

SUNSET ADVISORY COMMISSION

Staff Report

*Public Utility
Commission of Texas*

*Electric Reliability
Council of Texas*

*Office of Public Utility
Counsel*

April 2010



Sunset Advisory Commission



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In 1977, the Texas Legislature created the Sunset Advisory Commission to identify and eliminate waste, duplication, and inefficiency in government agencies. The 12-member Commission is a legislative body that reviews the policies and programs of more than 130 government agencies every 12 years. The Commission questions the need for each agency, looks for potential duplication of other public services or programs, and considers new and innovative changes to improve each agency’s operations and activities. The Commission seeks public input through hearings on every agency under Sunset review and recommends actions on each agency to the full Legislature. In most cases, agencies under Sunset review are automatically abolished unless legislation is enacted to continue them.

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

SUNSET STAFF REPORT
APRIL 2010

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Summary

Summary

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

The Public Utility Commission is the most reviewed of all agencies subject to Sunset evaluation, possibly because of the dynamic nature of electric and telecommunications industries in Texas in the last 15 years. Reflecting the changing needs of times past, reviews have led to the creation of the Office of Public Utility Counsel (OPUC) in 1983, promotion of telecommunications and electric deregulation in 1995, and the continuing shift to more competition with greater market oversight and consumer protection in 2005.

The current review intersects electric and telecommunications industries five years later, at a time when market forces and technological advances were expected to hail still greater change. For all these expectations, much remains the same as in 2005. PUC continues to regulate monopoly providers and to protect consumers in competitive markets through rulemaking, investigation and enforcement, and complaint resolution. The Electric Reliability Council of Texas (ERCOT) still manages the electric grid for three-quarters of the state to ensure the lights stay on and to operate key components of the competitive electric marketplace. OPUC maintains its charge to represent residential and small commercial consumers in both rate regulated and deregulated environments.

For all the expectations for market and technology change, the needs of utility regulation are much the same as in the last Sunset review in 2005.

Recent legislative decisions have set a clear market-oriented policy for overseeing electric and telecommunications utilities, which Sunset staff did not attempt to re-evaluate. For this reason, the report does not contain new regulatory requirements to force desired behavior by retail electric providers such as through standard offers, forms, or contracts; or through mandates for purchasing excess renewable generation from customers. In addition, Sunset staff could not devise the future direction and scope of state policy on promoting energy efficiency and renewable resources, especially in light of PUC's current efforts in these areas, which follow up on recent legislative proposals. In the telecommunications arena, the federal government is now considering major changes to promote broadband deployment, but the role the State should play, if any, is far from clear.

Because of these timing issues and policy decisions, Sunset staff concentrated on operational issues to improve PUC's ability to oversee these increasingly competitive markets to better protect consumers. Staff also evaluated statutory impediments that hinder the progression to more competition in

the telecommunications industry. Overall, staff found PUC to be effective in dealing with complex issues while contending in some cases with antiquated statutory provisions. Sunset staff also focused on ways to improve accountability and objectivity of ERCOT, given the high risk inherent in ensuring electric grid reliability and managing the electric marketplace for the majority of Texans. Staff also determined that OPUC was still needed to advocate for residential and small commercial consumers of electric and telecommunications services.

This Sunset cycle does offer an excellent opportunity for a comprehensive evaluation of consolidating utility oversight. This opportunity arises because the Railroad Commission, which regulates gas utilities, and the Texas Commission on Environmental Quality, which regulates water utilities, are also subject to Sunset review this cycle. Staff's determination of the benefits or drawbacks of utility consolidation will be made after the upcoming reviews of these two agencies.

The following recommendations address the issues from the review of PUC, ERCOT, and OPUC.

Issues and Recommendations

Public Utility Commission

Issue 1

PUC Lacks Regulatory Tools Needed to Provide Effective Oversight and Prevent Harm to the Public.

Since 1995, the Legislature has enacted laws transitioning electric and telecommunications industries from traditional rate regulated monopoly markets to restructured markets open to competition. In these restructured markets, PUC relies on licensing-related functions to achieve oversight instead of focusing on rate regulation. These functions include granting businesses operating authority, resolving consumer complaints, and taking enforcement actions against violators.

PUC still lacks a degree of regulatory authority necessary for effective oversight in these restructured markets. Needed provisions would provide for restitution authority, additional administrative penalty authority in limited areas, and stronger registration and renewal authority to ensure continued responsibility by market participants. These revisions would allow PUC to better oversee Texas' restructured markets and improve PUC's ability to resolve issues in these markets as they continue to evolve.

Key Recommendations

- Authorize PUC to order restitution to market participants harmed by market power abuse.
- Increase PUC's administrative penalty authority to \$100,000 per violation per day for violations of ERCOT's reliability protocols or PUC's wholesale reliability rules.
- Authorize PUC to issue emergency cease-and-desist orders.
- Authorize PUC to require, by rule, renewal of registrations, certifications, and permits as it deems appropriate, and set fees to recover costs.

Issue 2

Outdated Statutory Provisions Make PUC's Regulation of the Telecommunications Industry Unnecessarily Restrictive.

The State has established a policy to provide for competition in the telecommunications market so that customers can benefit from innovations in products and services. Telecommunications statutes, however, weave a tangled web of old and new, highly interrelated policies and requirements that work despite their complexity. Eventually, the inexorable march of technology will cause a broad restructuring of the market and the statutes governing them. For now, Sunset staff has addressed more limited statutory impediments that stand in the way of this transition of telecommunications to a more competitive industry.

The statute contains an outdated provision for determining whether telecommunications markets with a population between 30,000 and 100,000 are competitive and should be deregulated. This statutory test is overly restrictive and inflexible and has not kept up with changes in technology. One result of this outdated policy could be the lack of any new markets being deregulated since 2005. Further, statutory provisions requiring telecommunications providers to submit contracts for competitive services to PUC and establishing extended area service no longer benefit PUC or the public.

Key Recommendations

- Eliminate the statutory test for deregulating a telecommunications market with a population between 30,000 and 100,000, replacing it with a test developed by PUC in rule.
- Eliminate the requirement for PUC to approve customer-specific contracts.

Issue 3

Consider the Administrative Structure of Utility Regulation Following Reviews of the Railroad Commission of Texas and the Texas Commission on Environmental Quality.

Regulatory oversight is still needed for Texas' essential electric and telecommunications industries. The State needs to regulate remaining electric and telecommunications monopoly utilities to ensure just and reasonable rates and high quality service. In addition, the State still needs to oversee the competitive aspects of the electric and telecommunications markets because of their complexity and the potential for fraud and abuse.

The bigger question is the organizational structure that this oversight should have. The upcoming Sunset reviews of the Railroad Commission, which is responsible for regulating gas utilities, and the Texas Commission on Environmental Quality, which is responsible for water utilities, provide a unique opportunity for evaluating the consolidation of all utility regulation in a way that cannot be fully considered at this time.

Key Recommendation

- Postpone the decision on continuing PUC and the administrative structure of utility regulation until completing the upcoming Sunset reviews of the Railroad Commission and the Texas Commission on Environmental Quality.

Electric Reliability Council of Texas

Issue 1

The Electric Reliability Council of Texas Needs Better Oversight to Address High Risk in Its Operations.

The Electric Reliability Council of Texas plays a large, important role in the safety and well-being of Texans, ensuring the reliable distribution of electricity and coordinating the operation of the competitive electric market. To accomplish its mission, ERCOT will spend \$267 million this year in funds derived from statutorily permitted charges on electricity. Because of its public purposes, PUC oversees ERCOT's collection of fee revenue.

Oversight of an entity like ERCOT needs to be scaled to the risk and public importance of its functions. However, PUC's oversight of ERCOT is inconsistent as PUC only reviews requests for increases in ERCOT's fee authority and does not review spending in years in which ERCOT does not request an increase. In fact, PUC has not reviewed ERCOT's budget since 2006, over which time its operating expenses have increased 62 percent. PUC also does not review ERCOT's use of debt financing, an important point given ERCOT's accumulated debt of \$365 million. As a public-purpose, nonprofit corporation, ERCOT also does not receive routine legislative oversight. Although the corporation is under Sunset review this legislative cycle, the Sunset review is a one-time requirement.

Key Recommendations

- Require PUC to exercise additional oversight authority of ERCOT by annually reviewing and approving its entire budget and reviewing and approving all uses of debt financing.
- Provide for future Sunset reviews of ERCOT, concurrent with reviews of the Public Utility Commission.

Issue 2

The Presence of Electric Market Stakeholders Impairs the Impartiality of the ERCOT Board.

The Legislature has transitioned ERCOT from an industry group that managed the exchange of power among monopoly electric companies into a public-purpose agency. Today ERCOT serves as Texas' Independent System Operator, a role that gives it responsibility to ensure reliable transmission of electricity and to operate the electric market. ERCOT is governed by a 16-member Board of Directors composed of directors representing stakeholders in the electric market as well as directors who are unaffiliated with the market, having no financial stake in its operation.

Although the Board makes critical decisions affecting Texas' \$34 billion competitive electric market, industry stakeholders with financial interests in these decisions hold a majority of votes. ERCOT is unique as being the only transmission system operator in North America to not have a fully independent board. Authorizing PUC to directly make appointments to the Board would ensure public discussion of appointments and bring differing viewpoints to the selection process rather than the homogenous approach a self-appointing entity tends to take.

Key Recommendation

- Restructure the ERCOT Board to consist of nine directors appointed by PUC, including seven directors unaffiliated with the electric market, and two non-voting, ex officio directors – the Chair of the Public Utility Commission or a designee, and the Public Utility Counsel.

Office of Public Utility Counsel

Issue 1

Texas Has a Continuing Need for the Office of Public Utility Counsel.

Sunset staff found that the State has a continuing interest in having an advocate for residential and small commercial utility consumers. The complexity of today's electric and telecommunications markets means small consumers need someone representing their interests in regulatory proceedings at PUC, ERCOT, Texas Regional Entity, and at the federal level. Further, the independence of the Public Counsel is key because it allows more focused advocacy on the needs of consumers.

Key Recommendation

- Continue the Office of Public Utility Counsel for 12 years.

Fiscal Implication Summary

Public Utility Commission

PUC Issue 1 should result in no net fiscal impact to the State, assuming that new revenue collections would be appropriated back to PUC for its use.

- **Issue 1** – Recommendations would give PUC clear authority to set fees for licensing-related functions, including original applications and renewals. No revenue gain to the State would result from this authority, assuming that revenues collected would be appropriated back to the agency for administering these functions. Requirements also would increase administrative penalties for endangering electric market reliability, and these penalties would be deposited to the General Revenue Fund. However, the fiscal impact resulting from increased penalties could not be estimated.

Electric Reliability Council of Texas

ERCOT Issue 2 has a fiscal impact; however, it would not result in an additional cost to the State.

- **Issue 2** – Requirements to add two new unaffiliated directors to the ERCOT Board would increase ERCOT costs up to \$180,000 for the new directors' salaries, although this cost would be borne by the System Administration Fee and not a state fund.

Public Utility Commission of Texas

Agency at a Glance

Agency at a Glance

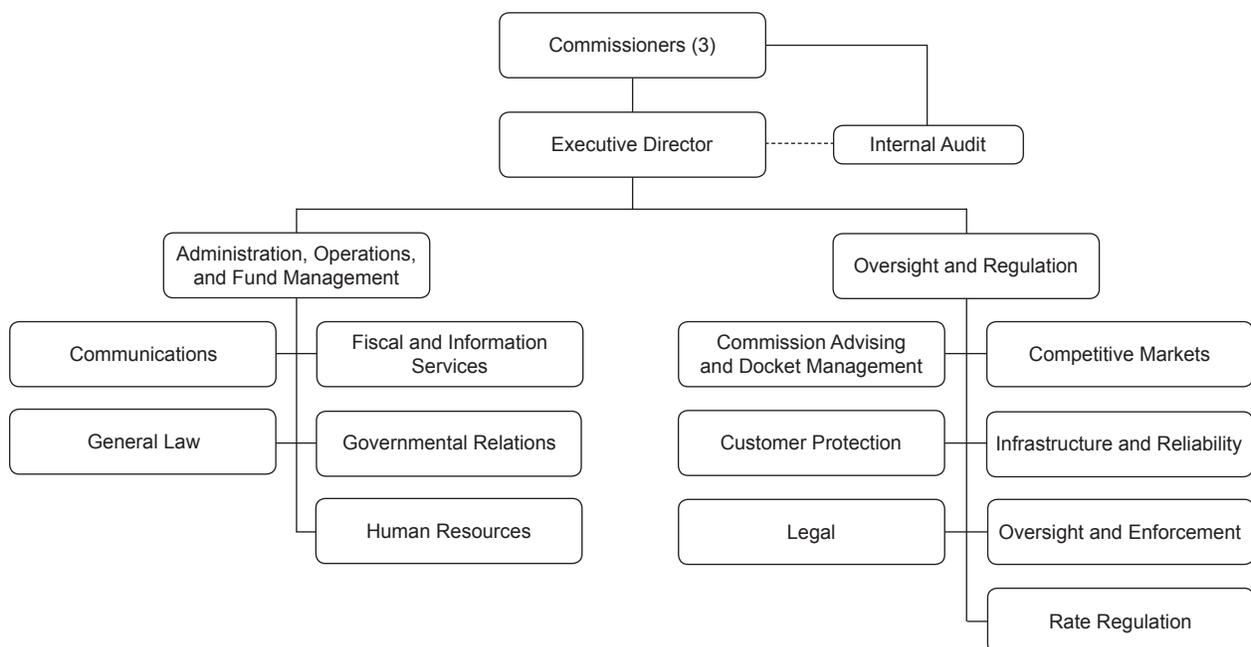
The Public Utility Commission oversees electric and telecommunications companies in Texas. The Legislature created PUC in 1975 to regulate rates and services of monopoly utilities as a substitute for competition. Since then, legislative changes restructuring and deregulating major portions of electric and telecommunications markets have modified PUC's focus to also include fostering competition through functions such as market design, licensing, resolution of disputes among telecommunications companies, investigation and enforcement, and complaint resolution. PUC also administers programs for assisting low-income consumers with their electric and telephone bills.

In fiscal year 2009, PUC estimates that, of staff hours directly devoted to utility regulation, about 83 percent were allocated to electric-related activities, showing the agency's dominant focus in this area. Appendix B, *Companies Regulated by PUC*, gives details on PUC's regulatory oversight by type of company.

Key Facts

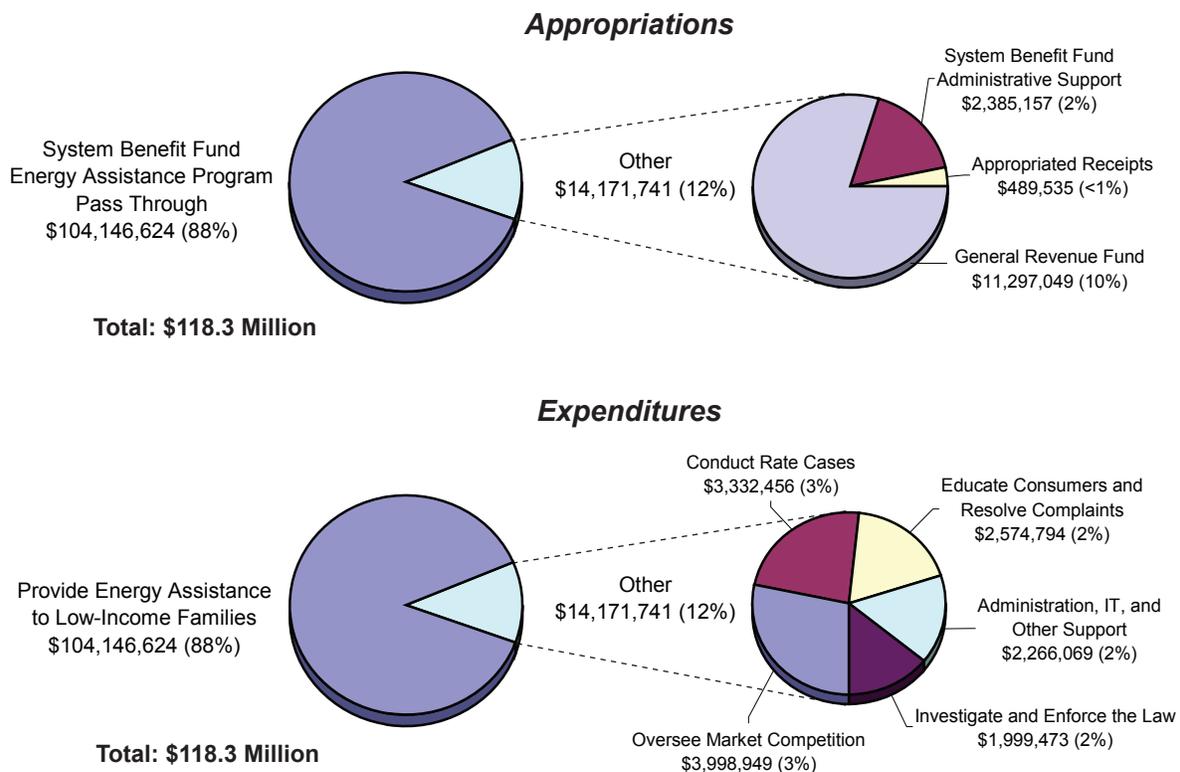
- **Policy Board.** PUC is governed by a three-member, full-time Commission appointed by the Governor to represent the general public: Barry T. Smitherman, Chair; Donna L. Nelson; and Kenneth W. Anderson, Jr.
- **Staffing.** PUC had about 189 authorized staff in fiscal year 2009, the same number as authorized in fiscal years 2010 and 2011. The following organizational chart displays the agency's divisions for fiscal year 2009.

