



Public Utility Commission of Texas

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The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
U.S. House of Representatives
Washington, D.C. 20515

P-15749

Dear Mr. Dingell:

The Public Utility Commission of Texas is pleased to provide you with the attached response to your recent questionnaire relating to the various policy concerns associated with the potential deregulation of U.S. retail electricity markets.

We apologize for being unable to respond by the requested date of May 9, 1997, but are hopeful that the response will be a useful resource to you and your fellow legislators in examining the issues involved in your ongoing electric restructuring deliberations. If you have any questions regarding the response or if we can provide any further assistance, please contact Mr. Dan Jones in our Office of Policy Development at (512)936-7233.

Done in Austin, Texas this twenty-first day of May, 1997 and respectfully submitted,

Pat Wood, III,
Chairman

Robert W. Gee,
Commissioner

Judy Walsh,
Commissioner

**RESPONSES OF THE PUBLIC UTILITY COMMISSION OF TEXAS TO THE
QUESTIONS OF THE HONORABLE JOHN D. DINGELL, RANKING
MEMBER, COMMERCE COMMITTEE DEMOCRATIC OFFICE, U.S.
HOUSE OF REPRESENTATIVES**

- 1. Has your Commission or State legislature considered or adopted retail competition? If retail competition is occurring at this point, what effect has it had on consumer prices?**

In its 1995 session, the Texas Legislature directed the Public Utility Commission of Texas (Texas PUC or Commission) to prepare a report on the scope of competition in the electric utility industry in Texas. In that report, which the Texas PUC submitted to the Legislature this January, many of the aspects of retail competition are investigated in detail; however, the Texas PUC has not adopted retail competition. The 75th Texas Legislature is currently in session; that session will end in early June. Several bills addressing retail competition in the electric industry have been introduced or discussed. At this time, no such bill has been adopted.

- 2. Has your State asked Congress to enact legislation mandating retail competition? Has it sought Congressional action to enable or assist it in adopting retail competition? Has it requested or recommended any other type of Congressional action?**

The Texas PUC has not asked Congress to enact legislation mandating retail competition. The National Association of Regulatory Utility Commissioners (NARUC), of which the Texas PUC is a member, has opposed a federal "date certain" for the implementation of retail competition, favoring instead an approach that leaves the timing and method of implementing retail access to the individual states. The Texas Legislature is currently considering several proposals for implementing retail competition in Texas, however, none of the proposed legislation has been passed as of the date of this response providing for retail competition in the State of Texas. The NARUC has advocated certain Congressional actions that would serve to assist states in adopting retail competition.¹

- 3. Does your Commission currently have sufficient authority to resolve stranded cost issues in the event Congress enacts legislation providing for retail competition by a date certain? If not, what timing and other problems might ensue? What could Congress do to address such problems?**

The Texas PUC has taken the position that the Texas Legislature should provide guidance to the Commission on how to resolve stranded costs issues on a state-wide basis that result due to the implementation of retail competition. The Public Utility

¹ The NARUC has provided a response to this questionnaire, and the Texas PUC supports the views articulated by the NARUC in its response to this question.

Regulatory Act of 1995 (PURA95), which is the statutory basis for the Commission's jurisdiction and authority, does not address stranded cost recovery or retail competition. PURA95 includes sections that specifically address wholesale competition, but the Legislature, in drafting the relevant statutory language in 1995, declined to include provisions addressing retail competition.

The effective date of legislation enacted by the Texas Legislature is typically September 1 of the calendar year in which the Legislature meets. In accordance with the Texas Constitution, the Legislature convenes for a 140-day session commencing in January of each odd-numbered year (unless otherwise called into emergency session). Thus, if the Legislature were to grant explicit authority to the Commission to resolve stranded cost issues, it would need to do so on or before the close of the current session (June 2, 1997), and that authority would likely not become effective until September 1, 1997, at the earliest. The next anticipated opportunity for the Texas Legislature to address this issue will be during its 1999 regular session.

The Texas PUC believes that the decision of when to implement retail competition in Texas should be left to the Texas Legislature. However, if a date certain is mandated by Congress, the Texas PUC believes that stranded cost issues in each state are unique, and therefore cannot be addressed generically at the federal level. Thus, the Texas PUC believes that the issue of stranded costs should be explicitly left to each state to determine.

In the event retail competition is federally-mandated by a date certain, the Texas PUC feels that it is important for Congress to explicitly grant state regulatory agencies the authority to address any implementation issues left unresolved in federal legislation. In addition, state regulatory agencies should be granted the authority to create and enforce rules and regulations deemed necessary by the state regulatory agency to successfully implement retail competition as envisioned in the federal legislation.

