

Pat Wood, III
Chairman

Brett A. Perlman
Commissioner

W. Lane Lanford
Executive Director



Public Utility Commission of Texas

May 1, 2001

Donald S. Clark
Office of the Secretary
Federal Trade Commission
600 Pennsylvania Ave., N.W.
Washington, D.C. 20580

Re: Matter No. V010003--Comments Regarding Retail Energy Competition

Dear Mr. Clark:

Enclosed are the comments of the Public Utility Commission of Texas in response to the Federal Trade Commission's request for comments on electric competition issues. I am also sending a copy of the comments to the Commission by email.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Jess K. Totten".

Jess K. Totten
Director, Electric Division



Comments of the Public Utility Commission of Texas Regarding Retail Electricity Competition

The Federal Trade Commission (FTC) issued a notice requesting information about the results, to date, of different regulatory approaches to the issues that arise in restructuring the retail sale of electricity. The notice indicated that the FTC will produce a report that discusses the advantages and disadvantages associated with different approaches to particular issues and that identifies, if warranted, areas in which additional federal legislative or regulatory action may be desirable.

The Texas Legislature passed and Governor George Bush signed a law in 1999 that will introduce retail competition in the sale of electricity in Texas in January 2002. Texas introduced competition at wholesale under legislation that was enacted in 1995. While there is not yet direct experience under retail competition in Texas, we are optimistic that retail competition will bring benefits to customers. The introduction of wholesale competition and the adoption of rules to provide access to the transmission network to have been instrumental in stimulating significant new investment in generating facilities in Texas. We have also had the benefit of reviewing the deregulation programs adopted by other States that introduced retail competition earlier, which helped the Legislature and Texas PUC in shaping rules for the competitive market. We believe that with the significant additions of generation capacity in Texas and the adoption of legislation that draws on the experience of other states, retail competition in Texas will provide benefits for customers.

There are several areas in which the public debate over retail competition has already identified areas in which Federal legislation would be helpful in facilitating retail competition. Two of these areas that are of primary concern to the Texas PUC are provisions of the Internal Revenue Code that would preclude municipal utilities or electric cooperatives from using facilities that have been financed with tax-exempt bonds from participating in wholesale or retail competition and provisions of the Public Utility Regulatory Policies Act that impose purchase and sale requirements on electric utilities. The recent experience of the Federal Energy Regulatory Commission in attempting to create regional transmission organizations has been slow and frustrating. The progress to

date suggests that clear authority is needed in Federal law for the FERC to require utilities to establish RTOs or other similar organizations to facilitate regional transmission service and wholesale competition. Today the regulatory authority with respect to transmission facilities and service is divided among Federal and State agencies, and Federal, municipal and cooperative utilities have broad discretion with respect to transmission issues. Clear FERC authority on RTOs would permit the FERC to shape the RTOs so that they are more effective in facilitating regional wholesale power markets, that they include all of the transmission owners in a region, and that they adopt rational rate policies to support the construction of new transmission facilities where they are needed. The final area where Federal authority is sorely needed is in the area of generation market power. The FERC should have the mandate and resources to evaluate mergers and other transactions that result in the accretion of market share in the generation market. Wholesale and retail competition will not be effective if the large regional generation companies can increase their market share through mergers and acquisition of generating assets.

There are a number of factors that will facilitate competition that benefits customers. Some of the key factors are the following:

- adequate generation and delivery facilities;
- clear customer protection rules that ensure that customers have truthful information with which to make a choice and that their choice is honored;
- standardization of terms and conditions of distribution service and electronic transmission of information to facilitate mass markets for small customers; and
- protections against market power, including unbundling requirements and codes of conduct.

The investment in new electric facilities in Texas over the past six years, the law enacted in Texas to introduce retail competition, and the rules adopted by the Texas PUC to implement the new law will establish a sound foundation for retail competition in Texas. The key features of the Texas competition law are summarized below.

Open Access Date. Retail competition, or customer choice, begins in most of the State on January 1, 2002.

