SUBJECT: Continuing the PUC, regulation of electric utilities

COMMITTEE: State Affairs — committee substitute recommended

VOTE: 12 ayes — Seidlits, Alvarado, Black, Bosse, Carter, Craddick, Danburg, Hochberg, B. Hunter, D. Jones, McCall, Ramsay

1 nay — Wolens

2 absent — S. Turner, Hilbert

SENATE VOTE: On final passage, May 12 — voice vote

WITNESSES: For — Robert Reilly, New Electric Wholesalers of Texas; Rick Levy, Texas AFL-CIO and International Brotherhood of Electrical Workers; Jim Marston, Environmental Defense Fund; Katherine Mosley, City of Houston.

Against — Mark Shilling, Texas Chemical Council; Stephanie Kroger, Texas Industrial Energy Consumers; Peggy Venable, Texas Citizens for a Sound Economy; Janee Briesemeister, Consumers Union; Randy Eminger, Center for Energy and Economic Development; W. Paul Ruwe, Destec Energy, Inc.; Victor Gonzales, Kimberly Clark; Steve Perry, Texaco, Inc.; Hill Kemp, Competitive Energy Options.

On — Mike Ozymy and Kent Caperton, Association of Electric Companies of Texas; Robert W. Gee and Ali Al-Jabar, Public Utility Commission; Walter Washington, Office of the Public Utility Counsel; Tom Smith, Public Citizen, Rob Looney, Texas Mid-Continent Oil and Gas Association; Geoffrey Gay, Cities of Arlington and McAllen.

BACKGROUND: In 1975 the 64th Legislature created the Public Utilities Commission of Texas (PUC) to regulate public utilities in Texas. The Legislature found that these utilities operated as monopolies and were not subject to normal competitive forces. Regulation was established as a substitute for competition, with the PUC responsible for maintaining rates and services that are fair both to consumers and the utilities. The PUC currently regulates 10 investor-owned electric utilities (IOUs), 86 electric cooperatives, four river authorities and 61 local telephones companies. The

agency estimates that the utilities it regulates have a combined annual revenue of approximately $20 billion.

The four basic functions of the PUC are:

• **Certification.** Before a regulated utility can operate in the state or construct new facilities, it must obtain a certificate of convenience and necessity (CCN) from the PUC, which certifies that the utility's operation is in the public's best interest.

• Rate-setting. The PUC sets rates for all local telephone companies, IOUs and electric cooperatives. Cities have retained original ratemaking authority for electric utilities and cooperatives operating within their boundaries; the PUC reviews these rates on an appellate basis.

• **Monitoring.** The PUC monitors regulated utilities to ensure compliance with statutory requirements and agency policies, rules, orders and service standards.

• **Consumer advocate.** The PUC helps consumers resolve complaints against regulated utilities.

The PUC consists of three full-time, salaried commissioners who are appointed by the governor. The primary role of the three-member commission is to serve in a quasi-judicial capacity on utility rate cases and other proceedings that have gone through the hearings process.

The Office of Public Utility Counsel (OPUC) was created in 1983 as part of the 68th Legislature's sunset review of the PUC. The office was established to represent residential and small business consumers after concerns had been raised that these ratepayers, who share similar concerns and interests, were not adequately represented in utility rate cases at the PUC. OPUC is overseen by the public utility counsel who is appointed by the governor. OPUC only participates in roughly 6 percent of all rate cases before the PUC, mostly major rate cases, and roughly 11 percent of all non-rate cases before the PUC.

The PUC and OPUC are funded by a gross-receipts tax assessed against all regulated utilities. This tax is deposited into the general revenue fund from which appropriations for the PUC and OPUC are drawn. The PUC is authorized to adjust this gross receipts assessment, subject to approval of the Legislature.

The PUC and OPUC were originally scheduled for sunset review during the 73rd Legislature. During that session a number of bills were proposed to revise the PUC and OPUC and electric utility and telecommunications regulation. None passed, and the PUC and OPUC sunset review date was extended for two years. A joint interim committee on the PUC was appointed to study the PUC and OPUC and make recommendations.

POINT-BY-POINT ANALYSIS:

CSSB 373 would continue the Public Utilities Commission and Office of Public Counsel until September 1, 2001. CSSB 373 would revise Article I, administrative procedures, and Article II, electric utility regulation of the Public Utility Regulatory Act (PURA) as enacted by SB 319, Acts of the 74th Legislature, regular session, 1995.

ADMINISTRATIVE ISSUES

CSSB 373 would make a number of changes to the administrative portion of PURA. A majority of these changes involve the application of standard language developed by the Sunset Advisory Commission that is applied to all similar agencies reviewed by the commission. Administrative changes made by CSSB 373, and recommended by the joint interim committee, include:

• removing the age requirement for PUC commissioners;

• requiring appointed members of the commission to participate in a training program before taking office;

• providing that the executive director is responsible for running the day-today operations of the PUC;

• allowing persons otherwise ineligible to serve in the PUC or OPUC to do so if they divest ownership interest or control and inform the attorney general and the agency; and

• allowing the PUC and OPUC to receive and spend federal funds from grants or other forms of financial assistance and exempting special accounts established for such grants from funds consolidation.

Supporters say: The administrative changes included in this bill represent a combination of the standard language developed by the Sunset Advisory Commission now included in the reauthorizations of state agencies and the recommendations of the Joint Interim Committee on the Public Utility Commission. The implementation of these recommendations will help the PUC to run more smoothly, create a greater independence for the hearing examiners and hearing division, and allow the process of hearings to be conducted more efficiently.

