERC had been a subsidiary of Reliant Energy, Inc, CERC is a subsidiary of CenterPoint Energy, Inc.

CenterPoint Energy, Minnegasco, the successor to Reliant Energy, Minnegasco, is a division of CERC, just as Reliant Energy, Minnegasco had been a division of RERC. Certain analytical confusions can arise from Minnegasco's history as a Minnesota-based stand-alone company and the fact that Minnegasco's name continues to suggest that it is a company in its own right, while in fact it is simply a division of RERC. In this regard, the Commission notes that occasionally in their comments Minnegasco and the Department refer to Minnegasco as "the Company" despite

¹ Minnegasco is formerly Reliant Energy, Minnegasco and is now CenterPoint Energy, Minnegasco

the fact that all parties agree that Minnegasco is not a company but a division of a company. To reduce any analytical confusion that could result from beginning to view Minnegasco as a company rather than a division of a company, this Order will simply use the term “Minnegasco” when that entity is referenced rather than the potentially misleading term “the Company”.

III. THE DEPARTMENT OF COMMERCE COMMENTS

The Department addressed several main issues: 1) cash flow; 2) debt financing; 3) potential bankruptcy exposure; 4) non-regulated legal issues; and 5) cost of capital.

A. Cash Flow

The Department stated that Minnegasco transfers cash from its profits to CERC, but not to CenterPoint Energy. The Department stated that Minnegasco seeks to limit the amount transferred to CERC by having a goal to maintain the 50 percent equity ratio the Commission has used for ratemaking. The Department stated that according to Minnegasco, its capital structure for the twelve months ending June 20, 2002, was 44 percent debt to 56 percent equity.

The Department stated that Minnegasco's current capital structure is more favorable than a 50/50 capital structure. To ensure that this capital structure is maintained on a going-forward basis, the Department recommended that the Commission order Minnegasco to commit to maintaining a cash balance such that Minnegasco can fund its operations and capital expansions internally as to maintain its 50/50 debt to equity capital structure.

The Department also recommended that the Commission either order Minnegasco to file an annual Capital Structure filing or to make an annual report to the Commission specific to its capital structure so that regulators are kept current on Minnegasco's debt structure.

At the hearing on this matter, the Department stated that Minnegasco's reply comments adequately addressed these concerns and withdrew these recommendations.

B. Debt Financing

The Department stated that one indication of a company's financial strength and its ability to secure financing is its debt rating. The Department stated that because CERC issues debt for Minnegasco, the debt ratings for CERC directly affect Minnegasco's cost of debt. At the Commission's August 29, 2002 meeting Minnegasco indicated that it did not expect any further downgrade upon the restructure. Contrary to that expectation, the Department reported, the bond ratings for both CenterPoint Energy and CERC have been lowered since that Commission meeting.

The Department concluded that CERC's financial ratios indicate that CERC is in a non-favorable financial position and may encounter difficulties in financing its operations. The Department

made no recommendations on this subject, however.

C. Potential Bankruptcy Exposure

Regarding the impact of bankruptcy by CenterPoint Energy on Minnegasco, the Department noted that the holding company status of CERC would shield Minnesota ratepayers to some extent from CenterPoint Energy's financial situation. However, the Department stated, since Minnegasco's capital structure contains equity issued by CenterPoint Energy, a bankruptcy by CenterPoint Energy would have some level of impact on Minnegasco in that it would necessitate a corporate restructuring of Minnegasco.

As to a bankruptcy by RRI, the Department reported that Minnegasco has represented that there are no material cross-default provisions or financial obligations that could migrate from RRI to CenterPoint Energy. Therefore, the Department concluded, the regulated Minnegasco operations appear to be insulated from RRI's non-regulated operations.

D. Non-Regulated Legal Issues

The Department noted that CenterPoint Minnegasco has dismissed concerns for RRI liability for alleged electric market manipulation and trading misconduct, asserting that any such liability would rest solely with RRI. The Department noted, however, an argument - unresolved at this point - that if RRI developed liquidity issues and became subject to bankruptcy proceedings, creditors could "substantively consolidate" the assets of RRI and CenterPoint Energy. The Department stated that due to the number of legal actions being taken against the former Reliant Energy for its role as a provider of electricity in the western markets and specifically in California, this is a potential issue.

The Department recommended specific steps to protect Minnegasco ratepayers from any of these potential liabilities.

E. Cost of Capital

The Department stated that it is difficult to assess the nature of and risks associated with the new structure. The Department stated the new structure seems like a fairly secure situation for customers, in that there are no unregulated operations with the higher risk profile to endanger solid performing regulated assets but also noted that CenterPoint seems to have problems dealing with its financial situation and its debt-to-equity ratio.

