

## Questionnaire

Public Utility Commission  
Electric Reliability Council of Texas  
Office of Public Utility Counsel

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### Organizations you represent:

Cities Aggregation Power Project, Inc. (with 102 political subdivision members)  
South Texas Aggregation Power Project, Inc. (with 51 political subdivision members)  
Steering Committee of Cities Served by Oncor (with 146 city members)

### Public Utility Commission

#### 1. What changes should be made to the mission or functions of the Public Utility Commission (PUC), given today’s more competitive telecommunications and electricity markets?

The state’s PUC Commissioners are some of the state government’s most enthusiastic advocates for electric competition. The agency’s leaders rarely miss an opportunity to promote the concept of deregulation in general, and the Texas experience in particular. Moreover, the Commissioners’ philosophical cheerleading has permeated the entire agency, revealing it to be an organization more interested in defending deregulation theory than in working for meaningful protections that benefit all ratepayers. But in its zeal to excuse the failure of deregulation to deliver lower prices, the PUC appears to have lost sight of what should be the agency’s core mission: service to and protection of consumers.

Texans have gone from a long history of pre-deregulation rates that were below the national average to post-deregulation residential rates now consistently above the national average. This price switch is not simply reflected in two cherry-picked data points on a timeline, but rather is reflected in long trend lines that extend for more than a decade. Texans also pay prices well above those paid by residents in nearby regulated states — even those states that rely upon similar fuels for their electric generators. A recent survey has shown that even the **lowest cost** electricity deals from our state’s competitive electric suppliers cannot match the average prices of electricity in regulated Louisiana and Oklahoma.

But instead of acknowledging these realities and prioritizing policies designed to get Texas rates back in line, the PUC has stated in its self-evaluation report that not only are above-average rates acceptable — but they are a policy **target**. As noted on page 17 of its self-evaluation report, the PUC identifies its “target” for residential electric prices as those prices that are 113 percent of the national average. The same self-evaluation report also notes that Texas exceeded this target because its rates were even **higher** — that is, instead of paying rates just 13 percent above the national average, residential customers of the state’s competitive electric suppliers instead paid rates nearly 30 percent above the national average.

The Sunset process should force the PUC to harmonize the pursuit of competition with the protection of consumers of electricity with a slight modification of the statutory purpose for the PUC. PURA should be changed in the following manner:

Sec. 39.001. LEGISLATIVE POLICY AND PURPOSE. (a) The legislature finds that the production and sale of electricity is not a monopoly warranting regulation of rates, operations, and services and that the public interest in competitive electric markets requires that, except for transmission and distribution services and for the recovery of stranded costs, electric services and their prices should be determined by customer choices and the normal forces of competition. As a result, this chapter is enacted to protect the public interest ~~during the transition to and the establishment of a fully competitive electric power industry.~~ by minimizing consumer costs while facilitating the further development of a competitive electric power industry.

**2. How effectively does the PUC carry out its enforcement and consumer protection functions? Are there changes that you would recommend?**

The PUC has exercised too light a hand with regards to its enforcement and consumer protection responsibilities. But electric competition cannot flourish without strong market rules and aggressive consumer protections. Ensuring both is more important than ever.

Examples of policies that neither benefit consumers nor enhance competition include a 2008 fine against TXU for \$15 million. The agency touts it as the largest fine in its history. In reality, it should have been much greater. According to findings from the PUC's own staff, the fine failed to match even the level of illicit profits TXU received because of its anti-competitive behavior. Such a weak slap on the hand does not protect consumers, nor does it enhance competition. At a minimum, the PURA should require disgorgement of profit from anti-competitive actions.

Similarly, the PUC recently adopted rules whereby Retail Electric Providers (REPs) are required to send out customer notices 30-60 days in advance of the expiration of fixed-rate contracts. However, separate rules also allow REPs to charge early termination penalties up to 14 days before contract expiration. This disconnection in timing means that REPs can punish fixed-rate customers who, upon receiving notice that their contract is about to expire, immediately sign up with a competitor. Conversely, REPs can waive early termination penalties for those customers who, upon receiving notification that their contract is about to expire, agree instead to lock in another long-term deal with the original REP. Either way, this increases customer "stickiness" in the Texas electricity market, which neither enhances competition nor benefits consumers.