Opponents say: This legislation does not address the relationship of the general counsel to the commissioners. The general counsel acts as a advocate of the public interest in proceedings before the commission, but also acts as a corporate counsel for the PUC and the commissioners themselves. These roles should be separated, as was recommended by the joint interim committee.

Transferring hearings division to SOAH

CSSB 373 (Sections 1.34, 1.35) would transfer the administrative hearings division from the PUC to the State Office of Administrative Hearings (SOAH) and establish a task force to conduct the transfer.

Supporters say: Currently, the physical location of the hearings division at the PUC places hearings examiners and administrative law judges alongside the technical staff who testify in all proceedings at the agency. This situation contributes to a perception by the public that the hearings staff is virtually indistinguishable from the PUC staff as a whole. By transferring the hearings division to SOAH, the transfer would act to improve the independence, quality and cost effectiveness of PUC hearings. In order to ensure that enough resources and expertise will be transferred

from the PUC to SOAH, a task force would be established to oversee the transfer of equipment and personnel.

Opponents say: Hearings examiners at the PUC make independent decisions and are not partial to the staff of the PUC simply because they work in the same area. Many of the issues that come before the PUC are of a highly technical nature and would be subject to misinterpretation by a hearings officer who is not an expert in that subject matter. The transfer of the hearings division from the PUC to SOAH would cost at least $80,000. The questions should be whether the state should spend this amount of money only because there is a public perception of impartiality.

Conflict of interest provisions

PURA contains specific provisions aimed at prohibiting the appointment of commissioners who have direct ties to regulated utilities or their affiliates.

CSSB 373 (Sections 1.06-.09, 1.15-.17, 1.19) would extend to the general counsel and executive director of the PUC as well as the public counsel. These rules would prohibit such individuals from serving on boards of companies that supply fuel, services or utility-related goods to regulated and unregulated utilities. It would prohibit a person from having an interest in a competitor of a utility as well as the utility itself. It would also include revolving-door provisions on members and staff of the PUC and OPUC, prohibiting them from appearing on behalf of parties for two-years. (A revolving-door provision prohibits a person who worked at or for an agency from appearing before that agency representing another party for a certain length of time.)

Supporters say: These reforms would strengthen the image of the PUC and OPUC as independent regulatory bodies pursuing policies in the interest of the public based on the recommendations of both the joint interim committee and the Sunset Advisory Commission

Adjustment of gross receipts assessment

Originally, the PUC was given the ability to adjust the gross receipts assessment because it was unclear how much money the agency would need for its operations.

CSSB 373 (Section 1.28) would shift authority from the PUC to the Legislature to adjust the gross receipts tax.

Supporters say: Experience has shown that the gross receipts assessment is more than sufficient to cover appropriations for both the PUC and OPUC. In fiscal 1993 the assessment generated $28.6 million while the PUC's expenditures were $10.7 million and OPUC spent $1.4 million. Because the primary reason for the PUC to be able to adjust the gross receipts assessment no longer exists, the PUC need no longer retain control of that power.

Management audits

In 1983 PURA was amended to require the PUC to conduct a management audit of each utility at least once every ten years. The number of audits conducted each year depends on the size of the utilities to be studied, the scope of the audits, and the complexity of the issues to be addressed.

CSSB 373 (Section 1.22) would remove the requirement that the commission audit a utility every 10 years.

Supporters say: While these audits have been helpful and have implemented management improvements, PURA did not provide a separate funding source for these audits, nor did it authorize the PUC to recover costs of the audits from the utilities being audited. As a result, the PUC had not had the budget or staff resources capable of meeting this requirement. By removing the audit requirement and allowing the PUC to conduct management audits only as needed, the quality of such audits and their usefulness to the utilities could be greatly improved.

Administrative penalties

The PUC regulates almost every aspect of a public utility's business activities, from utility rates and quality of service to billing requirements. Many of these regulatory duties require cooperation from the utility.

CSSB 373 (Section 1.27) would authorize the PUC to assess administrative penalties. CSSB 373 would allow the commission to impose an administrative penalty of up to $5,000 per day for violations. Such penalties could only be imposed after a finding, by a preponderance of the evidence that a violation has occurred, and the process would include the requisite safeguards to ensure due process. All penalties would be deposited into the general revenue fund. Utilities would be prohibited from recovering administrative penalties from consumers through their rates.

Supporters say: Currently, the PUC has several tools in place for sanctioning utilities that violate statutes, rules and orders, but those enforcement powers are intended for major infractions and are seldom used because of their severity, expense and time-consuming nature. By allowing the PUC the ability to impose a small administrative penalty to enforce rules, it could ensure compliance with those rules sooner than if the PUC had to wait for the infraction to be severe enough to impose the sanctions currently available.

Settlement and hearings procedures

CSSB 373 (Section 1.21-.23) would allow the PUC to promulgate rules regarding the settlement of contested cases before the commission. It would also authorize judges in hearings to impose sanctions, limit discovery, focus parties on contested issues, group parties other than OPUC with the same interests and limit parties' time in presenting cases.