**Public Utility Commission
Organizational Chart**



- Funding.** PUC received appropriations of about \$118.3 million in fiscal year 2009. PUC operated on about \$14.2 million, mostly from General Revenue funding supported by a gross receipts assessment primarily against public utilities, retail electric providers, and electric cooperatives within PUC’s jurisdiction.¹ PUC passed through the remainder of the revenue, about \$104.1 million, to electric companies to provide discounts for low-income electricity consumers in competitive areas. The source of this pass-through amount was the System Benefit Fund, which is supported by fees charged to customers in areas of the state open to competition. The chart, *Public Utility Commission Appropriations and Expenditures*, depicts the agency’s funding for fiscal year 2009.

**Public Utility Commission Appropriations and Expenditures
FY 2009**



Over the next three years, PUC will receive \$1.7 million in federal stimulus funds to update the state’s emergency energy plan to include issues of computer security and the state’s emerging smart grid, and \$1.4 million to address regulatory and energy market design issues emerging from policies promoting renewable energy, energy efficiency, and deployment of advanced meters.

- Electric Industry Oversight.** PUC oversees the operations and fee requests of the Electric Reliability Council of Texas (ERCOT), a quasi-governmental entity that manages the electric grid and coordinates the activities of electric companies operating in the 75 percent of the state open to competition. The ERCOT region operates through companies that serve uniquely as either generators of electricity, transporters and distributors of electricity, or retail sellers of electricity. In fiscal year 2009, PUC registered 204 power generation companies, oversaw the rates and services

of eight transmission and distribution utilities, certified 148 retail electric providers, and adopted or amended 10 rules relating to electric competition. Transmission and distribution utilities are still regulated monopolies. As such, PUC conducted 21 transmission and distribution utility rate cases in fiscal year 2009.

In areas of the state not open to competition, PUC regulates the rates, services, and service quality of the four vertically integrated electric utilities that continue to operate as monopolies. In fiscal year 2009, PUC conducted seven electric rate cases for these utilities.

PUC also administers renewable energy and energy efficiency programs throughout the state. The renewable energy program is carried out by competitive generation companies and retailers, and the energy efficiency program is carried out by electric utilities, both under PUC rules and oversight.

- **Telecommunications Industry Oversight.** PUC has varying degrees of regulatory responsibility over local telephone lines operated by incumbent local exchange carriers (ILECs), such as AT&T and Verizon. About 70 percent of the state's local telephone lines are located in deregulated, mostly urban areas.² By contrast, mostly rural areas of the state are under PUC's full rate and quality of service regulation. For ILECs in these areas, PUC conducted 12 minor telephone rate proceedings in fiscal year 2009. In other areas of the state, ILECs operate under relaxed regulatory requirements called "incentive" regulation, generally with flexibility to change prices without going through a rate case.

PUC also oversees competitive local exchange carriers (CLECs) that may own their own facilities, such as a cable company offering voice service, or may resell services provided by an ILEC. These companies are not rate regulated, although they do have to meet certain service standards. Currently, 444 companies do business as CLECs in Texas. PUC resolves interconnection disputes among telephone companies, such as disputes that arise when a CLEC seeks to connect with the network of an incumbent carrier. PUC also provides some oversight of other telecommunications services, including automatic dial announcing devices, pay phones, and long distance providers. PUC has no jurisdiction over wireless companies, which the federal government oversees.

In 2005, the Legislature added to PUC's responsibilities the issuance of State-issued Certificates of Franchise Authority for video providers, taking the place of franchise agreements for video services that had been negotiated separately with each municipality. By the end of fiscal year 2009, PUC had issued 58 State-issued Certificates of Franchise Authority.

- **Customer Protection.** PUC educates the public about electricity and local telephone services, and assists customers with complaints. In fiscal year 2009, PUC received about 76,600 customer calls of all sorts, and informally resolved about 19,000 complaints, with each complaint resolved in an average of 26 days.
- **Enforcement.** PUC takes formal enforcement action against violators of the Public Utility Regulatory Act and PUC rules. The agency conducted 86 enforcement investigations and collected \$20.2 million in penalties against electric and telecommunications companies in fiscal year 2009.
- **Homeland Security and Emergency Response.** PUC assists the Texas Division of Emergency Management on homeland security and critical infrastructure matters involving electric and telecommunications utilities. PUC also has an emergency management response team that tracks outages and coordinates power and communications restoration after extreme weather events.

- **Assistance Programs.** PUC administers several programs to help ensure access to basic utility services. The Low-Income Discount Program provided discounts to about 442,000 low-income electricity customers per month for a five-month period in 2009 in areas open to electric competition. This program was funded by expenditures of \$104 million from the System Benefit Fund in fiscal year 2009.

The Universal Service Fund, which is funded through fees on telecommunications providers and maintained outside the State Treasury through a contractual arrangement, provides assistance through several programs. The Lifeline program, which offers discounts to low-income telephone customers, served about 885,000 participants per month in fiscal year 2009. Relay Texas, providing telecommunications services for people with speech and hearing impairments, completed about 1.8 million calls in fiscal year 2009. The Universal Service Fund also offsets the cost of telephone service in high-cost, mostly rural areas of the state, to help keep telephone rates affordable. Expenditures for these high-cost areas totaled \$448.6 million in fiscal year 2009, or about 87 percent of all Universal Service Fund expenditures of \$516 million in that fiscal year.

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¹ Texas Utilities Code, sec. 16.001.

² Public Utility Commission, *Report to the 81st Texas Legislature: Scope of Competition in Telecommunications Markets of Texas* (Austin, Texas, January 2009), p. 39.

Issues

Issue 1

PUC Lacks Regulatory Tools Needed to Provide Effective Oversight and Prevent Harm to the Public.

Background

Starting in 1995, the Legislature began enacting laws restructuring major aspects of monopolistic electric and telecommunications industries to allow competition and market forces to take the place of traditional rate regulation. PUC's oversight functions have evolved with market changes. In place of full rate regulation of monopoly providers, PUC's role now includes consumer protection through licensing-related functions, including: granting authority for electric and telecommunications businesses to operate, developing rules for overseeing company operations, resolving complaints, and investigating and taking enforcement action against violators. The table on the following page, *PUC Regulatory Responsibilities*, displays PUC's basic oversight responsibilities by type of industry participant.

Sunset has a long history of evaluating regulatory agencies. Ineffective occupational licensing programs served as an impetus behind the creation of Sunset in 1977. Sunset now has completed more than 90 certification and licensing agency reviews. These licensing programs share many of the same regulatory concepts as those used in oversight of PUC's industry-specific licensing functions. Sunset staff has documented standards for regulatory activities to serve as a guide for evaluating regulatory agencies and has used those standards in reviews of agencies such as the Texas Department of Insurance and Texas Alcoholic Beverage Commission. Areas in which PUC's statute and rules differ from these model standards and potential benefits from conforming agency practices to these standards are highlighted below.

Findings

PUC's lack of enforcement tools and authority reduce the agency's ability to prevent harm to market participants and the public.

- **Restitution.** Regulatory agencies should have the authority to restore harmed parties' losses as part of an enforcement action, especially in situations where substantial damage can occur. This authority complements administrative or other types of penalties, which, while essential to discourage wrongdoing, do nothing as a matter of simple fairness to make matters right for harmed parties. Restitution is an increasingly common tool for licensing agencies to return to persons some of what they lost as a result of wrongdoing by a licensee – typically returning a fee or other quantified damage through an agreed settlement with the alleged violator.

Regulatory agencies should have the authority to make matters right for harmed parties.

As part of its powers to protect retail customers, PUC has the authority to order a retail electric provider to make a customer whole for fraudulent practices or for charging a rate that has not been agreed to by the customer.¹ Other agencies, like the Texas Department of Insurance and the Texas State Board of Public Accountancy, also have some type of restitution

PUC Regulatory Responsibilities

The following chart summarizes PUC’s varied regulatory responsibilities over electric and telecommunications-related companies. Oversight categories shown across the top of the chart represent general areas of oversight. The specific requirements for oversight performed in a category can vary among different types of providers.

	Type of Company	License Type	Number of Entities	Rate Regulations	Oversight of Service or Customer Protection Requirements	Informal Complaints	Investigation and Enforcement
Electric Companies	Integrated Investor-Owned Utilities	CCN ^a	4	✓	✓	✓	✓
	Transmission and Distribution Utilities	CCN ^a	8	✓	✓	✓	✓
	Retail Electric Providers	Certification	148		✓	✓	✓
	Power Generation Companies	Registration	204		✓		✓
	Electric Cooperatives ^f	CCN ^a	75				
	Municipal Utilities ^g	CCN ^b	72				
	Power Aggregators	Registration	257		✓	✓	✓
	Power Marketers	Registration	197		✓		✓
	Qualified Scheduling Entities	None	490		✓		✓
Telephone Companies	Incumbent Local Exchange Carriers (including telephone cooperatives)	CCN ^a	63 ^h	✓ ⁱ	✓	✓	✓
	Competitive Local Exchange Carriers	COA ^c SPCOA ^d	444		✓	✓	✓
	Interexchange Carriers	Registration	937		✓	✓	✓
	Pay Phone Providers	Registration	105	✓ ^j	✓	✓	✓
	Automatic Dial Announcing Devices	Permit	246		✓	✓	✓
Cable and Video Service	Cable and Video Service Providers	SICFA ^e	58			✓ ^k	✓

^a Certificate of Convenience and Necessity

^b Certificate of Convenience and Necessity for retail service areas

^c Certificate of Operating Authority

^d Service Provider Certificate of Operating Authority

^e State-issued Certificate of Franchise Authority

^f Subject to PUC regulation of wholesale transmission services

^g Subject to PUC regulation of wholesale transmission services

^h Includes five partially deregulated telephone cooperatives, whose rates are subject to PUC review if they are challenged by at least 5 percent of affected customers

ⁱ Subject to traditional regulation in many exchanges, but may elect incentive regulation with pricing flexibility or petition PUC for deregulation in certain exchanges under certain conditions

^j Subject to regulation of rate caps

^k Subject to limited oversight requirements prohibiting discrimination in providing services

authority. PUC does not, however, have restitution authority in cases involving market power abuse in the wholesale electric market and has recommended the addition of this tool to its enforcement powers.²

Restitution makes sense for situations in which a company has engaged in market power abuse in the wholesale electric market. A company can do substantial harm and profit greatly by manipulating the market to raise the price of energy for all purchasers of power. In one such case, PUC alleged that a company withheld generation over a period of four months, driving up the cost of energy by \$57 million to retail electric providers and ultimately to consumers and profiting by \$18 million from its actions. In the absence of authority to order restitution to the retail electric providers who were allegedly harmed by the company's actions, PUC ultimately reached a settlement with the company resulting in a payment of a \$15 million administrative penalty with no admission of wrongdoing by the company.^{3,4}

Without restitution as a remedy, victims could attempt to seek damages in court. This route of redress, however, means additional expenses and uncertainty in the courts for aggrieved parties. A PUC enforcement order against a company could help the damaged party obtain a successful judgment. However, this support is greatly weakened if PUC settles the case with no admission of wrongdoing by the alleged violator, which is the typical outcome of PUC's penalty dockets. In fiscal year 2009, 29 of 30 PUC cases of all types, including the one market power abuse docket, settled in this fashion.

Despite the difficulties of determining who is harmed and by how much, PUC would have the ability through the Independent Market Monitor, an entity contracted to monitor the wholesale market, to make this determination, as it did in the one market power abuse case. PUC would also be able to deal with the harmed parties through a separate proceeding to calculate and distribute restitution amounts after issuing an enforcement order. This process is similar to that used by the Texas Department of Insurance, although the nature of its restitution cases, often dealing with individual consumers, do not typically draw intervenors.

Granting PUC restitution authority for wholesale market power abuse would create a disincentive to violate the law and provide an essential tool for helping restore market participants' losses. This authority could be used along with, or in lieu of, administrative penalties.

- **Administrative penalties.** An agency's administrative penalty authority should reflect the severity of the violation and serve as a deterrent to violations of law. PUC can assess an administrative penalty of \$25,000 per violation per day for violations of state law or PUC rules.

This level of administrative penalty may not be sufficient for violations that affect grid reliability, which can cause serious grid failures, such as

Market power abuse violators can drive up the cost of energy by millions of dollars.

Without restitution, victims are left with the cost and uncertainty of court action as a means of redress.

*PUC's
administrative
penalty authority
for reliability
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not be sufficient
to deter violators.*

blackouts. Also, companies potentially can profit from disregarding or delaying ERCOT's reliability-related orders to them. For example, by mutual agreement, ERCOT pays generators to curtail electric production at certain times; if late in acting on ERCOT's curtailment order, a generator could profit from the payment without adjusting electric generation as agreed.

Administrative penalties should be sufficiently high to overcome any such profit motive. In recent years, the Legislature has increased administrative penalties in many agencies help ensure that fines amount to more than profits from illegal action. PUC's administrative penalty went up during its 2005 Sunset review from \$5,000 to \$25,000, but it still lags behind the \$100,000 penalty of the Texas State Board of Public Accountancy.⁵

Assessing penalties on a per violation per day basis results in effective penalties for serious situations, such as market power abuse cases, in which a company may commit multiple violations in a single day. Historically, PUC staff interpreted PUC's authority in such a way that

reliability violations generally resulted in multiple violations per day. In February 2010, however, the PUC Commissioners issued a ruling that results in many reliability violations now being viewed as single violations. This interpretation limits PUC's ability to assess a meaningful penalty for reliability-related violations.

In fiscal year 2009, PUC collected about \$3.7 million in fines from 11 cases involving reliability protocol violations, but initial penalties assessed were based on PUC's earlier method for calculating reliability-related penalties. Today, 10 of these cases would probably each be viewed as addressing a single violation, resulting in a penalty that may not be enough to serve as an effective deterrent.

PUC has enforcement authority over its own reliability rules as well as ERCOT's reliability protocols. Additionally, underscoring its importance, grid reliability is one of the few areas of federal oversight of ERCOT, with federal standards being enforced through the Texas Regional Entity, described in the accompanying textbox.

In comparison to PUC's \$25,000 limit, the Texas Regional Entity has authority to assess administrative penalties up to \$1 million per violation per day for violations of federal reliability standards, demonstrating the importance the federal

Texas Regional Entity

The Texas Regional Entity has functioned as an independent division of ERCOT with its own staff responsible for ensuring electric reliability standards under a delegated arrangement with the North American Electric Reliability Corporation (NERC). The ERCOT Board has functioned as the Texas Regional Entity Board for the ERCOT region, but this arrangement will change, most likely in the summer of 2010 with federal approval, as the Texas Regional Entity transitions to becoming a separate entity with its own board. The Texas Regional Entity will then be known as the Texas Reliability Entity.

In its arrangement with NERC, the Texas Regional Entity conducts reliability assessments and administers a compliance monitoring and enforcement program to ensure that federal reliability standards are met in the ERCOT region. The Texas Regional Entity can assess administrative penalties up to \$1 million per violation per day to enforce these federal standards.

In a separate arrangement, PUC has contracted with the Texas Regional Entity to monitor and report back on compliance with ERCOT reliability protocols, which are generally distinct from federal standards. PUC continues to enforce the protocols with its own enforcement powers, including administrative penalties up to \$25,000 per violation per day.

government places on grid reliability. Federal and state reliability standards are different in most respects, so Texas cannot rely on the Texas Regional Entity's penalty to cover state standards or encourage compliance with them. Federal reliability standards are broad and tend to focus more on ERCOT's role in maintaining electric grid reliability, while ERCOT protocols are more specific and focus on the role of market participants in reliability.

- **Emergency cease-and-desist orders.** A regulatory agency should be able to stop unlicensed or harmful activity immediately. PUC's current authority does not meet this standard.

To stop an action, PUC first must issue a notice to the alleged violator and provide an opportunity for a hearing before issuing a cease-and-desist order. By then the harm may have been done. Because of the time taken for the hearing, PUC usually issues a final order in the case rather than a cease-and-desist order. PUC has issued only one cease-and-desist order since fiscal year 2007.

