SUBJECT: Promoting competition for retail electric customers

COMMITTEE: Regulated Industries — committee substitute recommended

VOTE: 5 ayes — P. King, Christian, Hartnett, Straus, Swinford

0 nays

4 absent — Turner, Crabb, Oliveira, Smithee

SENATE VOTE: On final passage, March 15 — 30-0

WITNESSES: (*On House companion bill, HB 1189 by P. King:*)
For — Jim T. Brown, Texas Affiliation of Affordable Housing Providers; Randall Chapman; Cyrus Reed, Lone Star Chapter of Sierra Club; Tom "Smitty" Smith, Public Citizen; Marcie Zlotnik, Star Tex Power, Texas Energy Association for Marketers (TEAM); (*Registered, but did not testify*: Monty Wynn, Texas Municipal League).

Against — Jim Burke, TXU Energy; Stephen Davis, Alliance for Retail Markets; John W. Fainter, Jr., Association of Electric Companies of Texas, Inc.; Charles Griffey, Reliant Energy; Michael Jewell, Direct Energy, CPL Retail Energy, WTU Retail Energy; Tim Morstad, AARP-Texas.

On — Bill Peacock, Texas Public Policy Foundation

BACKGROUND: The U.S. electric network is divided into three grids: the Western Interconnection, the Eastern Interconnection, and the Electric Reliability Council of Texas (ERCOT). While most of Texas is in the ERCOT power region, which is wholly contained within the state, portions of the Panhandle, northeast Texas, and southeast Texas are in the other adjacent power regions.

Before changes in the electric utilities industry began in the 1990s, electric service was provided by regulated, vertically integrated companies that handled generation, transmission, and distribution of electricity for a specific geographic region. In general, there are three types of utilities in

Texas: investor-owned utilities, rural electric cooperatives, and municipal utilities.

In 1999, the 76th Legislature enacted SB 7 by Sibley, which mandated restructuring of investor-owned utilities within ERCOT to provide retail competition. Areas of the state not part of ERCOT — portions of northeast, southeast and far western Texas as well as the Panhandle — were placed on a different schedule to start the transition to market competition. The state's 76 cooperatives and 85 municipally owned utilities, regardless of whether they are within ERCOT, can choose whether and when to open their systems to retail competition, but none have done so yet.

Even in ERCOT, the transmission and distribution utilities — the so-called "wires" portion — remain regulated by the Public Utility Commission (PUC), and this portion of the industry must file rate requests for PUC approval. Generation of electricity and sales to large industrial users represent the most developed competitive markets. However, the wholesale generation portion of the industry, even within ERCOT, remains subject to a degree of state oversight, including requirements for PUC registration and review by an Independent Market Monitor to detect and prevent potential market abuses. The PUC monitors market rules and practices within the retail electric service to residential and small business customers in the ERCOT region, but no longer has any jurisdiction over setting rates as of January 1, 2007.

Utilities Code, sec. 39.051(a) required that each electric utility separate or "unbundle" the former integrated portions of its business by September 1, 2000. Utilities Code, sec. 39.051(b) required by January 1, 2002, that each utility separate its business activities into three separate units:

- a power generating company;
- a retail electric provider; and
- a transmission and distribution utility.

Utilities Code, sec. 39.051(c) permitted a utility to unbundle its operations by creating a separate nonaffiliated company; creating a separated affiliated company owned by a common holding company; or selling the assets to a third party.

Utilities Code, sec. 11.003(2) defines an "affiliate" as a corporation or person who owns at least 5 percent of the voting securities in a public utility or a person who is an officer of a public utility. Affiliate is further defined as a person who exerts influence over a public utility, as determined by the PUC.

Utilities Code, sec. 39.052 froze retail electric rates for investor-owned utilities in ERCOT at the level approved on December 31, 1998, from September 1, 1999, until January 1, 2002. Utilities Code, sec. 39.202 required affiliated retail electric providers (or the portion of the vertically integrated utility that dealt directly with small business and residential customers) to reduce the frozen rates by 6 percent. The rates were those charged on January 1, 1999, adjusted to reflect any approval fuel charges. The frozen rate was set as the "price to beat" and remained in effect until January 1, 2007. The price to beat was designed to give a competitive advantage to retail electric providers other than the provider that formerly served exclusively a customer's traditional service area.