Supporters say: The PUC has two main processes for resolving contested cases, either through the formal hearings process or through informal settlements agreed to by some or all of the parties. The current settlement process occurs outside of the hearing process. By allowing the PUC to establish rules regarding settlement procedures, settlements could be

achieved in more efficient way and also include various provisions so that all parties to a contested matter who did not agree to the settlement could still retain full rights to a hearing. Other hearings procedures enacted by CSSB 373 would streamline the hearings process providing savings to both utilities and consumers.

CSSB 373 would take effect on September 1, 1995. The administrative penalties permitted by the act could only be imposed for violations occurring after the effective date. The settlement process could not apply to an electric utility merger proceeding filed before January 1, 1995, in which a final order had not been issued. The Sunset language regarding membership on the commission or employment would only apply to a member or employee hired or appointed after the effective date.

ELECTRIC UTILITY REGULATION ISSUES

The PUC regulates two major industries, the electric utility industry and the telecommunications industry. The regulations of telecommunications are not included in this bill, but a comprehensive revision of electric utility regulation is included.

The primary changes to electric utility regulation proposed by CSSB 373 include a revision of Integrated Resource Planning (the way a utility chooses which resources to use to supply electricity), deregulation of the wholesale power industry in order to promote competition for wholesale electric energy production, a revision of standards and policies related to utilities and their affiliates as well as transactions between the two, a revision of standards regarding Demand Side Management, which encourages resource conservation, and a partial deregulation of electric cooperatives if approved by members of those entities.

Integrated Resource Planning

Integrated resource planning (IRP) describes the selection of sources from which electricity can be produced. The goal of IRP is to select the proper mix of sources to promote cost efficiency, environmental protection and concern for the future.

CSSB 373 (Section 2.03) would require the PUC to develop an IRP process to provide reliable energy service at the lowest reasonable system cost. Generating utilities that are planning to construct generating resources would be required to submit an preliminary IRP to the PUC that would have to include

• a forecast of future demands;

• an estimate of energy savings and demand reduction that could be achieved over a 10-year period;

• the supply-side resources needed to meet the demand, including what those sources are and how the utility would choose and operate them;

• a description of how the utility would achieve equity among its customer classes; and

• any proposed incentive factors.

A municipally owned utility would be required to submit such a plan every three years to the PUC but would not be subject to other requirements of IRP.

The PUC would be required to hold a hearing on the IRP submitted by a utility and, within 180 days, would be required to issue an interim order. Once the interim order was issued, the utility could begin solicitations for demand-side and supply-side resources by a bidding process outlined in the bill. The utility would be required to review affiliate bids as it reviewed all other bids. Once the bidding process was complete, the utility would submit a final IRP to the commission, including any applications for certificates of convenience and necessity (CCNs) that may be necessary. The PUC would be allowed to set rates to recover the costs of a contract and any incentive mark-ups allowed by the commission. Before approving a final plan, the PUC would have to consider the community values and environmental impact of the IRP. The PUC would only be allowed to grant a CCN under an IRP if it found that:

• the proposed addition was necessary under the final IRP;

• the proposed addition was the best and most economical choice of technology for that service area; and

• cost-effective energy conservation and other cost-effective energy sources could not reasonably meet the need.

The PUC could hold another hearing on the final IRP at the request of any interested party and would have to issue a final order within 180 days after the utility files its final IRP.

The PUC would be required to promulgate rules that promote the development of renewable energy technologies.

The PUC would be allowed to:

• allow timely recovery of reasonable costs, including the ability to automatically adjust and pass through to its customers changes in fuel or other costs;

• authorize additional incentives for conservation, demand side management (DSM), purchasing power, and renewable resources;

• review the state's power transmission system to determine possible needed improvements; and

• authorize the utility to recover a surcharge to reimburse a municipality for the expense incurred in the IRP process.

After a utility had its IRP approved, it would be allowed to make certain changes in regard to that IRP such as contract renegotiation, short-term (less than two years) capacity purchases and exercising already granted options.

Non-generating utilities not planning to construct generation capacity would not be required to submit an IRP, but if that utility planned to purchase more than 25 percent or 70 megawatts of its capacity from a wholesale power supplier other than its current supplier, it would be required to follow the solicitation process.

Supporters say: Many of the changes made to the IRP process are a result of a two-year study made by the Joint Interim Committee on the PUC (JIC) (See Section 2, Recommendations 1-5) in order to promote the efficient use of resources to provide electricity to consumers. IRP is the crux of the entire utility regulation revision plan because it would allow a utility to use resources like purchased power gained from wholesale competition, demand-side management programs and incentives for conservation to be considered in long-term utility plans.

Each of these plans would be required to make projections for 10 years, and those projections would be renewed every three years if there were any changes. By allowing the PUC to structure the IRP process, this Legislature would allow the experts to develop the best way to protect Texas energy resources that still allows Texas utilities to be some of the most productive and profitable in the nation.

The specifics of the IRP process included in this legislation provide adequate safeguards to ensure that the selection of a utility's resources would be done in a way that promotes the public interest.

Opponents say: The IRP process must be strengthened to ensure that affiliates are not allowed to use the IRP process to gain an advantage over other wholesale competitors, costs of demand side management are not passed on to certain classes of consumers, especially renters and low income consumers who are in the worst position to bear such costs, and that environmental protection is given a high priority.

One of the most important changes needed is to remove the ability for utilities to automatically pass through to its customers changes in its cost of fuel or purchased power. This flexibility would allow a utility to burden certain consumer classes if the wholesale competitive market conditions change. The provision in the Senate-passed version allowing the IRP process to use the lowest reasonable cost should be retained, and language allowing for the lowest reasonable system cost should be struck. The addition of the word "system" would allow a utility to set the lowest cost based on its own cost, not the actual cost.