Municipal Utilities and Cooperatives. Municipal utilities and cooperatives will be able to choose to retain monopoly service areas or to opt in to customer choice beginning January 1, 2002. They will not be able to compete at retail outside of their service areas, unless they opt in to retail competition. A decision to opt in is irrevocable.

New Terms. A retail electric provider (REP) is a seller of electricity and other energy services to consumers. A utility provides delivery service to transmit electric power to customers' homes and businesses (transmission and distribution). A power generation company produces electricity. An independent organization is an entity that is not dominated by any competitive company in the electric business and performs functions related to transmission and distribution access, reliability, settlement of accounts among competitive companies, and managing the customer-related information that will permit customers to switch from one REP to another.

Rate Path. Utility base rates are frozen from September 1, 1999 to January 1, 2002. Rates for residential and small commercial customers will be reduced by about 6% on January 1, 2002. For other customers, rates will be based on market forces.

Competition. When competition begins, customers will not be switched to a different supplier, unless they choose to switch. Instead, they will remain with the REP that is affiliated with the incumbent utility in the area. Retail electric providers other than the REP that is affiliated with the incumbent utility in an area may begin offering competitive rates in 2002. Beginning in 2002, the utility-affiliated REP may compete on price for industrial and large commercial customers. (A small commercial customer is one whose peak load is less than 1000 kilowatts.) To stimulate competition for sales to residential and small commercial customers, a *price to beat* will be established for utility-affiliated REPs. The utility-affiliated REPs will not be able to offer a lower price than the price to beat during the first 36 months of retail competition, or until they lose 40% of the load of residential or small commercial customers. Initially the price to beat will be about 6% below current retail rates, but the rate can be adjusted if the price of natural gas increases.

It is expected that competing retail electric providers will be able to offer customers more attractive rates than the price to beat. The price to beat is intended to create an opportunity for new companies to enter the market and obtain customers. It should result in sufficient market shares for new entrants that competition will be vigorous and sustainable. The price to beat is available at the customer's option for five years.

Residential Service Obligation. Each REP that is serving at least 300 Mw of load must serve residential customers. Not less than 5% of the REP's sales must be residential sales; if it does not meet this requirement, the REP will be required to pay a penalty.

Market Power. The law requires integrated utilities to unbundle their operations into separate companies to produce power (power generation companies), deliver power (transmission and distribution utilities), and sell energy services to retail customers (retail electric providers). A transmission and distribution utility may be affiliated with a power generation company or a retail electric provider, but it may not produce or sell electric power. The law also limits the percentage of generation that a single company may own in a power region to 20% and establishes a code of conduct for transactions between affiliates. The new law also requires that a utility-affiliated power generation company with more than 400 Mw of capacity sell at auction rights to at least 15% of its capacity during the first five years of retail competition or until the utility-affiliated company loses 40% of its residential and small commercial business. Finally, the law requires that competitive energy services be unbundled well before full retail competition begins.

Stranded Costs. A utility that has costs that will be stranded by the introduction of retail competition may recover those costs in several ways. Prior to the introduction of retail competition, the utility must use any excess earnings and can redirect depreciation from transmission and distribution assets to generation-related assets to reduce stranded costs. Investor-owned utilities are required to file annual reports showing their revenues and expenses, so that the Commission can track their progress in reducing stranded costs and reflect excess earnings and redirected depreciation in the utility's transmission and distribution rates. Utilities can also securitize stranded costs and regulatory assets prior to the commencement of competition. Finally, the law permits stranded costs to be

recovered, after retail competition begins, through a non-bypassable charge to the customers taking delivery service from the utility.

Transmission and Distribution Service. Transmission and distribution service continue to be regulated as to rates and quality of service.

Wholesale Market. The legislation specifies competitive conditions that must be met before a region outside of ERCOT is considered fully competitive. Customer choice is available immediately, but certain customer pricing protections remain in effect until the conditions for open competition are met. The competitive conditions, which are intended to ensure vigorous competition at the wholesale level, include (1) the establishment of an independent organization consistent with the new law and (2) approval of open-access transmission tariffs within the region. Until the conditions for competition are met, the existing utilities would be limited in their ability to change rates.

Reliability. The PUC is authorized to adopt and enforce reliability standards. The independent organizations would be responsible for reliability on a day-to-day basis.