Utilities Code, sec. 15.023 allows the PUC to assess an administrative penalty of up to $25,000 per day for violation of a PUC rule or order.

DIGEST:

CSSB 482 would make several changes to the Utilities Code designed to promote electric utility retail competition and customer choice among residential ratepayers. Among its provisions, the bill would:

- penalize large retail electric companies for failing to compete and add customers outside their traditional service areas;
- promote advertising and other programs to encourage price-to-beat customers to choose different service plans;
- provide an additional role for the PUC to encourage retail competition and to investigate disputes between residential customers and retail electric providers;
- prohibit a retail electric provider from claiming a higher level of reliability for its customers and from engaging in other types of negative advertising; and
- require additional separation of functions as part of unbundling of electric utilities.

Penalties. CSSB 482 would add Utilities Code, sec. 39.110 to impose a penalty for electric companies that do not meet certain goals in adding customers outside the region they once served under regulation. The

provision would apply to retail electric providers that had more than 250,000 residential customers on December 31, 2006, and had been required to offer the price-to-beat rate.

The PUC would be required to penalize the retail provider if the company failed to meet its target outside its traditional service area for new customers moving into the area or those switching from existing companies. The goal would be a gain of 90,000 customers for retail providers serving 1 million or more customers on December 31, 2006, and a gain of 45,000 customers for retail providers serving fewer than 1 million customers on December 31, 2006.

The penalty would be calculated by subtracting the actual number of customers switched from the target number and multiplying the difference by:

- $100 per customer on December 31, 2007;
- $200 per customer on December 31, 2008; and
- $300 per customer on December 31, 2009.

Revenue from the penalties collected under this provision would be applied toward providing a 10-percent discount for low-income ratepayers under the System Benefit Fund (SBF), if SBF assessments were insufficient to generate enough money to match the appropriation for that program. If SBF assessments were sufficient to fund the low-income discount, penalty revenues would be applied toward consumer education programs designed to inform ratepayers about retail competition.

If a retail electric provider met its targets for acquiring new customers for two consecutive years, the penalties no longer would apply. Sec. 39.110 would expire on March 31, 2010.

Promotion of customer choice. CSSB 482 would add Utilities Code, sec. 39.2021 requiring electric providers to ensure that customers served at the price-to-beat rate — including those receiving reduced rates, bill credits, or customer appreciation bonuses — had made an affirmative choice to continue paying that rate. Until March 1, 2008, the retail electric provider would be required to help those customers served at the price-to-beat rate select another rate plan. After March 1, 2008, the provider would be allowed to list and describe its alternative electric service plans on a ballot delivered to the customer, which also would include a notice telling the

consumer to contact the PUC or visit www.powertochoose.com for information about retail electric services. If after 45 days the price-to-beat customer did not affirmatively select a plan through the balloting process, the electric provider would be required to change the customer to one of its alternative service plans that did not charge a termination fee.

Additional PUC role. CSSB 482 would require any electric retailer that did not provide a balloting process or paid a penalty for not acquiring additional nontraditional service area customers to provide the PUC a list of names and addresses of residential customers who had not made affirmative choices on service plans. The PUC could use this list to develop a customer education program to inform these customers of the availability of alternative service plans or alternative service providers.

As part of an overall consumer education program, the PUC would be required to include information about prices, savings available by switching plans or providers, and information about specific retail electric providers, including complaints about customer service.

The PUC could investigate and resolve disputes between residential customers and a public utility.

Prohibit negative advertising. The bill would prohibit a retail electric provider from stating or implying that it could provide a higher level of reliability or preferential treatment in restoring power after an outage because of its affiliation with the transmission and distribution utility. A retailer would be allowed to make claims about its customer service reliability. Any violation would be subject to penalties under Utilities Code, sec. 15.023.