Additionally, the IRP process should require any company, including exempt wholesale generators (EWGs), to submit a plan and an application for a CCN before constructing a new generating facility. Under CSSB 373 only regulated utilities would be required to submit such plans and make such applications.

Demand side management

Demand side management (DSM) refers to an economic theory of electric production. It is based on theory that regulated the rate of return allowed for utilities provide an incentive for the utilities to build excess generating capacity. The utilities will build this capacity because they will be able to achieve a rate of return (profit) on whatever they might build. The problem is that this over capacity promotes inefficiency. In order to promote efficiency, DSM would allow a utility to base its IRP decisions on how much capacity is actually needed and require the utility to promote conversation measures the reduce the amount actually needed.

CSSB 373 (Section 2.03, 2.04) would encourage the use of demand side management by allowing a utility to receive a cost recovery incentive for promoting DSM.

Supporters say: DSM is a way to promote cost efficiency and conservation of energy resources. Under rate of return regulation, utilities were rewarded for creating over capacity, resulting in the current situation where, on average, Texas utilities have more than 28 percent over capacity ability; the PUC recommends a 15 percent overcapacity for emergency situations.

Unfortunately, DSM will not work unless utilities are given some incentive to use it. If no incentive was present, utilities would simply continue to use the more inefficient means of producing electricity because, no matter, what, they would be guaranteed a rate of return on their investment. DSM incentives would help to move the utility industry to a new level of resource planning that could be used as a stepping stone for the conversion that will undoubtedly be required in the future.

Opponents say: Special incentives such as "mark-ups" proposed by the utilities are not necessary for DSM and purchased power and serve only to further increase rates. Any incentives should be strictly tied to the utility's performance. Only exceptional performance should be rewarded with an incentive. A utility's performance is reviewed in a rate case and thus any incentives should be made through an adjustment to the utility's rate of return, not through mark-ups that are automatically passed through to ratepayers without a review of the utility's performance. No incentive or mark-up should be approved before the utility has implemented the DSM program or purchased power and demonstrated its performance.

Affiliate transactions

If independent power producers are allowed to sell power to power distributors and if they are allowed to use transmission lines for the purpose of transmitting that power, the question arises as to how closely transactions will be monitored if the independent power producer is an affiliate of the power distribution company or the company that owns the transmission lines. For sales to regulated utilities, an affiliate might be given a contract even though the price for electricity that the affiliate is charging might be more than what another company could supply. When transmission services are involved, because the owner of the lines can charge a fee for using the transmission lines, the non-affiliates will want to ensure that the affiliate power company is charged the same rates, and therefore, not given a competitive advantage over other power producers.

CSSB 373 (Sections 1.24-.26) would require public utilities to report only information relating to transactions between themselves and their affiliates and only when those transactions are subject to the jurisdiction of the commission. The PUC would retain the right to examine the accounts and records of affiliates transacting with regulated electric utilities, but CSSB 373 would make it clear that such records would be confidential and not subject to disclosure under the Open Records Act.

Supporters say: Affiliate transactions are a necessary consequence of wholesale electric competition deregulation. Utilities need to be able to compete in the market in the same capacity as other IPPs. The problem is that whenever an affiliate must transact business with its parent company in

a competitive market, there is the danger that the situation would promote impropriety. The safeguards instituted by CSSB 373 are designed to protect against such improprieties and to make the wholesale competitive market more reasonable.

There are limits, though, as to how invasive such safeguards should be. If the PUC required too much regulation of affiliates, they would be placed at a competitive disadvantage in the wholesale competitive market. The Joint Interim Committee on the PUC (JIC) did recommend (Section 2, Recommendation 39) imposing measures to limit public access to books and records obtained from affiliates so that competing power producers would not have a competitive advantage.

The restrictions and safeguards placed on affiliate transactions represent a balance between guarding against impropriety and allowing affiliates to compete freely in the wholesale market.

Opponents say: The changes to PURA regarding affiliate transactions would substantially weaken the PUC's authority to examine utility affiliates. Rather than being provided with information concerning the affiliate generally, the PUC would be limited to receiving information regarding only certain transactions between the regulated electric utility and its affiliate. This limitation on the information would make it much more difficult for the PUC to determine if the relationship between a utility and its affiliate was anti-competitive.

This change is contrary to the recommendation of the JIC (Section 2, Recommendation 15) The committee recommended retaining existing levels of scrutiny for affiliate transactions, except between the regulated electric utility and its EWG affiliate where the committee suggested relaxing scrutiny in order to facilitate competition.

The amendment under Section 2.16 of this bill would remove any currently required finding for affiliate transactions that the price charged by an affiliate is not greater than the price available on the open market.

Sale or transfer of utility assets

CSSB 373 (Section 1.25) would require the PUC to consider whether a proposed utility sale would adversely affect the health and safety of customers or employees, would result in the loss of Texas jobs or a decline in service, whether the utility would be able to recoup its investment and whether the transaction was in the public interest.

Supporters say: When utilities or utility holding companies form exempt wholesale generators (EWGs), they may be tempted to transfer fully depreciated, or otherwise more efficient and cost effective generating units from the regulated utility to the EWG. If this were to occur, the utility would be able to receive a regulated rate of return on its least efficient units, while using its best units to compete in the wholesale market. By requiring the PUC to examine such transfers and asking the PUC to determine if the transfer is in the public interest, the utility would be prohibited from using its regulated electric generation facilities to support its competitive facilities.