Immediate action may be crucial if the harmful behavior affects electric reliability or causes an immediate harm to consumers, such as disconnecting consumers during a summer disconnect moratorium. Other regulatory agencies such as the Texas Department of Insurance have emergency cease-and-desist authority to quickly address harmful activities.

The authority to issue emergency cease-and-desist orders would help PUC better ensure electric reliability and better protect consumers. Further, making violations of these orders subject to additional sanctions, such as administrative penalties, would help make them more enforceable.

- **Public information on consumer complaints.** Agencies should keep and report statistical information detailing the number, source, and types of complaints received and the disposition of complaints resolved. Currently, PUC provides limited complaint information on its Power to Choose website and in its *Scope of Competition* reports. PUC does not publish this information in one central location, update all the information on a frequent basis, or indicate how these complaints are resolved. Making more detailed and updated complaint data public and easily accessible would help focus public attention on issues coming up for consumers in electric and telecommunications markets and how PUC handles those complaints.
- **Public information on enforcement actions.** Agencies should make all final enforcement information, such as final disciplinary orders and sanctions, readily available to the public. PUC publishes in its *Scope of Competition* reports the amounts of administrative penalties it has assessed by company and type of violation. While helpful, this information is not easily accessible and only updated every two years. The public also does

PUC does not have the authority to immediately stop a business from engaging in harmful activity.

PUC does not make updated complaint information easily accessible to the public.

not have easy access to data and trends on past enforcement actions, such as how many times a specific company has been disciplined. Making this information readily available in a user-friendly format would help protect consumers by assisting them in making informed choices and would help clarify PUC's enforcement activity.

Certain administrative provisions of PUC's statute could reduce the agency's efficiency and ability to adapt to changing circumstances.

- **Flexible fees.** A regulatory agency should have clear statutory authority to set reasonable fees in rule for licensing-related functions, such as original applications and renewals. Fee authority for an agency like PUC should allow the State to collect a reasonable amount for administrative expenses directly related to licensing-related services provided. Authorizing the fees to be set in rule allows for flexibility to meet changing needs without having to pass legislation to adjust fees. Because any fee revenue would still have to be appropriated to the agency, PUC would have no incentive to set fees at unreasonable levels. The public also has the opportunity to comment on proposed fees since the agency sets them in rule.

Currently, PUC does not charge fees for its licensing-related activities, nor does it have direct statutory authority to do so. Several large regulatory agencies, including the Texas Department of Insurance, Texas Racing Commission, and Railroad Commission of Texas, collect licensing-related fees from industries they regulate. In addition, similar to PUC, these agencies also collect other taxes or assessments from these industries. Establishing PUC's authority to set reasonable licensing-related fees in rule would allow fee adjustments as needs change and permit the State to recover a portion of the direct cost it incurs to regulate these entities.

- **Renewal process.** A regulatory agency should have clear renewal authority for its licensing-related activities, and this authority should allow for the staggered processing of renewals. The renewal process enables an agency to keep track of those it regulates, offers an opportunity to review their compliance history, and helps ensure compliance with regulatory requirements such as occurrence of disqualifying criminal offenses. Staggering renewals ensures that an agency is not overloaded with processing renewals that all come due at the same time. Renewals should include payment of a fee structured to help the State recover a reasonable portion of its cost, as described above.

PUC does not renew registrations, certifications, or permits, nor does it have the direct statutory authority to do so. Lack of a renewal feature in its licensing-related functions has made it difficult for PUC to know when a regulated entity goes out of business or has changed contact information. Without an accurate roster of regulated businesses, uncertainty develops

Unlike many agencies, PUC does not have clear authority to set licensing-related fees.

Having no renewal feature in its licensing-related activities impedes PUC's ability to keep track of regulated entities.

around who to send information to, where to send it, or from whom to expect required filings. These problems create inefficiencies in PUC's use of resources and make oversight less effective. Clear renewal authority, including a staggered renewal feature, would address these concerns.

Recommendations

Change in Statute

1.1 Authorize PUC to order restitution to market participants harmed by market power abuse.

Restitution would be limited to actual amounts overpaid by market participants, but could include interest; restitution would not include other damages or harm. PUC could make the determination of the damage caused by market power abuse on its own or through the Independent Market Monitor, its contracted entity responsible for overseeing the wholesale electric market. PUC would allocate any refunded amount to the various market participants proportionally according to their losses. PUC would make these refund decisions in a separate proceeding. PUC could use restitution in lieu of, or in addition to, a separate order assessing an administrative penalty. This recommendation would have no fiscal impact to the State.

1.2 Increase PUC's administrative penalty authority to \$100,000 per violation per day for violations of ERCOT's reliability protocols or PUC's wholesale reliability rules.

Under this recommendation, PUC's administrative penalty authority for reliability-related violations would increase from a maximum of \$25,000 per violation per day to \$100,000 per violation per day. Currently, each day a violation continues or occurs is a separate violation, and this construction would continue to apply. To ensure that all parties are aware of the potential penalties for reliability-related violations, PUC should pass rules adopting a penalty matrix and specifying which violations are serious enough to warrant higher penalties. Increasing PUC's administrative penalty authority in this area would not increase the agency's budget; however, it could result in a gain to General Revenue. The fiscal impact of this recommendation could not be estimated because the number of violations and their seriousness could not be predicted.

1.3 Authorize PUC to issue emergency cease-and-desist orders.

PUC could use this authority when a company's actions would harm the reliability of the electric grid; are fraudulent, hazardous, or create an immediate danger to public safety; or could reasonably be expected to cause immediate harm to consumers in situations in which monetary compensation would be inadequate. This recommendation also would authorize PUC to assess administrative penalties against companies that violate an emergency cease-and-desist order, and allow companies to appeal the orders and penalties through the normal enforcement process. Granting administrative penalty authority for violations of emergency cease-and-desist orders could result in a gain to General Revenue. The fiscal impact of this recommendation could not be estimated because the number of violations and their seriousness could not be predicted.

1.4 Authorize PUC to require, by rule, renewal of registrations, certifications, and permits as it deems appropriate.

Statute would authorize PUC to adopt rules requiring renewals for registrations, certifications, and permits as it deems appropriate, including any renewal requirements to be met. Statute also would authorize PUC to stagger renewals to even out workload.

1.5 Give PUC the authority to set reasonable fees in rule for its licensing-related activities related to certifications, registrations, and permits.

PUC would be authorized to set by rule reasonable fees that do not exceed administrative processing costs for these licensing-related functions.

Fee authority would result in additional funds being collected for initial applications and renewals. Entities already possessing registrations, permits, or certificates would not have to re-apply as a first-time applicant, but would be grandfathered under their pre-existing approved application and subject to renewals as described in Recommendation 1.4. This approach would likely result only in small collections from new applicants, but would generate more revenue from renewals. Fees collected would be deposited to the General Revenue Fund.

PUC should set its fees at a level sufficient to cover administrative processing costs, including background checks if it deems necessary, and should seek additional appropriations back to the agency to pay for these expenses. These new fees, then, would not result in a revenue gain for the State.

Fee levels and revenues generated could not be determined since these amounts would depend primarily on PUC decisions about which of its certifications, registrations, and permits require renewal as well as the frequency of renewal. Fee amounts should not be onerous since processing tasks for renewals should generally be routine. For example, a \$150 fee per renewal would generate \$150,000 annually if half of PUC's 2,000 active regulated entities were subject to renewal in a given year, assuming a two-year renewal period. Although the required amount may be more or less than this example, an amount in this range could support minimal staffing and supplies for licensing-related processing. Because the agency would only receive fee revenue appropriated by the Legislature, it would have no incentive to set actual fee levels higher than necessary to recover costs.

Management Action

1.6 PUC should publish additional complaint and enforcement data on its website.

Implementation of this recommendation would increase consumers' access to complaint and enforcement data online, and provide a more user-friendly format. Informal complaints received by PUC would be aggregated to display information such as the total number of complaints by type and a breakdown of how they were resolved.

Enforcement-related information displayed on PUC's website would include all investigation and enforcement activity, whether initiated from an informal complaint or elsewhere. Data shown, for example, could include the origin of the action, disposition of investigations, and the amount of final enforcement penalties by company. PUC also should make available trend data and analysis online from the information above.

Data should be updated periodically, such as quarterly. PUC staff should formally present information and analysis on complaint and enforcement activities to PUC commissioners at least annually, with the opportunity for the public to comment. Directing PUC to publish complaint and enforcement data on PUC's website would not have a significant fiscal impact.

Fiscal Implication Summary

These recommendations would give PUC clear authority to set fees for licensing-related functions. No revenue gain to the State would result from this authority, assuming that revenues collected would be appropriated back to the agency for administering these functions. Increasing administrative penalties could bring in more revenues to the General Revenue Fund, but because amounts generated would depend on the number and seriousness of future violations subject to increased enforcement penalties, a fiscal impact could not be estimated.

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¹ Texas Utilities Code, sec. 17.004.

² Public Utility Commission, *Report to the 81st Texas Legislature: Scope of Competition in Electric Markets in Texas* (Austin, Texas, January 2009), p. 74.

³ *Notices of Violation by TXU Corp., et al., of PURA Section 39.157(a) and P.U.C. SUBST. R. 25.503(g)(7)*, Docket No. 34061, Preliminary Order at 2 (June 27, 2007). Online. Available: http://interchange.puc.state.tx.us/WebApp/Interchange/application/dbapps/filings/pgSearch_Results.asp?TXT_CNTR_NO=34061&TXT_ITEM_NO=44. Accessed: March 16, 2010.

⁴ *Notices of Violation by TXU Corp., et al., of PURA Section 39.157(a) and P.U.C. SUBST. R. 25.503(g)(7)*, Docket No. 34061, Order at 7 (Dec. 22, 2008). Online. Available: http://interchange.puc.state.tx.us/WebApp/Interchange/application/dbapps/filings/pgSearch_Results.asp?TXT_CNTR_NO=34061&TXT_ITEM_NO=239. Accessed: March 25, 2010.

⁵ Texas Occupations Code, sec. 901.552.

Issue 2

Outdated Statutory Provisions Make PUC's Regulation of the Telecommunications Industry Unnecessarily Restrictive.

Background

The State has established a policy to provide for full competition in the telecommunications market so that customers can benefit from innovations in service quality and market-based pricing.¹ PUC continues to oversee the operations of incumbent local exchange carriers, the original providers of landline telephone service, and their more recently established competitors, competitive local exchange carriers. However, these providers have already transitioned substantially toward competition and enjoy significant regulatory freedoms from pricing and service requirements. The telecommunications industry as a whole is changing at a fast pace, both in Texas and nationally, driven by technological advances and the rapidly growing number of customers who get their communication needs met through wireless and broadband providers, entities unregulated by PUC.

A key Sunset review criterion is to determine whether less restrictive or alternative methods of performing any of the agency's functions could adequately protect or serve the public. This criterion is particularly important in reviewing PUC's telecommunications requirements, given the State's policy to move telecommunications from a regulated to a less restricted, competitive industry.

Several statutory obstacles, however, impede this transition. Telecommunications statutes weave a complex web of old and new, highly interrelated policies and requirements that affect the movement toward deregulation, and with it, greater competition in the telecommunications market as envisioned by the Legislature. These policies involve complex issues such as the suitability and affordability of telecommunications products in the market, the cost of providing these services, and even the continuing need to ensure that everyone has basic local telephone service, known as universal service, and the system of subsidies in place to support it. These are crucial issues affecting the safety and economic well-being of telecommunications consumers that are beyond the scope of the current staff review of PUC.

The provisions highlighted below are limited aspects of this larger set of policies and requirements that impede the movement to deregulation. Although not the most significant impediments preventing competition, over time they have become barriers that perpetuate outdated technological approaches and ultimately interfere with the market's ability to respond to changes. Their treatment here can also help move the state toward greater deregulation and frame the discussion that may occur regarding the necessary role of PUC in overseeing telecommunications of the future.

Findings

The statutory test for determining whether telecommunication markets are competitive is an inflexible and overly restrictive approach to overseeing these markets.

State statute provides for the deregulation of telecommunications markets, defined as local telephone exchanges, in which competitive choice provides consumers a level of protection against undesirable actions of the incumbent

provider. The State has set up a tiered system for evaluating the competitiveness of markets that guides the decision to deregulate.²

Legislation enacted in 2005 deems markets with a population of at least 100,000 to be automatically deregulated. Statute also directs PUC to establish a competitive test in rule for markets with less than 30,000 population, which it did in 2006. For markets with a population of between 30,000 and 100,000, however, statute specifies a test to determine if competition justifies deregulation.

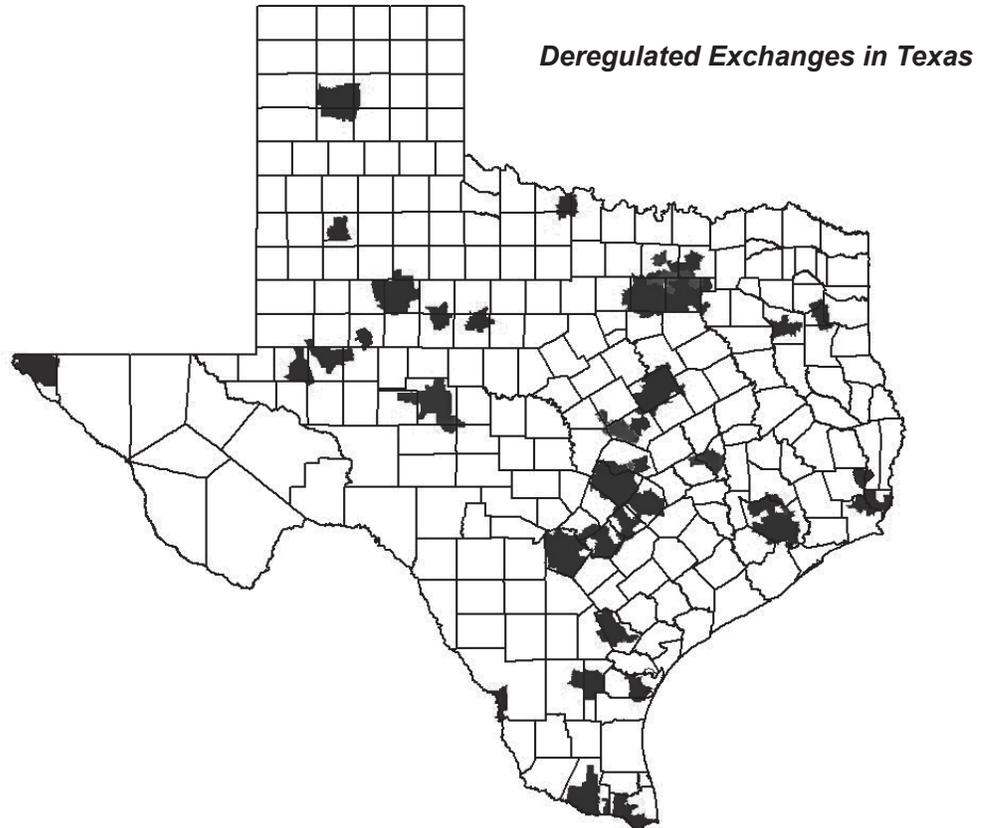
The test is based on the presence of different types of competitors in each market, as shown in the accompanying textbox. The incumbent provider that serves the market has the option to petition PUC for deregulation and must show that the market meets the test. The map, *Deregulated Exchanges in Texas*, displays the parts of the state that have been deregulated through these three methods.³

The competitive test established in law for markets between 30,000 and 100,000 is inflexible, outdated, and no longer meets its intended purpose. This test means that

**Competitive Market Test
30,000 to 100,000 Population**

To be eligible for deregulation, a market must have at least four competitors. In addition to the incumbent telephone company, which is a landline provider such as AT&T or Verizon, the market must have at least three competitors, of which:

- at least one is a certificated provider of residential telephone service, which is typically a competitive local exchange carrier that resells telephone service by the incumbent provider;
- at least one provides residential telephone service through its own facilities, such as a cable company that offers voice services; and
- at least one provides mobile service that is not affiliated with the incumbent provider.



a market must have at least three wireline and one wireless provider to be eligible for deregulation. For this to occur, the test relies in large part on a technology that is no longer being pursued in today's telecommunications market, namely competitive providers that resell the incumbent's services. New providers of this sort are unlikely to enter the market, and in fact, many have gone out of business in recent years. Of the 426 competitive resellers that are registered with PUC, the agency estimates that only 170 are still actively providing service. The market share of these companies declined from 18.8 percent in 2004 to 10.2 percent in 2008.⁴

The competitive test relies heavily on increasingly outdated technology.