In addition, the PUC would be allowed to require a transmission and distribution utility to make public service announcements that service reliability and restoration of power after an outage was not contingent on the selection of a particular retail electric provider.

An electric provider could not count any customer as making an affirmative choice if he or she selected a plan promoted by negative option marketing.

Unbundling. CSSB 482 would amend Utilities Code, sec. 39.051 to require that an electric utility and its affiliates owned by a common

holding company take additional steps by January 1, 2008, to ensure unbundling of its operations. The separate affiliates would be required to have:

- names and logos distinct from the names and logos of other entities owned by the common holding company;
- separate corporate boards composed of individuals who did not serve on other boards of the entities owned by the common holding company or the holding company itself;
- different chief executive officers for each entity; and
- a separate building for each headquarters.

In addition, the separate entities would be required to:

- maintain an arms-length relationship with each other;
- enter agreements based on a commercially reasonable basis and with approval of the independent board of directors; and
- prepare separate annual financial statements.

Also, CSSB 482 would require that the PUC have complete access to all of the entity's books and records on transactions among the entities owned by the common holding company.

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:

CSSB 482 would adjust market rules established through the enactment of SB 7 without resorting to re-regulation of electric utilities in the state. Texas should be proud of its success and achievements in restructuring the industry. Where monopolies once ruled, more than 33 percent of residential electrical customers have exercised their choice in the market and switched providers. The bill would create the right mix of incentives and penalties to encourage the incumbent utilities to look beyond their traditional service areas and encourage more consumers to choose electric plans that are right for their needs.

Texas cannot afford to reverse its decision on electric utility restructuring and introduction of market competition. Re-regulating electric rates for residential customers would not be sound public policy. Competition already is flourishing among large industrial users and smaller businesses,

and the marketplace has increased choices and lowered prices for these ratepayers. Mixing regulation and competition would increase the burden of managing the system for government, business and industry, and residential customers. Setting arbitrary price caps and mandatory rate reductions would not stop imposition of higher electricity costs, as shown by the experiences in California and Maryland, among other states. Short-term fixes only delay the pain.

Unlike the experience in California, Texas handled restructuring properly when the Legislature enacted SB 7 in 1999. Following the enactment of its restructuring law — AB 1890 — California saw its largest utility go bankrupt, and blackouts swept the state. Pennsylvania once was considered a model for restructuring, but the experiment has failed there and in many other states. Texas, by contrast, has shown a willingness to allow markets to work and did not try to manipulate prices or access policies. CSSB 482 would address potential flaws in the market structure without imposing additional and intrusive regulation.

Texas must assure existing utilities and potential investors that its markets are fair and efficient. Along with CSSB 483 by P. King, which would address generation capacity rules, CSSB 482 would make needed adjustments in the market rules without fundamentally changing the state's commitment to competition.

Compared with other states, Texas consumers are finding alternatives to their old electric providers and are deciding to switch. According to the PUC's 2007 *Scope of Competition in Electric Markets in Texas*, 33.9 percent of all residential customers in September 2006 were taking service from a retail provider other than the affiliated retail provider. By comparison, few residential customers have elected to change providers in markets in Illinois and New England, and few alternative retail providers have attempted to compete there. In New York, where the typical residential customer has about seven options available, only 6.7 percent of residential customers had switched by the end of 2005.

Admittedly, transition to a new market structure has been painful at times. However, recent higher electric rates cannot be attributed to competition. Disruptions caused by hurricanes Katrina and Rita in 2005 caused spikes in natural gas prices. Gas-fired units produce 73 percent of power in ERCOT, including 86 of the capacity in the Houston region. While natural gas prices tripled, however, electric rates did not increase by that

proportion. Notwithstanding those unprecedented increases, competitive prices for electricity are near the former regulated rates.

