

SUBJECT: Electric competition and regulation in Southeast Texas

COMMITTEE: Regulated Industries — committee substitute recommended

VOTE: 5 ayes — P. King, Hunter, R. Cook, Crabb, Hartnett
0 nays
2 absent — Baxter, Turner

WITNESSES: For — Joseph Domino, Entergy Gulf States; Richard Smith, Entergy Corporation; Philip Oldham, Texas Coalition for Competitive Electricity; Lori Ryerkerk, Exxon Mobil Corporation/Texas Oil and Gas Association/Texas Chemical Council; Daniel Lawton; (*Registered, but did not testify*: Victor Alcorta, Air Liquide Large Industries U.S. LP; Desiree Bryant, Silsbee Economic Development Corporation; George Christian, Texas Forest Industries Council/Mead Westvaco Corp.; John Fainter, Association of Electric Companies of Texas, Inc.; Carl Griffith, Jefferson County Community Center; Mike Meroney, Huntsman Corporation; Todd Morgan, Temple-Inland Inc.; Leonard Reed, City of Willis; Jim Rich, Greater Beaumont Chamber of Commerce; Vicky Rudy, City of Montgomery; Carlton Schwab, Fred Welch, Texas Economic Development Council; Keith Smith, Red Simpson, Inc.; Rick Williams, Jefferson County Chambers of Commerce; and 48 others)

Against — David Brian, Nelson Nease, East Texas Electric Cooperatives; (*Registered but did not testify*: Greg Flores, HEB Grocery Co.; Michael Jewell, Direct Energy/CPL Retail Energy/WTV Retail Energy; Michael Sparks, Suez Energy North America).

On — Rick Levy, Texas Association of Electrical Workers - IBEW/Texas AFL-CIO; Mike Williams, Texas Electric Cooperatives; (*Registered but did not testify*: John Baker).

BACKGROUND: The U.S. electric network is divided into three grids: the western and eastern interconnections and the Electric Reliability Council of Texas (ERCOT). While most of Texas is in the ERCOT region, portions of the Panhandle, far west Texas, Northeast Texas, and Southeast Texas are in the other adjacent power regions.

The 76th Legislature in 1999 enacted SB 7 by Sibley, restructuring electric utilities and allowing customers of Texas' investor-owned utilities to choose their electricity providers as of January 1, 2002. In non-ERCOT regions, implementation of customer choice has been delayed because of concerns about the scarcity of competitors entering the market to provide retail service and the shortage of available transmission capacity, among other factors. HB 1692 by Chisum, enacted in 2001 by the 77th Legislature, delayed implementation of retail competition in the Panhandle until 2007 or until the Public Utility Commission (PUC) authorizes customer choice in the area, whichever is later.

Utilities Code, ch. 39 sets out the criteria necessary for the PUC to certify a power region as qualified for competition. Besides requiring an independent system operator (ISO), nondiscriminatory access and uniform pricing for transmission and distribution, and limits of 20 percent on any one company's ownership of generating capacity (market power), power regions outside ERCOT must have adequate transmission interconnections to power regions outside Texas.

The southeast area outside of ERCOT is serviced by Entergy Corp. and operates in the Southeastern Electric Reliability Council, a region subject to regulation by the Federal Energy Regulatory Commission (FERC). Entergy serves approximately 373,000 customers in 24 counties, including about 326,000 residential customers. In 2001, the PUC issued orders to delay customer choice in this region after determining that there was insufficient competition in the region. In October 2004, the PUC denied a rate request by Entergy based on a previous agreement that rates remain frozen until competition had been introduced.

DIGEST:

For an investor-owned electric utility that was operating solely outside ERCOT in the Southeastern Electric Reliability Council on January 1, 2005 (Entergy Corp.), CSHB 1567 would regulate electric utility rates under traditional cost-of-service regulation. Such rate regulation would occur until the utility was authorized by the PUC to implement customer choice.

Any PUC order issued before the bill's effective date relating to the utility's compliance with electric restructuring under Utilities Code, ch. 39 would be void.

Except for fuel cost recovery and other exceptions included in this bill, an individual could not file a proceeding to change a rate charged by the utility prior to June 30, 2007. As part of a rate proceeding, the utility would have to propose a competitive generation tariff to allow customers to contract for competitive generation. The tariff would be subject to PUC approval. A tariff could not be considered to offer a discounted rate. The utility's rates would be set to recover costs resulting from the tariff's implementation.

Aside from provisions governing renewable energy, energy efficiency, permitting of generation facilities, and emissions reduction, chapter 39 provisions would not apply to the utility until it had implemented customer choice. The utility would not be subject to a rate freeze and could apply for rate changes, subject to the June 30, 2007, limitation.

The utility could separate into two vertically integrated utilities, with one regulated by the PUC and the other regulated by the Louisiana Public Service Commission.

Customer choice. By January 1, 2006, the utility would have to file a plan identifying the applicable power region or regions, enumerating the steps required to achieve customer choice, and specifying the schedule for achieving customer choice certification. The PUC could certify a qualified power region when the relevant conditions existed.

