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Retail Market Overview of Texas

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Contents

1. Description of structure for distribution companies in a context of a retail market considering benefits and costs associated with Texan model
2. Description of responsibilities of distribution companies and best model considering small users perception of service and electricity costs
3. Mechanisms to ensure investments on distribution infrastructure
4. Regulatory and market tools for congestion management



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1. Description of structure for distribution companies in a context of a retail market considering benefits and costs associated with Texan model



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Structural Unbundling

- **Incumbents required to separate business activities into the following units.**
 - Power generation company.
 - Retail electric provider.
 - Transmission and distribution utility.
- **Generation and retail businesses are not regulated utilities.**
 - Power Generation Companies must be registered with PUC.
 - Retail Electric Providers must be certified by PUC.
- **Transmission and distribution businesses remain regulated utilities.**
- **Methods for separation of business activities.**
 - Creation of separate non-affiliated companies.
 - Creation of separate affiliated companies owned by a common holding company.
 - Sale of assets to a third party.
- **PUCT Code of conduct rules enforce separation requirements.**



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Transition Period

“Affiliated” generators

- Required to make 15% of their power available to non-affiliated retail providers
- During first two years, limited to guaranteed market price for power as projected by PUC
- Given incentives to install environmental clean-up equipment

Transmission and Distribution Utilities (TDUs)

- Initial rates set using estimated/generic costs
- Recovery of stranded and other transition costs authorized
 - Use of Securitization bonds lowered cost to customers

“Affiliated” retail electric providers (REPs)

- Required to lower base rates by six percent (Price to Beat)
 - Adjusted only for increases in natural gas prices
 - Price to Beat remained in place until 12-31-06



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Customer Protection & Public Confidence

PUC Customer protection rules provide strong safeguards

- Apply to all REPs
- Anti-slamming / anti-cramming
- Information disclosures / advertising requirements
- Anti-discrimination provisions
- Do not call” list
- Privacy of Customer Information
- Credit and Deposits
- Billing
- Disconnection of Service
- Terms of Service Statement
- Electricity Facts Label



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Unbundling Generation

- Statute and Rules Address Market Power and Generation Merger Issues
 - Independent Market Monitor oversees wholesale market operations.
 - Generating capacity owned and controlled by a Power Generation Company limited to 20% of installed generating capacity capable of delivering power to a power region.
 - Administrative penalties for market power abuse were reviewed and updated during the 79th Regular Session.
 - Mergers of Power Generation Companies subject to PUC review.



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Business Climate for Generators

- In ERCOT, generation companies assume all of the financial risk included in a new generation projects.
- The decision to build new generation thus depends upon whether the generator believes the electricity can be sold at a price to recoup construction costs, cover operations and maintenance costs and achieve a profit.
- Market forces have been effective in bringing new generation to the state, with over 46,000 MW of generation constructed since the advent of wholesale competition in 1995



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Results

Competition has brought greater efficiency to the wholesale market

1. Generators shoulder the risk of building new power plants, bringing efficient, cost-effective generation to consumers.
2. New power plants produce more electricity per unit of fuel.
3. New power plants include modern environmental emissions controls.



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“Texas has the most robust retail competition anywhere in the country. I think that’s a fantastic experiment to see how that’s moving forward and to see how that plays out to the benefit of Texas consumers.”

(Jon Wellinghoff, Former Federal Energy Regulatory Commission Chairman, *Texas Tribune*, Dec. 7, 2011)



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2. Description of responsibilities of distribution companies and best model considering small users perception of service and electricity costs



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Transmission and Distribution Utilities

- Provide reliable delivery of electricity on a 24-7 basis.
- Invest in and build infrastructure (e.g., transmission lines, Smart Grid) to support the needs of Texas' growing economy.
- Manage their transmission networks under the direction of ERCOT; coordinating with ERCOT on transmission planning activities.
- Respond to outages (e.g., storms, natural disasters) that affect the grid and restore service as quickly as safely possible.



