

SUBJECT: ERCOT revisions and changes in electric power market regulation

COMMITTEE: Regulated Industries — committee substitute recommended

VOTE: 6 ayes — P. King, Hunter, Baxter, R. Cook, Crabb, Hartnett

0 nays

1 absent — Turner

WITNESSES: For — Neil Eddleman, Alliance for a Competitive Electric Market; John Fainter, Association of Electric Companies of Texas, Inc.; Michael Jewell, Direct Energy, CPL Retail Energy, WTU Retail Energy, and Alliance for Retail Markets; Eddie Kolodziej, DFW Electric Consumer Coalition; David McCalla, GEUS, City of Greenville's Municipally-owned Electric System; Amy Mian, Fire Fly Electricity, LLC; Rob Potosky, Utility Choice Electric and Alliance for Competitive Electric Markets; John Rainey, Denton Municipal Electricity; Fred Sherman, Garland Power and Light; Kay Trostle, TXI-Chaparral Steel Midlothian, Nucor Steel and Structural Metals, Inc.; Mark Zion, Texas Public Power Association; (*Registered, but did not testify*: Tom Darte, GEUS; Jay Doegey, Cities Aggregation Power Project, Inc. and City of Arlington; Scott Gahn, Just Energy Texas, LLC and Alliance for a Competitive Electric Market; Jerry Valdez, Texas Competitive Power Advocates; Mike Williams, Texas Electric Cooperatives)

Against — Nick Fehrenbach, The City of Dallas and the Committee of Concerned Load; (*Registered, but did not testify*: Charles Frazier, Frazier and Frazier Ind., Inc.; Geoffrey Gay, Patrick Wilkins, Cities Aggregation Power Project, Inc. and South Texas Aggregation Project, Inc.; David Ragsdale)

On — Carol Biedrzycki, Texas Ratepayers Organization to Save Energy; (*Registered, but did not testify*: Jim Darling, South Texas Aggregation Project and City of McAllen; Phillip Oldham, Texas Coalition for Competitive Electricity; Thomas Schrader, Electric Reliability Council of Texas; Tom Smith, Public Citizen Members; Randall Chapman)

**BACKGROUND:** The Public Utility Commission of Texas regulates electric companies in Texas. This includes overseeing fair competition in the wholesale and retail electric market, governing transmission and distribution utilities in competitive areas, and regulating the rates of service in areas of investor-owned utilities in areas of the state not subject to competition.

The 76th Legislature in 1999 enacted SB 7 by Sibley, restructuring electric utilities and allowing customers of Texas' investor-owned utilities to choose their electricity providers as of January 1, 2002.

The Electric Reliability Council of Texas (ERCOT) is one of 10 regional reliability councils in North America and the Independent System Operator for the ERCOT area. The organization serves 7 million electricity customers and oversees the operation of more than 78,000 megawatts of generation and 37,500 miles of transmission lines in the state. ERCOT serves about 85 percent of the state's demand for electricity and 75 percent of the geographic land area of the state. While most of Texas is in the ERCOT region, portions of the Panhandle, far West Texas, Northeast Texas, and Southeast Texas are in the other adjacent power regions.

ERCOT is responsible for facilitating wholesale electricity transactions among power generators and retailers, ensuring customer information is provided to retailers, maintaining the reliability of the transmission network, and ensuring open access to the network.

ERCOT is governed by a 14-member board of directors that includes representatives of electric market segments, consumers, unaffiliated members, and ex officio members.

**DIGEST:**

**ERCOT**

***PUC oversight.*** The PUC would have the authority to oversee, approve, and order modifications of any part of the finances, budget, or administration of ERCOT. ERCOT would be accountable directly to the PUC. ERCOT would be required fully to cooperate with the PUC in its oversight and investigatory functions. The PUC could decertify ERCOT if it did not comply with its duties under the bill.