Customer Protection. The new law includes a number of provisions that are intended to protect customers and prevent the kind of abusive marketing behavior that has taken place in the telephone industry. Customers' rights include the choice of REPs to provide service, access to a provider of last resort, sufficient information to make an informed choice of service provider, and protection from unfair, misleading, or deceptive practices, including protection from being billed for services that were not authorized. A REP would be required to obtain Commission certification prior to providing service, and it must demonstrate that it has the technical and financial resources to provide reliable service, in order to be certified. The law also requires that the Commission adopt rules to facilitate comparison of offers by competing REPs, and the Commission has adopted a fact label that requires the disclosure of key terms of a REP's service offer, including pricing, term of service, early termination charges, air emission profile, and the price per kilowatt hour at specified levels of consumption.

Pilot Projects. Retail-choice pilot projects will be conducted in each investor-owned utility's service area beginning June 1, 2001.

Renewables. The legislation establishes goals for renewable resources that would increase the use of these resources significantly. In 1999, Texas had about 640 Mw of hydro-power and 240 Mw of wind and other renewable resources; together they were about 1.3% of the capacity in Texas. Under the legislation, 2000 Mw of new renewable resources would have to be added by 2009, increasing the renewable capacity to about 3.4% of the total capacity in the State. The PUC established a credit-trading program to ensure that this goal is met in a cost-effective manner.

Air Emissions. A number of utility power plants in non-attainment areas in Texas were grandfathered when the air-permit program was established under the Clean Air Act. These plants emit nitrogen oxides and sulfur-dioxide at higher levels than the plants that have permits. The new legislation requires emissions from these plants to be reduced and permits utilities to recover the costs of the environmental upgrades through the mechanisms for the recovery of stranded costs. These provisions are intended to reduce NOx emissions by 50% and sulfur-dioxide emissions by 25%.

Public Benefits. The legislation creates a System Benefit Fund to cover the costs of new programs for low-income customers, the cost of an education program to inform customers of retail competition, and the additional tax burden on school districts resulting from reductions in the value of generating plants. The expected annual revenue of this fund is at least \$120 million. The legislation also requires that electric utilities create programs to meet 10% of their growth in demand through energy-efficiency programs.

History and Overview

The retail competition law was enacted with the expectation that competition would benefit customers through lower prices and better services. The construction of nuclear power plants to serve Texas customers was a significant event in the recent history of the industry in Texas that resulted in large rate increases for many of the investor-owned utilities. One of the expectations for a competitive market is that customers would not

have to pay for facilities like these whose book value in a regulatory environment is significantly above their value in an open market. In a competitive environment, companies selling power would be able to recover no more than market rates. In addition, it was recognized that the deregulation of the telecommunications industry has resulted in many innovations that have improved the telecommunications services available to customers. Similar innovations in the energy industry were expected, bringing customers new and valuable products and services. Finally, Texas has a strong independent-power industry, and independent producers sought access to broader markets through retail competition.

Natural gas is an important fuel for the electric industry in Texas. When the Texas law was enacted, natural-gas prices were in the two-dollar range, and it was expected that retail competition would result in lower prices in absolute terms and relative to the results of a regulated industry. Since then, gas prices have increased significantly, and the expectation is that the savings on electricity costs will be more modest. While affiliated REPs will reduce their rates by about 6% for residential and small commercial customers, and other customers are likely to be able to negotiate lower rates than what they pay today, prices for electricity in 2002 are likely to be higher than they were in 1999.

Consumer Protection Issues

It is too early to assess the success of the customer protections in the new law, because retail competition does not begin until January 2002. The law prohibits slamming and cramming, and the Commission has adopted rules to ensure that customers understand what they are agreeing to when they switch REPs and to prevent unauthorized switches. The rules prescribe methods for obtaining and verifying an authorization to switch REPs and mandatory disclosures to customers, including requirements that the customer receive a document that sets out the terms of service and that the REP keep a record of verifications of switch authorizations. One of the functions of the independent organization that is responsible for transmission access and reliability will be confirming customer switches. The independent organization will notify customers of a switch after it receives notification from a REP, and the customer will have an opportunity to cancel the switch if he has not authorized it.

