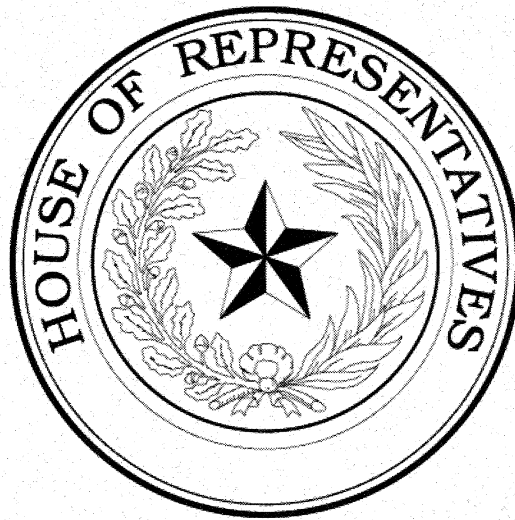


INTERIM REPORT TO THE
80TH TEXAS LEGISLATURE



COMMITTEE ON
REGULATED INDUSTRIES

JANUARY 2007

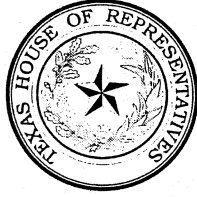
**HOUSE COMMITTEE ON REGULATED INDUSTRIES
TEXAS HOUSE OF REPRESENTATIVES
INTERIM REPORT 2006**

**A REPORT TO
THE HOUSE OF REPRESENTATIVES
80th TEXAS LEGISLATURE**

**PHIL KING
CHAIRMAN**

**TREY TRAINOR
GENERAL COUNSEL**

**CALEB TROXCLAIR
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**COMMITTEE ON
REGULATED INDUSTRIES**

**Phil King
Chairman**

**P.O. Box 2910
Austin, Texas 78768-2910**

December 2007

The Honorable Tom Craddick
Speaker, Texas House of Representatives
Members of the Texas House of Representatives
Texas State Capitol
Austin, Texas 78701

Dear Mr. Speaker and Fellow Members:

The House Committee on Regulated Industries of the Seventy-Ninth Legislature hereby submits its interim report with findings and observations for consideration by the Eightieth Legislature.

Respectfully submitted,

Handwritten signature of Phil King in cursive script.

Phil King, Chairman

Bob Hunter, Vice-Chairman

Handwritten signature of Sylvester Turner in cursive script.

Sylvester Turner, CBO

Handwritten signature of Joe Crabb in cursive script.

Joe Crabb

Handwritten signature of Will Hartnett in cursive script.

Will Hartnett

Robby Cook

Handwritten signature of Joe Straus in cursive script.

Joe Straus

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Introduction

On October 24, 2005, The Honorable Tom Craddick, Speaker of the Texas House of Representatives, issued nine interim charges to the House Committee on Regulated Industries (the Committee). This report outlines the Committee's examination of the issues, presents the facts and data obtained by the Committee, raises legislative concerns, and summarizes the recommendations of the Committee with regard to its interim charges.

Pursuant to House Rules, the Committee has jurisdiction over all matters pertaining to:

1. The regulation and deregulation of electric utilities and the electric industry;
2. The regulation and deregulation of telecommunication utilities and the telecommunication industry;
3. The regulation of science and technology, including telecommunication, electronic technology, and automated data processing;
4. Electric utility regulation as it relates to energy production and consumption;
5. Pipelines, pipeline companies, and all others operating as common carriers in the state;
6. The regulation and deregulation of other industries not specifically assigned to another committee under these rules; and
7. The Public Utility Commission of Texas, the Office of Public Utility Counsel, and the Telecommunications Infrastructure Fund Board.

The interim Committee membership included Chairman Phil King, Vice-Chairman Bob Hunter, Sylvester Turner, Joe Crabb, Will Hartnett, Robby Cook, and Joe Straus.

The current Committee membership for the 80th Regular Session includes Chairman Phil King, Vice -Chairman Wayne Christian, Sylvester Turner, Joe Crabb, Will Hartnett, Joe Straus, David Swinford, John Smithee, and Rene Oliveria.

Public Hearings Summary

The Committee received numerous hours of testimony during eight public hearings held over the interim charges, including joint hearings with the House Committee on Energy Resources and the Senate Committee on Business and Commerce. Each hearing was open to the public and held at the State Capitol Complex in Austin. The hearings took place on the following days and in the following specific locations:

1. November 14, 2005, at 10:00 a.m. in room 140 of the John H. Reagan Building.
2. December 12, 2005, at 10:00 a.m. in room 140 of the John H. Reagan Building.
3. April 18, 2006, at 1:30 p.m. in room 140 of the John H. Reagan Building.
4. April 27, 2006, at 10:30 a.m. in room 140 of the John H. Reagan Building.
5. May 4, 2006, at 10:30 a.m. in room 140 of the John H. Reagan Building.
6. May 11, 2006, at 10:30 a.m. in room 140 of the John H. Reagan Building.

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7. September 6, 2006, at 10:30 a.m. in room 140 of the John H Reagan Building.¹
8. November 6, 2006, at 1:00 p.m. in the Capitol Extension, Room E1.036.²

Findings and Observations

Charge #1

Gather and review information on the generation capacity and fuel diversity of the Texas electric market. Recommend changes to Texas law that would encourage new investment and technological innovation in emerging energy fields, such as clean coal and next generation nuclear technologies.

Generation Capacity of the Texas Electric Market

With the Texas economy ever dependent on affordable electricity it is now more important than ever before that generation capacity be sufficient. As demand continues to grow along with population, it is crucial that new electric generation facilities, with a diverse fuel mix be built. The latest numbers from the Energy Information Administration show that by 2025 the U.S. will need as much as 281 gigawatts (GW) of new generation capacity to meet rising demands. This is equivalent to 937 power plants at 300 megawatts (MW) apiece.

Approximately 80,000 megawatts of installed generating capacity currently serves the Electric Reliability Council of Texas (ERCOT) market.³ Approximately 26,000 MW of this 80,000 has been added since the introduction of wholesale electric competition in 1995. The majority of this added capacity has been in the form of either natural gas-fueled combined cycle combustion turbines (CCCTs) or wind turbines. All of this added capacity has been paid for through investment capital, based on rational investment decisions.

While the recent capacity additions have mainly been CCCTs, generating capacity located in ERCOT is fueled by a variety of sources – nuclear, lignite/coal, natural gas, hydro (water) and other renewable sources.⁴

Peak demand, that is, the maximum demand for electricity by customers at any one time, was 60,229 MW in 2005 for the ERCOT portion of Texas. Peak demand is expected to grow at 1.6% per year between 2006 and 2011 – meaning that approximately 1,000 MW of new generating capacity must be added to ERCOT each year just to keep up with demand growth.

¹ The Committee met jointly with the House Committee on Energy Resources.

² The Committee met jointly with the Senate Committee on Business and Commerce.

³ Electric Reliability Council of Texas, Report on Existing and Potential Electrical System Constraints and Needs, October 1, 2005 (ERCOT October 2005 Report) at 13.

