

# **Sunset Advisory Commission**



**Public Utility Commission  
of Texas**

**Office of Public Utility Counsel**

**Telecommunications  
Infrastructure Fund Board**

**Electric Utility  
Restructuring Legislative  
Oversight Committee**

**Staff Report  
April 2004**

**PUBLIC UTILITY COMMISSION OF TEXAS**  
**OFFICE OF PUBLIC UTILITY COUNSEL**  
**TELECOMMUNICATIONS INFRASTRUCTURE FUND BOARD**

**AND**

**ELECTRIC UTILITY RESTRUCTURING**  
**LEGISLATIVE OVERSIGHT COMMITTEE**

**SUNSET STAFF REPORT**  
**APRIL 2004**

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# SUMMARY

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# Summary

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## *Public Utility Commission of Texas*

## *Office of Public Utility Counsel*

## *Telecommunications Infrastructure Fund Board*

## *Electric Utility Restructuring Legislative Oversight Committee*

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The Sunset staff review of the Public Utility Commission (PUC) and the Office of Public Utility Counsel (OPUC) followed a time of dramatic change in the electric and telecommunications industries due to the introduction of competition by the Legislature and Congress. In forming its approach to the review, Sunset staff sought to assess what changes need to be made to the operations and statutes governing PUC and OPUC to facilitate the transition to electric and telecommunications competition.

While competition benefits consumers by lowering rates and increasing choice of services, competition also requires a fundamental change in the regulation of the industries. Before competition, PUC acted as an adjudicative body exerting control over monopoly companies with authority to approve or deny requests for rate increases. In this environment, PUC acted in the public interest, approving rates that were reasonable for consumers while allowing individual companies to make a fair return on their investments. Companies had every incentive to fully comply with the statutes to gain approval for new rates, and OPUC functioned as the residential and small commercial consumers' representative in these proceedings. In today's competitive environment, PUC oversees most of the companies under its jurisdiction using the techniques of rule-based regulation. Under this regulatory strategy, PUC no longer controls a company's rate-of-return, but acts to protect consumers by ensuring fair competition through enforcement actions against companies that fail to comply with the statutes or rules.

While Texas has made significant progress towards creating competitive electric and telephone markets, Sunset staff identified several key concerns regarding PUC's oversight of the markets, and OPUC's role in advocating for consumers. These concerns, outlined below, include the independence of the Electric Reliability Council of Texas (ERCOT), effectiveness of PUC's electric market monitoring, authority of PUC to enforce wholesale telephone performance measures, and continuation of the Office of Public Utility Counsel as an independent, stand-alone agency.

- PUC relies heavily on the ERCOT, the Independent System Operator (ISO) for Texas, to perform important functions in the competitive electric market. ERCOT oversees the daily operation of the transmission network, ensuring its continued reliability, and provides a platform for the competitive electric marketplace. Through legislation bringing



*The Legislature's introduction of competition to public utilities has dramatically changed how the State regulates these entities.*

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competition to the electric market, the Legislature granted PUC authority to approve ERCOT as the ISO if PUC found that ERCOT had sufficient independence from individual market stakeholders. The Legislature also provided ERCOT with statutory authority to charge electricity users a fee to fund its operations, subject to PUC approval. Sunset staff examined ERCOT's independence from electric market participants and found that ERCOT would benefit from oversight by an independent board. Staff also found that PUC should exercise greater oversight over ERCOT's fees.

- The Legislature charged PUC with oversight of the wholesale electric market to discover, correct, and prevent potential market manipulations that can add millions of dollars to the bills of electricity consumers. However, resource constraints prevent PUC from effectively monitoring the market, limiting PUC's ability to quickly identify manipulations, prosecute suspected manipulators, and deter participants from manipulating the market in the future.
- Unlike the introduction of competition in the electricity markets, Texas telephone markets have single providers that sell both wholesale services to other companies and retail services directly to consumers. This dichotomy places new competitive providers in the unique role of being the customers and competitors of Incumbent Local Exchange Companies (ILECs). To prevent ILECs from providing poor wholesale service to preserve strong retail market shares, PUC enforces wholesale performance measures that require ILECs to provide the competitive companies with services that are at least as good as the ILEC provides to its own retail customers. However, while PUC has general authority to create these performance measures, its strongest authority exists only in a contract that is currently subject to renegotiation.
- In light of how the introduction of competition has changed utility regulation from rate regulation of monopolies to rule-based regulation of competitive companies, Sunset staff assessed the proper location of the consumer representation function. As a stand-alone agency, the Office of Public Utility Counsel independently represents residential and small commercial consumers as a party to rate cases and other regulatory proceedings at PUC, and through appeals of PUC rulings and other litigation. Sunset staff found that while residential consumers may still need independent representation in the declining number of rate cases, a stronger consumer focus at PUC could be more beneficial to Texas consumers than the current adversarial role of OPUC.

The recommendations in this report are designed to address these concerns and others related to PUC's reporting requirements on telephone companies, enforcement authority, and need to continue as a state agency. This report also contains recommendations on the Telecommunications Infrastructure Fund Board and the Electric Utility Restructuring Legislative Oversight Committee.