ERCOT would have to provide the PUC with information to allow the commission to review ERCOT's budget for efficiency and necessity of

budget items. The PUC would review the salaries, employee benefits, and debt of ERCOT.

After determining ERCOT's budget to be reasonable, the PUC could authorize ERCOT to charge wholesale buyers and sellers of electricity a competitively neutral rate set by the commission. This rate would allow ERCOT to take in an amount of revenue determined by the commission. ERCOT could change this rate only with PUC approval. The commission could inquire into the reasonableness of ERCOT's budget or rate after receiving a complaint.

***ERCOT's governing body.*** ERCOT's governing body would be composed of 16 members, including:

- the PUC chairman as an ex officio nonvoting member;
- the Office of Public Utility Counsel (OPUC) counselor as an ex officio voting member representing residential and small commercial consumer interests;
- the chief executive officer of ERCOT as an ex officio voting member;
- six market participants elected by their market segments to serve one-year terms, with one member each representing independent generators, investor-owned utilities, power marketers, retail electric providers, municipally owned utilities, and electric cooperatives;
- a representative of industrial consumer interests, elected by this market segment to serve a one-year term;
- a representative of large commercial consumer interests selected by the outgoing large commercial consumer representative to serve a one-year term; and
- five representatives unaffiliated with any market segment selected by the other members of the governing body to serve three-year terms.

One of the five unaffiliated representatives would serve as presiding officer of ERCOT's governing body.

***Violations by market participants.*** Any person who participated in a market overseen by ERCOT would observe all scheduling, operating, planning, reliability, and settlement guidelines established by ERCOT. A violation by any person of those rules could result in the revocation of that person's registration or in an administrative penalty.

The PUC could require the refunding or disgorgement of unjust profits that accrued in violation of the bill.

***Open meeting requirements.*** The ERCOT governing body and its members would be subject to state open meeting laws in the same way those laws apply to a governmental body. However, requirements in ERCOT's bylaws pertaining to executive sessions, advance notice of meetings and agendas, and public comment on items discussed in meetings would apply in lieu of conflicting state laws.

ERCOT's bylaws and PUC rules would allow the ERCOT governing body or a subcommittee to enter into a closed executive session to address sensitive matters. The bylaws and rules also would ensure that a person interested in the organization's activities could obtain at least seven days' notice of meetings of the governing body and the planned agenda. An addendum to the agenda could be posted at least two hours before the meeting if the notice identified an emergency or public necessity for the addendum.

***Conflicts of interest.*** If a member of the ERCOT governing body had a direct interest in a matter before the body, the member would have to disclose that interest and recuse himself or herself from deliberations and votes on the matter. Such a recusal would not affect quorum.

***Market monitor.*** ERCOT would contract with a private person selected by the PUC to act as the wholesale electric market monitor to detect market power abuses. ERCOT would pay the monitor through its authorized rate and allow the monitor to use the organization's main operations center. ERCOT would ensure that the monitor had the resources available to monitor the wholesale electric market effectively.

The monitor would operate under the supervision of the PUC. The PUC would define:

- the monitor's responsibilities;
- funding and staff levels for the monitor;
- qualifications for staff;
- ethical standards for the monitor;
- procedures for communication among the monitor, the PUC, and ERCOT;

- the reporting requirements of the monitor; and
- confidentiality requirements.

The PUC would consult with a subcommittee of the ERCOT board to determine funding for the monitor. The monitor would have to be independent from market participants.

The monitor would report any market power abuses or violations of PUC or ERCOT to the PUC and to a market participant who was the subject of the report. The monitor would submit an annual report to the PUC and ERCOT identifying market design flaws, which the PUC and ERCOT would use to evaluate whether rule changes should be made.

**Securitization.** The bill would specify that securitization financing should be used by utilities to recover regulatory assets, amounts determined under a true-up proceeding, and any amounts recovered under a competition transition charge.