Opponents say: While this change is a step in the right direction, it would not go nearly far enough in ensuring that a utility could not apportion its facilities so that its regulated units would support its unregulated units, because it would only govern the transfer of more than 50 percent of the assets of the regulated electric utility.

Wholesale competition

Wholesale electric competition refers to the ability of electric power producers to sell power to power distributors. Regulated electric utilities are those companies that currently sell power to retail consumers. Under the current regulatory scheme, the retail power companies may only sell power that they produce or power generated by co-generators. By allowing wholesale competition, a regulated electric utility would be able to purchase power any independent power producer (IPP). Independent power producers are primarily exempt wholesale generators (EWGs). These power producers have the generating capacity to produce electricity but do not have the transmission lines to pass it to the distributing utility nor do

they have the capability or desire to sell the power directly to retail customers.

Texas is the only state that regulates the wholesale electricity market. This situation can occur because Texas is the only state that constitutes a single Electric Reliability Council (ERC). ERCs were instituted years ago as a way to provide for power-sharing in case of need. These ERCs crossed the boundaries of every state but Texas. Therefore, Texas was the only state not subject to regulation by the Federal Energy Regulatory Commission (FERC). FERC allows IPPs to charge market-based rates to regulated electric utilities (which are regulated under rate-of-return formulas).

A power marketer is another type of wholesale electric seller. The power marketer purchases power from one generator, stores the power, then sells it to the customer (the regulated electric utility). Because power marketers actually come into possession of the power, they are considered to be utilities under PURA.

CSSB 373 (Sections 2.05, 2.06, 2.08) would deregulate the wholesale electric market, allowing EWGs and power marketers to operate. These wholesale power producers and marketers would be required to register with the PUC to show proof of their registration with FERC.

CSSB 373 would allow an affiliate of a regulated electric utility to be an EWG or a power marketer and would allow such an affiliate to sell electricity to the utility so long as such sales were made in accordance with the IRP requirements. If a facility was in operation by a regulated electric utility as of the effective date of this legislation and was later to be transferred or sold to an affiliate, the commission would be allowed, after notice and hearing, to allow such a transfer or sale if it would benefit the ratepayers, was in the public interest and otherwise complied with state law. The transfer of assets from a utility to an affiliated EWG or power marketer would be valued at the greater of net book cost or fair market value. Any transfer of assets from an affiliated EWG or power marketer to a utility would be valued at the lesser of net book cost or fair market value.

CSSB 373 (Section 2.08 (f)) would allow an affiliated EWG or power marketer to sell power to a regulated electric utility but that utility would

not be allowed to grant any undue preference to that affiliate in the transaction.

Supporters say: Now is the time for electric wholesale competition to come into Texas. Wholesale electric competition is permitted throughout the rest of the United States under regulation promulgated by FERC. Texas consumers pay some of the highest rates for electricity. Wholesale competition could play a significant role in reducing these costs.

By having a wholesale power purchaser as an option in integrated resource planning, utilities would be allowed to use the generating capacity in Texas to the greatest advantage. For example, if a utility knows that it will need new generating capacity to meet growing customer needs, it has the option of building a new generating facility or purchasing the power from an existing facility with excess capacity. It is clearly the most cost effective and resource efficient method to have the utility purchase the power, but without a wholesale market for the power, guaranteed transmission capabilities, and an IRP process, such an efficient choice could not be made.

CSSB 373 would retain the same regulation over the wholesale market as that provided by FERC in the national wholesale market.

The restrictions on affiliate transaction in wholesale competition help to prohibit utilities from using wholesale affiliates to gain an advantage in the market. Restrictions on the transfer of assets requiring them to be at fair market value or net book cost help to ensure that affiliates do not use wholesale companies to transfer the most profitable facilities into the competitive market and keeping the unprofitable facilities in the regulated market.

Opponents say: Wholesale competition is a laudable goal and could help to promote conservation and cost savings, but the potential abuses of affiliates must be regulated in order to achieve a level competitive playing field.

Transmission of electricity

CSSB 373 (Section 2.07, 2.08) would allow the PUC to require a utility, including a municipal owned utility, to provide access to its transmission capabilities at wholesale cost to any other utility, co-generator, EWG or power marketer. On such transmission services, the PUC would not be allowed to issue a rule that is contrary to an applicable decision, rule or policy set by the federal regulatory agency on such transmission. The PUC would be required to develop rules within 180 days to the effective date of this legislation that would guarantee that utilities provide nondiscriminatory access to transmission services. The utility would be prohibited from passing the costs of providing transmission service to other customers.

A five-member interstate connection committee would be appointed by the PUC with the advice and consent of the governor to study the feasibility and cost of connecting the utilities within the Electric Reliability Council of Texas (ERCOT) to other facilities within the Southwest Power Pool reliability area. Such a study would be submitted by September 1, 1997.

Supporters say: Inherent in the ability to have wholesale competition is the ability to gain access to transmission lines at a reasonable price. Access to transmission lines is an integral competent of wholesale competition that must be promoted. This section would allow for such access at the same rates, terms of access, and conditions that are comparable to the utility's use of its own system. In other words, the utility would have to allow wholesale competitors the same access as it gives itself, charging only for the cost of the transmission to the utility.