Sunset staff also examined one other area of concern during its review of PUC, but without the development of a recommendation in this report. Texas currently allocates \$97.1 million from the System Benefit Fund, derived from a fee assessed to electricity ratepayers in areas of Texas with a choice of providers, to provide a discount off electricity bills to eligible, low-income customers. While about 700,000 customers receive a 10 percent discount, many of these customers may not be aware of the benefit they are receiving. In addition, because federal matching funds are not available for utility discount programs, the actual benefit of the program is not as great as an equal expenditure of funds to many health and human service programs. Because this program is the subject of a current audit by the State Auditor's Office, Sunset staff decided to await further information before considering any recommendations in this area.

A summary follows of the Sunset staff recommendations on the Public Utility Commission, Office of Public Utility Counsel, Telecommunications Infrastructure Fund Board, and Electric Utility Restructuring Legislative Oversight Committee.

# Public Utility Commission

## Issues/Recommendations

### Issue 1

#### ***The Electric Reliability Council of Texas Lacks Certain Standard Components for Ensuring Independence and Accountability.***

##### **Key Recommendations**

- Change the Electric Reliability Council of Texas Board to a nine-member independent Board by September 1, 2006.
- Require ERCOT Board members to disclose any conflicts of interest and recuse themselves from any vote related to those interests.
- Grant PUC clear authority to require ERCOT to submit detailed financial information needed to scrutinize ERCOT's fee requests.
- Apply the Open Meetings Act to ERCOT.

### Issue 2

#### ***PUC's Market Oversight Function Cannot Adequately Address Manipulations of the Wholesale Electric Market.***

##### **Key Recommendations**

- Require ERCOT to contract with, fund, and support the operations of a private company to perform market monitoring.
- Require PUC to select the monitoring company, define the company's monitoring responsibilities, and set standards for funding, staff qualifications, and ethical conduct.
- Require the market monitoring company to report potential violations of PUC or ERCOT rules or other potential market manipulations to PUC.
- Require the market monitoring company to submit an annual report to PUC and ERCOT identifying market design flaws and recommending methods to fix the flaws.

### Issue 3

#### ***Lack of Clear Authority to Establish and Enforce Wholesale Performance Measures Limits PUC's Ability to Foster Fair Telephone Competition.***

##### **Key Recommendation**

- Grant PUC clear statutory authority to establish and enforce wholesale performance measures for telecommunications service.



#### **Issue 4**

##### ***PUC Requires Telephone Utilities to File Reports That May Not Be Needed in Today's Regulatory Environment.***

###### **Key Recommendations**

- Eliminate the requirement for telecommunications utilities to file the *Report of Certain Expenses*.
- Require PUC to conduct a one-time review of its reporting requirements for telecommunications utilities to determine the ongoing need for the required reports.
- Direct PUC to consider the burden of new reporting requirements on telecommunications utilities before adopting new rules regarding reporting.

#### **Issue 5**

##### ***PUC's Administrative Penalty Authority Is Inadequate to Address Violations of PURA by Wholesale Electricity and Telecommunications Providers.***

###### **Key Recommendation**

- Increase PUC's maximum administrative penalty from \$5,000 to \$25,000 per day, per violation.

#### **Issue 6**

##### ***Texas Has a Continuing Need for the Public Utility Commission.***

###### **Key Recommendation**

- Continue the Public Utility Commission of Texas for 12 years.

## **Office of Public Utility Counsel**

### Issue/Recommendations

#### **Issue 1**

***Due to Significant Changes in Utility Regulation, Texas No Longer Needs a Stand-Alone Agency to Advocate Solely on Behalf of Residential and Small Commercial Consumers.***

#### **Key Recommendations**

- Abolish the Office of Public Utility Counsel.
- Transfer the responsibility for independent representation of residential and small commercial consumers in utility rate cases to the Office of the Attorney General.
- Transfer OPUC's remaining consumer representation functions to the Public Utility Commission.
- Require PUC staff to evaluate and report findings related to the impact on residential and small commercial ratepayers for each decision by the Commission and the Electric Reliability Council of Texas.
- Replace OPUC's role on the Electric Reliability Council of Texas Board with a consumer representative appointed by the Governor.

## **Telecommunications Infrastructure Fund Board**

### Issue/Recommendation

#### **Issue 1**

***The Telecommunications Infrastructure Fund Board Is No Longer Operational and Should Be Allowed to Expire Under the Sunset Act.***

#### **Key Recommendation**

- Abolish the Telecommunications Infrastructure Fund Board and the related enabling legislation.

## **Electric Utility Restructuring Legislative Oversight Committee**

### Issue/Recommendation

#### **Issue 1**

***Remove the Electric Utility Restructuring Legislative Oversight Committee From Sunset Review.***

#### **Key Recommendation**

- Repeal the expiration date for the Electric Utility Restructuring Legislative Oversight Committee.