The Legislature authorized the PUC to conduct a customer education program, and the program began in February. The early phases of the program are intended to inform customers that retail competition will be coming next January and let them know about the pilot project that begins in June. Later phases of the project will focus on how to compare offers from different REPs and switch to a different REP.

Texas will launch its retail choice pilot market on June 1, 2001. Up to five percent of customers in Texas will be able to pick a different REP in the pilot project. Some REPs have begun advertising in the Texas press and have enrolled customers using toll-free phone numbers and websites. The PUC has certified about fifteen retail electric providers to operate in the State.

The PUC is monitoring advertising for accuracy, compliance with PUC rules, and in response to customer complaints. This includes activities such as verifying the information that must be included in advertising and determining that comparisons to the price-to-beat are accurate. In addition, the PUC is conducting a rulemaking that will require competitive retailers to provide customers with electricity labels that will list the fuel mix of and air emissions from the generating units from which the customers purchased electricity. A key element of this rule is verifying that such claims are true. The PUC has proposed a rule that would establish a verification process for claims related to air emissions that relies on information compiled by Federal agencies, namely the Environmental Protection Agency and the Energy Information Administration (EIA). The EIA has recently proposed modifications to the information (relating to fuel content) that it requires owners of power plants to report to it that might affect the PUC's efforts to validate claims relating to air emissions. We intend to file comments on this issue with the EIA. It is our view that many customers are interested in the subject of air emissions, whether they buy power from a particular plant or not. In our view, there is a significant public interest in making air emission information available to the public.

Retail Supply Issues

Companies were able to request Commission certification as REPs beginning September 2000, and since then about 15 companies have received certification as REPs. The REPs

that intend to participate in the pilot program have begun their marketing efforts. Because of the early stage of the Texas market, we do not have extensive experience with the factors that make a market attractive or not. We have made an effort to make the Texas market attractive to retailers by building a vibrant wholesale market and adopting our rules as early as possible, so that the companies that considered entering the market would have adequate time to reach a decision on whether to enter the market. We have also attempted to standardize the rules across the state by adopting a standard tariff for distribution service and encouraging the development of a statewide standard for electronic communication between REPs and utilities. We also recognize the importance of a customer education campaign. It is our view that most customers will not be ready to choose a new supplier of electricity unless they are prepared by a neutral education campaign that first explains that they will be able to choose a different supplier and then explains how to do so.

Based on the early marketing efforts for residential service for the pilot project, it appears that some of the new REPs will market their service in relation to the rates of the incumbent, the REP that is affiliated with the utility. The pilot project will begin June 1, 2001 for 5% of the customer in Texas. One company has recently begun marketing several plans in Texas that guarantee savings compared to the incumbent's rates. Because the price to beat can be adjusted, these competitive offers will presumably be adjustable in response to changing market conditions as the price to beat is adjusted. Some REPs are also offering fixed rate plans. One feature of the rate offers of the new REPs is that the rates are much simpler than the current rates of the integrated utility. The new offers appear to typically contain a customer charge and a single energy (cents per kWh) charge, as opposed to the blocked energy charges of existing utility rates, in which the rate varies with the level of monthly consumption.

Based on observation of other markets, the difficulties encountered by a new supplier entering other markets include:

- Lack of name recognition;
- Need to spend large amounts to lure customers away from incumbents and their affiliates;

- Uncertainty about the loads a supplier must serve, and corresponding problems in securing long term contracts and managing risk;
- Inability to change retail rates in response to changing conditions in wholesale markets; and
- Low potential profit margins (headroom) in markets with regulated retail rates.

The conditions and incentives that have a potential to attract retail suppliers to retail markets include:

- Predictability of market rules;
- Size of the market;
- Predictability of power and congestion management costs;
- Robust competitive wholesale market;
- Standardized of terms and conditions for distribution service and electronic transmission of information between REPs and utilities;
- Freedom to change retail prices in response to changes in the wholesale market;
- Relatively low price volatility; and
- An effective customer education program.