Opponents say: Additional safeguards should be put in place to ensure that the utility can not unfairly allow its own affiliate to use its transmission capabilities to gain a competitive advantage.

Mark-ups

Mark-up refers to the ability of a utility to purchase power at wholesale from an independent power producer and then add an additional cost to that power before it is sold to the ultimate consumer, customers of the utility.

CSSB 373 (Section 2.11) would allow a utility that purchases power to add a mark-up to the actual cost of purchasing the power to compensate the

utility for any financial risks and the value added by the utility in making the purchased power available to its customers. The amount of a mark-up allowed would be determined by the PUC. The mark-ups could also be used to encourage the utility to include economical purchased power as part of its capacity resource supply plan.

Supporters say: Mark-ups provide a much needed incentive to allow a utility to purchase power. Currently a utility may find it more profitable to simply build another generating facility rather than purchase power, even though purchasing power would be the most efficient and effective way to meet its capacity needs. If the utility is allowed to add a small profit to purchased power, the utility would be more apt to purchase power, thus promoting conservation and demand side management.

Opponents say: This section would allow a utility to make a profit for simply purchasing power and transmitting that power to the customer. No other state allows such mark-ups, so the only justification for them can be as a way to increase the profits of the utility.

Additionally, because CSSB 373 would allow a utility to purchase power from an affiliate and then apparently mark-up the price of that power when it is sold to the utility's customers, the utility would essentially be able to "double-dip" into ratepayers pockets for the sake of that utility's profits.

The Senate-passed version of SB 373 carried the caveat that mark-ups were an exceptional form of rate relief that could only be recovered on a finding that the incentive was necessary to maintain the financial stability of the utility.

Retail competition

Retail competition refers to the ability of independent power producers to sell electricity directly to individual customers. Retail competition would essentially require a complete deregulation of the electric utility industry. In order for retail competition to work, the utility company that owns the transmission lines would be required to grant very inexpensive access to those transmission lines for the transfer of electricity.

CSSB 373 (Section 2.08 (g)) would allow the PUC to establish one pilot program to require an electric utility to provide transmission service from EWGs, power marketers, co-generators, and other public utilities to consumers. In such a program, the PUC would be required to ensure, to the extent possible, that all classes of customers were provided an opportunity to participate in the pilot program. Such a program would have to be designed to prevent the shifting of costs from currently paid by the program participants to other ratepayers of the transmitting utility. The pilot program could remain in effect for up to six years after the PUC approved such a program. After such a time, the commission would be required to report the results to the Legislature.

Supporters say: Retail competition is the wave of the future. In states where wholesale competition has been available for several years, electric companies are moving closer and closer to unlimited retail competition. In Texas the transition to wholesale competition must be allowed before retail completion can begin, but a pilot project to study the feasibility of retail competition, closely monitored by the PUC, is warranted. If such a pilot project is successful, then perhaps, by the end of such a project, wholesale completion in Texas will have advanced far enough that the transition to retail competition could be possible.

Opponents say: While it may be beneficial to attempt a retail competition project, the safeguards included in the Senate-passed version of SB 373 regarding such a project should be restored. Specifically, in that version the project would last only three years, the PUC could only issue an order establishing a pilot project if it found that the program would not adversely affect the ratepayers of the transmitting utility, and the PUC could terminate the program at any time if the program does adversely affect the ratepayers.

Other opponents say: Retail completion should be expressly permitted when it benefits the ratepayers. Retail and affiliate/self-service wheeling can be a cost-effective resource that can utilize co-generation and can defer or eliminate the need for a new power plant. The PUC should have the express authority to consider such retail transactions on a case-by-case basis, thus retaining full control over such competition. Retail completion has been repeatedly shown in other industries, such as telecommunications,

natural gas, and the airline industry, to produce lower costs and rates for customers.

Wholesale and retail pricing flexibility

Pricing flexibility refers to the ability of a utility to charge different rates to different customers. Such flexibility is already available so long as the utility requests such changes from the PUC and the PUC authorizes such changes.

CSSB 373 (Section 2.18, 2.19, 2.21) would allow a utility to change its rates without a ruling from the PUC so long as such adjustments are made to coincide with the utility's fuel factor (the cost of producing energy). The utility's fuel factor could include the price of purchased power. A utility would be prohibited from charging rates to certain customers that constitute an impressible difference, preference or advantage. It is also impermissible for a utility to charge less than the rate approved by the PUC unless such a discount is done to promote DSM.

Supporters say: CSSB 373 would provide pricing flexibility only in limited circumstances and only to promote the competitive market. Without some degree of pricing flexibility, utilities would not be able to adjust their rates without a hearing that could take as long as six months to a year. In a competitive market, this amount of lag-time would prevent a utility from remaining competitive.

This pricing flexibility would also allow utilities to promote conservation measures and demand side management by giving discounts to those companies or individuals that practice such measures.

Opponents say: CSSB 373 would remove two essential provisions from the Senate-passed version that guard against impermissible pricing flexibility. The Senate version contains a series of safeguards to ensure wholesale price flexibility would not be used to disadvantage either captive retail customers or wholesale competitors. Such safeguards would ensure that the requirements of FERC are followed for wholesale pricing. Additionally, the Senate would prohibit a utility from either directly or indirectly subsidizing discounts to large industrial customers with rates

charged to other customer classes. These two restrictions should be placed back into CSSB 373 in order to prevent new wholesale competitors from being squeezed out of the new market and avoid burdening residential customers with the discounts given to industry to keep them in a utility's rate base.