## Fiscal Implication Summary

When fully implemented, the recommendations in this report would result in more than \$1 million in savings to the General Revenue Fund. In addition to these savings to the State, two recommendations would result in a cost of about \$1.85 million to the Electric Reliability Council of Texas, a private, non-profit corporation that operates outside the appropriations process. The specific fiscal impact of these recommendations is summarized below.

- **PUC Issue 1** – Adding six new independent members to the ERCOT Board would not have a fiscal impact to the State. However, ERCOT would incur total costs of \$450,000 per year, beginning in September 2006, to compensate the new independent Board members.
- **PUC Issue 2** – Transferring responsibility for conducting wholesale electric market monitoring to ERCOT would not have a fiscal impact to the State. However, ERCOT would incur a cost to conduct \$1.4 million per year for six to seven FTEs, analytical software, and other capital expenses of adequate market monitoring.
- **OPUC Issue 1** – Abolishing the Office of Public Utility Counsel and transferring its residential consumer representation responsibilities to the Office of the Attorney General (OAG) and PUC would result in a net annual savings of more than \$1 million, including the reduction of 16 full-time employees. These savings would not be fully realized until fiscal year 2007, following the transition period outlined in the recommendations. To handle cases that directly affect retail rates, the OAG would incur a cost of \$197,000 and require an additional three full-time employees. Increased consumer representation efforts at PUC would cost an estimated \$365,000 per year, including an additional four full-time employees. Finally, ERCOT would incur additional costs of \$75,000 to compensate the gubernatorial-appointed Board member representing residential and small commercial consumers, although this cost is assumed within PUC Issue 1 discussed above.

<b>Fiscal Year</b>	<b>Savings to General Revenue Fund</b>	<b>Change in FTEs From 2003</b>
2006	\$692,000	-12
2007	\$1,038,000	-16
2008	\$1,038,000	-16
2009	\$1,038,000	-16
2010	\$1,038,000	-16

# ISSUES

## *The Electric Reliability Council of Texas Lacks Certain Standard Components for Ensuring Independence and Accountability.*

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### Summary

#### Key Recommendations

- Change the Electric Reliability Council of Texas Board to a nine-member independent Board by September 1, 2006.
- Require ERCOT Board members to disclose any conflicts of interest and recuse themselves from any vote related to those interests.
- Grant PUC clear authority to require ERCOT to submit detailed financial information needed to scrutinize ERCOT's fee requests.
- Apply the Open Meetings Act to ERCOT.

#### Key Findings

- The Electric Reliability Council of Texas performs numerous public functions in the electric market using funds derived from ratepayers.
- Unlike other independent ISO boards, the ERCOT Board still includes a large number of industry representatives, whose direct involvement in the market may lead to conflicts of interest.
- ERCOT's budget and debt are growing significantly, yet PUC reports that ERCOT's fee requests lack the necessary detail for PUC to effectively evaluate the reasonableness of the requests.
- ERCOT posts meeting notices on its Web site, but does not follow the requirements of the Open Meetings Act, potentially limiting the opportunity for public input.

#### Conclusion

The Electric Reliability Council of Texas (ERCOT) serves an important function as the Independent System Operator (ISO) for Texas, overseeing the daily operation of the transmission network, ensuring its continued reliability, and providing a platform for the competitive electric marketplace. Through legislation bringing competition to the electric market, the Legislature granted PUC authority to approve ERCOT as the ISO if PUC found that ERCOT had sufficient independence from individual market stakeholders. The Legislature also provided ERCOT with statutory authority to charge electricity users a fee to fund its operations, subject to PUC approval. Sunset staff examined ERCOT's independence from electric market participants, and PUC's ability to oversee the actions and budget of ERCOT, recognizing its separate status as a non-profit, private organization.

Sunset staff found that ERCOT, while operating with funds authorized by the Legislature, lacks many of the standard components for ensuring accountability. ERCOT is not fully accountable to PUC for its rapidly growing expenditures, debt, and fees. In addition, unlike all other ISOs nationwide, the ERCOT Board still includes a number of industry representatives, which raises questions of

conflicts of interest. Staff concluded that accountability of ERCOT could be increased by moving to a fully independent ERCOT Board, adding restrictions on conflicts of interest, improving PUC's ability to oversee its fee requests, and making Board meetings more open to the public.

## Support

### **The Electric Reliability Council of Texas performs numerous public functions in the electric market using funds derived from ratepayers.**

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*The Legislature granted ERCOT, as the ISO, authority to collect fees from electricity buyers, subject to PUC oversight.*