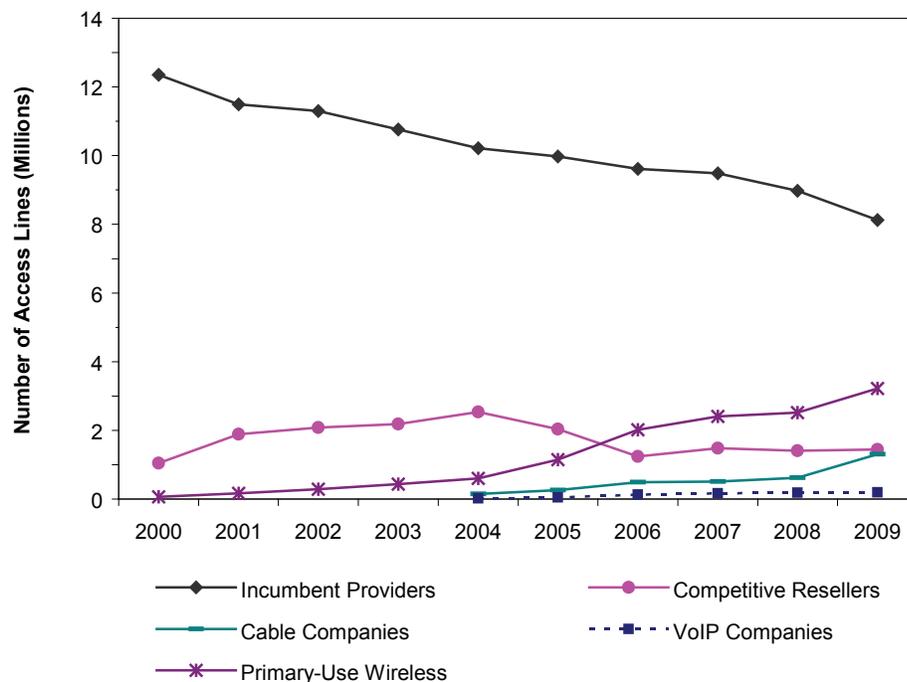
Partly as a result, PUC has not received a petition to deregulate a market of this size since 2005, despite dramatic changes in the industry and advances in technology. Overall, only 70 of more than 1,000 markets in Texas have been deregulated. Although these markets account for 74 percent of all residential telephone lines in Texas, huge sections of the state continue under more restrictive regulation.⁵

PUC has not received a petition to deregulate a mid-sized market since 2005.

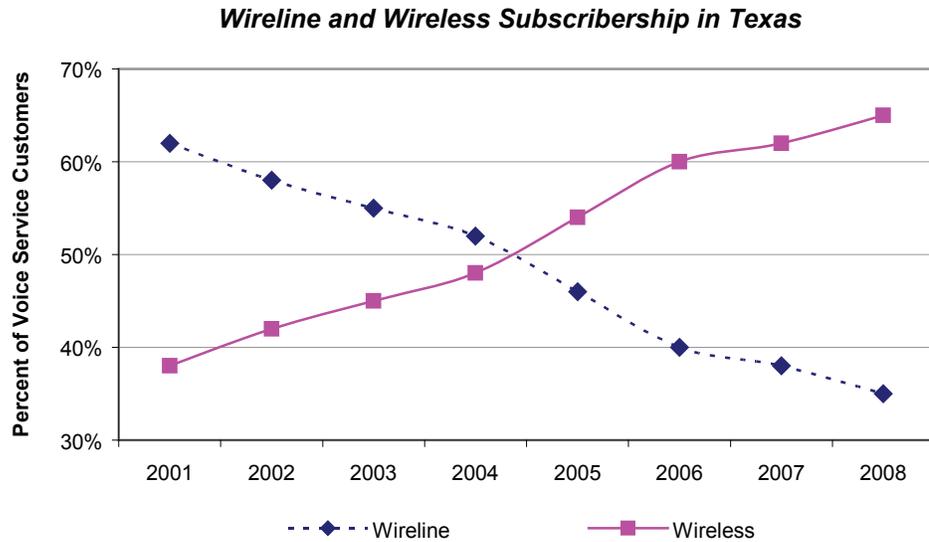
A 2009 PUC report explains that telecommunications services are becoming increasingly intermodal, involving different types of telecommunications facilities rather than simply traditional landline services.⁶ In today's world, incumbent and competitive providers compete against cable and wireless companies, as well as other companies that use newer technologies such as Voice over Internet Protocol.

The graph, *Voice Telecommunications Access Lines in Texas*, shows the decrease in customers of incumbent and competitive providers and the increase in customers who use wireless as a substitute for traditional wireline service.⁷

Voice Telecommunications Access Lines in Texas



In fact, wireless use by all customers, and not just as their primary phone service, has increased its market share of all voice service customers from 38 percent in 2001 to 65 percent in 2008, as shown in the chart, *Wireline and Wireless Subscribership in Texas*.⁸



PUC does not have the flexibility to adjust the competitive test to meet this rapid evolution of technology and promote continued market deregulation because the test is set in statute.

Certain statutory provisions related to regulation of the telecommunications industry are rarely used or outdated.

PUC has identified in a 2009 report, as well as in other documents, certain statutory requirements for telecommunications providers that no longer benefit PUC or the public.⁹ The requirements identified below are particularly appropriate for Sunset consideration because of their statutory basis; clear anachronism; lack of interest from the public; and restrictive nature, including the submission of documents which takes the providers’ time to prepare and PUC staff time to process and review.

Statute requires companies to file contracts with PUC despite their highly competitive nature.

- **Customer-specific contracts.** Statute requires PUC to approve contracts between incumbent providers and individual customers, usually large businesses, for specific customized services, such as billing and collection or high-speed private lines.¹⁰ PUC has implemented this provision by requiring incumbent providers to file quarterly reports on their customer-specific contracts, including details such as types of services and customers, locations and quantities of provided services, and rates and terms. PUC received quarterly reports representing approximately 2,260 of these contracts in fiscal year 2009.

This requirement was originally intended to allow PUC to monitor these contracts to ensure competitive prices. Today, the market for these services

is highly competitive without PUC's oversight. Filing these reports also gave customers the ability to compare prices among incumbent providers, but most incumbents now file confidentially because of the competitive nature of the services. As a result, the requirement for PUC to approve these contracts no longer serves a useful purpose. PUC has received no complaints or inquiries about customer-specific contracts in recent years.

- **Contracts for private network services.** Statute requires certain incumbent providers to file with PUC their private network services contracts with educational institutions, libraries, and nonprofit medical facilities.¹¹ Private network services include broadband services, packaged network services, and other customer-specific offerings. PUC is not required to take any action on these filings. PUC received 877 of these contracts in fiscal year 2009.

The original purpose of this requirement was to ensure that incumbents were offering private network services at competitive prices. Similar to customer-specific contracts, the market for private network services is highly competitive and routine filing of the contracts with PUC no longer serves a useful purpose. PUC has received no complaints or inquiries about private network services in recent years.

- **Extended area service.** Extended area service allows customers of an incumbent telephone carrier to make calls outside their local calling area to neighboring communities for a flat monthly fee. PUC may order an incumbent provider to offer this type of service if communities express sufficient interest. Extended area service used to be popular among rural customers because it allowed them to call nearby cities for a fixed monthly charge, rather than for long-distance fees. However, this service is now outdated because of competitive options available from companies using other technologies such as wireless or Voice over Internet Protocol. PUC has not received a petition for new extended area service in a metropolitan area since May 1998.¹²

PUC has not received a petition for new extended area service since 1998.

Recommendations

Change in Statute

- 2.1 Eliminate the statutory test for deregulating a telecommunications market with a population between 30,000 and 100,000, replacing it with a test developed by PUC in rule.**

In developing the rule, PUC should consider the full range of types of voice services, including newer technologies, available in many areas. Through the rulemaking process, PUC would gather input from multiple stakeholders to determine the proper types of competitors that should exist in a market for it to be deregulated. Incumbent providers would still have to petition PUC to determine whether specific markets are eligible for deregulation. Further, this recommendation would not be retroactive, meaning PUC would not be able to apply the new test to markets that are already deregulated.

2.2 Eliminate the requirement for PUC to approve customer-specific contracts.

By eliminating the approval requirement, PUC would no longer need to require incumbent telecommunications providers to routinely file their customer-specific contracts with the agency. However, this recommendation would still allow PUC to require providers to file these contracts upon an inquiry or complaint filed by an affected party or upon request by the agency. Providers would need to maintain their customer-specific contracts for a specific period of time established by PUC in rule.

2.3 Eliminate the requirement for telecommunications providers to routinely file contracts for private networks with PUC.

Rather than requiring certain incumbent telecommunications providers to file all private network contracts with PUC, this recommendation would allow PUC to require those providers to file the contracts only if the agency received an inquiry or complaint filed by an affected party or if it wanted the information. Providers would need to keep their private network contracts for a specific period of time established by PUC in rule.

2.4 Eliminate the process for establishing new extended area service.

Although PUC would no longer establish new service of this type, communities that already have the service would be able to retain their service plans.

Fiscal Implication Summary

None of these recommendations will have a significant fiscal impact to the State.

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¹ Texas Utilities Code, sec. 65.001.

² Texas Utilities Code, sec. 65.052.

³ Public Utility Commission, *Report to the 80th Texas Legislature: Scope of Competition in Telecommunications Markets of Texas* (Austin, Texas, January 2007), p. 4.

⁴ Public Utility Commission, *Report to the 81st Texas Legislature: Scope of Competition in Telecommunications Markets of Texas* (Austin, Texas, January 2009), p. 13.

⁵ PUC, *Report to the 80th Texas Legislature*, p. 4.

⁶ PUC, *Report to the 81st Texas Legislature*, p. 1.

⁷ *Ibid.*, p. 12 (updated for 2009 by PUC).

⁸ *Ibid.*, pp. 13-14 (with additional data points provided by PUC).

⁹ *Ibid.*, pp. 63-64.

¹⁰ Texas Utilities Code, sec. 52.057.

¹¹ Texas Utilities Code, secs. 58.255 and 59.074.

¹² PUC, *Report to the 81st Texas Legislature*, p. 64.

Issue 3

Consider the Administrative Structure of Utility Regulation Following Reviews of the Railroad Commission of Texas and the Texas Commission on Environmental Quality.

Background

The Public Utility Commission oversees electric and telecommunications companies in Texas. The Legislature created PUC in 1975 to regulate rates and services of monopoly utility service providers in place of the patchwork of municipal regulations that had existed previously. This regulation was intended as a substitute for competition. Since that time, legislative changes restructuring and deregulating major portions of electric and telecommunications markets have modified PUC's focus to also include fostering competition through functions such as market design, licensing, resolution of disputes among telecommunications companies, investigations and enforcement, and complaint resolution. Three full-time commissioners oversee PUC, which operated with a staff of 189 full-time employees and a budget of \$118.3 million in fiscal year 2009.

Findings

Texas has a continuing need to regulate the electric and telecommunications industries and oversee evolving competition in the industries.

To warrant continuation of a regulatory function, an activity must require government oversight to ensure the protection of the public's health, safety, or welfare. Other factors determining the need for regulation include the public's expectation for protection and the complexity of the activity that makes it difficult for consumers to adequately judge the appropriateness of the service or the qualifications of the practitioner.

The State needs to oversee the electric and telecommunications industries because of their essential nature. The original need for state regulation of these industries continues. This regulation substitutes for competition for monopoly providers that still remain under PUC's rate authority in both industries. These providers include investor-owned utilities outside, and transmission and distribution companies inside, the area of Texas restructured for electric competition. Incumbent local exchange telephone companies also still operate in areas of Texas whose telephone markets have not been deregulated. In fiscal year 2009, PUC conducted 41 electric and 12 telephone rate proceedings.

Oversight also is necessary in areas of the state restructured for competition. In theory, the continuing transition from electric and telecommunications monopolies toward greater competition would change the nature, if not the need, for regulation of these industries. Competition would protect consumers from undesirable actions by participants in the market through

Texas needs to oversee the electric and telecom industries because of their essential nature.

Regulation is needed because of the complexity of electric and telecom markets.

a greater choice of providers competing for customers by keeping prices low and ensuring quality services. In practice, regulation is still needed even in a more competitive environment because of the complexity of the electric and telecommunications markets and the web of service providers involved in the delivery of electricity or the completion of calls by telecommunications carriers. Oversight also is needed to prevent fraud and abuse that can still cause harm to the public. Rate regulation has been replaced with rules establishing operating requirements, complaint monitoring, and enforcement.

This oversight has addressed problems that otherwise would go unattended. In fiscal year 2009, PUC received about 76,600 customer calls and informally resolved about 19,000 complaints. Also in that year, PUC conducted 86 enforcement investigations and sought administrative penalties in 30 cases, resulting in the assessment of \$20.2 million in penalties.

Different organizational options for carrying out the regulation of the electric and telecommunications industries could be considered with upcoming Sunset reviews.

The review of PUC identified the need to evaluate the consolidation of PUC programs in some fashion with gas and water utility regulation at the Railroad Commission of Texas (RRC) or the Texas Commission on Environmental Quality (TCEQ). The decision to consolidate these functions should occur only with identification of clear benefits from improved oversight, realistic cost savings, or more efficient administration. The potential for merger options to meet these criteria could be best determined during this biennium's Sunset reviews of RRC and TCEQ after the opportunity for a full evaluation.

The decision to consolidate utility regulation should occur only with the identification of clear benefits.

Consolidation of utility regulatory functions is not a new topic. Legislative history since 1991, shown in the textbox *Unsuccessful Legislative Efforts to Merge Utility Regulatory Functions* on the following page, depicts the major organizational options that could be considered. The most frequently discussed merger option, the subject of four bills, would have transferred the functions of PUC to RRC. Another bill would have transferred RRC's regulation of gas utilities to PUC, while still another would have transferred regulation of water rates and services from TCEQ's predecessor agency to PUC. Finally, one bill would have created a new agency composed of programs from PUC and some of RRC's programs.

All states regulate electric and telecommunications functions, but typically do so in an agency that also regulates gas and water utilities.

Unlike Texas, nearly all states have only one agency that regulates electric, telecommunications, natural gas, and water utilities. Parting from this typical pattern, Massachusetts regulates telecommunications and cable providers in a separate agency from other utilities;¹ and Nebraska has a separate agency to regulate its electric utilities, which are all publicly owned.² A few states do not regulate water utilities.

Unsuccessful Legislative Efforts to Merge Utility Regulatory Functions

- **1991 (1st Called Session) – S.B. 26 (Montford):** Would have transferred the functions of PUC to RRC. Referred to Senate Finance Committee. No action taken.
- **1997 – S.B. 1768 (Cain):** Would have abolished PUC and transferred its powers and duties to RRC. Placed on Senate Intent Calendar, then removed.
- **1999 – H.B. 603 (Siebert, Wohlgemuth, Homer):** Would have abolished PUC and transferred its powers and duties to RRC. Referred to House committee. No action taken.
- **2001 – H.B. 3429 (Merritt):** Would have transferred RRC powers and duties regarding regulation of gas utilities to PUC. Referred to House committee. No action taken.
- **2001 – H.B. 724 (S. Turner):** Would have transferred regulation of water rates and services from the Texas Natural Resource Conservation Commission, predecessor to TCEQ, to PUC. Left pending in House committee.
- **2003 – S.B. 1048 (Ellis):** Would have abolished PUC and RRC and created the Texas Energy and Communications Commission. Left pending in Senate committee. Bill was based on the recommendations of the Comptroller of Public Accounts.
- **2003 – H.B. 2596 (Homer):** Would have abolished PUC and transferred its powers and duties to RRC. Referred to House committee. No action taken.

Recommendation

3.1 Postpone the decision on continuing PUC and the administrative structure of utility regulation until completing the upcoming Sunset reviews of the Railroad Commission and the Texas Commission on Environmental Quality.

This recommendation would postpone the staff recommendation and the Sunset Commission's decision to continue PUC as a separate agency or to merge its programs with other utility regulatory programs until completion of this biennium's Sunset reviews of RRC and TCEQ. Postponement would permit a more complete evaluation of merger options during those reviews.

Fiscal Implication Summary

This recommendation would not have a fiscal impact to the State.

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¹ Massachusetts Department of Telecommunications and Cable, <http://www.mass.gov/dtc>. Accessed: March 19, 2010.

² Nebraska Power Review Board, <http://www.powerreview.nebraska.gov/>. Accessed: March 19, 2010.

Electric Reliability Council of Texas

Agency at a Glance

Agency at a Glance

The Electric Reliability Council of Texas (ERCOT) manages the electric grid for most of Texas, ensuring the “lights stay on” by coordinating the flow of power on and off the grid. The ERCOT region in Texas accounts for 85 percent of Texas’ electric consumption and 75 percent of the Texas land area. A map of the ERCOT service area is depicted in Appendix C. In the last 15 years, the Legislature has restructured the generation and retail sale of electricity in the ERCOT region to be competitive. As central coordinator of the grid, ERCOT oversees and settles grid-related financial transactions among market participants.