At the same time, the Department stated that the Department's concern over CenterPoint's financial condition does not automatically transfer to Minnegasco. The Department stated that Minnegasco's healthy cash flow means that Minnegasco should be able to avoid any significant new borrowing and if, as Minnegasco reported, none of the proceeds from the new \$4.7 billion loan will be allocated to CERC or Minnegasco, there should not be a long-term impact on

Minnegasco's cost of debt due to that loan.

The Department stated that it wants to ensure that the cost of debt for Minnegasco reflects only Minnegasco's risk profile and the risk profile of similarly situated natural gas local distribution companies (LDCs). The Department made several recommendations to mitigate any adverse impact caused by CenterPoint Energy's financial problems.

F. The Department's Conclusions

The Department found no material cross-default provisions or financial obligations that could migrate from RRI to CenterPoint Energy. The Department stated that since RRI and CenterPoint Energy now appear to be separate companies, the possibility of unregulated operations endangering CenterPoint Energy's financial status is less cause for concern. The Department noted that the holding company status of CenterPoint Energy/CERC/Minnegasco shields Minnegasco's Minnesota customers to some extent from CenterPoint Energy's financial situation, though a bankruptcy at CenterPoint would have some impact on Minnegasco and its ratepayers since it would necessitate restructuring. The Department stated that any concern for CenterPoint Energy, then, is not due to its unregulated affiliates, but rather to its own poor debt-to-equity ratio.

As to the legal issue of substantive consolidation, the Department stated that Minnegasco provided a responsive discussion of this issue in response to the RUD's information request and did not recommend further development of this issue at this time. Finally, the Department stated that the current level of risk to regulated ratepayers regarding cost of capital is not known at this time.

The Department made specific recommendations regarding several of these issues.

IV. RUD-OAG COMMENTS

The RUD-OAG raised the concern that in the event of the bankruptcy of either CenterPoint or RRI, a bankruptcy judge could apply the doctrine of substantive consolidation to consolidate the assets and liabilities of separate but related legal entities, casting all the assets and liabilities of two or more entities into a single bankruptcy estate.

The RUD-OAG stated that some of the ties that could be cited as warranting the consolidation include the following:

- (1) the spin-off resulted in each company having a nearly identical body of shareholders;
- (2) the spin-off resulted in the movement of directors, officers, and other employees between the two companies, along with concomitant insider stock purchases and

sales, and the continued sharing of facilities;

(3) RRI has an option to purchase CenterPoint's electric generation capacity in January 2004, and CenterPoint anticipates the recovery of billions of dollars in stranded costs; and

(4) more than half of CenterPoint Houston's revenues from retail electric providers is derived from its former affiliate, RRI.

V. MINNEGASCO'S REPLY COMMENTS

Minnegasco claimed that the Department's comments fail to recognize the significance of the complete and total separation of former Reliant Energy, Incorporated into CenterPoint Energy, a registered holding company under the Public Utility Holding Company Act of 1935, and Reliant Resources, an independent, unaffiliated entity engaged in unregulated energy industry businesses.

Minnegasco asserted that it addressed each of the Department's concerns and has provided all of the assurances possible that Minnegasco ratepayers are not and will not be at risk for any financial consequences of the separation from RRI or from the current turbulence in the financial markets.

Minnegasco addressed each of the Department's recommendations as follows:

- the debt issuance and cost information has been and will be voluntarily included in the Annual Jurisdictional Reports;
- there is no legal basis or other need for annual statutory capital structure filings;
- the annual Jurisdictional Report provides the debt information requested; CenterPoint's debt costs have no bearing on Minnegasco's costs of capital used for ratemaking purposes;
- Minnegasco has committed to discuss the effects of CenterPoint's financial situation on Minnegasco's cost of equity;
- Minnegasco has already agreed to report on significant financial events for CenterPoint and CERC, and provide copies of SEC filings; and
- none of the criteria in which a debtor and its debtor affiliates might be consolidated apply to the RRI/CenterPoint situation.

Minnegasco concluded that there are no issues arising out of CenterPoint's financial status that could or will have an impact on Minnegasco customers and that there is nothing further that can or should be done to protect Minnegasco's customers other than to close this docket.

In supplemental reply comments, Minnegasco 1) explained the difference between CenterPoint Energy Resources Corp. market based debt and Minnegasco's hypothetical debt; 2) described the

process Minnegasco uses to recognize hypothetical debt; and 3) listed Minnegasco's commitments.

VI. COMMISSION ANALYSIS AND ACTION

As a division of RERC, Minnegasco has no corporate structure and therefore technically no capital structure or debt structure. And while a division may experience revenues, it does not have profits. Treating Minnegasco as if it were a company rather than a division of a company will be avoided in this Order.