- Texas electric utilities originally formed ERCOT in 1970 to ensure the reliability of the transmission network. In 2001, PUC certified ERCOT to serve as the independent system operator (ISO) for the competitive electric market in Texas, as authorized in statute. The ISO serves as a third-party administrator to provide a platform for the competitive electric marketplace. As the ISO, ERCOT ensures reliable electricity service, ensures equal access to the transmission network for all market participants, accounts for electricity production and delivery, and ensures customer information is conveyed to retail electric providers. ERCOT's service area covers about 85 percent of the demand for electricity in Texas. Appendix C contains more information about ERCOT, including a map of its service area.
- In 2003, ERCOT's revenues totaled \$98.7 million, primarily derived from a statutorily authorized fee on wholesale electricity. The ERCOT fee in 2003 equaled \$0.33 per megawatt hour (MWH), and PUC recently authorized increasing it to \$0.44 per MWH. Membership in ERCOT totals 153 electric industry companies, including generators, power marketers, retail electric providers, investor-owned utilities, municipal utilities, and electric cooperatives. Companies must have a financial interest in the retail or wholesale electric market to join ERCOT. ERCOT currently has 377 staff located in Taylor and Austin.
- The ERCOT Board is composed of 14 part-time members, as shown in the chart, *ERCOT Board of Directors*. The Board includes market participants, independent members, consumers, the Public Utility Counsel, the Chief Executive Officer of ERCOT, and the Chair of PUC who serves as a non-voting member. Independent Board members receive compensation for their service including a retainer and a set amount for attendance at meetings. A Technical Advisory Committee (TAC) made up of 35 members representing all segments of the ERCOT market advises the Board on market issues.
- In all other states with competitive electric markets, ISOs are primarily overseen by the Federal Energy Regulatory Commission (FERC), with some oversight by state agencies. However, because ERCOT operates solely within Texas, PUC oversees ERCOT exclusively. As part of this oversight, PUC must approve any changes in ERCOT's fees.

<b>ERCOT Board of Directors</b>		
<b>Member</b>	<b>Represents</b>	<b>Method of Selection</b>
6 Market Participants	Independent Generator	Elected by their respective market segments to one-year terms
	Investor-Owned Utility	
	Power Marketer	
	Retail Electric Provider	
	Municipal Utility	
	Electric Cooperative	
3 Independent Members	Must be unaffiliated with any market segment	Selected by the ERCOT Board to serve three-year terms
3 Consumer Representatives	Industrial Consumer	Elected by segment to one-year terms
	Large Commercial Consumer	Selected by outgoing large commercial consumer to serve one-year terms
	Residential Consumers represented by the Public Utility Counsel	Ex officio
ERCOT Chief Executive Officer	ERCOT staff	Ex officio
PUC Chair (non-voting)	PUC	Ex officio

**Unlike other independent ISO boards, the ERCOT Board still includes a large number of industry representatives, whose direct involvement in the market may lead to conflicts of interest.**

- The ERCOT Board historically consisted solely of market participants. However, when ERCOT was selected to serve as the ISO in 2001, it began serving a very different and greatly expanded role, with funds obtained through a statutorily authorized fee. In recognition of this changing role, the Legislature has encouraged greater independent representation on the Board. In 2003, the Board responded by adding three independent members with no affiliation to the electric industry. At the same time, the Board reduced the total number of members from 22 to 14.

The Board selects the three unaffiliated members based on recommendations from an executive search firm. Under ERCOT bylaws, unaffiliated members must have experience in at least one of the following areas: corporate leadership, finance, accounting, engineering, law, utility regulation, risk management, or information technology. These members must also be independent of any ERCOT market participants.

- In contrast, all five of the other ISO boards in the United States are made up entirely of independent, unaffiliated members. This includes the ISOs serving California, New York, New England, and parts of the Midwest; as well as the PJM ISO, which serves Pennsylvania, New Jersey, and Maryland. The size of these boards varies from five to 10 members, all serving part-time with compensation. In California, the Governor appoints the members, with confirmation by the California Electricity Oversight Board. The other ISOs use a mix of appointment mechanisms. To ensure expert input, each of these boards has advisory committees made up of stakeholders with an interest in the electric market. While qualifications of independent members in other ISOs vary, the requirement for all board members to be unaffiliated with the electric industry ensures against any potential conflicts.

  
*In recognition of its public role, the Legislature has encouraged greater independent representation on the ERCOT Board.*

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*ERCOT bylaws do not require Board members to recuse themselves even if a vote would financially benefit their company.*

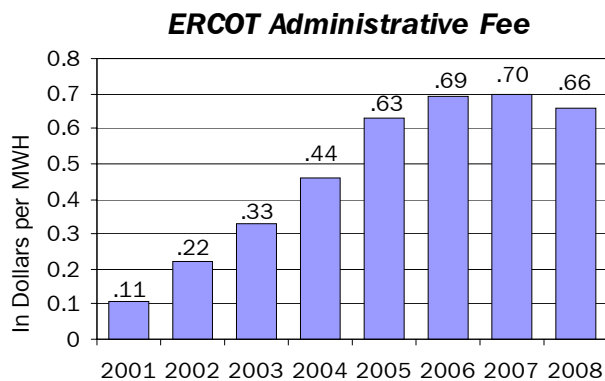
- The presence of a large number of industry representatives on the ERCOT Board can create an environment that focuses more on balancing the specific needs of different market participants rather than the best interests of the public or the ratepayers that fund the system. As a private, non-profit organization, ERCOT operates outside of traditional government accountability to the Legislature. Individual market participants have no real incentive to act in the best interest of consumers, or to keep spending in check, as the costs are spread across all ratepayers.
- Another concern is the potential for a Board vote to be inappropriately controlled by a class of market participants or by multiple classes of market participants working together. In response to a proposed rule by the Federal Energy Regulatory Commission (FERC) to encourage the formation of ISOs, the Department of Justice strongly argued in support of fully independent boards, citing the danger that utilities could work together to unreasonably restrain trade and lessen competition.<sup>1</sup> Based on experience with competitive electric markets, FERC encourages ISO boards to be fully independent. Although ERCOT is not under FERC jurisdiction, all other ISOs have adopted this independence standard.
- ERCOT bylaws do not require members to recuse themselves from voting when they have a conflict of interest. The bylaws simply require members to disclose matters in which they have an interest, but do not prohibit them from voting, even when the decision would clearly give their company a substantial benefit. In contrast, appointed state officials must disclose any personal or private interest in a measure, proposal, or decision, and may not vote or otherwise participate in a decision on the matter.<sup>2</sup>