For the pilot program in Texas, each utility conducted an enrollment process that was open to industrial and large commercial customers for a period of four weeks. A short period was chosen, based on the expectation that interest in the pilot program would be strong among these business customers. Experience has borne this expectation out. The industrial and large commercial pilot programs for all of the major utilities in Texas were over-subscribed, and the utilities have conducted lotteries to select the five percent of customers who will be eligible for the pilot program.

As of April 9, 2001, over 25,000 residential customer had signed up with new providers for service during the pilot project in Reliant HL&P's service territory. This number is approximately 42% of the 5% of current customers eligible to participate in the pilot program. Over 12,000 residential customers have signed up in the TXU Electric service area. In the other utility service areas of the state, few or no customers have signed up for the pilot project. It appears that the new market entrants have focused their marketing efforts in the major metropolitan areas, Dallas, Fort Worth and Houston.

In most utility service territories, the commercial and industrial customer classes were over-subscribed, and lotteries were held by the utilities to determine which customers would be permitted to participate in the pilot. Customer in these groups are currently negotiation with suppliers for service during the pilot, so data on the number of customers that have arranged for service to begin during the pilot is not yet available.

Based on the switching rates for the pilot project, it appears that for small customers acquisition costs and headroom are key factors in determining where new entrants focus their marketing. The Commission has attempted to standardize as many of the business processes as possible in order to reduce costs for new entrants seeking to compete in multiple utility service areas. For example, the Commission has standardized the terms and conditions of access to the transmission and distribution grid so that those terms will be the same no matter where the REP is doing business. The Commission relied heavily on the Coalition for Uniform Business Standards (CUBR) guidelines in developing these rules, in order to conform them to the standards in other states, to the extent possible. In addition, there is a standard switching process in Texas, administered by the ERCOT ISO for all utilities in Texas, that should reduce the administrative costs to REPs of switching customers.

Market Structure Issues

The Texas retail competition law recognizes that independent regional organizations are essential to the development of both retail and wholesale competition and that a competitive wholesale market is a necessary condition for vibrant retail competition. The Texas law prescribes criteria for the competitiveness of the wholesale market. Texas law calls for the creation of independent organizations to perform the following functions:

- (1) ensure access to the transmission and distribution systems for all buyers and sellers of electricity on nondiscriminatory terms;
- (2) ensure the reliability and adequacy of the regional electrical network;
- (3) ensure that information relating to a customer's choice of retail electric provider is conveyed in a timely manner to the persons who need that information (referred to as the customer registration function); and

(4) ensure that electricity production and delivery are accurately accounted for among generators and wholesale buyers and sellers in the region.¹

The Electric Reliability Council of Texas will provide these functions for the ERCOT power region. (Approximately 85 percent of load in Texas is located in ERCOT, which is primarily regulated by the PUC, rather than the FERC.) In addition, the ERCOT organization will begin to operate a single control area for the ERCOT region prior to the implementation of retail access. Furthermore, the ERCOT organization will ensure that information relating to a customer's choice of retail electric provider is conveyed in a timely manner to the persons who need that information, in both the ERCOT region and the non-ERCOT areas of Texas.

For non-ERCOT areas of Texas, FERC Order 2000 requires the creation of regional transmission organizations. The Southwest Power Pool, in conjunction with the proposed Entergy transmission company, is expected to carry out the statutory functions of an independent organization, other than the customer registration function. It is our view that the provisions of Texas law relating to independent organizations are consistent with FERC Order 2000 and that regional organizations can be formed or restructured in the non-ERCOT areas of Texas to meet the requirements of both Federal and State law and foster vibrant wholesale competition in the areas that they operate.

Texas law also prescribes criteria for the competitiveness of wholesale markets in power regions. These criteria require that there be sufficient interconnected utilities under the operational control of an independent organization, that the power region have a generally applicable tariff that guarantees open access to all users of the transmission and distribution system, and that no person own and control more than 20% of the installed generation capacity in the region.