Penalties. CSSB 482 would establish meaningful, but attainable, goals for larger utilities to compete outside their traditional service areas. The requirements would apply mostly to TXU and Reliant. Requiring each of these large companies to compete directly in the other's service area would draw more attention to the advantages of competition. Even if customers did not switch over to the large competitor, there could be spillover effects as consumers selected alternative plans with their current provider or signed up with other retailers.

Channeling administrative penalties into customer education would a proper use of those funds. Further, penalty revenues only would be used to fund customer education if the Legislature did not appropriate enough funds to offer a 10-percent discount to low-income electric customers.

Promotion of consumer choice. The "price to beat," the partially regulated price for residential electricity customer, was a uniquely successful transition tool. In retrospect, Texas probably maintained the price to beat for too long, and that program distorted prices and market behavior throughout 2006. While the PUC's 2007 *Scope of Competition in Electric Markets in Texas* concedes that too many Texans remain on the price-to-beat rates, there are plenty of opportunities to lower their rates. When the report appeared, 75 alternative retail providers were offering service to customers, with other providers in the process of beginning operation. Thirty-two of these alternative providers have at least 500 residential customers, and residential customers throughout the competitive market have multiple providers from which to choose. CSSB 482 would bolster PUC's efforts to inform customers of their available options in the marketplace.

CSSB 482 would adopt a better approach by ending the legacy of the price to beat and setting competitive goals for companies to meet outside their traditional service areas. The bill properly would balance encouraging customer choice against penalizing retail providers for failure to compete. Because studies show that customers choose primarily on the basis of price, encouraging the larger retail providers to win customers outside their service territories might offer a better way to encourage price reductions.

Too much confusion persists despite all the information available about consumer choice in electric service. For example, perplexed consumers have been known to ask alternative retail providers whether changing electric service would require rewiring their houses. There remains a need for a knowledgeable and neutral source, such as the PUC, to provide answers to Texas consumers about electric service.

Additional PUC role. CSSB 482 correctly would narrow the focus of PUC efforts to investigate and resolve disputes involving residential customers and utilities. Competitive markets work for small business customers. Businesses are familiar with how to manage risk, and the ability to choose electric providers helps them control the costs. Even small businesses such as coffee shops and convenience stores have more leverage in negotiating prices than do most residential customers. The PUC should allocate its limited resources to assisting residential customers and allow the courts to settle disputes over business contracts.

The PUC should be able to provide the type of neutral and non-promotional information that customers need through public service announcements and its Web site. CSSB 482 would allow the commission to target customers who had not made an affirmative decision to select a service plan other than the price to beat. Turning these names over to other providers would be an invasion of privacy for these customers and would subject them to unwanted solicitation. Sending bill inserts to all customers would be regarded as just more junk mail.

Prohibit negative advertising. The bill would discourage a company from seeking an unfair advantage by implying that it provides more reliable service through its affiliation with the transmission and distribution — or "wires" — company. One reason customers resist changing electric companies is the uncertainty that their service will be restored by an alternative provider. Under current requirements, the "wires" company must provide service to all customers on an equitable basis, regardless of provider. CSSB 482 would make this clear to customers by forbidding utility service trucks from carrying the same name and logo as the provider.

Unbundling. Unlike California, Texas made a policy decision on restructuring not to require existing vertically integrated utilities to divest all of their generation capacity. CSSB 482 would complete an orderly transition into the new competitive market by creating functional

separation of all the components of the old electric monopolies. Requiring independent boards of directors and chief executive officers, as well as separate headquarters, would end the unfair advantages that some retailer providers still hold in the market.

Other provisions. The PUC should have the authority to establish rules on security deposits, disconnection policies, and designations of extreme weather emergencies. Making those decisions by PUC rule, rather than by statute, would provide for more flexibility and responsiveness, especially when the Legislature is not in session.