**ERCOT’s budget and debt are growing significantly, yet PUC reports that ERCOT’s fee requests lack the necessary detail for PUC to effectively evaluate the reasonableness of the requests.**

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*This year, ERCOT will pay \$23.4 million in debt service costs against its total debt of \$193 million.*

- ERCOT’s budget has grown about 40 percent since being certified as Texas’ ISO by PUC in 2001. ERCOT projections indicate that the budget will grow an additional 62 percent by 2008. The chart, *ERCOT Administrative Fee*, demonstrates the past growth and proposed future growth in ERCOT’s fee since 2001.

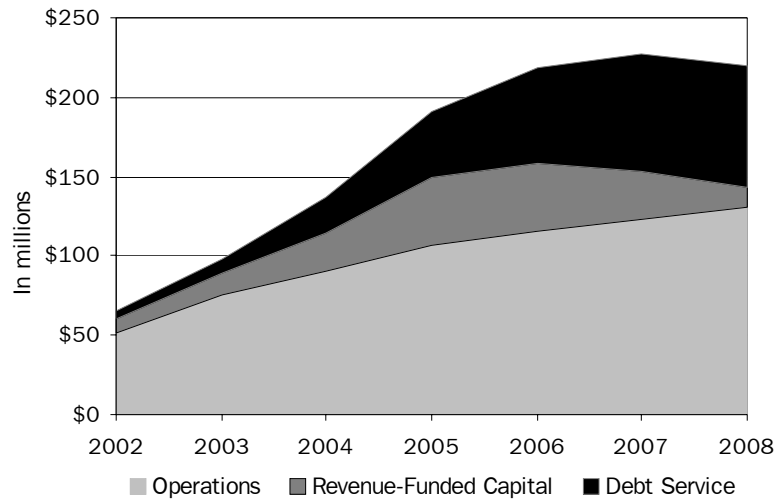


- ERCOT’s use of debt financing to fund a significant portion of its capital expenses has also grown dramatically. ERCOT reports that its debt in 2004 will total \$193 million, with debt service costs totaling \$23.4 million. ERCOT projects that debt service will rise from the current 9.8 percent of ERCOT’s total budget to 35



percent by 2008. The chart, *ERCOT Fee Expenditures*, illustrates the projected growth in operating expenses, revenue-funded capital, and debt service payments given ERCOT's assumptions. ERCOT's Board has historically assumed an 80 to 20 percent ratio of debt to revenue funding for capital expenditures. Of each dollar spent on capital expenditures, ERCOT planned to borrow 80 cents of the total. In the budget approved by the ERCOT Board for 2004, the Board changed the ratio to a 60 to 40 percent ratio of debt to revenue funding.

**ERCOT Fee Expenditures**



Delaying the costs of capital purchases with extensive debt financing increases the overall costs of such purchases. The ERCOT Board has debated the merits of debt, with those that support debt financing arguing that ERCOT is in a start-up period and that debt financing is appropriate to fund capital expenditures with benefits extending over many years. Those opposed have raised concerns that relying on debt financing simply postpones the associated costs in an effort to keep the administrative fee at a low level during this initial period.

- ERCOT's employee costs account for more than 45 percent of ERCOT's total budget. ERCOT projects these costs will continue to rise. ERCOT also assumes a 5 percent increase in labor costs for employee promotions and merit increases, if warranted, over each of the next four years. In addition to direct salary costs, ERCOT pays recruiting and relocation costs, full health premiums for employees and families, and provides incentive compensation to officers and directors of up to 30 percent of base salary. In 2003, ERCOT's budget included \$1.06 million for employee recruiting and relocation. ERCOT proposes a similar amount in the 2004 budget.
- The significant growth in ERCOT's budget and debt financing makes PUC oversight critical to ensure accountability for fee increases. However, according to PUC, ERCOT's fee requests lack the necessary detail for effective evaluation. In the final order approving ERCOT's 2004 administrative fee, PUC found that ERCOT's supporting documentation contained inadequate details for PUC to gauge the relative merits and historical trends of the budget.<sup>3</sup> Although the documentation included total expenditures, required staffing levels, and the total amount of revenue needed to fund the budget, it did not clearly link costs with tasks. Therefore, PUC could not link specific costs to designated functions or projects, limiting PUC's ability to ensure that ERCOT was spending an appropriate amount of funds per function or project.