We would recommend the following policy changes:

- The PUC must more vigilantly monitor the market. More resources should be assigned to enforcement activity, fines should be increased, and potential violators should be put on notice that abusive behavior will not be tolerated.

- The REP or Transmission and Distribution Utility (TDU) should compensate the consumer through billing credits or direct payments for the failures of companies to deliver services that meet the service standards set by the PUC. The PUC should establish standard fines for billing errors, violation of disconnection rules, and other common rule violations.
- The PUC should create standard offer electricity products. Like the requirement that homeowner's insurance companies were under for years, REPs should be required to include among their offers one standard electricity package that has PUC-approved terms and conditions. Such standard offer products will ensure that REPs compete based on price, not on customer confusion.
- REPs should be required to employ only standardized contracts approved by the PUC. REPs should be prohibited from creating new fees that are not specifically required by the PUC.
- The PUC should be directed to prohibit pre-paid electricity contracts.
- Fines should be increased for market abuses in such a way that the PUC can order full restitution to the market, market participants, or parties injured by the violation. This would track some of the language in the PUC's self-evaluation report. As per deceptive trade practices law, violators also should be subject to fines set at three times the value of the harm caused to the market or market participants.
- The PUC enforcement division should be required to create monthly reports to indicate what enforcement actions have been initiated and the total amount in fines for the month. The monthly report would be posted online. Metrics should be established to evaluate the enforcement division on an annual basis. The PUC should also create monthly reports on complaints and how they have been resolved.
- The PUC should be required to establish a public relations campaign on an annual basis to publicize the role of the enforcement division. All publications and advertisements of the REPs should be reviewed by the PUC's enforcement division to make certain they contain no false, misleading or deceptive communications.

**3. How effectively does PUC discharge its regulatory responsibilities over telecommunications providers? Are there changes that you would recommend?**

No recommendation.

**4. What improvements could be made to the telecommunications assistance and high cost programs in the Universal Service Fund and the energy assistance programs in the System Benefit Fund?**

System Benefit Funds (SBF) should be used only for the purposes originally included in the legislation (i.e., rate discounts; bill payment assistance for the ill and the disabled; weatherization; customer education and administration). Therefore, all the revenue collected for the fund and accrued interest on the fund should be fully appropriated for the originally intended purposes. The SBF should be restructured as a trust fund outside the treasury with PUC oversight in the same manner as the

telephone Universal Service Fund. Budget guidelines should be established to simplify the process of establishing annual budgets for SBF programs.

**5. How effectively does PUC discharge its regulatory responsibilities over the electric industry? What changes are needed to ensure effective regulation?**

As previously noted, the agency in recent years has cast itself less as a regulator and more as a cheerleader for deregulation. As such, it has allowed potentially anti-consumer practices to continue unchecked. It also has failed to discharge its oversight responsibilities with regards to those entities that continue to be regulated, such as the state's transmission and distribution utilities. For example, the Commission increasingly allows utilities to add insufficiently-reviewed surcharges and cost-recovery factors onto consumer bills. Such surcharges are implemented outside the regular rate review process, and as a consequence, their reasonableness cannot be determined until it is too late to do much about them.

As such, we recommend:

- The PUC should immediately re-evaluate existing utility surcharges when those utilities experience relevant changes. In October 2009, for instance, CenterPoint Energy Electric received \$200 million in stimulus funds to help underwrite the cost of installing advanced meters throughout its distribution system. To date there is no plan to reduce the surcharge approved by the PUC to pay for the meters.
- The PUC should be directed to specifically prohibit the future use of such surcharges or cost-recovery factors, the practice of decoupling rates from actual cost of service, or other alternative ratemaking practices that result in piecemeal ratemaking. Such practices needlessly drive up rates.
- The cost of compliance with the PUC's customer protections should be built into rates — not separated out in separate fees.