Texas law does not directly require the divestiture of generation assets. The Texas law does require, however, a separation of the generation assets from the transmission and distribution and retail sales operations, and it has provisions for valuation of stranded assets that may lead to the sale of generation assets or the creation of independent

¹ Public Utility Regulatory Act, TEX. UTIL. CODE ANN. § 39.151 (Vernon 1998 & 2001 Supp.).

generation companies. In addition, the statute requires the power generation companies affiliated with the incumbent utilities to auction entitlement to 15% of their generating capacity for a period of four years after the start of customer choice. The statute also imposes a 20% limit on the amount of generation capacity any one company and its affiliates can own in a power region. However, certain existing utility generation facilities are exempted from this 20% limit, so that the largest utility in Texas has a generation market shares greater than 20%.

Texas law mandates the use of market-based methods for valuing stranded assets, other than nuclear generating facilities, that include the divestiture of generation assets. A utility may determine the value of its generation assets through a sale to a third party, the creation of a publicly-traded company that owns its generation assets, or through an exchange of assets with another company. Any of these methods would result in a divestiture where generation assets would be under separate ownership from transmission and distribution assets. In addition, the current financial climate appears to favor generation-only companies. This climate has created financial rewards for companies that separate their generation assets from other assets and then conduct a public offering of the generation assets.

One utility in Texas, TXU Electric Company, has sought to sell a small portion of its generation assets. TXU is the largest generation owner in ERCOT, with about 21,000 MW and roughly 30% of the generation, and it placed 3,116 MW of its generation fleet on sale. It has reported that it has not received attractive offers for these assets. Texas-New Mexico Power Company has recently announced that it plans to sell its sole generating asset, and Reliant Energy plans to transfer its generation assets to a new company which it will then sell in a public offering.

Merger proceedings have also been an avenue for interested parties to pursue divestiture of generation assets. In connection with its merger with Central and South West Corporation, American Electric Power Company agreed to divest 1,600 MW of capacity in ERCOT within two years of the closing of the merger. In another merger proceeding, Xcel Energy and New Century Energy agreed to divest about 3,000 MW in order to

reduce the generation market share of its affiliate, Southwestern Public Service Company (SPS), in the Texas Panhandle. However, legislation is currently under consideration by the Texas Legislature that would relieve SPS of the obligation to divest generation capacity and delay the introduction of retail competition in its service area. (An important consideration for SPS was the enactment of legislation in New Mexico to delay the introduction of retail competition. SPS provides retail service in both Texas and New Mexico.)

There has not been significant consolidation of generation ownership in Texas. Such consolidation is limited by the 20% limit on generation ownership imposed by Texas law. In addition, since the passage in 1995 of Texas law deregulating wholesale electricity markets, the number of independent power producers has increased appreciably. Ten independent power producers who were not active in Texas prior to 1995 have built or are currently building new capacity in Texas. Approximately 8000 Mw of new, independent generation has been built in Texas since 1995, and approximately 12,000 Mw of independent generation is under construction. The largest of the independent power producers, Calpine Corporation, is projected to own about 7% of the generation assets in ERCOT by 2004.

Utilities in Texas will provide transmission and distribution services and will not serve retail customers. However, when retail competition begins, the utilities' affiliated retail electric providers (REPs) will be able to provide service in the affiliated utility's service area to customers who do not affirmatively switch to a different REP and will be able to seek customers in other areas. They will have a limited obligation to serve customers, but there will be a REP that is selected as the provider of last resort, which will have an obligation to serve all customers in an area. REPs will not own generation assets, although most of the utility-affiliated REPs will be affiliated with a power generation company. Some of the new competitive REPs that are entering the market may also have an affiliated power generation company. The Texas PUC has adopted a code of conduct to preclude utilities from subsidizing the activities of competitive affiliates and discriminating against companies that are competing against their affiliates.

The affiliated REPs will have an obligation to provide service to residential and small commercial customers at a rate that is fixed by the PUC. This rate is called the price to beat. The affiliated REPs therefore will have to contract for power on the wholesale market or from their affiliated power generation company for the loads they have an obligation to serve. The affiliated REPs will have broad latitude in how they acquire energy to serve their customers. The PUC has adopted a rule that permits the price to beat to be adjusted for changes in the price of natural gas. It is anticipated that this adjustment mechanism will permit affiliated REPs to adjust their rates with adequate latitude that the rates will cover the cost of buying power in the wholesale market or from an affiliated power generation company. It is our view that the REPs are not exposed to the risk that the utilities in California faced, with fixed retail rates and volatile wholesale prices.