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*The significant growth in ERCOT's budget and debt highlights the need for PUC oversight.*

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*At a recent meeting, the ERCOT Board discussed opening a \$50 million line of credit, although the item was not posted.*

**ERCOT posts its meeting notices on its Web site, but does not follow the requirements of the Open Meetings Act, potentially limiting the opportunity for public input.**

- ERCOT has a large number of Board, TAC, subcommittee, and working group meetings. In February 2004, ERCOT held 64 scheduled meetings at 10 different locations in Austin and around the state. While ERCOT posts a calendar of events on its Web site, it requires any person planning on attending a meeting to RSVP at least four days in advance.
- In spite of its public function, ERCOT does not always operate in a manner that allows the maximum amount of public awareness and input. For example, at a recent meeting the ERCOT Board discussed methods to accommodate a lower than expected fee increase by PUC, including a proposal to open a \$50 million line of credit. However, this item was not a posted item on the agenda. Without proper posting of agenda items, the public cannot effectively provide input on ERCOT Board decisions.

## **Recommendations**

### **Change in Statute**

#### **1.1 Change the Electric Reliability Council of Texas Board to a nine-member independent Board by September 1, 2006.**

This recommendation would reduce the Board from 14 to nine members who would all be required to be completely independent and unaffiliated with the ERCOT electric market. Eight members would be chosen by ERCOT stakeholders through the same process used to select the three current, independent Board members, and would serve three-year staggered terms. One member would be appointed by the Governor to represent the interests of residential and small commercial consumers. This member would serve a two-year term, to conform with constitutional requirements for gubernatorial appointment terms. This is discussed in more detail in the Office of Public Utility Counsel issue in this report.

As part of this recommendation, members chosen by stakeholders would have to meet specific professional criteria similar to criteria in ERCOT's bylaws used to select current independent members. This recommendation would give the Board one year from the effective date of the legislation to plan for the transition to an independent Board, and allow for the completion of ongoing changes to the wholesale market. The Board members would be compensated for their time, similar to current independent Board members. The new Board would obtain stakeholder input and technical expertise from electric industry market participants and representatives of consumer groups through the Technical Advisory Committee and its subcommittees.

#### **1.2 Require ERCOT Board members to disclose any conflicts of interest and recuse themselves from any vote related to those interests.**

This recommendation would ensure that ERCOT Board members disclose conflicts of interest and are prohibited from voting on any matter in which they or their company would clearly benefit. The disclosure should be entered in the minutes of the meeting. The recusal of a member should not impact the existence of a quorum. This requirement would apply to the current Board, as well as the new independent Board; although the potential for conflicts should be greatly reduced at that point.

### **1.3 Grant PUC clear authority to require ERCOT to submit detailed financial information needed to scrutinize ERCOT's fee requests.**

The statute should be clarified to ensure that PUC may require ERCOT to provide sufficiently detailed information to effectively evaluate the reasonableness of ERCOT's fee requests. PUC should closely scrutinize ERCOT's cost efficiency, salaries and benefits, and use of debt financing. PUC should work with ERCOT to set the level of detail and historical budget information needed to effectively evaluate the fee requests. As part of this recommendation, ERCOT would be required to provide this information in a time frame prescribed by PUC.

### **1.4 Apply the Open Meetings Act to ERCOT.**

This recommendation would apply the Open Meetings Act to meetings of the ERCOT Board and subcommittees of the Board. This would ensure that anyone interested in the activities of ERCOT could find out about the meetings in advance, and have the opportunity to attend. The Board would be permitted to enter into executive session to address sensitive matters prescribed in the Act, such as confidential personnel information, contracts, and lawsuits. Also, the current practice of requiring an RSVP to attend would be eliminated. This recommendation is not intended to subject ERCOT to the Public Information Act.

## **Impact**

These recommendations are designed to ensure greater independence and accountability of ERCOT. An independent Board would reduce potential conflicts of interest tied to members that represent the electric market. The consumer input currently provided by the Public Utility Counsel would be preserved by having the Governor appoint a person to fill this role. The independent members would be assisted in their job of forming ERCOT's policy objectives by the continued existence of the Technical Advisory Committee. Requiring ERCOT Board members to fully recuse themselves from voting on matters in which they, or their companies, have a financial stake, would ensure that the industry representatives do not vote on matters which may present a conflict of interest. Requiring PUC to obtain more detailed financial information would allow the agency to exert greater scrutiny over ERCOT's budget, resulting in better justifications of expenses and greater containment of unnecessary costs. Applying the Open Meetings Act would also add greater accountability by ensuring that the work of ERCOT is more fully open to the public.