⁴ ERCOT, Report on the Capacity, Demand, and Reserves in the ERCOT Region, June 2005 (ERCOT June 2005 CDR Report), Summer Fuel Types at 2.

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Reserve Margins

The “reserve margin” is the difference between the amount of capacity available to serve customers needs and the peak demand; in simplest form, it is calculated as follows:

$$\text{Reserve margin} = (\text{Generating Capacity} - \text{Peak Demand}) / \text{Peak Demand}$$

ERCOT has adopted a minimum target reserve margin of 12.5%. According to studies performed using an ERCOT Board-approved methodology, the reserve margin in ERCOT is projected to remain above this minimum target level through 2007 and to fall below that level in 2008. The 2006 reserve margin in ERCOT is estimated at 16.9%.⁵

	2007	2008	2009	2010	2011
Reserve Margin	15.2%	11.8%	8.9%	7.2%	4.9%

These projections assume that some of the existing generating capacity that is “mothballed” will be returned to service over time and that planned generating units that have signed interconnection agreements with electric utilities will actually be constructed and placed into service. The margins projection is quite different if all “mothballed” capacity is returned to service over time or if none of this capacity is returned. In the latter scenario, the reserve margin falls to ERCOT’s minimum target as soon as 2007.⁶

	2007	2008	2009	2010	2011
Reserve Margin (all return)	26.4%	23.1%	19.9%	18.2%	15.6%
Reserve Margin (none return)	12.0%	9.0%	6.2%	4.5%	2.2%

Planned Generating Units and Fuel Diversity

With shrinking reserve margins and economic considerations in mind, construction of new generating units will be necessary in time. The combined elements of margin, wholesale electric market price projections, and the nature of the ERCOT market structure, have provided the appropriate price signals to investors that generation investment in ERCOT is attractive. As a result, ERCOT is tracking approximately 15,000 MW of proposed generation additions, some 9,200 MW of which have been publicly announced.⁷ Fuel type is always a consideration when investing in a new generating facility. The current and long-term projected price of natural gas makes gas-fired generation relatively less attractive than it has been for the last several years. At the same time, investors must also consider that solid fueled generators require more permitting time, construction time, and capital.⁸

⁵ ERCOT May2006 CDR Report, Summer Summary.

⁶ *Ibid.*

⁷ ERCOT October 2005 Report at 15.

⁸ From the announcement to entering commercial operation, solid fuel units require approximately 5 to 7 years. Gas-fired generation can be constructed in as little as 18 months. In addition, the capital costs of gas

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Coal

The State of Texas is fortunate to have significant lignite resources: two major lignite deposits that run Northeast to Southwest, from the Arkansas/Louisiana borders to Mexico. Texas is the fifth largest coal producing state in the United States. The existing 19 active coalmines⁹ and 21 lignite/coal-fired generating units¹⁰ combine to provide over 33,000 jobs and \$300 million annually in state and local revenues as well as royalties to landowners.¹¹

Seventeen lignite/coal-fueled power plant projects have been proposed at thirteen different sites in ERCOT. These plants, all of which are in various stages of the permitting or construction process, are:

Company	County	Capacity (MW)	Fuel
CPS Energy	Bexar	750	Powder River Basin Coal
LS Power	McClennen	800	Powder River Basin Coal
NRG Energy	Limestone	858	Powder River Basin Coal
Sempra-PNM	Robertson	600	Lignite and Powder River Basin Coal
TXU Power	Fannin	858	Powder River Basin Coal
TXU Power	Freestone	858	Powder River Basin Coal
TXU Power	McClennan	858	Powder River Basin Coal
TXU Power	McClennan	1,716	Powder River Basin Coal
TXU Power	Milam	581	Lignite and Powder River Basin Coal
TXU Power	Mitchell	858	Powder River Basin Coal
TXU Power	Robertson	1,634	Lignite
TXU Power	Rusk	858	Powder River Basin Coal
TXU Power	Titus	858	Powder River Basin Coal

In spite of the need for these power plants and the fundamental soundness of the ERCOT market, these new lignite/coal power plant investments face two significant risks to their completion. First, the facilities may not be constructed if pricing signals are skewed because of regulatory intervention. Second, potential new regulations related to nitrogen oxide (NOx) emissions also threaten these and existing lignite/coal-fueled power plants, even though Texas' electric generating plants are among the cleanest in the nation (ranked sixth) and Texas is the cleanest among coal-using states.¹²

Electric generators in Texas have made significant advancements to ensure clean air, including NOx reductions to fight ozone. For example, in the Dallas-Fort Worth and

generation is approximately half that of lignite/coal (600 \$/kW versus 1,200-1,400 \$/kW) according to EPRI.

⁹ www.rrc.state.tx.us/divisions/sm/programs/regprgms/mineinfo/mines

¹⁰ www.eia.doe.gov/cneaf/electricity/page/capacity/newunits2004

¹¹ The Perryman Report, 2004.

¹² EPA 2003 Acid Rain Database. Because new federal clean air rules will cap emissions at lower levels, new plants will not be adding incremental emissions.

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Houston-Galveston-Beaumont areas, power plants have achieved an 88% or higher reduction in NOx emissions. East Texas power plants have achieved 50% NOx reductions.¹³ Between 2000 and 2005, more than \$1 billion has been spent on NOx emission reductions at Texas power plants.

On May 4, 2006, Harold Green, Vice President of Communications for Jupiter Oxygen, Inc. testified before the Committee on a new technology called the “Oxygen fuel system” or Oxy-fuel. Oxy-fuel is a system that utilizes the fuel efficiency benefits of oil, gas, coal, and biomass combustion using substantially pure oxygen, with a high flame temperature and the exclusion of air from the boiler. In September, Jupiter Oxygen and Orrville Utilities in Ohio announced that they would retrofit a 25 MW coal plant with the Oxy-fuel technology and the National Energy Technology Laboratory’s Integrated Pollutant Removal (IPR) technology. The retrofit will be completed in 2008 and is expected to cost \$34 million. When completed, in addition to achieving CO2 capture-ready status, the Orrville plant will meet FutureGen’s 2020 goals for ultra-low emissions of mercury, NOx, sulfure oxide (Sox), and particulates.

Mr. Green’s testimony conveyed that the results of tests done on the Oxy-fuel technology indicated a 95% CO2 capture rate, 90% removal of all mercury, 99+% sulfur removal, 99+% particulate capture including more than 80% of the PM 2.5 particulate and a combustion level for NOx of only .008 Lbs/MMBtu.

Renewable Energy

During the 79th Regular Session, proposals to expand the state’s Goal for Renewable Energy received significant interest and debate in committees of both the House and the Senate. The existing goal, established by SB 7 in 1999, was for Texas to achieve 2,880 MW of renewable capacity by 2009 (about 2% of the state’s energy needs). During the 2005 regular session, it was clear that the state’s Retail Electric Providers (REPs) were ahead of schedule in achieving that goal. Several related bills in both the House and Senate were filed.