Because Texas’ electric grid is not directly connected to grids in other states, ERCOT is primarily regulated by the Public Utility Commission, not federal authorities. ERCOT is managed by a Board of Directors as a nonprofit corporation.

Key Facts

- **ERCOT Board.** The Board has 16 members in several membership categories and selected through different means, as shown below.

ERCOT Board Membership

Group	Board Member	Representation	Selection Method
5 Unaffiliated Members	Jan Newton, Chair	Unaffiliated member	ERCOT Membership
	Michehl Gent, Vice Chair	Unaffiliated member	
	Miguel Espinosa	Unaffiliated member	
	Alton D. “Dee” Patton	Unaffiliated member	
	Vacant	Unaffiliated member	
ERCOT	H.B. “Trip” Doggett, Interim President and Chief Executive Officer	ERCOT	Ex Officio
PUC	Barry T. Smitherman (Non-voting)	PUC, Chair	
3 Consumers	Sheri Givens, Public Utility Counsel	Residential and small commercial consumers	
	Andrew J. Dalton	Industrial consumers	
	Nikolaus Fehrenbach	Large commercial consumers	
6 Market Participants	Calvin Crowder	Investor-owned utilities	Elected by respective market segment
	Mark Dreyfus	Municipally owned utilities	
	Robert Helton	Independent generators	
	Clifton Karnei	Electric cooperatives	
	Jean Ryall	Independent power marketers	
	Marcie Zlotnik	Independent retail electric providers	

- **Funding.** ERCOT's budget for 2010 is about \$267 million, with most funding coming from fees on wholesale electricity and \$27.8 million in debt financing for capital projects. As a nonprofit corporation, ERCOT does not receive State appropriations, but instead collects two statutorily authorized fees – the System Administration Fee and the Nodal surcharge. The System Administration Fee is paid by retailers of electricity in the ERCOT region, and the Nodal surcharge is paid by power generation companies. While both fees are assumed to be passed on to consumers, neither fee appears as a separate charge on residential bills. The average monthly cost of the System Administration Fee for residential customers is about 42 cents, and the average cost of the Nodal surcharge is about 38 cents. The Public Utility Commission has oversight of ERCOT's fees.
- **Staffing.** In 2010, ERCOT has 695 staff and an authorized workforce of 745. ERCOT supplements its employed workforce with an additional 126 contractors, principally for its Nodal project, described below. The majority of the staff, 94 percent, are based in Taylor, and 6 percent of the staff are in Austin.
- **State Oversight.** Texas is unique in that most of its electric grid is not connected to the grid in the rest of the country. Because of its separateness, the ERCOT electric market is primarily regulated by the Texas Legislature and the Public Utility Commission, not federal authorities. However, the Federal Energy Regulatory Commission and the North American Electric Reliability Corporation do have oversight of ERCOT's compliance with federal standards for the reliability of electricity delivery.
- **Grid Operations.** ERCOT directs the transmission of electricity through a grid that connects 550 generation units to 22 million Texans through 40,000 miles of transmission lines. In this role, ERCOT coordinates the scheduling of power by market participants; ensures the matching of generation and consumption at all times; relieves transmission congestion, which is the overuse of certain lines at certain times; operates the wholesale electric market; and plans improvements to the transmission grid.
- **Nodal Project.** ERCOT is currently overseeing Texas' transition from a wholesale electric market that is based on four regional zones, to a marketplace based on more than 4,000 individual nodes in the ERCOT region. The goal of this market redesign is to improve the operating efficiency of the market and the electric grid by using much more accurate site-specific information for scheduling and pricing electric services.
- **Wholesale Electric Market.** While most power needs of Texas consumers are met through established agreements between retail electric providers and generators, ERCOT operates a wholesale power market that allows retail electric providers to meet power needs not covered by these agreements and to match supply and demand of electricity. Due to weather conditions and other factors affecting power availability, the prices in this market can vary between an average low of \$20 per megawatt to highs of \$2,000 per megawatt or more at peak times and when transmission is congested.

As coordinator of the wholesale market, ERCOT has detailed information about market participants' production and consumption of electricity. ERCOT uses that information to settle financial transactions among the participants.

- **Retail Customer Switching.** ERCOT manages databases containing information on all retail customers in competitive areas. When consumers in competitive retail areas choose to switch retail electric providers, ERCOT records the switch in its database.

Issues

Issue 1

The Electric Reliability Council of Texas Needs Better Oversight to Address High Risk in Its Operations.

Background

State law and PUC action have transformed the Electric Reliability Council of Texas (ERCOT) into a much more important participant in the Texas electric marketplace from its conception by Texas' electric utilities to manage transmission of electricity between service areas. ERCOT is the Independent System Operator in Texas' restructured electric market, a role that gives it responsibility to ensure the reliable delivery of electricity, oversee the electric grid, and operate the wholesale marketplace for electricity.

ERCOT's operating budget is funded primarily through a statutorily authorized fee on electricity, the System Administration Fee, and capital expenditures are funded through a mix of debt financing and revenue payments. ERCOT assesses the System Administration Fee against wholesale electricity transactions and it becomes part of the overall cost of electricity.¹ ERCOT does not have bonding authority and its debt financing consists of loans from financial institutions. ERCOT is also involved in a major project, called the Nodal project, to change the structure of the electric market. ERCOT pays the costs of this project through debt financing and a special surcharge, which also becomes part of the total cost of electricity.

As a nonprofit corporation, ERCOT is not subject to the oversight afforded to state agencies, such as the legislative appropriations process and periodic Sunset review. Instead, statute grants PUC broad authority to oversee ERCOT's finances, budget, and operations. The statute further authorizes PUC to require ERCOT to provide reports on its revenues, expenses, and other financial matters; conduct or require audits; inspect records and accounts; and assess administrative penalties against ERCOT if it fails to adequately perform its functions or duties.

ERCOT operates entirely within Texas and does not come under the direct oversight of the Federal Energy Regulatory Commission, unlike other independent system operators whose regions cross state lines. The federal government does have a limited oversight role, however, for ensuring ERCOT's compliance with federal reliability standards.

Findings

The size of ERCOT's operations and its important public role indicate the need for proper State oversight.

To be effective, external oversight of an entity such as ERCOT needs to be scaled to the level of risk and public importance of its operations. ERCOT's critical public operations and rapid growth show a need for careful oversight.

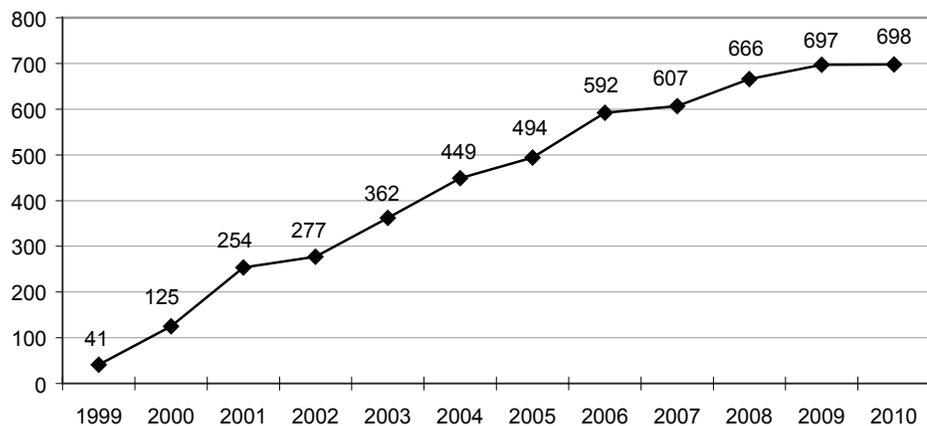
ERCOT plays a large and important role in the health and safety of Texans by ensuring the reliable transmission of electricity. Since deregulation and the break-up of monopoly electric companies, ERCOT has assumed the

ERCOT oversees key parts of the electric market which has a total retail value of \$34 billion.

important economic role of operating key components of the wholesale electric market; facilitating wholesale electricity transactions among power generators and retailers; and serving as a registry of customer information for retailers for billing and switching. ERCOT also ensures the reliability of the electric grid and plans improvements to the transmission network. The total retail value of Texas' electric marketplace is about \$34 billion annually.

To accomplish its public functions, ERCOT has grown rapidly as illustrated in the graph, *ERCOT Employees by Year*. ERCOT's budget has grown similarly. In 2001, the year ERCOT began public functions as Texas' Independent System Operator, ERCOT's overall spending was \$60 million; within a decade, its overall spending has increased to \$267 million for its 2010 budget year. ERCOT's operations are paid for by public funds, coming from the statutorily authorized System Administration Fee on wholesale electricity. The average residential consumer's share of this cost is \$5.04 per year, up from \$1.32 in 2001. ERCOT's surcharge for the Nodal project now adds another \$4.50 to each ratepayer's annual electricity cost.

ERCOT Employees by Year



ERCOT has grown rapidly in the past decade.

The Nodal project illustrates the risk inherent in ERCOT's operations and the need for careful oversight. The purpose of this project is to achieve greater efficiency in transactions involving Texas' wholesale electric market, moving from a system based on four regional zones to a much more complex system that tracks these transactions through more than 4,000 pricing nodes. ERCOT's management of this project, however, has resulted in huge cost overruns and project delays. The project's cost has risen from \$95 million² to \$644 million, while the start date has been delayed by two years and is now expected to be operational in December 2010.

PUC's ability to oversee ERCOT finances is inadequate.

The PUC Commissioners have said that the statute does not provide them with adequate authority over ERCOT's budget and use of debt financing.³ Although the statute grants PUC authority to review ERCOT's fee requests and to order audits of ERCOT's finances, PUC reviews ERCOT's revenue

requests as if it were a regulated utility rate case. In this fashion, PUC waits to review ERCOT’s financial operations until receiving ERCOT’s request for a revision in the System Administration Fee that funds its programs.

This reactive approach does not result in a regular, systematic assessment of ERCOT’s budget and finances. As ERCOT has not requested changes in its fee assessment since 2006, PUC has not reviewed its spending for four years. ERCOT submitted a fee increase request to PUC in 2008, but withdrew it before PUC’s review. In 2010, ERCOT proposed increasing the System Administration Fee from 42 cents per megawatt-hour to 45 cents.⁴ When the PUC Commissioners indicated that this request would be carefully evaluated, ERCOT reworked the budget, cut costs, and again did not undergo a PUC review.

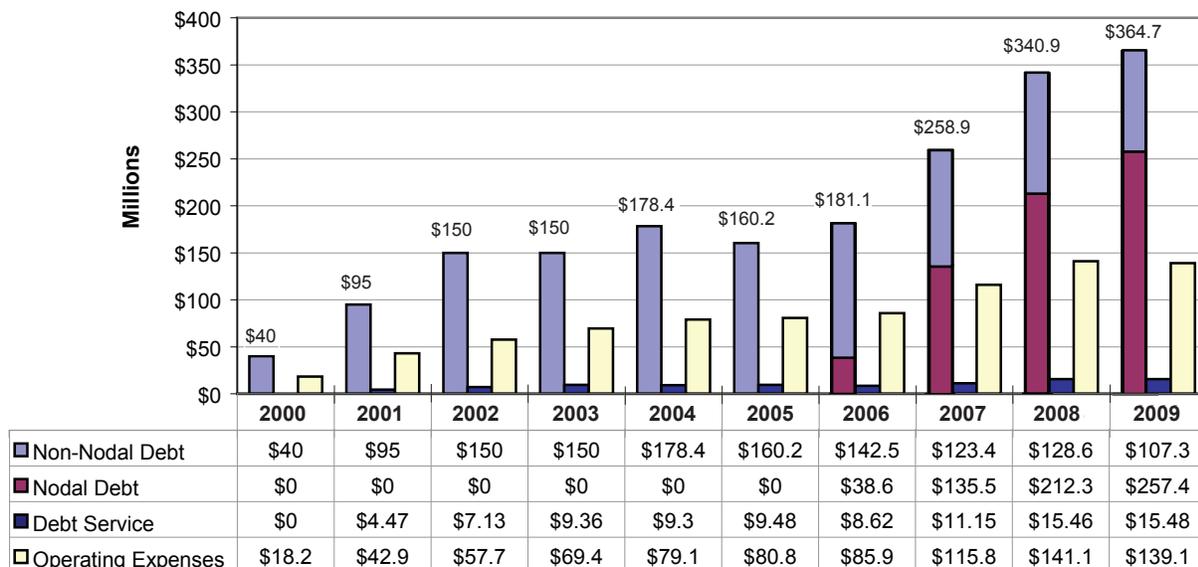
PUC also lacks the clear authority to require prior approval of ERCOT’s use of debt financing.⁵ Scrutiny of ERCOT’s debt is important because of ERCOT’s extensive use of debt financing and its significant impact on overall spending. ERCOT is carrying an accumulated debt of \$365 million and expects to borrow an additional \$27.8 million this year. Debt service for these borrowed funds cost \$15.5 million in 2009.⁶

Although debt financing may be appropriate for long-term infrastructure projects, debt that is handled incorrectly results in increased costs. For example, debt used to pay off previous debt and interest or to purchase short-term assets with long-term financing can create an increasingly expensive financing pattern if not balanced with appropriate increases in revenues. The agency currently matches debt to the expected life of the asset, but ERCOT’s older debt represents a 14-year payout for some assets that were in use for only three to five years. The chart, *Growth of ERCOT Debt, Debt Service, and Operating Expenses*, shows ERCOT’s accumulated debt in comparison to its current operating spending.

PUC does not review ERCOT’s budget, but only its infrequent requests for fee increases.

PUC lacks clear authority to approve ERCOT’s debt financing, although the total debt is now \$365 million.

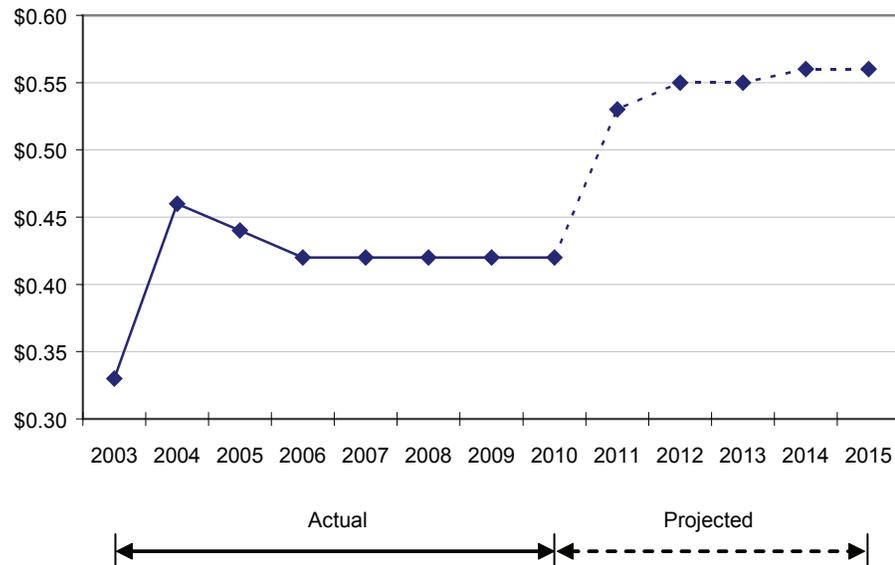
Growth of ERCOT Debt, Debt Service, and Operating Expenses



Without systematic debt approval, PUC's oversight of ERCOT's budget is weakened. A potential danger is that ERCOT could increase its budget simply by issuing more debt, and later come to PUC for approval of a fee increase to pay off that debt. PUC would then have little choice but to approve a fee increase just to pay for an obligation already incurred.

Active oversight of ERCOT's debt and finances is needed to avoid this type of circumstance. An increasing budget most likely means increasing fee, both for operating costs and to service mounting debt. These fees, as noted, become part of the total cost of electricity. ERCOT already projects fee increases of 33 percent within the next four years.⁷ Assuming all fees are passed on to consumers, the average residential household would see its share of ERCOT's operating expenses go from \$5 to \$6.72 per year. The chart, *Projected Increases in the System Administration Fee*, shows the actual fees from 2003 to 2010, and the projected increases through 2015.

Projected Increases in the System Administration Fee



In comparison, typical state processes provide for more effective oversight of budgets and debt issuance. The Legislature's appropriations process ensures that the budget of each state agency is systematically and fully reviewed each biennium, without depending on an agency to initiate the process. Appropriations oversight encompasses a staff-level review by the Legislative Budget Board, and a full airing of all relevant issues by House and Senate committees.

ERCOT's reliance on the System Administration Fee results in uncertain finances.