## **Fiscal Implication**

These recommendations would not have a fiscal impact to the State. The recommendation to transition the ERCOT Board to a nine-member independent Board would have a fiscal impact to ERCOT. This impact would be dependent upon the level of compensation for the members, as set by the Board. If the Board continues at the current level of compensation of \$75,000 per independent member, the cost to ERCOT of six new, independent members would be \$450,000 per year.

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<sup>1</sup> Federal Energy Regulatory Commission, Docket No. RM01-12 (July 31, 2002).

<sup>2</sup> Texas Government Code, sec. 572.058(a).

<sup>3</sup> Public Utility Commission, Docket No. 28832, Item No. 172 (March 18, 2004).



### *PUC's Market Oversight Function Cannot Adequately Address Manipulations of the Wholesale Electric Market.*

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## Summary

### Key Recommendations

- Require ERCOT to contract with, fund, and support the operations of a private company to perform market monitoring.
- Require PUC to select the monitoring company, define the company's monitoring responsibilities, and set standards for funding, staff qualifications, and ethical conduct.
- Require the market monitoring company to report potential violations of PUC or ERCOT rules or other potential market manipulations to PUC.
- Require the market monitoring company to submit an annual report to PUC and ERCOT identifying market design flaws and recommending methods to fix the flaws.

### Key Findings

- Market manipulations, if left unchecked, can significantly increase electricity costs and erode confidence in a competitive market.
- PUC cannot effectively discover and correct market manipulations before they become severe.
- Limited monitoring impairs PUC's ability to prosecute and deter manipulations of the wholesale electric market, potentially increasing electricity costs by millions of dollars.

### Conclusion

The Legislature charged PUC with oversight of the wholesale electric market to discover, correct, and prevent potential market manipulations that can add millions of dollars to the bills of electricity consumers. However, resource constraints prevent PUC from effectively monitoring the market, limiting PUC's ability to quickly identify manipulations, prosecute suspected manipulators, and deter participants from manipulating the market in the future. A monitoring unit located at and funded by the Electric Reliability Council of Texas (ERCOT), reporting to and supervised by PUC, would improve market monitoring performance while maintaining the independence of monitoring staff from the influence of market participants. A monitoring unit at ERCOT would also bring the market oversight methods in Texas in line with other states with competitive wholesale markets, which have determined that market monitoring works best on-site at an Independent System Operator, such as ERCOT.

## Support

  
*PUC oversees the operation of a \$20 billion electric market that involves more than 500 participants that buy and sell electricity.*

### **PUC oversees the operation of the competitive wholesale electric market at the Electric Reliability Council of Texas.**

- The Electric Reliability Council of Texas, an independent, non-profit organization, ensures the reliable transmission of electricity across a major portion of Texas. Because the ERCOT transmission network has limited interconnection with networks outside Texas, PUC serves as ERCOT's sole regulatory authority. Within ERCOT, retail electric providers purchase electricity at wholesale rates from power generators and resell the electricity at retail rates to large and small consumers. More than 500 market participants buy and sell wholesale electricity in the ERCOT network, in a market worth about \$20 billion. In 2003, ERCOT operated on a budget of \$98.7 million, paid for by electricity users. For more details on ERCOT and a map of its service area, see Appendix C.
- In recent years, ERCOT's role has expanded significantly. Since 1970, ERCOT has monitored the safety and reliability of the transmission network. In 2001, ERCOT began coordinating access to the network to facilitate the day-to-day operation of the competitive wholesale market as an Independent System Operator (ISO), without favoring any individual market participant. The wholesale market is comprised of a series of sub-markets for electricity and related services, as described in the textbox, *Wholesale Electric Market Components*.

ERCOT collects data on the thousands of daily transactions between market participants and monitors the transmission network for signs of congestion or other imbalances that threaten network reliability. To mitigate threats to network reliability, ERCOT orders increases and decreases of balancing energy and deployment of ancillary services; compensates participants for their increases or decreases of activity; and charges the cost of resolving local congestion to market participants based on each participant's level of activity in the market.

#### **Wholesale Electric Market Components**

**Bilateral Energy Market:** Contracts between generators and retail providers to buy and sell electricity. Such contracts can be for long-term, short-term, or spot purchases and sale. Electricity from the bilateral market represents about 90 to 95 percent of total energy transacted.

**Balancing Energy Market:** A pool of energy used to correct unanticipated imbalances between supply and demand on very short notice. Supplies about 5 to 10 percent of the total demand for electricity. Purchased real-time by ERCOT as needed.

**Ancillary Services Market:** Services purchased from generators to balance supply and demand at all times and to maintain network reliability. Includes a market for capacity reserves to protect against outages of power plants or transmission lines. Purchased real-time or in advance by ERCOT as needed.

**Transmission Congestion Rights:** Financial instrument purchased by market participants as a credit against penalties for contributing to congestion on the network.



- PUC plays a key role in overseeing the wholesale electric market at ERCOT by developing rules to foster fair competition and good market design; monitoring market operations; and taking enforcement actions to control market abuse and manipulation. PUC's Market Oversight Division (MOD) monitors the activities of market participants with eight full-time employees and a budget of \$600,000. The textbox, *Wholesale Market Monitoring*, describes PUC's monitoring duties in greater detail.