OPPONENTS SAY:

CSSB 482 fundamentally would change the rules of the game and put the future of competitive markets in Texas at risk. The bill would address past problems without necessarily improving prospects for the future. Two of the major problems have been high electricity rates caused by spikes in natural gas prices after hurricanes Katrina and Rita and alleged market abuses by TXU. The proposed acquisition of TXU by Kohlberg Kravis Roberts (KKR) and Texas Pacific Group (TPG) could be a way to remedy these past concerns. KKR/TPG has committed to diversifying fuel sources that would reduce vulnerability to high natural gas prices while creating environmental benefits. The enactment of CSSB 482 or similar legislation could put the transaction at risk and leave Texas stuck with the same TXU leadership structure and its outrageous behavior.

Changing the market rules could have implications beyond the KKR/TPG's proposed purchase of TXU. Texas must attract capital to meet its growing electricity needs, and investors might avoid the state if they believed that the Legislature would reverse its commitment to market competition or arbitrarily change its rules.

Penalties. The goals proposed for attracting new customers outside the traditional service areas and the penalties for missing those targets are too low and would not provide adequate incentives to spur marketing for additional customers.

Administrative penalties should be dedicated entirely to programs funded by the SBF to assist low-income ratepayers. The benefits of funding consumer education program are uncertain, while offering low-income discounts would provide a tangible benefit.

Promotion of consumer choice. Texans generally are aware of the availability of retail choice in electric service, but almost two-thirds of them have not switched providers or service plans. Sorting out offers among the competing electric retailers can be as complex and confusing as choosing a cellular telephone carrier or a long-distance telephone service. Far from being unaware of customer choice, Texans are confused and frustrated and are choosing not to choose.

Additional PUC role. CSSB 482 unfairly would end PUC assistance for small businesses owners. These customers face high electric bills and must resolve disputes over bill errors and other problems with their electric providers. They should be able to take advantage of the alternative process through the PUC and not have to go through the lengthy and expensive process of filing a lawsuit.

The proposed balloting process effectively would "lock in" customers on price-to-beat rates with their existing electric providers. There should be a mechanism to allow alternative providers to contact those customers.

Supposedly neutral and non-promotional educational campaigns by the PUC might not be effective and could not cut through the existing clutter of advertising regarding electric retail choice. The first media blitz based on a campaign used in Pennsylvania turned out to be ineffectual and unsuitable for the Texas market. It is uncertain that future campaigns would make better use of resources.

Prohibit negative advertising. The distinction between unfair statements about reliability and allowed promotion of service is unclear and would be difficult to enforce.

Unbundling. Requiring separate boards of directors, executive officers, and headquarters would have little real effect if the company still were owned by the same holding company. Artificial regulatory barriers among the various components of the utility would make its management more difficult without adequately eliminating the potential for collusion and anti-market behavior. It would be best to break up the old vertically integrated utilities and create complete independent companies.

OTHER OPPONENTS SAY:

The benefits of electric utility competition for residential customers were oversold initially, and the experience with increasing electricity bills during the past eight years only has increased the skepticism and anger

most ratepayers feel. Freedom to choose among competing electric providers turns into an empty abstraction when the customer receives a monthly electric bill of $700 or more during a hot Texas summer. The Legislature should reconsider its decision on SB 7 and begin the process of re-regulating residential electric rates again.

SB 482 as passed by the Senate would accomplish the goal of expanding competition in the marketplace by providing choices and lower prices for customers and would give the PUC a tool to do that if the market did prices not bring prices down. The original Senate bill also would have set stricter goals to require utilities have 35 percent of their customers outside their traditional service areas and would have imposed more meaningful penalties to ensure that competition occurred.

The PUC should have the authority to revisit and regulate residential rates to provide relief for those still paying the old price to beat. That rate stems from previous PUC decisions based on contested rate hearings. The commission should be able to review remaining price-to-beat rates to determine whether they are reasonable and lower them, if necessary.

CSSB 482 should include provisions on applying for new service, termination fees, deposits, and stricter consumer protections for critical-care residential customers and elderly low-income customers. The standard for an extreme weather emergency that would trigger protections against disconnections should be placed in statute, rather than determined each year by the PUC. One certainty about Texas is that the summer will be hot, and the state is experiencing even more spells of cold weather. Time wasted on making bureaucratic decisions would be better spent helping citizens who cannot pay high utility bills.

