HOUSE RESEARCH ORGANIZATION bill analysis 4/4/2007 HB 1190 P. King (CSHB 1190 by P. King)

SUBJECT: Restricting share of generation capacity in wholesale electric markets

COMMITTEE: Regulated Industries — committee substitute recommended

VOTE: 8 ayes — P. King, Christian, Crabb, Hartnett, Smithee, Straus, Swinford, Turner

1 nay — Oliveira

WITNESSES: For — Bonnie Mathias, ACORN; Tim Rogers, Cirro Energy, Texas Energy Association for Marketers (TEAM); Tom "Smitty" Smith, Public Citizen; *(Registered, but did not testify*: Geoffrey Gay, Cities Aggregation Power Project, Inc.; Tim Morstad, AARP-Texas; Cyrus Reed, Lone Star Chapter Sierra Club; Monty Wynn, Texas Municipal League)

Against — John W. Fainter, Jr., Association of Electric Companies of Texas, Inc.; Bradley Jones, TXU (Luminant)

On — Michael Jewell, Direct Energy, CPL Retail Energy, WTU Retail Energy; Bill Peacock, Texas Public Policy Foundation.

BACKGROUND: In 1978, Congress enacted the federal Public Utility Regulatory Policy Act (PURPA) in response to the energy crisis caused by the oil price shocks of the 1970s. One provision opened the wholesale electric generation market to non-utility power producers and ended the monopoly held by regulated vertically integrated electric utilities. The Energy Policy Act of 2005 has since repealed and amended many provisions of PURPA, but the original legislation helped initiate restructuring of the electric utility industry by encouraging non-utility electric generation.

SB 7 by Sibley, which was enacted in 1999 to restructure the electricity market in Texas, added Utilities Code, sec. 39.154 to provide that a power generating company cannot own and control more than 20 percent of the "installed capacity" located in, or capable of delivering electricity to, a power region as of January 1, 2002, the start date of consumer choice.

Utilities Code, sec. 39.515 authorizes the Public Utilities Commission (PUC) to contract with an independent market monitor to help detect and prevent market manipulation strategies and to recommend measures to enhance the efficiency of the wholesale electricity market.

Utilities Code, sec. 154(e) exempts any "grandfathered facility" within an ozone nonattainment area as of September 1, 1999, from the calculation of installed capacity.

Utilities Code, sec. 153 required any utility that owned more than 400 megawatts of installed generation capacity to auction off at least 15 percent of its Electric Reliability of Texas (ERCOT) capacity at least 60 days before the January 1, 2002, the start date of consumer choice. Utilities Code, sec. 153(b) required that the obligation to auction entitled installed generation capacity would continue for five years after the introduction of consumer choice, or if the PUC determined that 40 percent of electric power consumed by residential and small commercial customers was provided by companies other than the former vertically integrated utility.

DIGEST:

CSHB 1190 would amend several portions of Utilities Code, ch. 39, subchap. D to limit the ability of any power generation company to own, control, or own and control in any combination more than 20 percent of the installed capacity in the ERCOT region. The bill also would amend Utilities Code, sec. 39.153 to require any electric utility or power generation company that held more than 20 percent of installed capacity in ERCOT to auction or otherwise divest that additional capacity by September 30, 2008. An exception would be made for a utility or power generation company that made a mitigation agreement with the independent market monitor that was approved by the PUC. The mitigation agreement would require the power generation company to file its mitigation plan within 90 days of when its generation capacity exceeded 20 percent of installed capacity.

CSHB 1190 would authorize the PUC to require refunds or disgorgement of overcharges due to market manipulation. The commission also could respond to market manipulation by ordering an auction of the rights to hold generating capacity, in addition to its ability to impose administrative penalties, or suspend, revoke, or amend the certificate or registration required to operate generating plants in Texas.