4. Are there any other areas in which your State currently does not have the necessary authority to address issues arising from federal legislation mandating competition, or repeal of the Public Utility Holding Company Act of 1935 (PUHCA) or the Public Utility Regulatory Policies Act of 1978?

The Texas PUC cannot answer this question definitively without knowing the specifics of any federal legislation. With respect to the proposed repeal of PUHCA, the Texas PUC does not have the authority to pre-approve mergers involving electric utilities under existing state law. The authority of the Texas PUC in electric mergers is limited to a determination of whether a proposed merger of electric utilities is in the public interest. If it is determined that such a merger is not in the public interest, the Texas PUC can make the appropriate revenue adjustment in the utility's next rate case. No Texas agencies, including the Texas PUC, have

explicit statutory authority to address a proposed merger involving an electric utility and a gas utility.

- 5. Would any constitutional issues be raised by federal legislation:**
- a) mandating that states choose between adopting retail competition by a date certain and having a federal agency preemptively impose retail competition?**
 - b) requiring states to conduct a proceeding on retail competition, reserving states discretion not to adopt retail competition if they determine doing so would not be in its consumers' best interests?**

This question is not addressed.

- 6. From a practical standpoint, what problems would arise if Congress adopted legislation mandating retail competition which did not grandfather prior state action?**

Three problems may arise from the failure of federal legislation to grandfather prior state action, some of which may delay the realization of effective retail competition: (1) business plans developed by incumbents, entrants, and customers to take advantage of the state action would be disrupted and subsequent investment may be put at risk; (2) resources will be diverted from implementing retail competition to harmonizing federal and state statutes and determining proper regulatory jurisdiction; and (3) any advantages inherent in state legislation that result from accommodating the state's transition plan and final retail electric market to the special circumstances of the state will be lost in broader federal legislation.

- 7. In hearings before the Energy and Power Subcommittee during the last Congress, some witnesses took the position that Congressional legislation mandating retail competition is necessary to protect the interests of small and residential consumers. This was based upon the assertion that large industrial customers are able to negotiate lower rates with state utility commissions, and the incidence of such rate reductions is on the increase.**

- a) Are you aware of any study or analysis relevant to your State that supports this conclusion?**

The Texas PUC is not aware of any studies relevant to Texas that support the assertion that large industrial customers are able to negotiate lower rates with state utility commissions at the expense of small and residential consumers.

PURA95 allows utilities, upon approval of the PUC, to offer rates that are discounted below the standard embedded cost rate that was developed using traditional cost of service regulation. However, the statute also explicitly requires that the Texas PUC ensure that the "utility's allocable costs of serving customers paying discounted rates . . . are not borne by the utility's other customers." In other

words, utility shareholders, not utility ratepayers, shoulder the cost burden associated with revenues lost through any rate discounting activities of the utility. Also, with this cost-shifting prohibition in place, rate subsidies are avoided because the utility cannot reallocate the "lost revenues" to its other ratepayers (see response to question 7b regarding subsidies).

b) Please provide any information you can on the historical relationship between residential and industrial rates, the extent to which one customer class has subsidized another, and whether or not this trend has altered in recent years.

The historical relationship between residential, commercial and industrial rates in Texas for the years 1990-1996 is depicted in Attachment 1. It should be noted that, while differentials exist between the prices per kilowatt-hour (kWh) for these various customer classes, there are valid rationale why this price relationship exists other than the existence of a subsidy.

For instance, the residential rate includes costs related to the utility's distribution system, whereas the industrial rate generally includes few distribution costs as these customers typically receive high voltage power directly from the utility's transmission grid. Also, the different usage patterns of the various customer classes will produce higher *rates* for customers with a lower load factor² even when the allocated *costs* are identical.

As a simple example, assume the residential and industrial classes have identical peak demands (measured in kilowatts or kW) and use the same utility facilities for the delivery of power. Also assume that the residential class consumes half the energy of the industrial class (measured in kWh)³. In this example, the allocated costs (and thus, the total bill) would be the same for both classes, however the residential rate (measured in \$ per kWh) would be twice that of the industrial rate due to the fact that the allocated residential costs are spread over only half the units of consumption (kWh) of the industrial class. Thus, even without a subsidy, various cost causation factors can and do result in divergent electricity rates for the various customer classes.

A subsidy exists when rates do not appropriately reflect the underlying cost causation factors, thus resulting a skewed allocation of costs among customer classes. Regulation of electric rates in Texas has worked to minimize subsidization among rate classes. No generalizations about specific rate classes can be drawn

² The "load factor" is a percentage measure of a customer's or customer class' energy usage over a period of time relative to the energy it would consume at its peak demand over the same period of time.

$$\text{For a year, Load factor} = \frac{\text{Annual Energy Usage (kWh)}}{\text{Peak Demand (kW)} \times 8760 \text{ hours}}$$

³ As portrayed in this example, the residential class typically has a significantly lower load factor than the industrial class.

regarding subsidization in Texas. At times residential classes have provided a subsidy to commercial and/or industrial classes, and at other times residential classes have received a subsidy from those classes of customers.