Senate Bill 20, filed during a special session in 2005 provided for a goal of 5,880 MW by January 1, 2015, and a softer “target” of 10,000 MW by 2025, including a “target” of 500 MW of non-wind renewables within the 5,880 MW goal. This bill was passed overwhelmingly by the Legislature and signed by Governor Perry.

Since much of Texas’ wind resources are located in West Texas, far from urban load centers, the bill requires substantial expansion of the transmission grid. Thus, the bill required the Public Utility Commission (PUC or Commission) to designate “competitive

¹³ Per Statewide Implementation Plans adopted by the Texas Commission on Environmental Quality and codified at 30 Tex Admin Code 117.

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renewable energy zones” and examine transmission needs to provide for recovery of the intended investment in transmission facilities to support the increased renewable goal.

The General Land Office recently finalized an offshore lease for wind power – the first in the nation. While recent severe weather conditions serve as a reminder of the difficulty of building on the Texas Coast, the offshore turbines are designed to resist category 5 hurricanes, the first developed with this capability. Likewise, the transmission cable that runs from shore to the turbines will be an underwater armored cable.

A key remnant of Texas’ historical past as an independent republic is that the state controls land up to 10.3 miles off the coast – a far greater distance than is the case in other coastal states. This additional distance helps address concerns with visual pollution and noise that have stymied offshore wind development in other states. In addition, offshore Gulf Coast wind is touted as being more dependable, as it blows during the day (*i.e.*, more consistent with peak electricity demand) and at a more consistent speed.

Next-Generation Nuclear

Nuclear power has multiple benefits to recommend its advancement in Texas. Because nuclear power is the largest source of emission-free electric energy, while providing power at a low operations and maintenance cost, new nuclear generation can provide Texas with needed additional generation without emitting NOx, Sox, or other pollutants. Nuclear fuel costs are stable and a relatively small component of production cost, while the safety record for nuclear generation is very strong.

Furthermore, the federal Energy Policy Act of 2005 provides numerous incentives for the development of nuclear generation, including a production tax credit, a loan guarantee program, and risk management mechanisms. As a result of these factors, 26 new reactors have been announced and are expected to file Combined Operating License applications with the Nuclear Regulatory Commission (NRC) by the end of 2008.

In Texas, TXU announced plans to develop NRC applications for two to six GW of new nuclear-fueled generation, with the goal of bringing three reactors online between 2015 and 2020. TXU said it is considering its Comanche Peak site for an additional unit; however, TXU is not limiting its search for nuclear sites to Texas. NRG Energy, which owns a 40 percent share the South Texas Project nuclear site, plans to add two new reactors, providing an additional 2.7 GW of available baseload generation by 2015.

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Charge #2

Examine the effects of retail competition in the Texas electric market including provider of last resort options for residential customers. Recommend changes to Texas law, including incentives for market participants and residential customers.

There is ongoing discourse regarding the success of the retail electric market in Texas. Calendar year 2006 ends the final year of the Price to Beat (PTB), which served as a transitional pricing mechanism for the incumbent Retail Electric Providers. In 2007, we will begin a fully restructured competitive retail market.

Status of Retail Customer Choice

Full retail electric competition began in areas of Texas within the ERCOT grid on January 1, 2002, which includes the state's largest metropolitan areas. Since the onset of competition in ERCOT, the number of retail electric providers has grown from a mere handful of providers to 55 REPs active in the market.¹⁴ In 2005, 18 active REPs collectively offered as many as 20 different electric products to residential consumers.¹⁵ These choices included the PTB, indexed pricing plans, guaranteed savings products, fixed price plans, multi-year and month-to-month term lengths, and renewable energy options.¹⁶

The Texas market switch rates compare favorably to other industries that now have multi-year deregulation experience, such as local and long distance telephone service. Four years into deregulation, more than 35% of residential electric customers had switched providers.¹⁷ Additionally, the number of switchers to Competitive REPs (CREPs) has steadily increased; in 2005, the increase in customers served by a CREP was about 0.75% each month.¹⁸

¹⁴ 55 REPs have been certified by the Public Utility Commission. Testimony of PUC Commissioner Barry T. Smitherman before the House Committee on Regulated Industries, December 12, 2005, at 4.

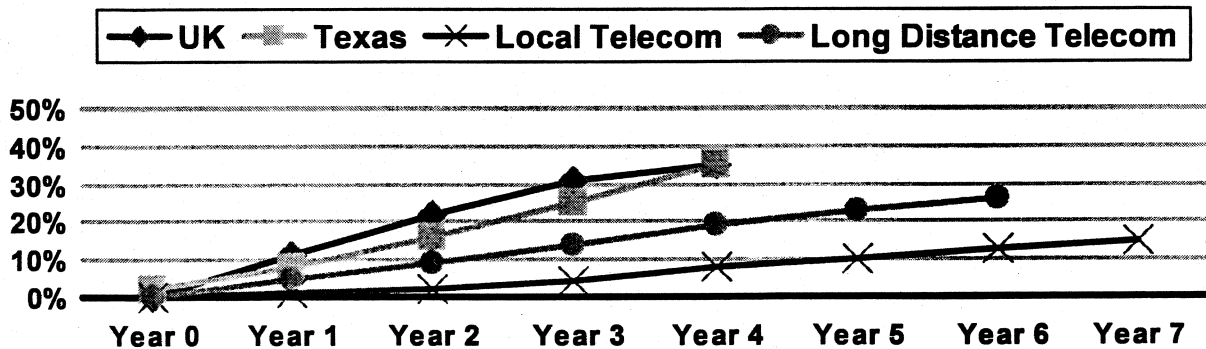
¹⁵ Testimony of Jim Burke, TXU Energy, on behalf of the Association of Electric Companies of Texas (AECT) before the House Committee on Regulated Industries, December 12, 2005, at 5.

¹⁶ *Ibid.*

¹⁷ *Ibid.* at 7.

¹⁸ Public Utility Commission of Texas, Summary of Performance Measure Data (non-confidential version) http://www.puc.state.tx.us/electric/reports/RptCard/Market_Share_Data.xls.

New Entrant Market Share



Source: PUC; FCC; ERCOT; PA Consulting

More than 75% of large commercial and industrial load switched, while 80% of small businesses switched.¹⁹

Other realized benefits of competition include unprecedented amounts of generation investment. The PUC reports that 26 GW of new generation have been installed since 1998, while older, less efficient, and more expensive to run generation has been mothballed.²⁰ Because these newer units are more efficient, they are also more environmentally friendly. Since 1998, Texas sulfur dioxide emissions have reduced by 20 percent, while nitrous oxide emissions have been decreased by 55 percent, with NOX emissions down more than 65 percent in the Dallas-Fort Worth area and the Houston-Galveston area.²¹

According to a report by The Perryman Group, as a result of retail electric competition, the stimulus to the Texas economy includes: \$5.3 billion in annual total expenditures; \$2.6 billion in annual gross state product; \$1.4 billion in annual personal income; \$946 million in annual retail sales; and 28,903 permanent jobs.²² Furthermore, the study found that “the increment to business activity is growing markedly over time”²³ with significant increases in permanent jobs compared to previous years.

¹⁹ Burke testimony at 7.