**Effective date.** ERCOT would have to modify its governing body no later than January 1, 2006.

### **Transition to competition in certain non-ERCOT areas**

The bill would establish transition to competition procedures for any multi-state electric utility operating solely outside ERCOT that served customers in the state within the Western Electric Coordinating Council. This would include the region in and around El Paso.

The rates of a utility under this section would be subject to regulation by the PUC until the utility was authorized to implement retail customer choice. The utility would be subject only to renewable energy and natural gas goals under Utilities Code, ch. 39. A utility would have to obtain at least enough renewable energy credits to meet its requirements for each compliance period beginning on January 1, 2006. A utility would have to meet at least 5 percent of its growth in demand through energy efficiency savings resulting from energy efficiency programs by January 1, 2007, and 10 percent of its growth after that.

**Transition to competition.** The bill would establish five stages to be followed before retail competition by a utility in the service area defined in the bill was introduced.

The first stage would consist of:

- approval of a regional transmission organization by the Federal Energy Regulatory Commission (FERC) for the utility's power region and the commencement of independent operation of the network;
- development of retail market protocols to facilitate competition; and
- the completion of an expedited proceeding to develop non-bypassable delivery rate for a customer choice pilot project.

The second stage would consist of:

- initiation of a customer choice pilot project;
- development of a balancing energy market, an ancillary services market, and a market-based congestion management system; and
- implementation of a seams agreement with adjacent power regions.

The third stage would consist of the utility filing applications for and the PUC approving:

- business separation;
- unbundled transmission and distribution rates;
- certification of a qualified power region; and
- price-to-beat rates

The third stage also would require the testing of retail and wholesale systems.

The fourth stage would consist of:

- PUC evaluation of the pilot project;
- initiation of a capacity auction by the utility; and
- separation of the utility's competitive energy services from its regulated activities.

The fifth stage would consist of:

- PUC evaluation of whether the region could offer fair competition and reliable service to retail customers.

If the PUC determined the region could offer fair competition and reliable service, the commission would initiate retail competition for the utility. Otherwise, the commission would delay competition. Upon initiation of competition, the fifth stage also would consist of business separation and unbundling by the utility.

### **Other provisions**

***Consumer protection.*** The bill would delete references to telecommunications services in Utilities Code, ch. 17, which governs consumer protection. Chapter 17 would be redesignated as ch. 42.

The bill would delete references to a "billing utility." Instead, a "billing entity" would be any retail electric provider or electric utility that issued a bill to a customer for any electric product or service. The commission no longer would have to include lifeline service in its integrated eligibility process for customer service discounts.

***Complaints regarding a recreational vehicle park owner.*** The bill would allow an affected person to complain to the regulatory authority, which is defined as the PUC or the governing body of a municipality, regarding a recreational vehicle park owner who provided metered electric service in violation of a law over which the regulatory authority had jurisdiction. The PUC would keep a file on each complaint. The PUC would notify complainants of the status of the complaint on at least a quarterly basis.

***Ratemaking proceedings.*** An electric utility would reimburse a municipality's governing body for the reasonable and necessary cost of services related to a case to the extent that those costs were determined to be reasonable and necessary by the regulatory authority. The regulatory authority would have to consider factors described in Texas Disciplinary Rules of Professional Conduct in determining whether attorney's fees were reasonable and necessary.

***Transmission cost recovery by non-ERCOT utilities.*** This would apply to an electric utility operating outside of ERCOT in areas of the state not included in the Southeastern Electric Reliability Council on January 1, 2005, that owned or operated transmission facilities. This would exclude the service area of Entergy Corp. in Southeast Texas. The PUC could allow affected utilities to recover transmission infrastructure costs and changes in wholesale transmission charges under a tariff approved by a

federal regulatory authority. A utility could recover only the costs that were allocable to retail customers in the state. A utility could not over-recover costs.