Some of the goals of this proceeding are to ensure that facts and relevant information are recorded and available for an appropriate future rate setting proceeding, to ensure that ratepayers receive a high quality of service, and to ensure that Minnegasco is unaffected by parent or affiliate financial difficulties and that any cost related increases are not passed on to ratepayers.

Based on the record to date, the Commission cannot conclude that Minnegasco customers are fully insulated from the financial conditions of CenterPoint Energy and CenterPoint Energy Resources, that everything that can be done has been done to protect Minnesota ratepayers, or that the problems associated with RRI could not have an impact on Minnegasco. While the outcome of the current situation at CenterPoint cannot be known at this time, this does not prevent the Commission from taking prudent action, where possible, to protect Minnesota customers.

The Commission analyzes the Department's recommendations as follows.

1. Cash Flow Recommendations

The Department recommended that the Commission require Minnegasco to commit to maintaining a cash balance such that Minnegasco can fund its operations and capital expansions internally as to maintain its 50/50 debt to equity capital structure.

In its supplementary reply comments, Minnegasco has committed to maintaining a cash balance such that Minnegasco can fund its operations and capital expansions internally as to maintain its 50/50 debt to equity capital structure. The Commission finds that this commitment is appropriate and will so order.

The Department also recommended that the Commission either order Minnegasco to file an annual Capital Structure filing or to make an annual report to the Commission specific to its capital structure so that regulators are kept current of Minnegasco's debt structure.

Minnegasco responded that it provides detailed information regarding its capital structure in its Annual Jurisdictional Report.

The Commission clarifies that as a division of RERC, Minnegasco has no capital structure or debt structure of its own, but for ratemaking purposes has used hypothetical capital and debt structures. With that clarification, the Commission find that Minnegasco's promise to provide the identified information is satisfactory and will make no further requirement in this regard.

2. Documentation of Customer Indemnification

The Department recommended that the Commission require Minnegasco to provide documentation that Minnegasco customers are indemnified from certain potential liabilities pending against RRI, such as those associated with electric and/or natural gas trading irregularities, investigations of California and Western market price investigations, and shareholder and class-action lawsuits.

Minnegasco responded that the Department's recommendation was unwarranted because 1) the Master Separation Agreement sets forth the indemnification and release arrangements that protect CenterPoint from the actions of RRI and no information filing by Minnegasco concerning RRI would be meaningful because RRI is an entirely separate entity; 2) the substantive consolidation doctrine has been fully explained and is not applicable under the present circumstances so there is no need to have further reports on this doctrine; and 3) Minnegasco has committed, and recommits that no legal or financing costs associated with RRI's legal problems will be borne by Minnegasco's ratepayers, nor will Minnegasco seek to recover such costs in any rate proceeding.

The Commission agrees that adequate hypothetical discussion of the substantive consolidation doctrine has occurred and no further exploration of the doctrine need occur at this time. Minnegasco's potential liability for RRI's actions, however, remains a concern for the Commission. Minnegasco's comments in this docket, assuring the Commission that no legal or financing costs associated with RRI's legal problems will be borne by Minnegasco's ratepayers and that Minnegasco will not seek to recover such costs in any rate proceeding, are inadequate. The Commission agrees with the Department on this point and will require Minnegasco to provide documentation that Minnegasco customers are indemnified from the liabilities pending against RRI.

3. Impact on Cost of Common Equity

The Department recommended that the Commission direct Minnegasco to provide in its next rate case a discussion and analysis of the effects, at that time, of CenterPoint Energy's financial situation on Minnegasco's cost of common equity.

In the NorAm/Houston Industries (HI) merger filings (Docket No. G-008/PA-96-950), Minnegasco promised to file testimony and supporting schedules or workpapers in its next general rate case on several financial matters, including the cost of equity that is associated with the actual

capital structures for CenterPoint Energy, Inc. and CERC. As another reasonable way to monitor the possible impact of CenterPoint's financial difficulties on Minnegasco, the Commission will require Minnegasco to file the specific piece of additional analysis requested by the Department at this time: a discussion and analysis of the effects, at that time, of CenterPoint Energy's financial situation on Minnegasco's cost of common equity.

4. Reporting Significant Financial Events

The Department recommended that the Commission require Minnegasco to report immediately and on a continuous basis any significant financial event for CenterPoint Energy or CERC and to provide copies of any report made to the SEC or any other federal agency from this point forward. The Commission agrees that this reasonable and prudent measure will assist the Commission to monitor the potential threats to Minnegasco and will so order.

5. Maintaining Service Quality

The Department recommended that the Commission require Minnegasco to maintain service quality at or above levels that existed when the Commission ordered Minnegasco to develop service quality standards in Docket No. G-008/PA-01-1694. The Department stated that in that docket the Commission adopted the Department recommendation and required Minnegasco to

- 1) file proposed gas service quality standards within 30 days of the transfer of Minnegasco's assets;
- 2) begin using those mechanisms on a going-forward basis to gauge customer service quality; and
- 3) file Minnegasco's results annually after that.