²⁰ Testimony of Commissioner Barry T. Smitherman, Public Utility Commission of Texas, before the House Committee on Regulated Industries at 5.

²¹ *Ibid.*

²² *Ibid.*

²³ *Ibid.*

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Electricity Prices

Consumers have justifiably expressed concern about increasing electric bills.²⁴ **The Committee shares these concerns.** No doubt, that natural gas prices have been a culprit of the rising electricity costs. We must also keep in mind that with deregulation, there was no guarantee that prices would always be lower; rather, the promise of deregulation is that a competitive retail electric market will yield more efficient results than traditional cost of service regulation of vertically integrated monopolies. In other words, with increased economic efficiency, a properly structured competitive retail market should offer prices that are lower than a regulated market, all other things equal.

In accordance with the market structure set forth in SB 7, the obligation on AREPs to offer the PTB expired December 31, 2006. Following the PTB transition period, customers will continue to have multiple choices of products from among a number of REPs who are differentiating their products by price, term, environmental attributes, and customer service. Nevertheless, in anticipation of the conclusion of the PTB transition period, the PUC initiated a project to review the PTB “default service” and the Provider of Last Resort.²⁵ One or more rules may be adopted as a result of this review. It is noteworthy that a coalition of REPs, including all of the affiliated REPs who were required to offer the PTB, agrees that the following guidelines are applicable to service for all customers as of the end of 2006:

- The customer’s provider will not be changed unless the customer affirmatively chooses a new provider;
- Prices will be determined by the forces of competition;
- A customer’s service term will not be increased without the customer’s choice; and
- Customers will receive notice at least 45 days in advance of any material change in the terms of service, unless such changes benefit the customer.²⁶

The Committee agrees that this is the appropriate treatment for customers at the close of the transitional PTB period.

Provider of Last Resort

The Provider of Last Resort (POLR) has worked as designed in SB7. Specifically, the POLR structure has allowed for orderly and seamless transfers of customers when REPs have exited the market. The PUC has worked with ERCOT and market participants to develop a process for mass transfers of customers to POLRs when REPs exit the market.

²⁴ Testimony of Carol Biedrzycki, Texas Ratepayers’ Organization to Save Energy, before the House Committee on Regulated Industries, Dec. 12, 2005, at 2

²⁵ See PUC Project No. 31416.

²⁶ PUC Project No. 31416, *Evaluation of Default Service for Residential Customers and Review of Rules Related to the Price to Beat and Provider of Last Resort*, Comments of the Retail Market Coalition at 34 (Dec. 12, 2005)

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Since the mass transfer procedures were developed, six REPs have stopped serving customers. As a result, approximately 27,000 meters in all customer classes have been transferred, with the transitions taking approximately 11-17 days to complete. Under the procedures, customers may switch to a CREP instead of being transferred to POLR if a switch request is submitted timely. Furthermore, an exiting REP may also transfer or sell customers to a Competitive REP rather than initiating a mass transfer to POLR.²⁷ Most importantly, the transfer to POLR process provided continuity of service, with no interruption of service for any customer.

Programs for Low-Income Residential Customers

PURA §39.903 establishes a system benefit fund (SBF) account in the state's general revenue fund that is funded through a non-bypassable fee on all electric bills in competitive areas of the state. If appropriated, these funds can be used to reimburse REPs for a uniform discount provided to qualifying low-income customers under the "LITE-UP Texas" program.

During the 79th Regular Session, appropriations to the LITE-UP program were eliminated from the final version of the SB 1 state budget bill. The result: hundreds of thousands of customers were no longer able to take advantage of this benefit after August 31, 2005, when the fiscal year ended. Although some REPs were able to continue some scaled back low-income discounts, there currently is no uniformly available program as envisioned in PURA §39.903, despite the collection of non-bypassable charges on every bill to fund this program. The Committee supports using the collected non-bypassable charges for the purpose for which it was intended.

Integration

The Committee recommends an examination of the integration of Entergy into the ERCOT market in order to provide certainty as to the status of retail open access in the relevant region of the state. Benefits could be realized from the inclusion of Southeast Texas within the ERCOT region, such as increased reliability, better access to generation facilities, improved congestion management and reserve margins within ERCOT, as well as the introduction of another major utility into the competitive electric market.

²⁷ Testimony of Commissioner Julie Parsley, Public Utility Commission of Texas, before the House Committee on Regulated Industries, Dec. 12, 2005, at 7.

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Charge #3

Monitor the implementation of the state-issued cable and video franchise system. Recommend updates that would further encourage competition and economic investment in the Texas broadband cable and video market.

Economic Investment

Since the passage of SB 5, the state-issued cable and video franchise bill, Texas has realized substantial new economic investment. More than \$1 billion in new investments statewide have been announced since its passage. Economist Ray Perryman projects 11,000 new permanent jobs will come to Texas as a result of increased competition stemming from SB 5. As of mid-year 2006, Verizon has created nearly 1,100 full-time North Texas jobs including fiber technicians, fiber splicers, fiber construction engineers and customer service representatives dating back to the launch of Verizon's fiber initiative in Texas in 2004. More than 800 contractors have also been retained to conduct underground boring, trenching, and fiber splicing.

Estimates for the overall impact of the investments include \$3.3 billion in Total Expenditures, \$1.6 billion in Gross State Product, and 19,731 person-years of employment. The evidence to date suggests that these amounts will in all probability be exceeded. Moreover, as expected in the wake of SB 5, several other states have now approved similar measures. In the absence of SB 5, much of these resources would have been deployed elsewhere, thus reducing or delaying the gains that would have been achieved by Texas.

Providers such as AT&T and Verizon are already rolling their video services out in communities around San Antonio and many communities in the North Texas area. Many smaller companies are obtaining state-issued franchises and investing in new products for their customers, such as Boerne-based Guadalupe Valley Telephone Cooperative.

Consumer Choice

Consumers are already being given a much greater range of choices in terms of service options than was available in old bundles. This stands to reason, as such a pattern has been observed in all other aspects of communications that have been subjected to competitive forces.

A few of the new features Texas consumers realize as a result of competition in the video market place include: packages that have more than 350 channels; up to twenty-five high-definition (HD) channels with extraordinary clarity and theater-quality sound; large video-on-demand libraries with hundreds of hours of diverse content; easy-to-use interactive programming guide that integrates HD programming; On Demand content and the digital video recorder along with broadcast television; the ability to search for programs using title or actor's name; and HD-capable DVR that gives customers the freedom to pause and rewind live TV and record one show while watching another.

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Consumer Savings

Based on the limited amount of information available from locations around the country with effective competition, Perryman conservatively assumed that price reduction of about 15% would be observed in a market setting. The available evidence from areas where entry has occurred to date in Texas reveals price decreases of about 20%. Although the coverage is presently modest and no definitive conclusions can be drawn, the observable patterns suggest that savings of 15% or more are likely to be achieved. The study estimated the ongoing benefits to be about \$1.8 billion in annual spending, \$0.95 billion in annual gross product, and more than 11,800 permanent jobs. It is quite probable that these anticipated benefits will be surpassed.