Other provisions would prevent a utility from suggesting or implying that reliability of electric service or restoration of service after an outage depended on a customer receiving service from an affiliate of that utility. Also, the affiliate would be prohibited from using the utility's corporate

name, trademark, brand or logo, or any portion of the name after January 1, 2008.

CSHB 1190 also would repeal Utilities Code, sec. 39.153(b) calling for the auction of capacity after five years of consumer choice and would repeal Utilities Code, sec. 39.154(e), which exempted "grandfathered" generating plants in ozone nonattainment areas from the 20 percent restriction.

The minimum duration of temporary assignments among affiliated companies would be extended to three years.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2007.

SUPPORTERS SAY:

CSHB 1190 would grant the PUC necessary tools to detect and prevent abuse of "market power" — the ability of a single company to dominate the market — that interferes with the efficient operations of the market and can cost electricity consumers millions of dollars. Markets — irrespective of their mix of competition and regulation — require clear rules to function, which this bill would provide.

The standard of "own or control, or any combination" in CSHB 1190 would address a variety of potential market power abuses. According to the PUC's 2007 *Scope of Competition in Electric Markets in Texas*, market power is an issue over a range of time horizons. The ability to control the output of a generation plant without owning it can create market power in the short run, and the long-term ownership and control of generation capacity could dissuade other companies from building and owning competing generation plants.

Assessment of installed generation capacity should occur throughout ERCOT, rather than in just a portion of the reliability region. The Senate proposal would require a utility to sell at auction or otherwise divest excess capacity once it owned more than 25 percent of installed capacity within a nodal pricing zone — one of the market regions being created within ERCOT. Not only would this standard be overly restrictive, forcing both TXU and NRG Energy to sell off significant portions their generation capacity, it likely would be premature pending the transition by ERCOT to a nodal market model in 2009. While taking a more measured approach,

CSHB 1190 still would require TXU to sell a portion of its Dallas area generation plants by ending the "grandfather" exemption for plants in ozone nonattaintment areas, which would put TXU's share of the installed generation market within ERCOT at more than 20 percent.

The bill would provide a flexible approach to market power issues that are consistent with the creation of the independent market monitor last session. A power generation company would be able to work with the independent market monitor to craft a mitigation plan, subject to PUC approval, that would not necessarily include forced sale of assets.

CSHB 1190 would clarify the PUC's ability to collect refunds or force disgorgements of overcharges, in addition to the collection of administrative penalties. The PUC recently announced that it would be seeking $210 million in penalties, including $140 million in fines and $70 in refunds, after a Potomac Economics report alleged that TXU manipulated the wholesale electricity market in 2005. The bill would make certain that overcharges would be collected and would reduce the monetary incentives for manipulating the market.

The bill would strengthen the code of conduct for power generation operators and would create a greater separation between affiliated businesses. It also would prevent companies from misleading customers into believing that the choice of a particular retail provider is connected to more reliable service and preferential treatment in the restoration of service after power outrage.

The enactment of CSHB 1190 would be part of a measured and incremental improvement of market rules. The Legislature already has approved a Market Oversight Division in PUC and an independent market monitor to oversee wholesale markets. Market rules already prohibit bids of more than $1,000 per megawatt hour in ERCOT balancing markets, regardless of the circumstances. ERCOT also has a "shame cap" requiring public disclosure of names of companies submitting bids in the balancing market of more than $300 per megawatt hour. That "sunshine" requirement prevents "hockey stick bidding" — i.e., offering a small amount of energy at an extremely high price in an attempt to drive up prices in the balancing portion of the wholesale electricity market.

OPPONENTS SAY:

While it may seem straightforward, the "own, control, or any combination" standard would not provide the clear guidance the PUC believes it might. The restriction may not be sufficient for the PUC to address market power issues, and its ambiguity may invite lengthy litigation on applying the standard.

CSHB 1190 would not address the issue whether refunds or other restitution to ratepayers or other market participants should be paid by stockholders or company officers — or be perversely passed through to current ratepayers. Companies violating market rules should pay additional penalties — such as the treble damages plus attorney fees standard in most consumer fraud cases — as a disincentive to future misbehavior.