The current process of funding ERCOT's operations by a fee assessed on electricity consumption means that ERCOT must operate on revenue collections that may not match its costs. As ERCOT's fee revenues vary

with the consumption of electricity, ERCOT has had to institute cost savings measures in years that power consumption is lower than projected. In years of greater electricity consumption, ERCOT overcollects revenues, and has used excess funds for capital projects or to make debt payments.

Certain state agencies have the means to adjust funding streams in order to ensure adequate funding for the work they must perform. For example, the State's financial regulatory agencies – Department of Banking, Department of Savings and Mortgage Lending, and Credit Union Department – are funded by fees set by each agency's commission to match revenues to expenditures.

ERCOT's revenues are uncertain, varying according to how much power is consumed.

ERCOT's statute lacks a provision for continued Sunset review, limiting opportunities for legislative oversight.

ERCOT's Sunset clause requires only this current one-time review, so future reviews are not assured. The clause does not provide for automatic termination, although existing statute includes a method by which PUC could remove ERCOT's public functions, making automatic termination less necessary. PUC has the authority to decertify ERCOT as Texas' Independent System Operator and then transfer ERCOT's assets to a successor organization.

ERCOT's essential role in ensuring the reliable distribution of electricity and operating the wholesale electric marketplace has drawn legislative attention in recent sessions, suggesting interest in ongoing legislative oversight. Future reviews of ERCOT could occur as part of future Sunset reviews of PUC without a separate Sunset clause. However, the emphasis on continued, systematic legislative oversight would be stronger with ERCOT having its own ongoing Sunset requirement. The Sunset clause could require that reviews be conducted concurrent with future PUC reviews.

Recommendations

Change in Statute

1.1 Require PUC to exercise additional oversight authority of the Electric Reliability Council of Texas by:

- **annual review and approval of ERCOT's entire budget; and**
- **prior review and approval of all uses of debt financing.**

Statute would require PUC to take an active role in reviewing ERCOT's spending by focusing on the agency's entire budget, not just requests for additional fee authority. The statute would require PUC to review and approve ERCOT's budget annually, with the explicit authority to approve, disapprove, or modify each item in ERCOT's budget. These reviews would be exempt from requirements to conduct proceedings as a contested case and PUC would be granted authority to determine the most appropriate process for allowing public participation in conducting the reviews. PUC would be granted rulemaking authority to establish reasonable dates for submission of all necessary budget documents, and the necessary level of detail contained within the documents. Statute also would require PUC to review and approve each request for use of debt funding or refinancing of existing debt.

This recommendation would not have a fiscal impact to the State, as PUC could provide additional oversight of ERCOT’s finances with existing staff. Although PUC does not fully scrutinize ERCOT’s budget annually, the agency does have current staff that observe ERCOT and examine its requests for increases in the System Administration Fee.

1.2 Establish that the System Administration Fee vary according to the revenues needed to fund the budget approved by PUC.

PUC would approve the appropriate level of funding for ERCOT’s annual budget, instead of the current procedure of approving the fee needed to raise a particular amount of funding. ERCOT would then set the System Administration Fee, within a range set by PUC, to raise the projected amount of budgeted funds. The ERCOT Board would adjust the fee on a quarterly basis as more accurate information is known about the revenues that the fee is actually producing. ERCOT would be expected to closely match the fee to the budget so that budgetary years would not end with extra or inadequate funds. This recommendation would not have a fiscal impact because ERCOT’s accounting and collection systems already have the capacity to accommodate variations in the System Administration Fee.

1.3 Create a Sunset clause providing for future Sunset reviews of ERCOT, concurrent with reviews of the Public Utility Commission.

This recommendation would require the Sunset Commission to review ERCOT, but would not include an automatic termination clause. Future Sunset reviews would occur in the same legislative cycle that the Commission reviews PUC. As a public-purpose, nonprofit corporation not receiving state appropriations, ERCOT would continue to pay the cost of its Sunset reviews.

Fiscal Implication Summary

These recommendations would not have a fiscal impact to the State.

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¹ Electric Reliability Council of Texas, *Self-Evaluation Report*, submitted to the Sunset Advisory Commission (September 2009), p. 21.

² Thomas F. Schrader, ERCOT President and Chief Executive Officer, “State of the Market & What’s Ahead at ERCOT,” presentation to Gulf Coast Power Association (Houston, March 23, 2006). Online. Available: <http://www.gulfcoastpower.org/default/3-06meeting-schrader-houston.pdf>. Accessed: March 29, 2010.

³ Public Utility Commission, *Report to the 81st Texas Legislature: Scope of Competition in Electric Markets in Texas* (Austin, Texas, January 2009), p. 75.

⁴ John Moritz, *Texas Energy Report*, “ERCOT’s Proposed Budget Would Trim Costs But Hike Surcharge” (August 17, 2009).

⁵ PUC, *Scope of Competition*.

⁶ ERCOT does plan to pay off most of its existing debt by 2015.

⁷ Electric Reliability Council of Texas, “2010 Proposed Budget” (September 15, 2009), p. 14.

Issue 2

The Presence of Electric Market Stakeholders Impairs the Impartiality of the ERCOT Board.

Background

The Electric Reliability Council of Texas (ERCOT) serves as the Independent System Operator (ISO) for most of Texas, a role that gives it responsibility to ensure reliability of the electric grid and to operate the electric market. ERCOT is governed by a 16-member Board of Directors (Board) composed of directors representing stakeholders in the electric market as well as directors who are unaffiliated with the market, having no financial stake in its operation. See the table, *ERCOT Board of Directors*, for more information about the composition, methods of selection, and terms of the members.

ERCOT Board of Directors

16 Total Members	Represents	Method of Selection	Term
8 Electric Market Stakeholders	Electric cooperatives	Elected by respective market segment	1 Year
	Independent generators		
	Independent power marketers		
	Investor-owned utilities		
	Municipally owned utilities		
	Retail electric providers		
	Industrial consumers		
	Large commercial consumers		
5 Unaffiliated Directors	Unaffiliated with any market segment	ERCOT Membership	3 Years
PUC Chair (non-voting)	Public Utility Commission	Ex Officio	N/A
ERCOT CEO	ERCOT	Ex Officio	N/A
Public Counsel of the Office of Public Utility Counsel	Residential and small commercial consumers	Ex Officio	N/A

ERCOT's Board directs an entity whose organization and operation is different from that of a state agency. ERCOT operates as a nonprofit corporation under Section 501(c)(4) of the Internal Revenue Code. As such, this nonprofit has a membership as well as a staff. ERCOT's membership reflects the stakeholder composition of the Board; the membership comprises electric market stakeholders who typically pay a fee to participate in the organization and are entitled to elect representatives to the ERCOT Board.

By statute, the Board includes five unaffiliated directors, one of whom must serve as ERCOT's Board Chair, as elected by the Board. Unaffiliated directors are compensated for attendance at meetings, up to \$90,000 per year, with the Chair receiving an extra \$10,000. The Public Utility Counsel serves as a voting, ex officio director representing both residential and small commercial consumers. The ERCOT

Chief Executive Officer (CEO) also serves as a voting, ex officio director, while the Public Utility Commission (PUC) Chair serves as a non-voting, ex officio director.

The ERCOT Board hires the CEO, oversees the CEO's management of the agency, approves the budget, approves major purchases and contracts, establishes the agency's goals and objectives, and creates the ERCOT protocols that control how electricity is generated, transmitted, and sold. PUC may review each of these actions.

Most issues going to the ERCOT Board begin with discussions in ERCOT's Technical Advisory Committee (TAC). This committee recommends policies and procedures to the Board and prioritizes protocol revision requests, which are requests to change the rules and procedures governing market operations. TAC is composed of 30 stakeholders representing various electric company and consumer interests, including representation of residential consumer interests by a staff member from the Office of Public Utility Counsel and a person selected by the Public Counsel and compensated up to \$36,000 annually out of ERCOT funds. To work out the details of complex proposals, TAC frequently assigns issues to one of its five subcommittees or to an ad hoc task force or workgroup. Membership on these task forces changes according to the topic at hand.

Findings

The makeup and selection of the ERCOT Board gives extensive influence to stakeholders with an interest in the decisions of the Board.

- **Financial interests on the Board.** Changes in ERCOT's role have made the presence of stakeholders on its Board inappropriate. ERCOT began as a private consortium of investor-owned utilities. Through several legislative sessions beginning in 1995, the Legislature restructured the wholesale and retail electric markets by introducing competition. These actions transformed ERCOT into Texas' Independent System Operator with responsibility for ensuring system reliability, open access to the transmission grid, switching retail customers between electricity providers, and settlement of wholesale market transactions. Today, transactions in ERCOT's wholesale electric market have a retail value of \$34 billion per year.

Industry stakeholders on the ERCOT Board can influence policies that may unfairly benefit their company or industry.

Eight of the 15 voting directors of the ERCOT Board are industry stakeholders who have a direct and significant financial interest in the workings of the electric market. These stakeholders include generators, sellers, marketers, transmission and distribution utilities, and industrial and commercial consumers of electricity who are in the position of influencing policies that may unfairly benefit their company or industry. For industrial and large commercial consumers, this interest is not readily apparent, but still real. For example, in ERCOT's efforts to match the generation and consumption of electricity, industrial and large commercial consumers are paid to help balance generation and use of electricity at certain times by agreeing to curtail their consumption. In this instance, large consumers have a vested interest in ERCOT's decisions on market operations.

While residential consumers represented on the Board by the Public Counsel also are stakeholders with an interest in low electricity prices, they do not have the same direct financial interest in the electric market as the other stakeholder Board directors. The Public Counsel, in fact, does not work for a specific employer that could stand to gain or lose financially in the market.

- **Differences in makeup from other transmission system operators.** ERCOT is the only transmission system operator in North America that does not have a fully unaffiliated board.^{1,2} The table, *Transmission System Operator Comparison*, has more information on the composition of the boards in North America with functions similar to ERCOT.

ERCOT is the only transmission system operator in North America without an unaffiliated board.

Transmission System Operator Comparison

Organization	Board Size	Unaffiliated Directors	Appointing Body	Area
ERCOT	16	5	Stakeholder groups approve Unaffiliated Directors and elect market segment members	Texas
Alberta Electric System Operator (AESO)	7	All	Minister of Alberta	Alberta, Canada
California ISO (CAISO)	5	All	California Governor	California
Independent Electricity System Operator (IESO)	10 (9 members plus CEO)	All	Ontario Minister of Energy and Infrastructure	Ontario, Canada
ISO New England (ISO-NE)	10 (9 members plus CEO)	All	Elected by Board	All or parts of 6 U.S. States
New Brunswick System Operator (NBSO)	5	All	Appointed by Lieutenant-Governor in Council (Executive Council of New Brunswick)	New Brunswick, Nova Scotia, Prince Edward Island, and Northern Maine
New York ISO (NYISO)	10 (9 members plus CEO)	All	Elected by Board from nominations by stakeholder Management Committee	New York
Midwest Independent Transmission System Operator (MISO)	8 (7 members plus CEO)	All	Elected by Members	All or parts of 13 U.S. States and Manitoba, Canada
PJM Interconnection	10 (9 members plus CEO)	All	Elected by Members Committee	All or parts of 13 U.S. States and the District of Columbia
Southwest Power Pool (SPP)	7 (6 members plus CEO)	All	Elected by Members	All or parts of 9 U.S. States

The Federal Energy Regulatory Commission (FERC), which oversees all U.S. transmission system operator boards except for ERCOT, adopted a final rule in 1999 addressing their makeup. Such a board “will be judged on a case-by-case basis against the overarching standard that its decisionmaking process must be independent of individual market participants and classes of market participants.”³ FERC created this standard partly in response to U.S. Justice Department arguments that industry officials be kept off these boards due to concerns that utilities could band together to unreasonably restrain trade and lessen competition.⁴

FERC has required the Southwest Power Pool, a transmission system operator for parts of Texas and nine other states, to transition to a fully independent board as a condition for approval. FERC also found the California Independent System Operator board, including 11 stakeholders, to be insufficiently independent and directed it to reform as an independent, non-stakeholder board.⁵

- **Financially interested stakeholder dominance in selecting unaffiliated directors.** Electric market stakeholders with direct financial interest in ERCOT policies exercise a large degree of control in selecting unaffiliated directors. This control could potentially orient the selection process toward an unaffiliated director with a stronger industry leaning than might otherwise be the case.

Industry stakeholders exercise a large degree of control in selecting unaffiliated directors.

The selection process begins with an independent search firm that finds candidates for an unaffiliated slot. First, the Board’s nominating committee, comprising all voting Board directors excluding the CEO, chooses a nominee by at least a two-thirds majority from candidates submitted. Being in the majority at the Board level, stakeholder directors with direct financial interests have the greatest voting influence on selecting a nominee for an unaffiliated slot.

Next, the nominee goes to ERCOT’s voting membership for approval or disapproval. ERCOT’s bylaws divides the organization’s membership into the following seven groups, called “market segments”:

- electric cooperatives;
- independent generators;
- independent power marketers;
- investor-owned utilities;
- municipally owned utilities;
- retail electric providers; and
- consumers, further divided into residential, commercial, and industrial groups.

Each of these market segments gets one vote, with a majority vote needed for the nominee's approval. Six of these seven market segments consist solely of electric industry participants with direct financial interests in the industry. The seventh segment combines all consumers – industrial, large commercial, small commercial, and residential – further diluting any residential consumer influence. The voting arrangement gives financially invested stakeholders a clear majority to approve or reject the unaffiliated director nominee. Finally, an unaffiliated director nominee approved by the membership goes to PUC for final approval.

- **Legislative interest in Board restructuring.** The Legislature has shown concern in the large stakeholder presence on the ERCOT board and has taken action to change it. When PUC first certified ERCOT as the Independent System Operator, ERCOT's Board had no unaffiliated directors but added three at the urging of legislators. In 2005, the Legislature required ERCOT to add two more unaffiliated directors. In the 2009 legislative session, bills were introduced in both Houses to remove all industry directors from the Board, although these bills failed enactment.

Residential consumers are generally underrepresented in the ERCOT decision-making hierarchy.

Decision making at ERCOT starts with the Technical Advisory Committee, along with its subcommittees and ad hoc task forces, and ends with the Board. ERCOT typically conducts more than 500 TAC, subcommittee, and task force meetings annually. Unlike industry stakeholder groups, residential consumers do not have the time and resources needed to participate in ERCOT's decision-making process. In fact, the only representatives of residential consumer interests who routinely participate in these meetings are the staff designee of the Public Counsel and the person selected by the Public Counsel.

In recent proceedings before FERC, the National Association of State Utility Consumer Advocates summarized problems with small consumer representation in ISOs. The association said that the structure "prevents effective participation by end-user consumers because the rule development and stakeholder process is too complicated, time-intensive, and costly for most consumers and their advocates."⁶

Statutory requirements defining the service of the ERCOT CEO and PUC Chair need improvement and clarity.

The service of the ERCOT Chief Executive Officer as a voting director of the Board may lead to conflicts between roles as a staff member and policy maker, especially when a Board vote is close and the CEO must break a tie. Since the Board hires and reviews the performance of the CEO, this conflict is intensified.

Residential consumers have little input into ERCOT's complicated, time-intensive committee process.

Although all PUC Commissioners usually attend ERCOT Board meetings, the statute designates only the PUC Chair as an ex officio, non-voting director. If the PUC Chair is not available for closed executive sessions, the ERCOT Board invites another Commissioner to attend, although this practice is not specifically authorized by statute.

The size of the ERCOT Board hampers efficient decision making.

With 16 directors, the ERCOT Board is North America's largest transmission system operator board. Large boards make efficient decision making difficult, a fact ERCOT itself acknowledged when the Board voted to decrease its size in two steps. The Board first downsized from 25 to 19 directors in 2002, and then decreased further to 14 directors in 2003. Legislation introduced in the 2009 session would have reduced the Board to nine directors if enacted.

ERCOT benefits from the technical expertise of stakeholders through the committee process.

ERCOT uses its Technical Advisory Committee to funnel input from all of its committees to the Board. While having stakeholders serving in a voting capacity on the ERCOT Board raises questions concerning the Board's independence, technical input into ERCOT's decision making remains essential. Currently, TAC and its subcommittees and task forces serve this useful function in an appropriate manner.

The Technical Advisory Committee serves a useful and necessary function.

Recommendations

Change in Statute

- 2.1 Restructure the ERCOT Board to consist of nine directors, including seven directors unaffiliated with the electric market, and two non-voting, ex officio directors – the Chair of the Public Utility Commission or a designee, and the Public Utility Counsel.**

This recommendation would restructure the ERCOT Board from its current 16 directors by removing all electric industry stakeholder representatives and increasing the number of unaffiliated directors from five to seven. The Public Utility Counsel would serve as a non-voting director representing residential consumers. The PUC Chair would also serve as a non-voting director and be authorized to designate another PUC Commissioner to serve in the Chair's place. ERCOT's Chief Executive Officer would no longer serve as a director of the Board.