Electric cooperatives

Electric cooperatives (co-ops) are nonprofit companies owned by the customers of the co-op. Co-ops are considered utilities by the PUC and as utilities must still submit any plans for rate increase to the PUC for approval. The PUC determines if the rate increase is needed by conducting a hearing where anyone who wishes to participate may do so.

CSSB 373 (Section 2.14) would establish a procedure to allow an electric cooperative to be exempted from rate regulation if the members of the co-op approved the measure. A ballot would be sent to every member of the co-op and could be included in the monthly billing statement. If a majority of the members of the co-op voted to approve the deregulation, co-ops would only be required to follow the procedures set out in order to raise its rates. Approval of deregulation would not remove the co-op from the authority of the PUC for anything except the rate-setting procedures.

In order for an electric co-op to raise its rates for any class of customers, the co-op would be required to mail notice of that change to the PUC, each affected municipality and utility within or adjacent to the co-op's service area, and each affected customer. The notice given to the customers would be required to include a statement of the increase or decrease in the total operating revenues, the classes of customers affected and the increases or decreases in rates for each class, notice that the PUC may review the rate change if it receives a petition within 60 days and the address and telephone number of the PUC, a statement that a customer opposed to the rate should notify the co-op in writing, and notice that customers may review a copy of any written opposition the co-op receives.

The co-op would be required to keep available for public review a cost-of-service study that shows the need for the rate increase. The co-op would

also be required to make available to the public responses in opposition to the proposed rate increase.

Unless a review was initiated under the provisions of this bill, the rate change proposed by the co-op would become effective 70 days after notice was provided.

If during the 60-day review period for proposed rate increase the PUC received a petition opposing the increase from at least 10 percent of the members of the co-op or members of the co-op who purchased more than 50 percent of the co-op's energy sales to a customer class, the PUC would be required to conduct a review as it would for any other rate increase application.

If during the 60-day review period a petition was filed with the PUC by an executive officer of an affected electric utility, the PUC would be required to review the cost-of-service study prepared by the co-op. If the commission found that the revenues for any class of customers were *less* than the cost of providing service, it would be required to disapprove the rate.

The PUC could at any time, on its own motion, review the rates of a co-op if it found that there was good cause to believe the co-op was earning more than a reasonable rate of return on overall revenues or revenues of a particular class.

Supporters say: Electric cooperatives are actually owned by the customers that they serve. The point of a co-op is to reduce costs to the customers. The problem is that because of the expensive procedures for rate increases required by PURA, customers have to pay extra just for a procedure to keep the co-op's revenues above its costs. As a practical matter, almost none of the rate increases proposed by co-ops are contested by members of the co-op, but the co-op must still go through the expense — anywhere from $200,000 to $1 million — of presenting its side before the PUC at a rate hearing. If the costs of this rate hearing could be saved, it would result in savings to the co-op's customers.

The procedure established in the bill for raising rates would provide every customer of the co-op with adequate notice of the rate change and a substantial opportunity to respond. Because every negative response to the rate change would have to be made available to the public, a customer who wished to submit a petition to the PUC would be able to find people who are opposed to the rate change without having to contact every customer of the co-op. Once such a petition was filed, the co-op would be treated exactly as it is under current procedures, but such a procedure would not be commenced unless there is some significant opposition to the rate increase, thus helping to keep the co-op's costs down.

This legislation would also retain the PUC's right to initiate proceedings on its own motion, maintaining the regulatory authority of the PUC.

Opponents say: Electric cooperatives are owned by the customers only in theory. In reality an individual residential customer has almost no input into the decision making process of the co-op. This legislation allows the co-op to gain an even greater control over its small customers.

The ballot given to customers to vote for deregulation of the co-op should be required to include information drafted by the PUC or perhaps OPUC explaining to customers what the potential consequences of deregulation may be.

Notes: SB 1227, passed by the Senate on April 4 and placed on the House General State Calendar for May 19, is identical to the provisions of SB 373 regarding electric cooperatives.

Co-generation

Co-generation refers to the process of customers actually generating excess power from production. This is most often done in industrial settings when the industrial user needs a specific type of power. That power is generated at the plant using electricity provided by the regulated electric utility. However, when that power is generated by the industrial user, there is often excess energy or by-product energy that is not used by the industrial customer, but that can be sold back to the regulated utility.

Co-generation has been considered an energy conservation measure because it allows excess energy to be put to use rather than wasted. FERC regulations encourage the use of co-generation. The PUC has allowed co-generators to sell power back to electric utilities.

CSSB 373 (Section 2.22) would allow a co-generator to sell its power at retail to the sole purchaser of the co-generators' thermal output pursuant to the goals of DSM.

Rates

CSSB 373 (Section 2.10, 2.12, 2.15, 2.17) would allow the PUC to approve interim rates to avoid confiscation during the period beginning on the filing of the application and ending on the date that the order becomes final. The utility would also be allowed to recover reasonable costs of participating in a proceeding under PURA.

The PUC could, when fixing a reasonable rate of return on invested capital, consider the utility's efforts to comply with its most recently approved IRP.

This bill (Section 2.17) would amend the filing deadlines for rate cases to achieve a more efficient timetable.