Prior to the earlier of January 1, 2007, or 90 days after customer choice was certified, the utility would have to file a transition to competition plan that:

- identified how the utility intended to mitigate market power and achieve full customer choice;
- reinstated a customer choice pilot project and established a price to beat for residential and commercial customers with a peak load of 1,000 kilowatts or less; and
- included other information required by the commission.

The PUC would be required to approve, modify, or reject the plan within 180 days unless a hearing was requested by any party to the proceeding. A modification of the plan could not conflict with FERC orders or result in additional costs, unless those costs were allowed to be recovered in a timely manner. The plan would be updated annually until the utility had

initiated customer choice. The commission could require the utility to facilitate the development of a wholesale generation market in the utility's service territory.

The PUC could not authorize customer choice until it had certified that:

- a sufficient number of interconnected utilities were under the control of an independent organization;
- the region had a tariff that guaranteed open access to transmission and distribution facilities for all users (50,000 megawatts deliverable to part of the region through the payment of one transmission tariff); and
- no person owned or controlled more than 20 percent of the installed generation capacity capable of delivering electricity to the region.

In addition, the PUC would have to consider the extent to which transmission facilities limited the delivery of electricity from generators located outside the state. The PUC would certify a utility only if it found that the total capacity owned and controlled by the utility did not exceed 20 percent of the total installed generation capacity within the power region of the utility.

Cost recovery. The utility could recover expenditures toward compliance with customer choice requirements incurred before the bill's effective date, to the extent those costs had not already been recovered. After review, the PUC would approve a retail rate rider for the recovery of costs associated with the transition to competition. The rate rider would enable recovery of costs over a period of up to 15 years.

The utility also could recover through a rate rider resource costs related to meeting load requirements, to the extent that those costs resulted in greater capacity cost expenditures under purchase power agreements than were included in the utility's last base rate case, adjusted for load growth. Any rider would be implemented after PUC review and a hearing. After a rider's initial implementation, the utility could request revisions on a semiannual basis. The commission would have to reconcile costs recovered through the rider with actual incremental capacity costs eligible for recovery under the bill. The rider for recovery of load requirement costs would expire upon introduction of customer choice or upon the implementation of a new rate following a rate hearing. The rider could not exceed 5 percent of the utility's annual base rate revenues.

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, 2005.

**SUPPORTERS
SAY:**

CSHB 1567 would enable Entergy Corp., the primary provider of electric service in Southeast Texas, to obtain regulatory relief for electric rates that have been frozen since 1999. Entergy has invested more than \$130 million since enactment of SB 7 to move its service area toward competition, without the ability to raise its rates. However, a lack of development of the wholesale market has slowed competition in Southeast Texas. This bill would provide the regulatory and financial certainty necessary to facilitate investment in the region. Increased investment would serve consumers and move the region toward true competition.

When the PUC denied Entergy's rate request in 2004, it did so without addressing the merits of the proposal, because the utility was tied up under a rate freeze agreement. Because Entergy is subject to a tangle of federal and state regulations, it has been unable to attain the competitive requirements laid out in SB 7. Without the ability to recover costs, Entergy will be unable to make the investments necessary to ensure the reliability of its infrastructure.

CSHB 1567 would put Entergy back under traditional PUC rate of return regulation, exactly where it belongs until competition prevails in its service area. Rates could not be increased without commission approval, and the amount of increase would be limited under the bill. Once customer choice is possible, Entergy could join an independent transmission organization such as ERCOT and link up to electric producers in other regions. Consumers would continue to receive protection from the PUC until their region enjoyed the benefits that go along with a fully competitive marketplace.

The bill would continue the current rate freeze for three years, providing rate stability for consumers through that period. The PUC could approve cost recovery in the interim to maintain a reliable system. Although no one likes it when rates go up, a reasonable rate of return is necessary to ensure the security of the region's electric supplies, attract new industry, and facilitate competition.

Allowing Entergy to split into two entities, one in Texas and one in Louisiana, would smooth regulatory framework governing Entergy in Texas, enabling the company region to move further toward competition.

OPPONENTS
SAY:

CSHB 1567 would lead to electric rate increases for thousands of customers in the Entergy service area. Entergy agreed to have its rates frozen until competition was introduced, a fact recognized by the PUC in its denial of Entergy's rate request last year. Entergy should honor the agreement it has made with the state and its residential and business customers.

Rate increases would hit low-income consumers particularly hard. Half a million Texas households with incomes below 50 percent of the federal poverty line spend nearly 50 percent of their income for energy utilities. Coupled with rising fuel costs, the increases in CSHB 1567 particularly would harm poor Texans.

OTHER
OPPONENTS
SAY:

Rural cooperatives in East Texas that have contracts with Entergy could see their costs and those of their customers increase. These entities could be forced to pay higher rates to transport electricity generated outside Texas across the Louisiana state line. CSHB 1567 should be amended to ensure the maintenance of current agreements between Entergy and these providers.

NOTES:

HB 1567, as introduced, would have allowed a rate change request immediately. It would have allowed the utility to file a transition to competition plan, instead requiring it to file one. The bill would not have allowed for recovery of incremental capacity costs.

The companion bill, SB 735 by Williams, has been referred to the Senate Business and Commerce Committee.