Recently, some interruptible rates in Texas have been examined in light of their potential to lead to subsidization among classes. Most investor-owned utilities in Texas offer interruptible service to their large industrial customers. Customers taking service under these rates give the utility the right to interrupt their electric service at periods of peak system demand. In return, these interruptible customers pay less than so-called "firm" service customers who cannot be interrupted.

In practice these rates have raised questions. For example, if service under these rates is only rarely interrupted, and yet significantly discounted, then there is the possibility that other classes are subsidizing service to the interruptible class.

In a recent decision, the Texas PUC implemented changes with respect to an existing interruptible rate that will more appropriately reflect the cost of serving the customers receiving the interruptible rate. This action by the Texas PUC is representative of its policy to minimize and/or eliminate identifiable subsidies that may exist in regulated utility rates in Texas.

- 8. Although electricity rates vary widely within the U.S., they have fallen recently in some parts of the country. Please provide any information you can about rate trends in your State, and how they affect various customer classes.**

Please see the response to question 7b and Attachment 1.

- 9. Some proponents of retail competition hold the view that all electricity resources should be sold at a market price and that the state authority to regulate retail rates should be eliminated. How would such a policy affect shareholders and ratepayers? What mechanisms could states or Congress employ to manage these issues? In a restructured electric industry, who should receive the benefits of these low-cost resources—utility ratepayers, utility shareholders or the highest bidder?**

The Texas PUC assumes that this question is referring to the potential divestiture of utility generation assets, and that the elimination of state authority to regulate retail rates is limited to the price of electricity, with transmission and distribution remaining subject to cost-based regulation.

Given these assumptions, the Texas PUC offers the following comments regarding the divestiture of utility generation assets:

1. The proper disposition of above- or below-market generation resources is a policy matter for state commissions and legislatures to decide.
2. As a general policy, the allocation of benefits and costs should be consistent. In other words, if ratepayers are expected to bear some or all

of the burden of any resources with book values that are above market value, ratepayers should receive some or all of the benefit of any resources with book values that are below market value (the low-cost resources).

3. It is important to recognize that, under current regulation, the total cost of utility above- and below-market generation resources is being fully recovered in regulated rates. Thus, even if the recovery of 100 percent of stranded costs is granted to utilities, prices in a restructured electric market should be less than or equal to the current regulated rates.
- 10. Of those states which have adopted retail competition, how many have addressed the issue of "reciprocity", (that is, whether or not the state can bar sellers located in states which have not adopted retail competition from access to its retail markets)? Whose interests does a reciprocity requirement affect? Is a reciprocity requirement the only way to protect those interests, or are there alternatives? Would such a requirement raise constitutional issues?**

Generally speaking, a state may desire to adopt a reciprocity provision to avoid the creation of additional stranded generation costs in that state and/or the shifting of stranded generation costs among jurisdictions.

This situation could occur if regulated utilities in neighboring states are allowed to sell excess capacity in the deregulated state, as those utilities would be recovering fixed costs from customers in the still regulated state, but would be able to sell at or above marginal cost to retail customers in the deregulated state. The effect would be to drive down prices in the deregulated state, thereby increasing stranded generation costs in the deregulated state. In contrast, any revenues achieved in excess of marginal cost by the still regulated utilities in the neighboring states selling to retail customers in the deregulated state would flow to that jurisdiction, thereby reducing the potential stranded cost exposure of the still regulated utilities in those states at the expense of retail customers in the deregulated state. Thus, the result may be a shifting of stranded generation costs among retail jurisdictions.

Practically, the establishment of a retail reciprocity provision may not produce the desired results simply due to the open access in the wholesale market achieved through FERC Order No. 888. Because wholesale power transactions will not be affected by any retail reciprocity provision, such wholesale power will still be available from regulated out-of-state utilities (and other electricity generators) for resale by in-state aggregators (*e.g.*, power marketers) to retail customers in the deregulated state (indirect third-party retail access). This may create a "loophole" that would render a retail reciprocity provision ineffective. There are undoubtedly other creative means by which a retail reciprocity provision may be rendered ineffective in achieving its desired goal.