Minnegasco objected that there are no service quality standards in effect for Minnegasco at this time and that service quality standards are unrelated to the financial concerns which are the focus of this docket.

The Department clarified that the purpose of its recommendation was to ensure that Minnegasco did not lower its service quality performance. The RUD-OAG clarified that attention to service quality was relevant to this docket since a utility's financial difficulties can lead it to reduce expenditures, which can have a negative impact on service quality.

The Commission agrees that it is important that Minnegasco not reduce its service quality performance below pre-financial difficulty levels and that it is prudent to direct Minnegasco to maintain its service quality at or above the levels that have existed prior to the financial difficulties in question. At the hearing, Minnegasco and the Department agreed to address service quality

standards and to inform the Commission's Executive Secretary of their progress. The Executive Secretary would then direct Minnegasco to file service quality standards. Based on this agreement and assuming that the service quality standards in question will soon be submitted, the Commission need not reach the merits of Minnegasco's assertion that there are no service quality standards applicable to Minnegasco at this time.²

6. Minnegasco Commitments

In its Supplemental Reply Comments, Minnegasco stated that it would 1) maintain on its Minnesota jurisdictional books and for regulatory purposes, a capitalization structure and applicable cost of financing typical of an A-rated utility and 2) maintain approximately a 50/50 debt equity ratio, with each debt instrument reflecting the costs associated with that of an A-rated utility at the time that the debt instrument is booked. Due to the usefulness of the data resulting from these commitments, the Commission will specifically direct Minnegasco to adhere to them.

By listing these two specific commitments, the Commission does not imply that Minnegasco is not bound by the other commitments it has made in this and other related dockets.³ Nor does the Commission imply that Minnegasco is released from the requirements of other Orders in those dockets simply because they are not specifically mentioned in this Order.

² See *In the Matter of a Petition by Minnegasco, a Division of Reliant Energy Resources Corp., for Approval of Various Aspects of a Corporate Restructuring*, Docket No. G-008/PA-01-1694, ORDER APPROVING ASSET TRANSFER WITH CONDITIONS (April 1, 2002) at pages 2-3). In that Order, the Commission directed Minnegasco to file proposed gas service quality standards similar to those required of Northern States Power Company, d/b/a Xcel Energy in merger Docket No. E, G0002/PA-99-1031 within 30 days of the transfer of Minnegasco's assets and to begin using these mechanisms on a going forward basis to gauge customer service quality.

³ See, e.g. Docket No. G-008/PA-96-950 (the Nor/AM-Houston Industries merger docket) and Docket No. G-008/PA-01-1694 (the restructuring docket).

7. Future Steps

The Commission will not close the docket as Minnegasco has requested but will direct Minnegasco to comply with this Order. The Commission will determine at a future date what, if any, additional means of monitoring will be appropriate.

ORDER

1. Minnegasco shall provide documentation that Minnegasco customers are indemnified from potential Reliant Resources, Inc. (RRI) liabilities such as refunds and penalties associated with, for example, a) electric and/or natural gas trading irregularities, b) investigations of California and Western market price investigations, and c) shareholders and class-action lawsuits pending against RRI.
2. Minnegasco shall ensure that such legal or financing costs associated with RRI's numerous pending legal issues will not be borne by Minnesota ratepayers either now or in a future rate case.
3. Minnegasco shall provide a discussion and analysis in its next rate case of the effects, at that time, of CenterPoint Energy's financial situation on Minnegasco's cost of common equity.
4. Minnegasco shall report immediately and on a continuous basis any significant financial event for CenterPoint Energy or CERC, and provide copies of any report made to the SEC or any other federal agency from this point forward.
5. Minnegasco shall maintain service quality at or above levels that existed when Minnegasco was ordered by the Commission to develop service quality standards in Docket No. G008/PA-01-1694.
6. Upon receipt of a report of discussions between Minnegasco and the Department of Commerce regarding service quality standards, the Executive Secretary will issue and Minnegasco shall comply with a directive to file service quality standards.

7. Without releasing Minnegasco from commitments and requirements made and imposed in this and related dockets, Minnegasco shall adhere to the following commitments:
 - a. on its Minnesota jurisdictional books and for regulatory purposes, Minnegasco shall recognize capitalization structure and applicable cost of financing typical of an A-rated utility; and
 - b. Minnegasco shall maintain approximately a 50/50 debt equity ratio, with each debt instrument reflecting the costs associated with that of an A-rated utility at the time that the debt instrument is booked.
8. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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