Adding two unaffiliated directors to the Board would cost up to \$180,000 as ERCOT compensates unaffiliated directors for each meeting attended, up to \$90,000. The costs would be paid from the ERCOT System Administration Fee, so no expense would be incurred by the State.

2.2 Provide that PUC select ERCOT’s unaffiliated board directors and have the authority to remove them from office when necessary.

ERCOT’s current process of hiring a national search firm to find candidates would continue. However, the search firm would report directly to PUC, which would make appointments to the Board. The current involvement of the ERCOT Board and market segment votes would end. The statute would bar unaffiliated directors from having business ties to the electric industry, as is currently provided in ERCOT bylaws, and provide grounds for PUC to remove a director based on the standard language applied across the board to state agencies undergoing Sunset review. Statute would provide for PUC’s removal of a director if the director was no longer eligible to serve as an unaffiliated director, could not discharge duties, or was chronically absent.

2.3 Establish the Technical Advisory Committee in statute.

This recommendation would ensure that the ERCOT Board continues to benefit from the technical knowledge of the electric industry through the Technical Advisory Committee. ERCOT would be required to establish the composition of TAC in its bylaws and to ensure appropriate representation of industry and consumer interests, subject to PUC approval.

Fiscal Implication Summary

These recommendations would have no cost to the State, although additional costs of up to \$180,000 for salaries of two new unaffiliated directors would be funded by the System Administration Fee.

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¹ The term, transmission system operator, is used here to refer to two similar organizations – Regional Transmission Operators (RTO) and Independent System Operators. In recent years, the definitional difference in these two terms has blurred and ERCOT has duties that cross the boundaries of both an RTO and an ISO.

² Because the transmission organizations for Canadian provinces interconnect with U.S. grids, these organizations are usually included in discussions about U.S. ISOs and RTOs, and fall within the jurisdiction of the North American Electric Reliability Corporation (NERC).

³ Federal Energy Regulatory Commission, Docket No. RM99-2-000 (December 20, 1999), p. 229. Online. Available: <http://www.ferc.gov/legal/maj-ord-reg/land-docs/rm99-2-00k.pdf>. Accessed: March 20, 2010.

⁴ Federal Energy Regulatory Commission, Docket No. RM01-12 (July 31, 2002).

⁵ Federal Energy Regulatory Commission, “Commission Orders Overhaul of California ISO Governing Board, Stresses Need For Independence,” *News Release* (July 17, 2002).

⁶ Glen Boshart, “FERC hears plenty of complaints about RTO responsiveness, transparency,” *SNL Power Daily* (February 11, 2010).

Office of Public Utility Counsel

Agency at a Glance

Agency at a Glance

The Legislature created the Office of Public Utility Counsel (OPUC) in 1983 as an independent agency, separate from the state's Public Utility Commission (PUC), to represent the interests of residential and small commercial customers in state electric and telecommunication utility matters. Key duties include the following.

- Intervenes in rate cases and contested cases that may affect rates at PUC.
- Participates in rulemakings and projects at PUC.
- Advocates on behalf of consumers in federal regulatory proceedings, primarily before the Federal Communications Commission and Federal Energy Regulatory Commission.
- Appeals decisions by PUC, or intervenes in appeals brought by others, to state district court.
- Represents residential and small commercial consumers as a member of the Board of the Electric Reliability Council of Texas (ERCOT), several advisory committees to the ERCOT Board, and the Board of the Texas Regional Entity.
- Recommends legislation concerning consumer issues.

Key Facts

- **Public Counsel.** The Office of Public Utility Counsel does not have a policy board. The Governor, with advice and consent of the Senate, appoints the Public Counsel for a two-year term. The Public Counsel oversees the Office.
- **Funding.** The Office spent about \$1.81 million in fiscal year 2009. OPUC is funded from the General Revenue Fund, which receives revenue from the Public Utility Gross Receipts Assessment on electric and telecommunications services provided to Texas customers. In fiscal year 2009, the Office spent about two-thirds of its budget on electric projects and one-third on telecommunications projects. OPUC's appropriation for fiscal year 2010 is \$1.76 million.
- **Staffing.** In fiscal year 2009, the Office employed 18 full-time and one part-time staff, but was authorized 23 FTEs. The staff is located in Austin and consists mainly of attorneys, along with economists, regulatory analysts, and administrative staff. The Office also spent more than \$126,000 in fiscal year 2009 to contract with outside experts to provide testimony in electric proceedings.
- **Litigation.** In fiscal year 2009, OPUC intervened in 56 contested cases, including 51 electric cases and 5 telecommunications cases. These contested cases included rate cases for regulated electric utilities and other cases that affect the rates consumers pay, such as for energy efficiency programs, fuel costs, hurricane cost recovery, and the Universal Service Fund. In that same year, OPUC participated in seven district court appeals of PUC decisions, all of which involved electric cases.
- **PUC Rulemakings and Projects.** In fiscal year 2009, OPUC participated in 42 rulemakings and other projects at PUC, including 30 related to electric issues and 12 related to telecommunications issues. OPUC provided comment on projects concerning requirements for retail electric providers, the use of standard billing terms, and other consumer protection issues.

- **ERCOT Involvement.** The Public Counsel serves as one of three consumer representatives on the ERCOT Board, specifically representing residential and small commercial consumers. OPUC also represents these consumer interests on ERCOT's Technical Advisory Committee and three other subcommittees. These roles enable OPUC to provide input on issues affecting consumers such as advanced meter deployment, provider-of-last-resort switching, and transition to the Nodal market design.
- **Texas Regional Entity Involvement.** The Public Counsel, as a member of the ERCOT Board, also serves as an ex-officio, voting member on the Board of the Texas Regional Entity to represent the interests of residential and small commercial consumers. This Entity, through agreements with the federal government and PUC, develops, monitors, assesses, and enforces compliance with federal reliability standards and investigates compliance with ERCOT protocols and operating guides.
- **Consumer Outreach.** OPUC has expanded its consumer outreach efforts in recent years, mainly to inform consumers of their choices in the electric retail market, to educate consumers about programs that help low-income residents pay their utility bills, and to get feedback from consumers about their priorities. OPUC holds at least one public hearing for interested consumers each year. In fiscal year 2009, OPUC held its public hearing in Houston and in fiscal year 2008, the Office held hearings in Nacogdoches and McAllen. OPUC also gives presentations to and meets with community stakeholder groups, and helps consumers who have inquiries about or complaints against their utilities, but have been unable to get resolution from PUC.
- **Federal Involvement.** In fiscal year 2009, OPUC provided comment to the Federal Communications Commission in 11 proceedings. Topics of these proceedings included consumer protection rules, the federal Universal Service Fund, and competitive issues among telecommunication providers.

Issue

Issue 1

Texas Has a Continuing Need for the Office of Public Utility Counsel.

Background

The Legislature created the Office of Public Utility Counsel (OPUC) in 1983 as an independent agency, separate from the state's Public Utility Commission, to represent the interests of residential and small commercial customers in electric and telecommunications utility matters. OPUC intervenes in rate cases and contested cases that may affect consumers at PUC, participates in rulemakings and projects at PUC, appeals PUC decisions to district court, advocates on behalf of consumers in federal regulatory proceedings and as a member of the boards of the Electric Reliability Council of Texas (ERCOT) and Texas Regional Entity, and recommends legislation concerning consumer issues.

The Governor, with advice and consent of the Senate, appoints the Public Counsel for a two-year term to oversee OPUC. In fiscal year 2009, the Office spent about \$1.81 million and employed 18 full-time and one part-time staff.

Findings

Texas has a continuing interest in having an advocate for residential and small commercial utility consumers.

Regulation and oversight of essential electric and telecommunications industries have not become simpler, but more complex, as their markets have continued to evolve since the introduction of competition and market restructuring 15 years ago. The complexity and importance of these services argue for effective advocacy for all consumer classes in regulatory proceedings, rulemakings, and other projects at PUC, ERCOT, and the Texas Regional Entity, as well as at the federal level. Residential and small commercial consumers are at a disadvantage, however, compared to other interests such as large commercial and industrial consumers, who generally have more resources and expertise available to them. Having the assistance of an advocate to help fill this gap balances the regulatory playing field.

Residential and small commercial consumers will continue to need an advocate in electricity and telecommunications matters in the foreseeable future. PUC anticipates that, in 2010, electric utilities still subject to rate regulation will file seven large rate cases, which are likely to have a significant impact on the interests of residential and small commercial consumers. Other emerging issues that may affect these consumers include: the building of transmission lines through PUC's Competitive Renewable Energy Zones project; the need for utility infrastructure upgrades and preparation for severe storms; ongoing changes to the design of the ERCOT competitive market; increasing goals for energy efficiency and renewable energy programs; and the use of the federal Universal Service Fund for broadband access.

*Having an
advocate for
residential and
small commercial
consumers
helps balance
the regulatory
playing field.*

While other organizational options exist, OPUC’s independent organizational structure makes sense for its advocacy role.

Independence is a key characteristic for a consumer advocate because it allows the advocate to focus on the needs of consumers. OPUC could be administratively attached to PUC, but doing so could affect the independence that is vital to its success. PUC has to remain neutral, represent the public interest in general, and balance the needs of industry and consumers. In contrast, due to its well-established independence, OPUC can advocate exclusively for residential and small business consumers, as statute requires. Minimal potential cost savings to be gained by administrative attachment to PUC do not warrant jeopardizing OPUC’s status as an independent advocate in PUC proceedings.

Due to its independence, OPUC can advocate exclusively for consumers.

OPUC’s duties could be transferred to the Office of the Attorney General. Since the Attorney General currently represents the interests of the State in contested cases before PUC, however, it may have difficulty also representing consumers in the same cases due to potential conflicts between the interests of the two parties. Further, the Attorney General’s Office does not have the resources or expertise to represent consumer interests in rulemakings or other projects or to work with individual consumers, as OPUC does through its outreach and assistance activities.

Twice in recent years, the Sunset Commission did not adopt staff recommendations to abolish the public counsels for utility and insurance regulation. A 2005 recommendation to abolish OPUC and split its duties between PUC and the Attorney General’s Office and a 2009 recommendation to consolidate the duties of the Office of Public Insurance Counsel into the Texas Department of Insurance were both declined.

OPUC meets the legislative intent to advocate for small consumers.

OPUC has the staff and expertise to advocate for residential and small commercial consumers. Since 1983, OPUC has been performing its statutory duties on behalf of consumers. The table on the following page, *OPUC Activity*, illustrates how the Office spent its time in fiscal year 2009.

OPUC’s outreach efforts complement PUC’s larger consumer education initiatives.

OPUC has helped raise awareness of consumer needs in proceedings such as rate cases, rulemakings, and various projects. OPUC has also been active in outreach and assistance to consumers. The agency has helped educate consumers about their choices in the electric and telecommunications markets as resources allow, complementing PUC’s larger effort to provide education through its Power to Choose website, community service announcements, publications, and other initiatives.

OPUC uses its annual public hearings and connections with community groups throughout the state to talk to consumers. OPUC also attends outreach events sponsored by utilities and community groups and recently

OPUC Activity – FY 2009

Type of Proceeding	Electric		Telecommunications	
	# of Cases	Staff Hours	# of Cases	Staff Hours
Rate Cases and Contested Cases	51	10,025.0	5	108.5
Rulemakings and Other PUC Projects	30	1,722.5	12	184.5
Federal Proceedings	0	0	11	39.0
Other OPUC Projects*	5	5,280.0	3	473.5
Appeals	7	559.0	0	0
Total	93	17,586.5	31	805.5

* The Other OPUC Projects category includes preparing for and attending its annual meeting, developing its annual report, conducting outreach activities, preparing for and attending ERCOT meetings, handling consumer complaints, monitoring federal and state carbon legislation, and preparing for its Sunset review.

established a toll-free phone number. In fiscal year 2009, OPUC staff spent 2,616 hours on electric outreach, 231 hours on telecommunications outreach, 368 hours helping customers with complaints against their utilities, and 86 hours preparing for and conducting its annual hearing.

OPUC’s role as a consumer advocate could be expanded to other types of utility cases, but that decision should be postponed until later in this review cycle.

Sunset staff considered whether to expand OPUC’s role to include representation of consumer interests in water and wastewater utility cases at the Texas Commission on Environmental Quality and natural gas utility cases at the Railroad Commission. The Legislature has recently shown an interest in authorizing OPUC to intervene in water and wastewater cases.¹ Further, OPUC currently has statutory authority to represent small consumers in natural gas cases, but only at the request of a municipality, which has never happened. While OPUC could potentially provide a more independent consumer advocate voice to those proceedings, Sunset staff determined that consideration of such a significant change should occur after the upcoming Sunset reviews of the Texas Commission on Environmental Quality and the Railroad Commission, so that staff can study those agencies and determine whether this change is necessary.

OPUC could provide a more independent consumer advocate voice to water, wastewater, and natural gas utility cases.

Most states have an advocate for utility consumers, but they use a variety of organizational structures to accomplish this function.

All but five states have established a consumer advocate function that is focused specifically on utility issues. However, the consumer advocates in the 45 other states and Washington, D.C. represent a variety of organizational

structures. Like Texas, 17 states and Washington, D.C. have a statutorily-authorized, independent utility consumer advocacy agency. Fourteen states house their utility consumer advocate within their Office of Attorney General. Six states have a consumer advocate within their utility commission. The other states have either a consumer advocacy office or representative housed in a separate state agency, a nonprofit consumer advocacy entity, or a legislative office responsible for consumer advocacy.²

Recommendation

Change in Statute

1.1 Continue the Office of Public Utility Counsel for 12 years.

This recommendation would continue OPUC as an independent agency, responsible for advocating for residential and small commercial utility consumers.

Fiscal Implication Summary

If the Legislature continues the current functions of OPUC, using the existing organizational structure, the agency's annual appropriation of \$1.76 million would continue to be required for its operation.

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¹ Texas House Bill 3838, 81st Legislature (2009); and Texas House Bill 1695, 80th Legislature (2007).

² Office of Public Utility Counsel, *Self-Evaluation Report*, submitted to the Sunset Advisory Commission (September 2009), p. 13.

Appendices

Appendix A

Glossary of Terms

Aggregator – an entity registered with PUC that aggregates multiple customers for the purpose of negotiating or contracting electricity rates with a retail electric provider.

Automatic Dial Announcing Device (ADAD) – a device that automatically dials a telephone number and then plays a recorded message or leaves a recorded message on voicemail.

Basic local exchange service – residential or business local telephone service. Including primary directory listings, tone dialing service, access to operator services, access to directory assistance services, access to 911 service, the ability to report service problems seven days a week, and Lifeline and Texas Relay services.

Cable and Video Service Provider – a company that provides video service to customers through cable, fiber optics, or phone lines.

Certificate of Convenience and Necessity (CCN) – a certificate issued by PUC granting a telecommunications or electric company the authority to operate in a service area or carry out regulated expansion or construction, such as the construction of new electric transmission lines.

Certificate of Operating Authority (COA) – a certificate issued by PUC granting a competitive local exchange carrier the authority to operate in a service area, with an obligation to offer basic local service to each customer in its area.

Competitive Local Exchange Carrier (CLEC) – a telephone competitor that competes with other CLECs or incumbent local exchange carriers in providing telephone service in a service territory.

Competitive market test – a regulatory test used to determine whether a telecommunications exchange of an incumbent local exchange carrier should be designated as “competitive” and thus allow the carrier to operate in that market without traditional rate regulation and with greatly reduced statutory requirements.

Competitive Renewable Energy Zone (CREZ) – a geographic area designated by PUC where renewable generation facilities will be installed and from which transmission facilities will be built to various areas of the state to deliver renewable power to consumers.

Customer choice – freedom of a retail customer to purchase electric services from the provider of the customer’s choice.

Customer switching – the ability of customers to move from one retail electric provider to another in competitive areas of the state.

Customer-specific contracts – contracts relating to competitive services, usually between large telecommunications companies and large business customers, involving volume pricing.

Deregulated exchange – a telecommunications exchange that meets the *competitive market test* and as a result is deregulated.

Appendix A

Deregulation – See *Electric/Telecommunications Restructuring*.

Disconnect moratorium – a period of time, usually during a weather emergency, when PUC prohibits electric providers in the state from disconnecting certain classes of customers.

Distributed Renewable Generation (DRG) – customer-owned electricity generation from a small renewable energy source located on-site, such as solar panels on a rooftop, that replaces some portion of the electricity received from large, centralized facilities such as coal, nuclear, and gas powered plants.

Electric cooperative (Co-op) – a member-owned, member-controlled utility, that serves residents and businesses in a geographic area on a not-for-profit basis.

Electric/Telecommunications restructuring – the reorganization of electric or telecommunications markets to reduce or eliminate regulation as these markets become capable of supporting competition.

ERCOT – Electric Reliability Council of Texas; the independent entity that manages the ERCOT region of the Texas electric grid.