NOTES:

On March 22, the House Regulated Industries Committee substituted the text of the companion bill, CSHB 1189 by P. King, for SB 482 and reported it favorably. On April 4, the House considered CSSB 482 in lieu of CSHB 1189, which originally had been set on the Major State Calendar, but the bill was returned to committee on a point of order.

Floor amendments to CSSB 482 adopted on April 4. Before CSSB 482 was returned to committee, the House adopted an amendment that would allow the PUC to investigate complaints brought by residential customers and small commercial retail customers who did not exceed a certain limit on monthly or peak usage or use the services of an aggregator or broker.

Another portion of that amendment would specify the separation required among regulated transmission and distribution utilities and their affiliated power generation and retailer providers. The House also adopted an amendment would have given the PUC discretionary authority to review and order a lowering of rates for price-to-beat customers should that rate exceed the average utility rates by more than 2 cents per kilowatt during a six-month period. The amendments adopted during floor consideration on April 4 were not incorporated in the version of CSSB 482 reported by the Regulated Industries Committee on April 5 after the bill was recommitted.

Comparison of Senate-passed version of SB 482 and CSSB 482. SB 482, as passed by the Senate, and CSSB 482, as reported by the House Regulated Industries Committee, would take different approaches to promoting competition by larger electric providers outside their traditional service areas. The Senate-passed version of SB 482 would require the larger retail electric provider to have 35 percent of its customers outside its traditional service area, while CSSB 482 would require the retail provider, depending on its size, to add a fixed number of customers every year.

Both bills would impose a charge on larger retail electric providers as an incentive to compete for additional residential customers and would dedicate funds from those administrative penalties to consumer education programs. CSSB 482 would allow use of those administrative penalties to support the SBF program to assist low-income ratepayers, if there were insufficient funds for that program.

Both bills would require a transmission and distribution utility to make public service announcements that service reliability and restoration of electric service after an outage is not contingent on the customer receiving service from a particular electric service provider. However, the Senate-passed version of SB 482 would require affiliated service providers to include information about switching to other retail providers or products on inserts or statements enclosed with customer bills.

CSSB 482 would require affiliated retail competitors to conduct marketing campaigns directed to customers remaining at the price-to-beat rates and would allow providers to send a ballot describing alternatives to those remaining at the price-to-beat rate after March 1, 2008. The bill would require forwarding the names and addresses of those failing to make an affirmative choice to the PUC so that the commission could contact them. The Senate-passed version of SB 482 would change provisions on keeping

customer information confidential to allow the names and addresses of those not making an affirmative choice to be forwarded to competing retail electric service providers.

The Senate-passed version of SB 482 contains several provisions not included in CSSB 482 that would:

- permit the PUC to review the market price of electric service plans offered under the price-to-beat tariff and reduce the charge to 1-cent-per-kilowatt-hour higher than the simple average of prices charged for other similar plans in the service area;
- prohibit suspension or disconnection of electric service for critical-care residential and elderly low-income customers;
- provide a deferred payment plan for customers during an "extreme weather emergency" defined as a period when the National Weather Service forecasts temperatures at or below freezing or for heat indexes that reach or exceed 100ºF; and
- prohibit charging termination fees to switch electric service or using utility payment data to deny new service.

Related bills. On March 27, the House Regulated Industries Committee heard and left pending HB 2937 by McReynolds et al., which would delay retail electric competition in non-ERCOT areas, and HB 2818 by Ritter which would delay retail competition only in the non-ERCOT region in southeast Texas.

On March 6, the House Regulated Industries Committee scheduled for public hearing but took no action on HB 552 by Turner, which would restore the PUC's ability to set residential electric rates. HB 395 by Burnam and HB 2355 by Thompson, which would provide for re-regulation of the electric market, and HB 491 by Burnam, which would require a scheduled divestiture of installed generation capacity, have been referred to the Regulated Industries Committee.