***Electric service reliability.*** The PUC would adopt and enforce rules to ensure service quality and reliability for delivery of electricity to retail customers and transmission and distribution utilities. This would not authorize the PUC to establish quality standards or require reporting of service quality for a municipally owned utility or electric cooperative. All utilities, cooperatives, and independent system operators would have to observe all of the PUC's reliability, security, and emergency management rules. The commission could take enforcement action against a person who did not comply this requirement or suspend, revoke, or amend a utility's certificate of convenience and necessity.

***System benefit fund.*** CSHB 554 would specify that money in the System benefit fund (SBF) could be appropriated solely for the following purposes:

- a 10-20 percent rate reduction in the electric bills of low-income consumers;
- consumer education programs, administrative expenses, and expenditures by the Office of the Public Utility Counsel relating to SBF programs;
- energy efficiency (weatherization) programs for low-income individuals; and
- the school funding loss mechanism.

The bill also would allow for appropriations from the fund to educate residential and small business customers about the fund. Eligibility for low-income electric customer programs would include customers who receive food stamps, Medicaid, or federal housing assistance. A household with a child enrolled in the federal free or reduced lunch program also would be eligible. The PUC would establish the goal of enrolling at least 95 percent of customers eligible for reduced rates.

***Other provisions.*** The bill would include gasification of municipal solid waste in the definition of renewable energy.

After a contested case hearing, the PUC could release to the public any information in the commission's possession if the information would serve the public interest and was not competitively sensitive or confidential.

The PUC could adopt rules to ensure that money from nuclear decommissioning was collected and spent for its intended purpose, and that unspent money was returned to retail customers.

**Repealed.** The bill would repeal a section authorizing the PUC to require a public utility to report its expenditures for business gifts, entertainment, advertising, and public relations.

**Effective date.** The bill would take effect September 1, 2005.

SUPPORTERS  
SAY:

**ERCOT.** CSHB 1777 would institute much needed oversight and accountability reforms for ERCOT and its board of directors. ERCOT has been the target of serious allegations of mismanagement and wasteful spending, and several former employees and contractors have been indicted under felony charges relating to charges of contracting fraud. Due to ambiguity surrounding the applicability of state open meetings and public records laws, members of the public have been stymied in their attempts to learn more about ERCOT's business practices and participate in its decision-making process. ERCOT performs vital functions in its management of the state's electric market, and it is imperative that this powerful organization be accountable to the public it serves.

By explicitly requiring that state open meetings and public records laws apply to ERCOT, CSHB 1777 would ensure public confidence in the operations of this important organization. The PUC would gain the authority to review ERCOT's budget, and the commission would authorize fees for ERCOT only after approval of its budget. In addition, the bill explicitly would require board members to recuse themselves when conflicts of interest arose. ERCOT is funded by fees paid by millions of electric customers in Texas, and the public deserves to know that these funds are being spent appropriately.

CSHB 1777 would improve the representativeness of the ERCOT board by increasing the number of independent members from three to five. As ERCOT has become a more public entity, it has become important to have independent, non-market representation on its governing board. Having five independent members in addition to the bill's strong conflict-of-

interest provisions would allow for the public interest effectively to be served by the board.

***Market monitor.*** The adoption of an independent market monitor would enable the PUC to identify and sanction any abuses of market power that occur within ERCOT. Large wholesale generators have the capacity to manipulate the market and control prices, and it is important that an independent entity exists to ensure that such abuses do not occur. The bill would authorize the PUC to require refunds and disgorgement of any unjust profits realized through the abuse of market power. Such powers are necessary because profits resulting from large-scale manipulations easily could dwarf the penalty authority the PUC has over those market participants.

***System benefit fund.*** The bill would strengthen the SBF and make sure this important program served as many eligible families as possible. On average, customers save \$13 per month under the SBF, which they can allocate toward the purchase of other basic necessities. It is important for the Legislature to affirm its intent of making electricity in the restructured marketplace affordable for low-income Texans, and CSHB 1777 would help accomplish this goal.