In March 2006, just six months after passage of SB 5, a survey of three North Texas communities found that:

- 22% of customers had switched their cable TV or video provider.
- Half of those customers reported savings that averaged \$22.30 per month (a 30% decrease in price).
- Even customers staying with incumbents reported saving an average of \$26.83 due to more competitive price offerings.

Charge #4

Research and report on the transition to competition of incumbent telecommunications providers in Texas, and examine the effects of deregulation on local level competition, pricing and service offerings. Recommend changes to Texas law that would support further deregulation of the Texas telecommunications market.

In 2005, the Texas Legislature took bold moves to substantially deregulate the telecommunications market for the local telephone companies that operate in competitive markets. Moreover, SB 5 created a system whereby additional markets can be deregulated upon a demonstration of competitive alternatives in the market. In such a market, individual lines are deregulated if a customer purchases a bundle of services. Prices for so-called “stand-alone lines” are capped at current rates in all markets until the PUC has the opportunity to make modifications to the Texas Universal Service Fund.

Currently, about seventy percent of Texas telephone lines are in deregulated markets. Most rural telephone carriers have elected to remain regulated, however. Texas is also seeing an increase in local competition through the proliferation of new products such as voice over internet protocol (VoIP) and wireless phones.

Texas Universal Services Fund

The Texas Universal Service Fund (TUSF) was established in 1999 to help the state achieve its policy goal of providing universal, low-cost telephone service for citizens

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across the state. Specifically, it subsidizes local phone service in suburban and rural Texas where the costs of providing the telephone service were determined by the PUC to be higher than in more densely populated areas. It is also used to subsidize service to those with low incomes and disabilities. Furthermore, it is used to subsidize high-speed Internet connectivity (such as T-1 lines) provided by small carriers to state agencies, schools, and institutions involved with public and higher education.

Although frequently referred to in the singular, the TUSF is actually a collection of different funds, each focused on a particular purpose or group of carriers. For instance, there are funds targeted at specific purposes, such as funding the Texas Relay Services and Lifeline Service. A separate fund (the Small and Rural ILEC High Cost Fund) provides subsidy to those small local exchange carriers that typically provide regulated services *only* in high cost rural areas.

The largest individual fund, however, is the Large Carrier Fund. The Large Carrier Fund provides subsidies from customers to assure reasonable rates in the high-cost areas served by the state's largest companies, based on the number of customers served by the providers in those areas.

Concern has arisen over continuation of the TUSF in its current form. With that in mind, in 2005, the Legislature gave the PUC authority to revise the monthly per line support beginning September 1, 2007, upon notice and opportunity for public hearing. This process is intended to address cost issues associated with the TUSF. Changes in demographics and technology alone suggest the need for a downward revision of the fee as does the advancement of deregulated markets. The Committee's recommendation is to wait for the PUC to complete its study and implement revisions as warranted by its findings. The Committee encourages the PUC to expeditiously pursue this responsibility.

Charge #5

Study the current repayment mechanism to the county or municipality for utility relocations in the public rights-of-way. Report on the number of relocations statewide each year, total estimated costs for relocations, associated impacts with relocations, and possible alternative systems for funding utility relocations and associated impacts.

The only facility relocations telecommunications companies must make at their own expense are those associated with the widening or straightening of city streets.

It is actually the State of Texas, not municipalities, that holds legal title to the public Right-of-Way (ROW). Municipalities and other political subdivisions have limited, delegated control over the public ROW – as trustees for the public. The legal foundation for this position is a 1956 lawsuit that determined that legal title to municipal streets belongs to the State; municipalities exercise only such control and authority as has been delegated by the State under the Home Rule Amendment to the Texas Constitution.

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Municipalities control the streets as trustees for the public and have no proprietary title or right to exclusive possession, *i.e.* no ownership interest.

In 1874, the Texas Legislature, recognizing that the deployment of telecommunications infrastructure was essential to economic development, gave telecommunications companies broad authority with respect to the public ROW. Specifically, the Legislature said “A telephone or telegraph corporation may install a facility of the corporation along, on or across a public road, a public street, or public water in a manner that does not inconvenience the public in the use of the road, street, or water.” Thus, telecommunications providers have authority under Texas state law to use the public ROW for the provision of telecommunications service. However, the restriction on telecommunications companies is “not to inconvenience the public in the use of streets and roads.” Since 1874, the only limitation placed on telecommunications companies’ exercise of their property rights is not to “inconvenience the public in the use of the road [or] street.”²⁸

The Legislature, in keeping with this principle, established the policy that when city streets need to be widened or straightened, *i.e.*, when the public could be “inconvenienced,” telecommunications companies must absorb the cost of relocating their facilities. *This is the only instance where telecommunications companies must absorb relocation expenses in municipalities.*²⁹

Some Areas of Dispute

Some cities have argued that telecommunications companies should pay for relocations needed to accommodate any “public purpose” as defined by that city. Examples are beautification projects, drainage projects, and changes made to accommodate commercial businesses. However, imposing relocation costs for these kinds of purposes outside of “widening” or “straightening” within cities ignores the property rights of telecommunications companies – and would likely lead to litigation over those rights. Under the Texas and United States Constitutions, compensation must be provided when a mandate is imposed on telecommunications carriers (who have facilities located within the public ROW) that goes beyond the carriers’ obligation not to inconvenience the public in using the streets.

Municipalities cannot require telecommunications companies to pay for street widening and straightening made for the benefit of third parties. For example, if a developer is putting in a shopping center and needs a turn lane, the city cannot require a telecommunications company to pay for relocation under the guise of a road widening. In certain instances, the city or state negotiates an agreement to receive payment from a private developer to pay the cost of widening or straightening roads to provide better access to the developer’s project, but often do not include utility relocation costs, instead

²⁸ Tex. Util. Code § 181.082.

²⁹ See, PURA § 54.203(c).

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choosing to demand the utility absorb the costs of relocating the facilities – asserting that the work is simply a “widening or straightening” project.

Before HB 1777 was passed into law by the Texas Legislature in 1999, many telecommunications providers voluntarily entered “franchises” and accepted ordinance-agreements governing their use of the public ROW within the cities, similar to the agreements that many other utilities including electric operate under today. However, HB 1777 confirmed that providers of local telecommunications services (“certificated telecommunications providers”) have the authority to use the public ROW *without* entering into franchise agreements.³⁰

Debate at the State Level

Issues concerning the use of state ROW generally fall into two categories: (1) determination of who absorbs the cost of relocation – the state or the utility – on any given project; and (2) operational issues concerning how the relocation work is to be done, under what schedule, and under what regulations. Today, utilities absorb the cost of relocating their facilities on most state roadway projects. Again, at the municipal level, if the street or road project is for widening or straightening of the road, telecom companies and other utilities absorb the cost.

For relocation caused by creation or expansion of state toll roads, it was the policy of the state that the utilities would not be required to absorb that cost. Instead, relocation was reimbursed to the utility and rolled into the overall project cost that would be recovered via the toll road users.