The Texas PUC has primary oversight over all aspects of the ERCOT transmission grid. This oversight includes authority over the ERCOT independent system operator; the rates of all wholesale transmission providers, including public power entities; and construction and siting authority over all transmission providers other than municipally owned utilities.² The exception is the two American Electric Power utilities in ERCOT, Central Power and Light Company and West Texas Utilities Company, whose rates and terms of access are primarily regulated by FERC. Nevertheless, these utilities have requested, and FERC has approved, rates and terms of access that materially conform with the Texas PUC's rules and decisions. The Texas PUC considers its broad authority over the ERCOT grid as instrumental in its success in establishing a robust competitive wholesale market in ERCOT. One of the problems in other areas of the country is that there is not an agency with authority over all of the transmission owners with respect to the organization of regional transmission operations, transmission planning and siting, and transmission rates. Authority is typically divided among the FERC, State PUCs, municipal authorities, and other Federal agencies, such as the Tennessee Valley Authority and the Rural Utilities Service.

² There are no federally owned bulk transmission facilities in Texas.

With respect to the non-ERCOT portions of Texas, FERC has primary oversight over the rates for, and terms of access to, the transmission grid. The Texas PUC has siting authority over all transmission providers other than municipal utilities. Although the Texas PUC does have some ability to promote the construction of bulk power transmission facilities to facilitate competitive wholesale markets in these areas, these areas are located in interstate wholesale markets, and cost recovery for new facilities is dependent upon the policies of the FERC and neighboring states.

The companies that have default service obligations in Texas are the affiliated retail electric providers (REPs) and the REPs that are designated as providers of last resort. They do not receive preferential transmission access under the new market rules in ERCOT. Some entities in ERCOT, the electric cooperatives and municipal utilities that do not opt into competition, may be awarded preferential transmission-congestion rights for a term yet to be decided, for remote resources owned or contracted for by September 1, 1999. Non-ERCOT areas have not yet finalized their congestion management plans. It is likely that in the non-ERCOT areas integrated utilities serving retail customers in states that have not introduced retail competition will have some kind of priority to the transmission system over other users.

The PUC has received very few applications from utilities to build new power plants since the early 1990s. Prior to 1999, there was an integrated resource planning (IRP) process that placed a substantial burden on utilities to justify the need to build new generation facilities. However, the IRP process was repealed in 1999, partly in recognition of the impending move to retail competition.

The Texas Legislature deregulated electric generation at the wholesale level in 1995, which made it possible for non-utilities to build generation facilities in the state. Since then, the PUC has actively encouraged independent power companies to develop non-regulated power plants in Texas. This policy and the wholesale open-access rules adopted by the PUC have stimulated a building boom for new power plants in Texas. Since 1995, a total of 27 new power plants have been built in Texas, amounting to over 9300 megawatts of new capacity. An additional 27 power plants are under construction, which

will add another 14,000 megawatts of power in Texas in the next two or three years. These new plants will increase supply capacity by about 35%. In addition, 31 power plants have been announced for future construction. The new construction of power plants is expected to meet the growing demand for power in Texas. Generation and transmission needs have been identified in the Dallas-Fort Worth Metroplex area, where it is difficult to site transmission lines and the ozone rules make it difficult to build power plants. Each new generation facility must obtain air quality and water discharge permits from the Texas Natural Resources Conservation Commission (TNRCC) before it can operate, but there is not any State siting authority other than the environmental regulator.