Supporters say: These changes are necessary to allow the rate process to not hinder the competitive electricity market. Interim rates are used by several other regulatory authorities, such as the Texas Railroad Commission, as a way to alleviate the burden necessarily imposed on a utility by the long process of a rate hearing. These interim rates would only be allowed to protect a utility from losing a reasonable rate of return on investment, not to allow for greater profits.

This legislation would also allow the rates to include incentives for efficient production and management as proposed by the JIC (Section 2, Recommendation 13). By allowing such incentives to be included in the rate process, the PUC could promote more efficient uses of energy resources.

Opponents say: Allowing interim rates could permit a utility to differentiate between various classes of customers impermissibly for what could be a very long time between the original application and a final order.

University discounts

CSSB 373 (Section 2.20) would require public and municipal owned utilities to give a 20 percent discount for electric service to higher education institutions. The utility would be exempt from such restrictions if the discount would be greater than 1 percent of the utility's annual revenues or if the utility, before September 1, 1995, already discounted rates by 20 percent or more. This discount would also not apply to a state institution for which the discount granted to the state would be greater than 20 percent. CSSB 373 would prohibit an investor-owned public utility from recovering the cost of this discount from any other rate class.

Supporters say: This mandatory discount is already done by many cities and power companies to the benefit of higher education. It would help to keep the costs of higher education down. However, if it is provided by utilities, it should be provided to all higher education institutions and not be allowed to be used by the utility as a way to show favoritism to certain institutions. This provision would merely require utilities to provide the same institutions the same benefits.

Opponents say: Institutions of higher education consume electricity equivalent to sizable commercial or some industrial operations. They should not be specifically singled out for a substantial discount over other institutions.

This provision would also place a strain on certain utilities at the expense of others. Some utilities have as many as 10 or more institutions that would qualify under this section while other utilities may not have any such institutions within its coverage area.

NOTES:

CSHB 3164 by Seidlits, administrative reorganization of the PUC, passed the House on May 12 and was reported favorably, without amendment, by the Senate State Affairs Committee on May 19. The version that passed the House did not cover any regulation of electric utilities.

The committee substitute to the Senate-passed version of SB 373 contains numerous changes and amendments. Most of the major changes are discussed in the point-by-point analysis. The substitute:

• restored existing statutory authority for PUC to require utilities to report information about themselves. The Senate version had limited PUC's authority so that it could only require information relating to utility-affiliate transactions;

• restored PUC's existing jurisdiction over affiliated interests having transactions with public utilities. The Senate version had removed PUC's jurisdiction over utility affiliates and replaced it with jurisdiction over transactions between the utilities and the affiliated interests. The substitute would specify that accounts or records obtained by PUC related to sales of electrical energy at wholesale by an affiliate would be confidential and exempt from the open records law;

• added a provision repealing civil penalty authority for violations of the Act under the jurisdiction of the Railroad Commission that result in pollution;

• deleted a provision in the Senate version providing utilities a right of contribution against persons other than electric utilities that use a utility's transmission or distribution system for personal injury or property damage claims brought in connection with the utility's transmission or distribution system.

• changed language regarding pricing flexibility. Rather than authorizing a utility to charge individual customers lower prices for wholesale and retail electric service, as in the Senate version, the substitute would authorize the regulator to approve wholesale or retail tariffs or contracts containing charges that are less than approved rates;

• changed the requirement in the Senate version to develop an integrated resource planning system at the lowest reasonable *system* cost. The Senate version would instead require the commission to use the lowest reasonable cost;

• added a requirement for a description of how each utility will achieve equity among customer classes and provide demand-side programs to each customer class, including tenants and low income ratepayers to the list of required provisions in a preliminary plan. A similar provision is added in the list of determinations the commission must make for the final plan;

• changed the authority of the commission regarding transmission service from authorization to require a utility to provide transmission service for transmitting wholesale power as in the Senate version, to authorization to review the state's transmission system to determine and make recommendations to public utilities on the need to build new power lines, upgrade power lines, and make other improvements as necessary;

• added a provision not in the Senate version regarding the transfer of assets from a utility to an affiliated exempt wholesale generator. The substitute specifies that any transfer of assets from a utility to an affiliated exempt wholesale generator or power marketer would have to be valued at the greater of net book cost or fair market value. The provision also specifies that any transfer of assets from an exempt wholesale generator or power marketer to an affiliated public utility would have to be valued at the lesser of net book cost or fair market value;

• changed the pilot program in the Senate version to specify that the pilot program is one pilot program to provide transmission service for transactions between end users of electricity and qualifying facilities, exempt wholesale generators, power marketers, or public utilities. The substitute would change the life of the program from three years, as in the Senate version, to six years;

• deleted the provision in the Senate version that would authorize the commission to deal with increased competition;

• deleted the provision in the Senate version requiring the governing body of certain municipalities to have exclusive original jurisdiction over retail, rather than all, utility rates, operations, and services provided within city or town limits;

• added an exception for interim rate orders set by the commission to be prospective if the order was necessary to provide the utility the opportunity to avoid confiscation between the date of filing of a petition for review with the commission and the date of a final order setting rates. The substitute would require the commission to order interim rates on a showing by a utility that it has experienced confiscation during that period and defines confiscation. It would require the utility concerned to refund or credit against future bills any excess sums collected during the period of interim rates;

• deleted the provision in the Senate version authorizing flexible pricing for cooperatives and

• changed the date by which the commission would have to establish a separate rate class for electric service for a university and grouped public schools in a separate rate class from January 1, 1995, as in the Senate version to September 1, 1995.