ERCOT protocols – procedures and processes used by ERCOT and electric market participants to operate the ERCOT grid and the competitive electric market.

ERCOT region – consists of 75 percent of the geographic area of the state that is subject to electric competition and served by transmission and distribution utilities that are only marginally interconnected with electric utilities outside the state of Texas.

Extended Area Service – allows a person to make calls outside that person's local calling area to a nearby community for a flat-rate fee.

Federal Communications Commission (FCC) – an independent U.S. federal agency that regulates interstate and international communications by radio, television, wire, wireless, satellite, and cable.

Federal Energy Regulatory Commission (FERC) – an independent U.S. federal agency that regulates the interstate production, transmission and sale of electricity and natural gas, and establishes and enforces reliability standards.

Hurricane cost recovery – the ability of transmission and distribution utilities to recover, through their rates, the costs of repairing damage to electrical lines caused by natural disasters, after PUC approval.

Incentive regulation – a policy that allows telecommunications companies to operate under less restrictive rate regulation in exchange for meeting certain requirements, such as putting in place additional infrastructure.

Incumbent Local Exchange Carrier (ILEC) – a local exchange carrier that owns a telephone network in a geographical area and that obtained a certificate of convenience and necessity to provide telecommunications voice service before September 1, 1995.

Appendix A

Independent Market Monitor (IMM) – the organization designated by PUC and paid for by ERCOT to detect and prevent market manipulation, market rule violations, and market power abuses in the ERCOT wholesale electric market.

Independent System Operator (ISO) – an entity, either for profit or nonprofit, created to ensure equal access to transmission and distribution systems, ensure reliability of the electrical network, and ensure that customers' choice of retail electric provider is conveyed in a timely manner. ERCOT is the ISO for most of Texas. Also called *Transmission System Operator*, and similar to a *Regional Transmission Operator*.

Investor-Owned Utility (IOU) – a for-profit electric utility. Outside of the competitive areas of the state, it is a utility that owns all aspects of electricity production, including generation, transmission and distribution, and retail sales, and is sometimes called a *Vertically Integrated Investor-Owned Utility*. Inside the competitive areas of the state, it is a for-profit utility that operates a transmission and distribution system.

Interconnection Agreement – in the electric industry, an agreement that sets forth requirements for physical connection between a transmission service customer and a transmission and distribution utility. In the telecommunications industry, often an agreement between an ILEC and a CLEC to provide the CLEC access to the ILEC's network to complete calls.

Interexchange Carrier – a telecommunications carrier that provides long-distance service.

Lifeline – a program funded by the Universal Service Fund that provides low-income customers with discounts on their telephone bills.

Low-Income Discount Program (LiteUp) – a program that provides a discount on electricity rates to qualifying low-income customers in the competitive electric areas of Texas.

Megawatt (MW) – a measure of electric power; 1,000 kilowatts (kW) or 1,000,000 watts. One megawatt is enough electrical capacity to power 1,000 average homes.

Megawatt-hour (MWh) – a measure of the amount of power, expressed in megawatts, used over one hour.

Monopoly utility – in the basic economic sense, a utility that operates in a service area with no competitors and whose rates and service area are set, and quality of service monitored, by a governmental agency, such as PUC. Few electric or telecommunications companies operate as pure monopolies in Texas, although PUC does set rates, establish service areas, and monitor service quality for electric and telecommunications utilities having monopoly characteristics.

Municipally Owned Utility (MOU) – an electric utility owned and run by a city to deliver energy to the residents and businesses in and around that city.

Appendix A

Nodal project – a project undertaken by ERCOT in 2003 to improve wholesale electric market operation so that ERCOT can collect more specific electricity data and manage the grid more efficiently.

Nodal surcharge – a fee assessed by ERCOT on electric generation resources to pay for the transition to the new nodal market.

North America Electric Reliability Corporation (NERC) – a non-governmental organization designated by the Federal Energy Regulatory Commission to develop and enforce reliability standards in the United States for owners and operators of power system facilities.

Power Generation Company (PGC) – a firm that owns and operates electric generating capacity with the intent of selling power.

Power marketer – an entity that purchases and sells electric power.

Power to Choose – the website (www.powertochoose.org) established and maintained by PUC to provide residential and small business customers with information about the competitive electric market and information to compare rate plans among retail electric providers.

Private network services – services provided for a private network, often by an ILEC, that can include broadband services, packaged network services, or other customer-specific offerings for a private network.

Protocol revision request – a formal proceeding at ERCOT initiated by a member of the public, stakeholders, or ERCOT staff to change ERCOT protocols.

Provider of Last Resort (POLR) – in the electric industry, a designated retail electric provider required under the Public Utility Regulatory Act, section 39.106, to provide a standard retail electric service package to any requesting customer in its territory. In most cases, customers are served by the POLR for limited periods when the person's chosen retail electric provider goes out of business.

Public Utility Gross Receipts Assessment – a fee of 1/6 of 1 percent on gross receipts from electric and telephone rates charged to customers in Texas and imposed on each public utility, retail electric provider, and electric cooperative within the jurisdiction of PUC.

Qualified Scheduling Entity (QSE) – an entity licensed by ERCOT to represent power generation companies, retail electric providers, or large consumers in the periodic, daily scheduling of power production and distribution on the ERCOT wholesale market.

Regional Transmission Operator (RTO) – a form of *Independent System Operator*.

Relay Texas – a program funded by the Universal Service Fund that allows individuals who are hearing-impaired or speech-impaired to use specialized telecommunications devices to communicate with others who do not have such devices.

Appendix A

Retail Electric Provider (REP) – a firm that provides billing and electric service to a retail customer in areas that are open to customer choice.

Service Provider Certificate of Operating Authority (SPCOA) – a certificate issued by PUC granting a competitive local exchange carrier the authority to operate in a service area, without an obligation to offer basic local service to each customer in its area.

Southwest Power Pool (SPP) – a Regional Transmission Operator that ensures reliable supplies of power, adequate transmission infrastructure, and competitive wholesale prices for electricity in Arkansas, Kansas, Louisiana, Mississippi, Missouri, Nebraska, New Mexico, Oklahoma, and in the Texas panhandle and some eastern parts of the state.

State-issued Certificate of Franchise Authority (SICFA) – a PUC program that provides a standardized process for issuing certificates of franchise authority to cable and video providers.

System Administration Fee – a fee assessed on wholesale energy transactions to fund ERCOT's operations.

System Benefit Fund (SBF) – a dedicated account in the General Revenue Fund used primarily for consumer education and low-income rate reduction in the competitive electric areas of the state.

Technical Advisory Committee (TAC) – an advisory committee to the ERCOT Board that makes recommendations regarding ERCOT policies and procedures and is responsible for prioritizing projects through various processes.

Telecommunications Access Line – a telephone line connecting the customer's site to a telephone provider's network.

Texas Regional Entity – the entity that monitors and enforces compliance with federal reliability standards for the North American Electric Reliability Corporation (NERC), develops regional standards, and monitors and reports on compliance with the ERCOT protocols. In summer of 2010 with federal approval, the Texas Regional Entity will be replaced by a separate entity that will perform the same functions and be called the Texas Reliability Entity.

Transmission and Distribution Utility (TDU) – a regulated utility that owns transmission and distribution facilities in the ERCOT region of the state.

Transmission congestion – the situation that exists when requests for power across a transmission line exceed the line's capability to move that power.

Transmission System Operator – See *Independent System Operator*.

Universal service – a long-standing policy goal aimed at ensuring that all households have access to telephone service at reasonable rates.

Appendix A

Universal Service Fund – a fund outside the state treasury that funds programs to provide low-income and hearing- and speech-impaired customers with access to telecommunications services, and to provide telephone service at affordable rates to high-cost areas of the state.

Vertically Integrated Investor-Owned Utility – with respect to the electric industry, an electric utility operating outside the competitive electric area of Texas that owns all aspects of electricity production, including generation, transmission and distribution, and retail sales.

Voice over Internet Protocol (VoIP) – a technology that allows a customer to make voice calls by breaking down the voice sound into digital data, transmitting that data over a network, and reassembling it into sound for the end user. Different from traditional landline voice communication, which uses an analog rather than a digital system.

Wholesale electric market – a state-wide market where electricity is sold wholesale among producers, marketers, and retail electric providers, but not to consumers. This market may involve sales of different durations from an hour to a year or more, and may involve bilateral sales or sales to ERCOT. This market differs from the retail electric market, in which retail electric providers sell electricity at retail prices to customers.

Appendix B

Companies Regulated by PUC September 1, 2009

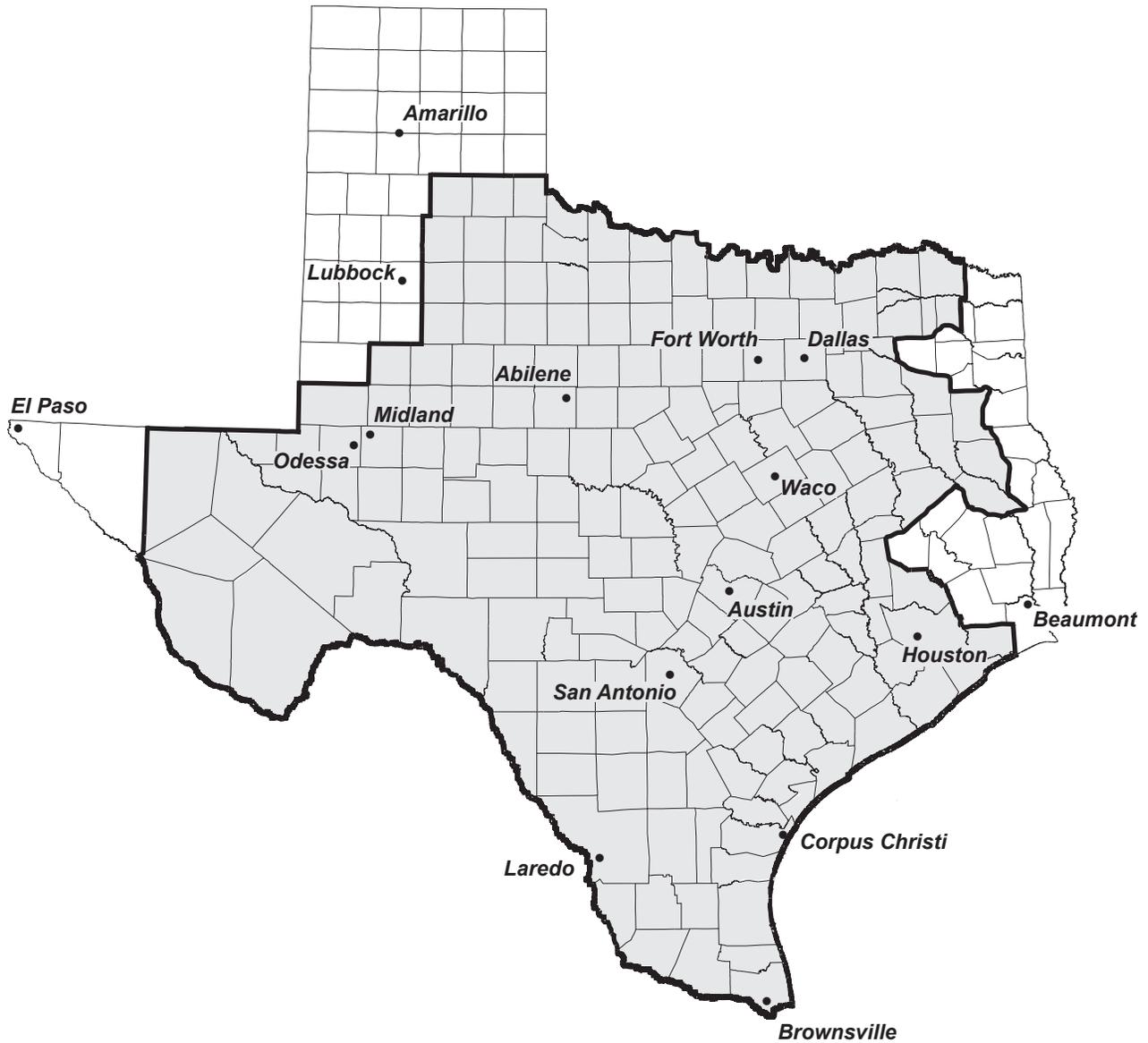
Type of Company	Explanation	PUC's Function	Number
Electric Companies			
Integrated Investor-Owned Utilities	Traditional monopoly electric utilities that exist in parts of Texas that have not been deregulated by the Legislature.	Fully regulates rates and services.	4
Transmission and Distribution Utilities (TDUs)	Monopoly investor-owned utilities that provide transmission and distribution services in otherwise deregulated parts of Texas.	Fully regulates rates and services.	8
Retail Electric Providers (REPs)	Competitive electric companies that purchase wholesale electricity from generators and directly bill consumers.	Regulates through licensing, customer protection rules, and enforcement actions.	148
Power Generation Companies (PGCs)	Competitive generators that sell electricity to retail electric providers.	Registers, but otherwise has limited regulatory authority. PGCs must comply with ERCOT protocols and are subject to PUC enforcement actions for violations.	204
Electric Cooperatives	Nonprofit, integrated utilities owned by customers. May opt in to customer choice if located in the part of the state that has been deregulated.	Authority to issue certificates of convenience and necessity for transmission lines and to regulate transmission services provided to other utilities but no authority over retail rates and services. For co-ops that opt into competition, PUC has jurisdiction over open access to distribution facilities.	75
Municipal Utilities	City-owned, integrated utilities. May opt in to customer choice if located in part of the state that has been deregulated.	Authority to regulate certification of retail service areas and transmission services provided to other utilities. No authority over retail rates and services, except to review rates charged to customers outside the municipality. For municipal utilities that opt into competition, PUC has jurisdiction over open access to distribution facilities.	72
Power Aggregators	Companies that contract with multiple customers to form a single purchasing unit to negotiate the purchase of electricity from retail electric providers.	Registers but otherwise has limited regulatory authority.	257
Power Marketers	Companies that purchase and resell wholesale electricity.	Registers but otherwise has limited regulatory authority.	197

Appendix B

Type of Company	Explanation	PUC's Function	Number
<i>Telephone Companies</i>			
Incumbent Local Exchange Carriers (ILECs)	Traditional phone companies that provide local service to businesses and residences, and wholesale services to competitive local exchange carriers.	Statute requires ILECs to offer telecommunications services for resale at wholesale rates and provide for the interconnection of telephone networks. ILECs are subject to traditional regulation, but may elect incentive regulation with pricing flexibility. Some ILEC exchanges are deregulated.	63
Competitive Local Exchange Carriers (CLECs)	Competitive companies that provide local service to businesses and residences in competition with ILECs.	CLECs must obtain a Certificate of Operating Authority or Service Provider Certificate of Operating Authority from PUC. Retail rates are not regulated.	444
Interexchange Carriers	Long distance service providers that do business in Texas.	Registers companies to facilitate enforcement.	937
Pay Phone Providers	Pay telephone providers.	Registers companies that are not local exchange companies.	105
Automatic Dial Announcing Devices	Companies that operate computerized telephones that play taped messages to consumers.	Registers companies to facilitate enforcement of statutory provisions on hours of operation, and content and length of messages.	246
<i>Cable and Video Service</i>			
Cable Service Providers and Video Service Providers	Companies that provide cable service or that distribute video programming service through wireline facilities located at least in part in the public right of way.	Issues State-issued Certificates of Franchise Authority. May enforce anti-discrimination requirements.	58

Appendix C

ERCOT Service Area



Appendix D

Staff Review Activities

During the review of the Public Utility Commission, the Electric Reliability Council of Texas, and the Office of Public Utility Counsel, Sunset staff engaged in the following activities that are standard to all Sunset reviews. Sunset staff worked extensively with agency personnel; attended PUC Commission meetings and ERCOT Board meetings; met with staff from key legislative offices; solicited written comments from, and conducted numerous meetings with, interest groups and the public; reviewed agency documents and reports, state statutes, legislative reports, previous legislation, and literature; researched the organization and functions of similar agencies in other states; and performed background and comparative research using the Internet.

In addition, Sunset staff also performed the following activities unique to this agency.

- Interviewed staff from the Office of the Attorney General, Texas Department of Insurance, Texas Comptroller of Public Accounts, and Texas Public Finance Authority.
- Researched federal issues related to the deployment of broadband technology to unserved areas and the federal Universal Service Fund.
- Attended OPUC's annual meeting and a community outreach event sponsored by OPUC.
- Attended discussion panels and policy conferences on issues such as federal climate change legislation and electricity deregulation.

SUNSET STAFF REVIEW OF THE
PUBLIC UTILITY COMMISSION OF TEXAS
ELECTRIC RELIABILITY COUNCIL OF TEXAS
OFFICE OF PUBLIC UTILITY COUNSEL

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