In contrast to generation, transmission will remain under regulation. The PUC has recognized the importance of nondiscriminatory transmission access and regional planning to the success of a competitive electricity market. One of the key access policies adopted by the PUC that enabled new power plants to be built in Texas was to require transmission owners to build the facilities to interconnect new generation plants and allow them to reach the market. In ERCOT, the cost of the new transmission facilities will be recovered through transmission rates, rather than through contributions from the developers of the generation facilities. Both reliability and market facilitation are important factors in expanding Texas' transmission systems, and they require a regional planning perspective. The Texas PUC has assigned transmission planning responsibility in ERCOT to the ERCOT organization, to evaluate transmission needs on a regional basis and identify where new transmission lines should be built. The Commission has overseen a significant increase in the number of utility applications for Certificates of Convenience and Necessity (CCN) for transmission lines. Since the introduction of wholesale transmission access, numerous transmission projects have been built to integrate new generation facilities into the market, and several transmission projects are being built or are in licensing review to increase transmission capacity between major sub-regions of ERCOT.

In many areas of the country, the transmission system has stagnated, despite strong economic growth. In the 1990's the economy of most areas of the United States was strong and consumption of electricity grew steadily. Construction of new transmission

facilities has not kept up with the growth in supply and demand of electricity. One of the critical shortcomings in many areas is the lack of a regional organization that is tasked to do regional transmission planning and that enjoys the confidence of transmission owners, transmission users, and regulators. In our view, the development of regional transmission organizations of a size and scope to effectively plan regional transmission systems is a critical need. The autonomy of Federal power agencies and the restrictions on use of facilities financed with tax-exempt bonds are obstacles to the creation of RTOs that include all of the transmission owners in a region. These are areas that warrant Federal legislation.

The Federal government needs to establish strong leadership on transmission policies to support wholesale competition and the growing economy. There is a need for a rational, equitable mechanism for pricing transmission service that will encourage the construction of new facilities. The division of rate-setting authority among the FERC and state regulators represents an impediment to the recovery of the costs of building new transmission facilities. In addition, we question the current transmission expansion policies of many RTOs, where developers of new generation projects must fund construction of new transmission facilities. This policy treats new generation projects differently from existing projects, unfairly permitting existing projects to use the transmission system without making the same capital investment required for new projects. This policy also fails to recognize the nature of transmission networks, which have significant external costs and benefits. The construction of a new transmission line to serve a new customer is likely to have either beneficial or detrimental collateral impacts on the transmission service of others using the same network. These collateral impacts are not easily quantified, and a developer that is asked to fund new transmission facilities has little assurance that the transmission rights he obtains by funding the project will have value as generators are added to the network elsewhere and new transmission projects are built. Finally, imposing such an obligation on developers of new generation will stifle the construction of transmission and generation needed to meet current and projected needs.

The PUC has actively monitored the development of new generation and transmission facilities in Texas to be sure that adequate capacity will be available to meet the growing demand for electricity in Texas. Under regulation, the PUC required a 15% planning reserve margin to maintain reliability and prevent extreme prices. As the retail market becomes competitive, some market players believe that reserve capacity should be left to the market. In contrast, other market players, have encouraged the Commission, as a matter of policy, to require market participants to maintain certain minimum reserve capacity. Currently, given the more than adequate generation capacity in Texas, no specific policies are in place to encourage maintenance of a minimum reserve margin. Nevertheless, a study is underway by ERCOT to evaluate the planning reserve issue, and the PUC intends to initiate a proceeding later this year to determine whether to mandate a planning reserve requirement in ERCOT.

The PUC has put into place rules to encourage and to eliminate obstacles for the development of distributed generation (DG). The rules are intended to ensure that electric customers have access to on-site DG, by prescribing terms and conditions for the connection of small power-generation equipment and establishing technical requirements to promote the safe and reliable operation of DG. The PUC has also adopted a manual for distributed generation that explains how to install DG and is accepting applications from testing laboratories that will certify the DG units. DG has an important role in the competitive market as a price and deliverability hedge for customers. DG is also a valuable resource for companies that need a higher level of reliability in their electricity supply, such a manufacturers with computerized processes and computer server farms.

We appreciate the opportunity to comment on these important issues. If your staff are interested in additional information about the Texas experience, we and our staff would be happy to discuss any issues that you wish to explore in greater detail. Our web site (www.puc.state.tx.us) includes the Public Utility Regulatory Act, the rules adopted by the Commission to implement the Act, and reports relating to the electric industry in Texas.



Pat Wood, III, Chairman



Brett Perlman, Commissioner

Date: *May 1, 2001*