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Transmission and Distribution Utilities

- Provide key market information, such as premise information and metering services to facilitate successful operation of the ERCOT deregulated market.
- Provide regulated transmission and distribution services to facilitate operations of wholesale and retail business entities.
- Charge regulated delivery rates to REPs
 - Rates based on a historical cost of service including a PUC-established return on capital investment Allocation of ERCOT-wide transmission costs
 - Non-bypassable charges include the cost to deliver electricity, System Benefit Fund, recovery of true-up costs and nuclear decommissioning expenses for existing nuclear facilities



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3. Mechanisms to ensure investments on distribution infrastructure



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Recovery for Distribution Investment

- Utility companies have for many years been seeking a similar type of streamlined recovery mechanism for distribution investment.
- For transmission and distribution utilities, about 2/3 of their rate base, on average, is related to distribution.
 - For the state's two largest utilities—Oncor and CenterPoint—that translates to over \$5 billion and about \$2.5 billion, respectively.



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Changes in Ratemaking

New legislation adopted:

- Provides for streamlined PUC proceedings that would authorize recovery of and on new distribution investment, along with related taxes.
- Does not provide for recovery of expenses (this provision is same as interim TCOS rule).
- Applies to both ERCOT and non-ERCOT (still vertically integrated) utilities.
- Provides for municipalities' continued original jurisdiction over a utility's rates (with PUC having appellate jurisdiction, as it has currently).



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Changes in Ratemaking

New legislation adopted: *(cont)*

- Provides for rate updates on an annual basis, but limits utilities to four PRA increases between full rate cases.
- Provides that new rates resulting from the PRA should reflect the effects of any increases in base-rate revenue resulting from load growth.
- Provides that PUC rules shall require utilities to file earnings reports that allow the PUC or regulatory authorities to determine whether the utility is over-earning.
- Has a six-year sunset provision (the law expires August 31, 2017).



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4. Regulatory and market tools for congestion management



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Texas Transmission Policy

- Texas policy has supported construction of new transmission
 - Centralized transmission planning
 - Commission support for new transmission
 - Cost-recovery mechanism for transmission investment
- These policies have resulted in new, efficient thermal generation and supported new wind generation
- Competitive wholesale and retail markets have also supported construction of new wind generation



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Texas Transmission Policy

- Texas policy has favored market entry by new generation facilities and companies
 - Standard interconnection agreement
 - Unbundling of generation and transmission and neutral planning organization
 - Transmission upgrades in regional rates
- Texas policy has favored competition among generators
 - Regional postage-stamp rate
 - Congestion managed through energy prices, transmission revenue rights