**6. How effectively does PUC monitor the wholesale electricity market?**

Wholesale electricity prices in Texas often surpass levels one would expect from a market with healthy competition. Troubling evidence has emerged that design flaws in the state's wholesale electricity market allow companies to act like monopolists at the expense of consumers. In 2007, for instance, a report determined that TXU (now Luminant) had been a "pivotal" supplier at least half the time, meaning that it had the ability to unilaterally impact prices in the balancing energy market — regardless of the actions of its competitors — during long periods.<sup>1</sup> TXU also engaged in activities in 2005 that the PUC staff characterized as abuse of the market, and a separate company in 2007 acknowledged engaging in practices in Texas that appeared very similar to hockey stick bidding, which has been found to violate market rules elsewhere in the nation.<sup>2</sup>

Given these realities one might expect extra vigilance from the Commission. But the PUC has avoided course corrections and on occasion even repealed useful protections. In 2006, for instance, the PUC increased wholesale price caps to levels well above those in other jurisdictions. It also has

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<sup>1</sup> R.A. Dyer, "PUC: TXU may be too dominant," *Fort Worth Star Telegram*, Jan. 29, 2004.

<sup>2</sup> Parviz Adib and Jay Zarnikau, "Will the Texas market succeed," page 11, 2007

reversed a long-standing “sunshine policy” whereby ERCOT was required to quickly identify market participants that sold electricity on the spot market at prices well above marginal cost. The PUC, in its self-evaluation report, also notes that it had not conducted a single investigation for abuse of market power, market design, or anti-competitive behavior during the 2008 fiscal year.<sup>3</sup> As previously noted, a recommended \$210 million fine against TXU for anti-competitive behavior was whittled down by the Commission to a mere \$15 million — which is even less than the \$20 million profit that the company reportedly reaped from its improper behavior.

Often, this hands-off approach is defended by claiming that the future nodal system will resolve many problems, or by claiming that the Independent Market Monitor will protect the market against abuses. Consumers should not take solace in either defense. A study by the American Public Power Association has found that nodal systems in other jurisdictions have not led to customer savings, nor have they reduced market abuses as advertised. Moreover, the Independent Market Monitor has not been found to be a strong consumer ally. He has called for policies that could lead to higher and more frequent price spikes in the wholesale market, and has not recommended the PUC begin any new enforcement actions for market abuses since at least 2007.

As such, we recommend that the PUC be given these additional tools and direction to police the market:

- Prohibit the five percent-of-market share safe harbor for market abusers. Under current rules, generators with less than five percent of the market are not deemed to have market power. As such they have a free hand to abuse the ERCOT market.
- Prohibit hockey stick bidding and prohibit any activities defined as market abuse by the Federal Energy Regulatory Commission.
- As stated above, maximum permissible fines should be increased for market abuses in such a way that the PUC can order full restitution to the market, market participants, or parties injured by the violation. As per deceptive trade practices law, violators should be subject to fines set at three times the value of the harm caused to the market or market participants. While a regulatory body should have reasonable discretion in the penalties it imposes, companies found to be engaging in any sort of anti-competitive behavior should be required, at a minimum, to disgorge profits associated with anti-competitive behavior.
- Create more transparency within the ERCOT spot market by requiring extensive disclosure of information about bidding in the wholesale market within two days of the bid, instead of the current 60 days. An independent study has found that with such additional transparency, Texas electric consumers could potentially save nearly \$1 billion annually — or more than \$50 per year for the average household.
- ERCOT should be directed to develop a wholesale pricing mechanism that better reflects the actual cost of generation, and re-examine current requirements whereby the price to each successful seller in the spot wholesale market for energy or capacity is established by the highest-priced bid accepted by ERCOT.

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<sup>3</sup> “Public Utility Commission of Texas Self-Evaluation Report,” September 2009, page 17.

**7. What changes should be made in the ways that PUC oversees the Electric Reliability Council of Texas (ERCOT)?**

- Make debt financing by ERCOT conditioned on prior approval by the PUC.
- Require the PUC to annually contract for an independent audit of ERCOT, with alternating financial and market protection reviews.

**8. Should PUC be continued for 12 years? Why or why not?**

Yes, with significant changes in the statute to require protection of consumers against market abuse and require pursuit of least cost regulated rates.