***Transition to competition in the El Paso region.*** The bill would adopt in statute a PUC ruling that lays out the stages through which a utility operating in and around El Paso would have to pass before the region was opened for competition. The commission determined that this area did not have sufficient competitive safeguards in place to allow for the functioning of a fully competitive market. This bill would include five specific, reasonable stages through which a utility operating in this area would pass before being opened to retail competition.

***Transmission costs.*** By allowing non-ERCOT utilities more easily to recover costs associated with construction of transmission infrastructure, CSHB 1777 would encourage investment in transmission lines and expand the capacity for bringing wind-generated electricity in West Texas to market. Currently, a rate-regulated utility outside of ERCOT must participate in a base rate hearing before the PUC before it can recover transmission infrastructure investments. This bill would allow non-ERCOT utilities to adjust costs through a tariff, facilitating the growth of renewable wind energy in many parts of the state.

***Consumer protection.*** The bill would separate consumer protection provisions governing the electric industry from telecommunications in PURA, a reasonable method for regulating two different industries.

OPPONENTS  
SAY:

***ERCOT.*** Although the bill would increase the number of independent members on ERCOT, consumer representation on the board would remain weak. Consumers pay the fees through which ERCOT is funded, and they deserve a strong voice to ensure that these funds are spent prudently. Market participants would continue to outnumber residential, industrial, and commercial consumers. The Sunset Commission found that industry representatives on the ERCOT board have little incentive to act in the best interest of consumers, and increasing public representation could address this imbalance.

There is no compelling reason for the representative of large commercial consumer interests to be appointed by the outgoing commercial representative rather than elected from that market segment. When this position on the ERCOT board was created, this market segment was not large enough to allow for an election of that representative. However, there are now numerous large commercial interests that participate in the electric market, and these participants should be able to elect their representative as other market segments do.

***Transmission costs.*** A non-ERCOT utility could recover its transmission costs through a rate hearing, and this is the proper forum for a regulated utility to seek those adjustments. A rate hearing would allow for adequate review of costs claimed by a utility and could allow for adjustments if the PUC determined that a request was inaccurate. CSHB 989 would provide for a more automatic certification of costs claimed by a utility, weakening PUC oversight of utilities and leading to higher costs for ratepayers.

OTHER  
OPPONENTS  
SAY:

While CSHB 1777 would strengthen protections against wholesale generation market manipulation, additional reforms are needed. Market manipulation can be difficult to identify after an abuse has occurred. A more effective method of preventing abusive practices by wholesale generators would be to require that no company control more than 20 percent of the generation capacity in a single congestion area, rather than the current, more general limitation of 20 percent across the entire ERCOT region.

NOTES:

As filed, HB 1777 would have limited the attorney's fees recovered by a municipality in a rate case to an amount proportional to the municipality's interest in the proceeding. The bill would have authorized the commission to suspend wholesale and retail market rules and rates in the event of an energy emergency. This bill also would have added three independent members to ERCOT's governing board instead of two.

The committee substitute added provisions that would:

- specify that the open meetings, conflict of interest, and market monitor sections would not apply to an independent organization established to serve areas located outside of ERCOT;
- govern the securitization of stranded costs;
- outline the transition to competition for the El Paso area;
- allow for transmission cost recovery by non-ERCOT utilities; and
- relate to System Benefit Fund eligibility and uses.

According to the fiscal note, HB 554 would increase the number of customers eligible for the SBF rate reduction by 525,000 in fiscal 2006-07. This would result in a decrease in the SBF balance of \$78.8 million in fiscal 2006-07.

HB 989 by Chisum, which contains language identical to provisions in CSHB 1777 that would allow transmission cost recovery by certain non-ERCOT utilities, passed the House by 137-4-2 on April 29 and has been referred to the Senate Business and Commerce Committee.

HB 554 by Turner, which contains language identical to provisions in CSHB 1777 relating to eligibility and uses of the System Benefit Fund, passed the House on March 30 and has been referred to the Senate Finance Committee.