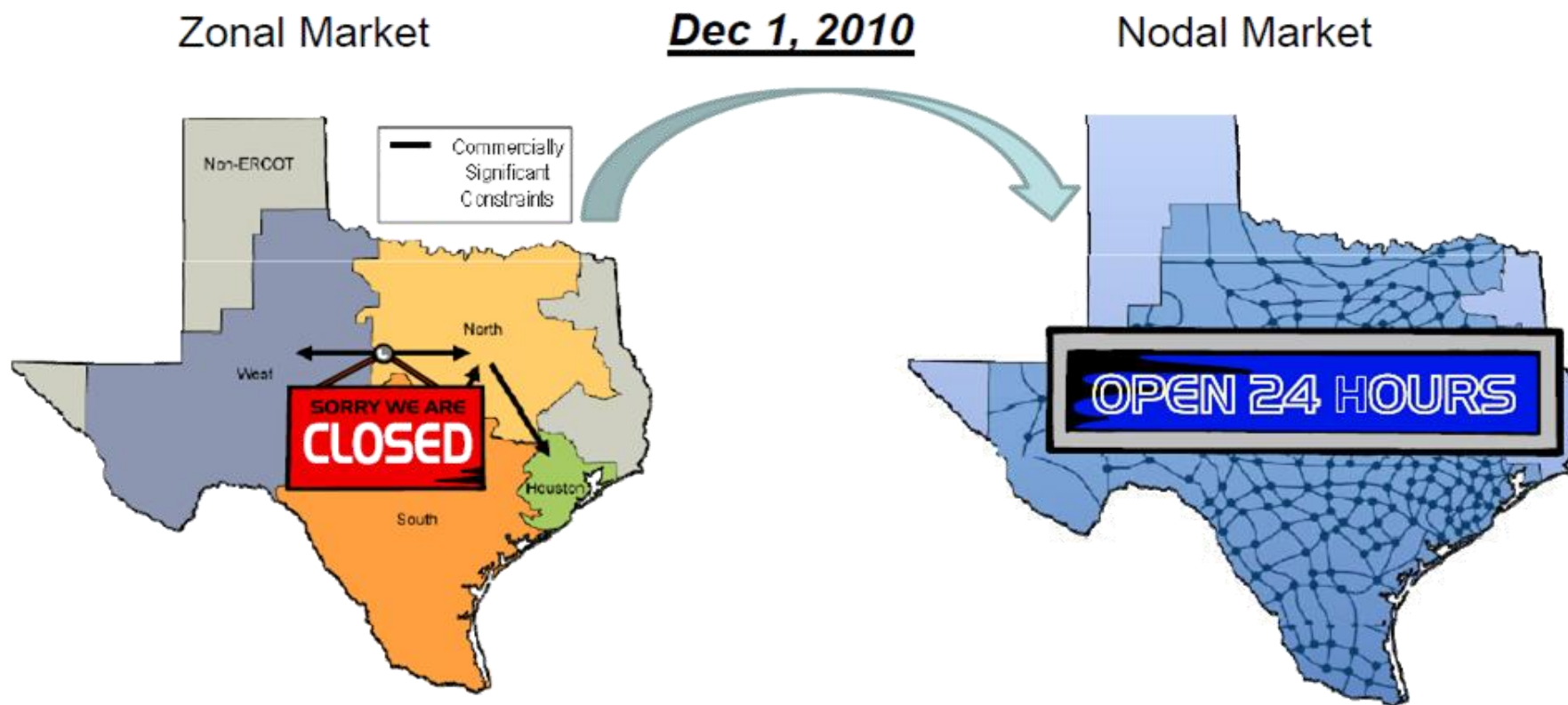


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Transition to Nodal Market



Source: ERCOT



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Competitive Renewable Energy Zones

- Stalemate arose between transmission and generation over construction of long transmission lines from West Texas
 - Transmission providers wanted financial commitment from generators
 - Developers concerned about cost and risk of financial commitment
- 2005 Legislation
 - Designate zones for renewable energy development
 - Develop transmission plan
 - Consider level of financial commitment in designating zones and granting CCNs



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PUC Proceeding on Competitive Renewable Energy Zones

- PUC initiated CREZ proceeding--December 2006
- ERCOT filed generic wind/transmission study--December 2006
- Wind developers submitted evidence of financial commitments--March 2007
- PUC ordered transmission study of four scenarios--October 2007
- ERCOT filed transmission study of PUC scenarios and ancillary service study--April 2008
- PUC issued CREZ final order--October 2008



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Appendices



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Non-ERCOT Transmission

- Wholesale open access transmission rights subject to Federal Energy Regulatory Commission (FERC) jurisdiction.
- FERC transmission pricing reflects location of generation.
- FERC requires generators to bear higher cost relative to the ERCOT system of connecting with the transmission grid.
- Certification in Texas is with the PUC.
- Recently adopted PUC rules allows most non-ERCOT utilities to recover transmission investments between rate cases through a transmission cost recovery factor (TCRF).