**Electric Reliability Council of Texas**

**9. Should the structure of the ERCOT Board be modified? If so, how?**

House Bill 2421, from the 81<sup>st</sup> Texas Legislature, included several useful reforms relating to ERCOT. That legislation fell victim to unrelated political maneuvering during the final days of the session and failed to pass. We believe many of the good ideas from HB 2421 should be resurrected and built upon. Namely:

- Increase the number of consumer representatives on the ERCOT board. Specifically, increase consumer representation from the current three members, to six. This can be achieved by giving the AG's office one seat to represent state consumer interests, giving cities one seat to represent municipal consumer interests, and assigning one citizen ratepayer to the board with the requirement that he or she is a consumer of electricity in the open market, and that he or she has no financial association or interest with any member of ERCOT, other than that of being a customer of a member company of ERCOT.
- Build upon the original recommendations of House Bill 2421 by removing electricity-asset-owning representatives from the board.

**10. How effectively does ERCOT staff manage the budget and operations of the organization?**

ERCOT has done a poor job of managing expenses and operations. The nodal project is the most obvious example. Initially projected to cost less than \$80 million and to be complete by 2006, the nodal system is now four years behind schedule and budgeted to cost more than \$640 million. Overall expenditures and debt financing at ERCOT also have increased steadily. A management breakdown at ERCOT allowed a criminal conspiracy to take hold inside the organization, leading to several arrests and prison sentences.

As such, we make the following recommendations:

- ERCOT should be required to reduce its dependence on the ERCOT Fee and Nodal Fees to cover costs. By 2012, ERCOT's budget should be supported by an ERCOT Fee of no more than 25¢ per MWh. All other expenses should be recovered directly from ERCOT's for-profit members.

- The Office of the Comptroller should be assigned a seat on the board as well as appropriate budget oversight panels at ERCOT. The Comptroller's office should be given access to all ERCOT contracting material and be charged with conducting a bi-annual performance review of ERCOT similar to those state agency reviews conducted by the Comptroller's office between 1991 and 2005. The Comptroller's office should release an ERCOT scorecard in advance of each regular legislative session.
- Make debt financing by ERCOT conditioned to prior approval by the PUC.
- Make ERCOT subject to open records laws, with appropriate exceptions for trade secrets. In the alternative, direct the PUC to establish rules consistent with Texas open records laws, including the creation of an appeal process to handle information disputes.

**11. How well does ERCOT balance its role in managing the wholesale electricity market with its duty to ensure reliability? Would you change this balance and, if so, how?**

ERCOT exercises its management duties of the wholesale electricity market and its duties over grid reliability through a stakeholder process that remains dominated by big industry players. These players pursue interests often at odds with those of consumers. As such, consumers should be given a greater voice at ERCOT, as per the recommendation in Question No. 9, above. That is, double the number of consumer representatives on the ERCOT board and remove electricity-asset-owning representatives from the board.

Reliability will increasingly involve questions of water rights, right-of-way acquisition, plans of private, unregulated entities that are driven by profit motives when deciding where to locate generation and transmission facilities, changing weather patterns that may be influenced by global warming, and federal and state laws that may compel conservation. System reliability should not be dependent upon private, profit motivated individuals, but rather the State of Texas should assume ultimate responsibility for ensuring a dynamic grid that considers and balances all the foregoing and other factors with customer demand for electricity. This effort should require coordination of the TCEQ and the PUC and should require all private parties to give notice of expected generation siting at least 18 months before commencing construction.

**Office of Public Utility Counsel**

**12. What changes should be made to the mission or functions of the Office of Public Utility Counsel, given today's more competitive telecommunications and electricity markets?**

No recommendation.

**13. Should the Office of Public Utility Counsel be continued for 12 years? Why or why not?**

No recommendation.

**Other**

- 14. Please add any other comments or recommendations you may have on any of these three agencies. If you suggest any changes, please provide:**
- **background information on how the current system works and a description of what you would like to see changed,**
  - **benefits of your recommendation, and**
  - **any potential difficulties that may arise from implementing your recommendation.**

No recommendations.

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