Competition in the wholesale ERCOT generation markets is particularly robust under current market rules and monitoring. The PUC's announcement that it is seeking $210 million in fines and penalties makes a great headline, but ultimately Potomac Economics' analysis may prove to be flawed and the allegations of $70 million in profits from market manipulation overstated. Besides, most ERCOT transactions involve bilateral contracts and less than 10 percent of transactions happen on the balancing market.

The prohibition against making misleading claims about reliability or preferential restoration after an outage is not clear and would be somewhat misleading. The standard should be reworked to provide guidance both to the utilities and alternative retail electric providers.

OTHER OPPONENTS SAY:

CSHB 1190 should retain provisions requiring that market manipulation cases be referred to the Attorney General's Office for additional fines and possible criminal prosecution. Most changes in the market rules — the balancing bid limit and the "shame cap" on "hockey stick bidding" — came in response to incidents that involved TXU. Increasing the level of penalties may deter future market misconduct for all market participants.

Money collected from penalties and fines should be directed to programs that provide emergency assistance for low-income electric customers. Market power abuse harms all Texans, but restitution should be offered to the most vulnerable citizens.

By removing the grandfathering exemption, CSHB 1190 merely would transfer ownership of the generation plants in the ozone nonattainment areas. Rather than perpetuate old technology, the bill should provide incentives for generating plants that use integrated gasification, combined cycle, or other clean-coal technologies.

NOTES:

On March 15, the Senate by 30-0 passed SB 483 by Fraser, the companion bill to HB 1190. On March 22, the House Regulated Industries Committee reported SB 483 favorably, substituting the text of CSHB 1190.

SB 483 also would amend Utilities Code, section 39.152 to prohibit a power generation company to own, control, or own and control in any combination more than 20 percent of installed generation capacity. However, the Senate version of SB 483 differs from CSHB 1190 in several provisions. SB 483 would require an electric utility that owns more than 20 percent of installed capacity within ERCOT or more than 25 percent of a nodal or functional market segment of ERCOT to sell at auction or otherwise divest any excess capacity. SB 483 also would require the PUC to establish rules for such auctions.

SB 483 would exclude any generation that uses integrated gasification, combined cycle or other similar clean-coal technologies from the 20 percent restriction for ERCOT or the 25 percent restriction from the ERCOT zone or functional market segment. The Senate bill also would require a mitigation plan to be filed within 90 days of the determination of that a power generation company had exceeded the limit. The 90-day limit would be the same as proposed in CSHB 1190, but a power generation company also would have the option of filing a mitigation agreement with the independent market monitor rather than divesting the additional capacity.

CSHB 1190 and SB 483 would take different approaches to refunds or disgorgement of revenues due to market power abuses. CSHB 1190 would not specify the recipient of the refunds and would allow the PUC to order an auction of the entitlement of generation capacity. SB 483 would require the PUC to order refunds to retail consumers, if feasible, and would authorize the PUC to order that an amount equivalent to any proposed administrative penalty be paid to emergency utility bill programs administered by local assistance agencies supported by the Texas Department of Housing and Community Affairs. Other provisions would allow the executive director to approve or reject the findings of the

independent market monitor's investigation into allegations of market abuse and recommend appropriate administrative remedies. In addition, SB 483 would require the PUC to refer cases alleging market power abuse to the Attorney General's Office for further action, including imposition of civil penalties or criminal prosecution by the attorney general's office or the appropriate local prosecuting attorney.

Both SB 483 and CSHB 1190 contain provisions that would:

- limit a power generation company from stating or implying that reliability or restoration of power after an outage depended on the customer's receiving service from a particular provider; and
- prohibit an affiliated retail provider from using the name, trademark, brand, or logo of a utility after January 1, 2008, if the PUC determined that the use would be misleading.