However, legislation passed in 2005 changed that to a 50/50 sharing of the cost of moving lines in toll roads between the state and the utility. That 50/50 provision expires September 1, 2007. After that, the law is less clear. The Texas Transportation Code says that full reimbursement is available to utilities on projects implemented by any of the state’s Regional Mobility Authorities (RMAs). However, clarity is lacking on certain projects as to whether they are under the auspices of an RMA or of the Texas Department of Transportation (TxDOT) – which affects the requirement for reimbursing the utilities.

Relocation reimbursement for federal (interstate) highway projects is – and has been – available to utilities in Texas through TxDOT. That long-standing policy is sound – it means that the relocation costs are ultimately borne by highway users, not telephone customers, in Texas. The state uses federal highway funds for this reimbursement.

Beyond the issue of reimbursement for relocating utilities, numerous other operational issues arise. At the core of these issues is the state’s need for relocation to occur in a timely manner, so that road construction can proceed on schedule. On the other hand,

³⁰ Tex. Local Gov’t Code § 283.052(a).

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utilities need advance notice of projects – and ultimately completed highway construction plans are needed, as well as access to new ROW in some cases, so facilities can be appropriately moved.

Charge #6

Review current industry mechanisms used to provide compensation to municipalities for use of the public rights-of-way, specifically whether all inter-modal communications providers receive equal treatment under the current system, and whether all providers of communications services pay for use of the public rights-of-way. Recommend possible alternative compensation systems.

Access line fees imposed by Chapter 283 of the Texas Local Government Code were intended to provide cities with “fair and reasonable” compensation for use of the public rights-of-way on a competitively neutral and nondiscriminatory basis. Not all communications carriers are treated equally under the current system. While most telecommunications utilities must collect and remit the access line fees imposed by Chapter 283, satellite, wireless and certain uncertificated telecommunications utilities do not pay access line fees. This creates a competitive disparity in the marketplace that is based on who is subject to this fee and who is not.

Chapter 283 created a system where each city set a dollar amount per access line based on three categories: residential, business and point-to-point lines. The fee is not based on the actual burden on the right-of-way nor is it based on the amount the carrier charges for a particular service. Because the fee is simply a set amount per access line, the actual percentage of the tax to the cost of the consumer’s service can vary wildly. As applied to certain services the access line fee is an unreasonable “tax.” For instance, when calculated and applied to a channelized voice service provided to a business customer, the amount of the access line fee can exceed twenty percent of the cost of the service depending on the price of the service and the city in which the consumer is located. For residential customers, the fee is somewhat lower; however, it is very regressive because a lifeline customer or a subscriber to basic local telecommunications service, for example, pays the same access line fee that a person with the most expensive bundle of services would pay in that city. Currently, there is no cap on access line fees. Each year, the access line amounts are adjusted according to the Consumer Pricing Index, to date upward, so every year the access line fee goes up and consumers’ fees go up even though their cost of service may go down. When the Legislature adopted the access line compensation scheme, it was not their intent that an access line fee could exceed twenty percent of the cost of the service sold.

While there should be a correlation between right-of-way fees and the actual burden imposed on the right-of-way, if right-of-way fees are going to be based on the services carried on the facilities occupying the rights-of-way, the fee should correspond to the cost of managing the right-of-way. With the access line fee compensation structure, there is

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no correlation between the cost of the service and the amount of the fee. In the past, various options on how best to resolve the issues with Chapter 283 access line fees have been explored. It is the Committee's recommendation that the Legislature evaluate whether this system should be revised so that all carriers are treated on a competitively neutral and nondiscriminatory basis and that the compensation system be based either on the actual cost of the burden on the right-of-way or at a minimum on a capped percentage of the cost of service. A competitive advantage or disadvantage in the marketplace should be based on the quality of the provider, their services and prices, not on whether or not a particular tax is or is not applicable to that carrier. That is the unfortunate result of the current system. Because the fee can be so high, consumers have an incentive to choose a carrier that is either not charging the fee at all or not charging the fee correctly and carriers have an incentive to arbitrage the system. The Legislature should also investigate the possibility of eliminating the access line fee altogether. Several alternative funding mechanisms could be explored that would allow municipalities to make up lost revenue if such revenue is appropriate.

Charge #7

Examine issues related to the creation, purchase of out-of-state renewable energy credits by non-ERCOT Texas utilities, and determine possible alternatives for establishing a regional approach that does not allow the double-counting of renewable energy credits for non-ERCOT utilities to meet their renewable goals.

For the purpose of this charge, the Committee focused on one electric utility in particular, although this issue is applicable to several different utilities in border regions of the state that are outside of the ERCOT service territory. The service area of El Paso Electric Company (EPE) is located within the Western Electricity Coordinating Council (WECC), or western grid, and represents the southeastern end of that grid. The WECC consists of all or part of 14 U.S. states, 2 Canadian Provinces and northern Baja California, Mexico, comprising nearly 1.8 million square miles with a population of over 71 million people.

EPE serves an area of far West Texas and Southern New Mexico, consisting of approximately 10,000 square miles extending from Van Horn, Texas to Hatch, New Mexico, with a total population of more than 900,000 people. Of EPE's approximately 341,000 retail customers, approximately 76% are in Texas and 24% are in New Mexico. EPE also has one long-term wholesale customer in West Texas and periodically makes wholesale sales to the Commission Federal de Electricidad de Mexico in Ciudad Juarez, Mexico. EPE's service area is connected to Southwestern Public Service Co. (SPS) in the Southwestern Power Pool (SPP) though a DC tie in Eddy County, New Mexico. EPE has no interconnection with ERCOT, and the distance between the nearest possible point of interconnection of an ERCOT transmission line with an EPE transmission line is over 250 miles.

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energy obligation.³¹ A critical element required for the production of RECs is that the output of a generating facility “must be readily capable of being physically metered and verified in Texas by the program administrator.” Under the current Commission rule, “energy from a renewable facility that is delivered into a transmission system where it is commingled with electricity from non-renewable resources cannot be verified as delivered to Texas customers.”³² Accordingly, since the power produced by EPE’s two wind turbines is interconnected at distribution voltage, rather than transmission voltage, these two facilities are qualified producers of Texas RECs under the existing rule.

In the rulemaking project pending at the PUC, as a result of the passage of SB 20 in 2005, Commission Staff has proposed language addressing the commingling issue.³³ Specifically, the Commission’s strawman rule revises the “commingling” provision to state:

Energy from a renewable facility that is delivered into a transmission system where it is commingled with electricity from non-renewable resources *before being metered* cannot be verified as delivered to Texas customers.³⁴

The Committee believes that this proposed language will eliminate the commingling problem associated with larger scale renewable generators in the EPE service area and other non-ERCOT areas.

New Mexico: New Mexico passed legislation in 2004 establishing a mandatory statewide renewable energy portfolio standard (RPS), effective beginning January 1, 2006. Under the New Mexico RPS, 5% of all jurisdictional retail sales must be met with renewable energy in 2006, increasing 1% per year until reaching 10% in January 2011, and thereafter remaining fixed under the law at the level of 10% of total jurisdictional retail sales. In order to maximize the development of the state’s renewable resources, there is also a diversity requirement in the RPS, taking into consideration the overall reliability, availability, dispatch flexibility, and cost of the various renewable energy resources made available by providers and suppliers. Renewable Energy Certificates in New Mexico, also referred to as RECs,³⁵ are produced from energy that is “contracted for

³¹ Although PURA §39.904 imposed the State’s renewable energy goal on REPs in the competitive retail market, the non-ERCOT IOUs have become participants in the renewable energy program through actions at the PUC.