The constitutionality of a retail reciprocity provision will likely be dependent upon the nature of the specific provision, the basis for establishing the reciprocity requirement, and the ultimate effect of the reciprocity provision on interstate commerce. To date, no interstate retail reciprocity provision has been included in

any of the restructuring proposals being discussed in Texas. However, some Legislative proposals in Texas have incorporated an intrastate retail reciprocity requirement.⁴

11. If Congress were to require “unbundling” of local distribution company services as part of a retail competition mandate, what practical problems might this present to state regulators?

The Texas PUC has an ongoing project in which rules are being developed to guide utilities in unbundling their rates and services. Those rules will likely be in place before any federal regulations become effective. The most significant potential practical problem of a prescriptive federal mandate is that the Congress could adopt requirements that are inconsistent with the requirements being developed and possibly already implemented by the Texas PUC.

12. Does your Commission face particular problems with public power or federal power in an increasingly competitive electricity market?

The electric industry in Texas is characterized by a diverse set of electric service providers. There are currently 10 investor-owned utilities operating in Texas, along with eight generation and transmission cooperatives, 70 municipally owned utilities, 78 distribution cooperatives, and five river authorities. In addition, over 60 power marketers and exempt wholesale generators have registered in Texas. Approximately 20 percent of the State is currently multiply certificated, and in most of those cases, distribution cooperatives and municipal utilities are multiply certificated with IOUs. Certainly, a shift to a more competitive market raises significant concerns for public power. Among these concerns:

1. In some cases, significant portions of the budgets of municipal governments are raised through municipal utility revenues.
2. In multiply certificated areas, municipal utilities and distribution cooperatives are concerned about the potential for expensive duplication of facilities in a competitive retail market.
3. Participation by public power entities in competitive markets outside of their established service areas could jeopardize the tax-exempt status of their outstanding debt.
4. The tax-exempt status of public power entities could create an unlevel playing field in a competitive market if not properly addressed.

⁴ Legislation has been proposed in Texas that would open the retail markets of investor-owned utilities by 2002, while allowing municipals and cooperatives to “opt-out” of retail competition until such time as those entities decided to “opt-in” and provide retail access. The proposed legislation would prohibit municipals and cooperative corporations from selling power to retail customers outside of their respective service territories until such time as those municipals and cooperatives elected to open their markets to retail competition.

5. Public power entities have expressed concerns that their abilities to compete may be constrained by their requirements for conducting business in an open public environment, while IOUs and power marketers can conduct business and strategic planning behind closed doors.

13. How would federal legislation mandating competition by a near term date certain affect funding needs for your Commission? If additional funding were needed, would it be available, and what problems might arise if it were not?

The Texas PUC cannot answer this question definitively without knowing the specifics of any federal legislation. However, the Texas PUC is funded by law through an assessment on public utility retail gross receipts. Any federal legislation that altered the structure of public utilities in Texas—for example, a requirement that utilities structurally unbundle or otherwise sell off generation assets—could significantly affect the annual revenues collected by the State under this assessment.

In addition, depending upon the time frame and the requirements placed upon states for implementing retail competition, workload requirements for state commissions could increase dramatically. For example, if retail competition were mandated to be implemented by the states effective in 1998 or 1999,⁵ the immediate impact on the workload of the Texas PUC may be significant. However, because the Texas PUC receives biennial appropriations from the Texas Legislature, an opportunity for an adjustment of appropriations would not become available until the next regular session of the Legislature in 1999.

14. Has your Commission considered or adopted securitization plans as a means of providing for recovery of utility stranded assets? What risks are inherent in this approach, and who bears them?

The Texas PUC has not adopted any securitization plans. Securitization of strandable assets is included as a component of at least one retail competition bill currently before the Texas Legislature. Securitization is a relatively new tool for addressing the stranded cost issue and deserves close scrutiny. Any securitization plan adopted should be carefully constructed so that ratepayers receive a definite and maximized benefit from the “refinancing” of the capital costs of above-market generation assets.

⁵ It is not clear what time frame is intended by the phrase “near term date.” It is the viewpoint of the Texas PUC that the actual implementation of full retail access should be delayed at least two years subsequent to the passage of restructuring legislation to ensure a smooth and equitable transition for all industry stakeholders.

- 15. There is wide divergence of opinion as to whether or not PUHCA should be modified or repealed. Given the level of merger activity, this question may become significant for all state regulators, whether or not they currently have regulatory responsibilities relating to registered holding company activities.**
- a) Do you believe PUHCA impedes competition, at the wholesale or retail level? Can “effective competition” be achieved regardless of whether Congress enacts changes to PUHCA?**
 - b) Do you believe Congress should modify or repeal PUHCA? If so, why, and under what if any conditions?**
 - c) Should Congress enact legislation to modify the holding in Ohio Power Co. V. FERC, 954 F.2d 779 (D.C. Cir. 1992)?**

The Texas PUC supports the views articulated by the NARUC in its response to this question.