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Traditional Utility Ratemaking

- Regulatory Objective: On behalf of the public, attempt to replicate the results that would be achieved by competition within the context of a monopolistic company operating in a regulated industry
 - ➔ By its very nature, the administrative process of rate proceedings results in filing costs, litigation costs, processing costs, and various other types of administrative costs



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Basic Purpose of the Ratemaking Process

- Develop the utility's revenue requirement (i.e., the utility's reasonable cost of service)
 - Design rates to recover cost of service
 - Cost of Service study is developed to allocate the utility's revenue requirement to various customer classes (e.g., residential, commercial, industrial)
 - Rates are designed, based on the Cost of Service study, to recover the utility's revenue requirement from the various customer classes
- ➔ Conceptually simple process, but massive undertaking in relation to effort and information required to complete process



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The Rate Filing Package (RFP) Filing Requirements – General

- Generally, there are standardized requirements for filing statements and schedules
 - Rate filing packages contain instructions and schedules for presentation of data
- Supporting data includes adjustments and other computations and information on which the applicant relies to justify the proposed rates
- Various other documents may be filed as required and/or pursuant to discovery



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The Rate Filing Package Prepared Testimony

- An RFP must be accompanied by the applicant's prepared testimony
 - Examples: General policy issues, Cost of Service, Rate Design, Rate of Return, Accounting, Depreciation, etc.
- Testimony and other forms of evidence (e.g., responses to requests for information) of the applicant and all other parties must be filed with the commission, with copies to each party of record



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The Parties—Applicant/Utility

- Rate case team will be inter-departmental and will include participation from:
 - Accounting
 - Finance and Budgets
 - Rates (rate design, cost of service, tariff management)
 - Economists
 - Engineering
 - Legal
- Outside consultants and experts are also often involved
 - Example: Cost estimates to decommission nuclear generation plants



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The Parties—Applicant/Utility

- Rate case team must:
 - Develop and review work papers and schedules
 - Develop and review testimony
 - Coordinate submission of the RFP including testimony, work papers and schedules
 - Conduct research and respond to discovery
 - Assist in development of direct and cross-examinations of witnesses for all parties
 - Maintain cross-referenced records and supporting documentation



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The Parties—Intervenors

- Parties interested in playing an active role in proceedings
 - Friends and foes
 - Could include State-appointed rate/consumer advocates, other utilities, competitors, independent consumer groups, legislators
- Interested intervenors must file motion, and have motion granted, to formally intervene in a rate proceeding



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The Parties—PUCT Staff

- Inter-departmental representatives on Commission's case review team
- Requires expertise in:
 - Electric and energy industry issues
 - Economics
 - Accounting and Finance
 - Legal and regulatory issues and analysis
 - Engineering



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Regulatory Timeline

- Hearings
 - Presentation of evidence and development of record
 - Witnesses may be cross-examined by commission staff, opposing counsel and commissioners/hearing examiner, as appropriate
- Settlement conferences
 - Any settlement needs commission approval
- Findings by hearings judge (hearings examiner)
 - Includes recommendation to commission



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Regulatory Timeline

- Commission Order
 - Based on evidentiary record developed at hearing
 - Adopts, modifies or rejects hearing examiner's recommendations
 - Motions for Rehearing, Rehearings
 - Appeals
- ➔ After Commission decision, tariffs are revised and compliance tariffs filed



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Compliance Tariff

- Utilities make tariff filings consistent with the Commission's Final Order.
- Tariff contains the provisions that the utility operates under (standardized Pro-Forma Tariff).
- Tariff contains Rate Schedules and Riders for all of the Rates to be charged to customers per the Rate Case.
- Tariff is the official document that reflects Commission decisions with which the utility must comply.



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Tariff Changes

- Non-substantive changes to tariffs can be requested and approved on an expedited basis.
- Changes in Riders (such as surcharges) can be made by the Commission on a case-by-case basis.
- Changes in the Rates contained in the Rate Schedules can only be changed as the result of a Commission Order in a Rate Case.



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Tariffs—other issues

- Time-of-use tariffs have traditionally not been used in Texas
 - With advent of advanced metering technology, time-of-use tariffs may become more common
 - “Dynamic pricing” can include time-of-use rates, which are different prices for different blocks of time over a day.
 - Dynamic pricing can also include real-time pricing, in which actual market prices are transmitted to consumers, generally in increments of an hour or less.
 - Dynamic pricing can actually improve system reliability because it can help alleviate peak-period consumption and strain on the system
- Cross-subsidization from tariff implementation is typically a consequence of rate-design decisions.
 - Cross-subsidies may sometimes be justified on policy grounds (more later)