³² PUC Substantive Rule §25.173(e)

³³ PUC Project No. 31852, *Rulemaking Related to Renewable Energy Amendments*, Staff Strawman Amendments to §25.173 and New §25.174 (April 19, 2006).

³⁴ *Ibid.* at p. 10 of 57.

³⁵ New Mexico RECs may not be the same standardized product as Texas RECs and would have to be addressed by regulators for the development of a regional market.

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delivery in New Mexico” unless the New Mexico Public Regulation Commission (NMPRC) determines that there is a regional market for exchanging certificates.³⁶

Under the New Mexico statute and implementing regulations, RPS compliance can be achieved through the acquisition of RECs with the associated energy delivered to EPE’s system or through the acquisition of RECs without delivered energy, where the energy is otherwise contracted for delivery in New Mexico. Further, even though there is a general RPS requirement in New Mexico beginning in 2006, the NMPRC’s renewable rule encourages voluntary tariffs that allow customers to purchase electricity produced from renewable resources. EPE has implemented a Voluntary Renewable Energy Tariff in New Mexico, similar to its voluntary tariff in Texas, whereby customers can subscribe to purchase 100 kWh blocks of energy.

For EPE (and presumably all non-ERCOT companies) and its service area, the renewable energy program in Texas presents several areas of concern:

- Retail electric providers in ERCOT can adjust their prices to recover the costs of their REC purchases directly from end-use customers.³⁷ In contrast, retailers of electricity outside of ERCOT (integrated electric utilities) do not have the flexibility to adjust pricing in this manner. Unless non-ERCOT retailers are authorized to recover their REC costs through fuel expense, they will be forced to bear costs of REC program compliance that the majority of electric retailers in the state are otherwise able to pass on to consumers.
- For EPE, there are two competing renewable requirements. Texas RECs do not satisfy the requirements of its Voluntary Renewable Energy Tariffs, which require electric energy actually produced by a renewable generating source. Consequently, unlike other utilities, satisfying the requirements for acquiring and retiring RECs and serving customers with renewable energy are virtually mutually exclusive endeavors, which will result in greater costs to be borne by EPE or its customers. Due to EPE’s geographic location in Texas and outside of ERCOT, EPE has limited access, if any, to the bulk of the renewable energy sited in Texas – most of which is interconnected to the ERCOT transmission system. EPE does not have a direct transmission line tie to ERCOT and, therefore, EPE cannot contract for the delivery of energy associated with the RECs it purchases from facilities located within ERCOT.
- Without the existence of a regional market for the exchange of RECs, EPE’s compliance with requirements in both Texas and New Mexico must be met pursuant to the mutually exclusive requirements of each state. This eliminates

³⁶ NMSA 1978 Section 62-16-5B1(b) (2004); NMAC 17.9.572.13B(2).

³⁷ Assumes fully transitioned competitive market in ERCOT as of January 1, 2007.

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any flexibility in planning for the full compliance with each state's requirements and will inevitably result in greater cost.

- A broader definition of the market for renewable energy and tradable credits or certificates that accounts for the diverse, multi-state nature of the non-ERCOT electric service areas of Texas will lead to the lowest reasonable cost to be borne by the consuming public, whether in a competitive or regulated retail electric market.

A number of social and economic factors have resulted in a growing emphasis throughout the country to increase the development of renewable energy generation through mandatory and voluntary programs. Because of interconnected systems that cross multiple state lines, compliance with the requirements of different states is already being addressed on a regional basis in the NEPOOL region and the PJM RTO.³⁸ In the WECC, a system is being developed that will facilitate the tracking of RECs. This system, called the Western Renewable Energy Generation Information System, is expected to be operational by early 2007.³⁹

Where operational inefficiencies and unnecessary limitations can be eliminated or substantially reduced through the mutual cooperation of regulators and by the critical review of statutory requirements, industry and consumers' interests are mutually benefited. If free markets and optimum efficiency are truly desirable objectives for all stakeholders, then barriers and hurdles should be reduced or eliminated where possible. To this end, the Committee believes that the PUC should be given the authority to work with regulators in other states, at least those bordering Texas, to explore and develop to the fullest extent possible a regional market or markets for renewable energy and the exchange or trading of renewable energy credits or certificates. Additionally, recovery of the costs of compliance with the State's renewable goal should be specifically provided for non-ERCOT companies that continue to provide cost-based, bundled electric service. Recovery of REC costs as an element of fuel represents the most efficient mechanism, as well as the most correct mechanism, since RECs represent a cost of generated power.

Charge #8

Examine the feasibility of additional nuclear generated power in Texas, focusing on supply and demand issues, current state nuclear projects, and possible federal government assistance. (Joint Interim Charge with Energy Resources)

As previously discussed in Charge #1 of this report, Texas lacks fuel diversity in electricity production. In Texas, there is a rising price and demand for natural gas, which

³⁸ The New England Power Pool consists of the states of Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont.

³⁹ Information regarding renewable energy programs and RECs can be obtained from the web site www.evomarkets.com.

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in turn is increasing the price of natural gas fired generation (the main source of electric generation). There is a finite supply of oil and gas. The Energy Information Administration predicts by 2025 the U.S. will need 50% more electricity. Thus, there is a growing demand for electricity. ERCOT projects that reserve margins in Texas will be near or below the minimum levels beginning in 2007 if more generation is not interconnected to the grid.

Texas Nuclear Projects

Currently four nuclear generation plants in Texas are producing approximately 11% of the generation capacity in the state. NRG and TXU both made recent announcements of intent to build nuclear facilities in Texas. NRG's project will be bringing 2,700 MW to ERCOT by 2015 and TXU's will be between 2,000 and 6,000 MW, which would be online between 2015 and 2020. Due to the lengthy permitting and processing times of the nuclear plants, these dates are the earliest that these plants could be online. It takes anywhere from five (if there are no complications) to 10 years to fully permit and build a nuclear facility.

Federal Incentives Assistance

Several avenues for federal incentives exist to assist in building and running nuclear generation facilities in Texas. The Department of Energy's Nuclear Power 2010 Program pays \$556 million in assistance on a cost-shared basis over 11 years for companies to use for first-of-a-kind engineering costs for new reactor designs and the preparation of Early Site Permits (ESPs) and Combined Construction and Operating Licenses (COLs).

In addition, the Energy Policy Act of 2005⁴⁰ offered incentives for nuclear generation. One of the incentives offered in the Act is standby support coverage (risk insurance) under which the Federal government will reimburse companies for delays resulting from the Nuclear Regulatory Commission's failure to comply with its scheduled review and approval of the inspections, tests, analyses, and acceptance criteria or from litigation that delays full power startup of the reactor. The Act provides 100% coverage for delays for the first two nuclear reactors built up to \$500 million each. The Act provides 50% reimbursement for delays for the next four nuclear reactors after an initial 180-day period of covered delays up to \$250 million a piece. The Act also offers a production tax credit of \$18 per MWH for up to 6,000 MWs of new nuclear capacity (the credit will be prorated among reactors that have had their application for a COL docketed by the NRC by December 31, 2008; construction must begin by January 1, 2014). This tax credit lasts for eight years and is capped at \$125 million per year per 1000 MWs of capacity. Finally, Title XVII of the Act establishes a Federal loan guarantee program for new technologies, including advanced nuclear reactors, which avoid, reduce or sequester greenhouse gases. A Federal loan guarantee would significantly reduce the cost of capital for a new nuclear plant.

⁴⁰ Pub.L. 109-58.

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The Energy Policy Act of 2005 extends the Price-Anderson Nuclear Industries Indemnity Act⁴¹ by 20 years. The Price-Anderson Act indemnifies the nuclear industry against liability claims arising from nuclear incidents while still ensuring prompt compensation for the general public.

Economic Benefits of Nuclear Facilities

Each new nuclear generating unit will add an estimated 500-700 permanent jobs to the state. Surveys indicate that the average salary at a nuclear facility is much higher than that of workers of similar skill set in other industries, sometimes as much as 40%. Each new unit will generate approximately 500 indirect jobs into the surrounding area. During the 60+-month construction phase of a nuclear facility, there will be an influx of 1400 to 1500 jobs from the start of land clearing to the time that commercial operations begin.

After construction, a nuclear facility will generate \$350 million annually in total spending in the local community. On average, each dollar spent at a nuclear plant results in \$1.13 additional spending in the local community. In addition, the benefit to local taxing entities is exceptional. The standard of living in the community where a plant is located is enhanced by the influx of highly skilled and educated workers.

It is the Committee's position that added nuclear generation in Texas is a feasible option that should be explored. Given the high cost of building these facilities, it should be a goal of the Legislature to incentivise private investment in nuclear facilities in Texas.

Charge #9

Monitor the agencies and programs under the Committee's jurisdiction.

The 64th Legislature enacted the Public Utility Regulatory Act (PURA) and created the Public Utility Commission of Texas (PUC or Commission) to regulate the rates and services of electric and telephone utilities statewide, radiotelephone statewide, and water and sewer utilities in unincorporated areas.

While the role of the PUC may be much different today than it was 30 years ago, the PUC still maintains a vital oversight role with regard to Texas' most critical utility infrastructure. In the Texas House of Representatives, the House Committee on Regulated Industries retains primary jurisdiction and oversight of the PUC as well as the Office of Public Utility Counsel (OPUC). The enactment of SB 408, following the 2005 legislative session, provided for the extension of both agencies through 2011. Since that time, the PUC has been charged with meeting many of the Legislature's goals relative to the continued deregulation of Texas' telecommunications market, establishing a

⁴¹ 42 U.S.C. 2011-2281.

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statewide video franchising process, studying the Texas Universal Service Fund (TUSF), as well as continuing to move Texas' electric market toward full competition.

Stable, Predictable Regulation

For those companies that remain subject to rate regulation in Texas, the cornerstone of the Texas regulatory regime must be stable, predictable regulation. The financial institutions and companies that choose to invest in Texas utility infrastructure must be assured of a consistent pattern of regulatory decision-making, resulting in a predictable regulatory environment. Part of the challenge in attaining such an environment is allowing the appointed PUC Commissioners the flexibility to communicate and discuss relevant issues. Under the current scheme, the quorum rule prohibits Commissioners from discussing PUC business outside of a formal hearing. This makes the most basic of business communications difficult, if not impossible. As a solution, some modification of the statute to alleviate quorum restrictions and allow for a broader forum of discussion among members would provide improved handling of proceedings before the Commission. Appellate judges are permitted to discuss their cases within a panel, trial judges are permitted to consult other judges, yet our PUC commissioners are not afforded this even when hearing a contested case.

Cost Driven Regulation

The regulated portions of the electric and telecommunications markets in Texas are much smaller than was the case in the past. The state's regulatory practices and policies must reflect the reduced scope of the activities of the regulated ERCOT utilities and the somewhat smaller size of the non-ERCOT investor-owned utilities. Texas must strive to lower the cost of regulation while carrying out its regulatory obligations.

In the past, utility companies were much larger fully integrated utilities and operated under traditional rate of return practices. Rate proceedings served as a mechanism for resolving high impact questions such as approval of power plant construction and fuel costs. Today, the ERCOT market is competitive and the remaining regulated utility companies are much smaller. ERCOT utilities now account for a significantly smaller portion of a consumer's electric bill and the dollar impact of potentially controversial issues is relatively modest. Thus, the protracted and expensive rate proceedings of the type that was common in the past may produce little or no benefit to ultimate consumers. However, the legal and support costs associated with managing such a process detract from investment and positive growth in our state utility sector. Regulation should be tailored to the times and ultimately inure to the benefit of the competitive market. This can be accomplished, in part, by having an agency focus on reducing the administrative cost and burden of doing business at the PUC, either through improved administrative rules, more efficient rate setting or adjustment mechanisms that do not require lengthy staff and intervenor involvement, or other mechanisms which use benchmarks or provide incentives to invest in technological advances. Such changes would allow utilities to focus less effort on the administrative burden of the regulatory process and more on

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initiatives, which enhance the market, such as nodal pricing, competitive renewable energy zones and other ERCOT-wide collaborative improvement projects.

Returns Must Attract Investment

The ability to continue to attract new business to our great state is a primary reason the Texas economy has continued to flourish in recent years. In large part, Texas has avoided a decline in job growth by its ability to convince companies that locating or investing in Texas will earn them an attractive return on their investment. Texas has accomplished this goal by various means including economic incentives to investors, tax credits, and reduced labor costs. The same sort of investment strategy must be utilized for Texas to attract and retain top quality utility investment, whether it be transmission or distribution system expansion, advanced fiber technologies or broadband over power lines. Companies who are regulated under Texas utility laws must also be assured of an attractive rate of return. For example, as a result of SB 5, advanced infrastructure is now being deployed to enable broadband over power line technology, making Texas a national leader in the BPL movement. This investment could be made in Texas electric infrastructure only because our state laws now allow regulated utilities who invest in such technology to reap the benefits of their investment, rather than being burdened with lengthy and expensive earnings reviews. In order to realize the potential of new technologies and advanced infrastructure improvements, Texas must be willing to look beyond the traditional forms of regulation and explore more efficient kinds of cost of service regulation. Improving the attractiveness of Texas regulated utility companies to investors requires that regulation be tailored to the times to establish growth opportunities for our remaining regulated utilities, spurring innovation and investment and providing a predictable and stable process for rate assessment and reducing the costs associated with the regulatory process.

Regulation in Texas and returns afforded Texas utilities should be benchmarked against other major states with whom Texas competes for jobs and investment. There are a number of sources that can help the Legislature and the Commission make that comparison.