### **Wholesale Market Monitoring**

PUC's Market Oversight Division (MOD) monitors activities of participants in the ERCOT market to ensure compliance with market rules. MOD has full access to ERCOT market data, consisting of hundreds of indices and thousands of data points produced every 15 minutes to summarize the activities of ERCOT and market participants.

If MOD suspects activities to manipulate the market in favor of one or more participants, it initiates an informal investigation to learn more about the suspicious activities, including requests for information from ERCOT and market participants. If necessary, MOD files a formal investigation, which may lead to an informal settlement or other enforcement action.

### **Market manipulations, if left unchecked, can significantly increase electricity costs and erode confidence in a competitive market.**

- Market manipulation occurs when a market participant conducts unfair, misleading, or deceptive practices to gain material advantage at the expense of other market participants and consumers.<sup>1</sup> Manipulation also refers to activities that restrict competition in the market, interfere with the efficient operation of the market, or adversely impact the reliability of the network. Manipulative activities may violate the rules for participation in the market or take advantage of loopholes in market design to gain advantage in a manner contrary to the spirit of the rules.
- Actions taken to manipulate the wholesale market are often difficult to identify and verify due to the complexity of the market and the need to analyze vast amounts of data produced through market trading. The textbox, *Market Manipulation Activities*, lists several activities that are alleged to have occurred in Texas and other states.
- In recent years, manipulation of competitive wholesale electric markets in other states has contributed to excessive costs to electricity consumers. For example, the California energy crisis of 2000 and 2001, caused in part by manipulative activities, increased the cost of electricity in that state by about \$20 billion during the peak 12 months of the crisis. This, in turn, led to the bankruptcy of one of California's largest utilities and the repeal of the competitive retail market.



*Market manipulations are difficult to identify due to complexity of the market.*

### **Market Manipulation Activities**

**Artificial Congestion:** Creating congestion on the transmission network to receive payments for reducing the self-created congestion.

**Economic Withholding:** Bidding large blocks of power at high prices to raise prices above market value.

**Hockey Stick Bidding:** Routinely offering final amounts of megawatts needed by the market at maximum price when the market is critically short of supply to earn windfall revenues far in excess of marginal cost.

**Misrepresentation of Schedules:** Providing inaccurate data to ERCOT on intentions to buy or sell electricity, to create an artificial imbalance on the network and receive payments to restore the balance.

**Physical Withholding:** Making generation unavailable to create an artificial shortage and raise prices above competitive levels.

**Predatory Pricing:** Offering balancing energy or ancillary services at prices below marginal cost to keep competitors with access to fewer resources out of the market.

  
*In 2003, potential market manipulation led to more than \$60 million in costs to consumers.*

- Texas electricity consumers and market participants have also suffered from market manipulations. For example, during the ice storm of February 2003, PUC estimates that the market was overcharged at least \$17 million as the result of a hockey stick bid, and that the ripple effect resulted in an overall cost in excess of \$60 million to the market. Although PUC determined that the activities that led to the overcharging were not violations when they occurred, these activities are now prohibited by PUC rule.

Since the opening of the competitive wholesale market in July 2001, PUC has reached settlements with 10 companies involved in activities that resulted in high prices to the market on four different occasions. The settlements have resulted in more than \$70 million in refunds to market participants as compensation for excessive costs and an additional \$7 million in administrative penalties. The chart, *PUC Market Oversight – Investigations and Enforcement Actions*, lists the major investigations by PUC of suspected market manipulations. Despite allegations of manipulative activities that have led to informal settlements, PUC has never formally charged any company with market manipulation.

<b>PUC Market Oversight – Investigations and Enforcement Actions</b>				
<b>Date</b>	<b>Name</b>	<b>Alleged Activities</b>	<b>Duration of Investigation</b>	<b>Results</b>
August 2001 – February 2002	Balancing Energy Neutrality Adjustment	Misrepresentation of demand schedules	18 months	Refund to market participants: \$12 million
August 2001 – February 2002	Enron Activities Under Balancing Energy Neutrality Adjustment	Misrepresentation of demand schedules by Enron - separated from previous settlement	26 months	Refund to market participants: \$2.9 million*  Administrative Penalty: \$6.5 million*
February 2003	Extreme Weather Event (Ice Storm)	Extreme increases in electricity prices caused by hockey stick bidding	6 months	Recommendations for PUC rule changes
February 2003	Market Power Abuse Related to the Extreme Weather Event	Abuse of market power through withholding electricity generation (allegations by Texas Commercial Energy)	12 months to date (continuing investigation)	Preliminary finding of no market power abuse - final analysis and report pending
June – July 2003	High Local Congestion	Noncompetitive bidding and possible artificial congestion	7 months to date (continuing investigation)	Refund to market participants: \$55 million
January – December 2002	City of Austin Wind Project Settlement	Misrepresentation of demand schedules	14 months	Refund to market participants: \$1.9 million

\*Recovery of refund and penalty from Enron is pending action in bankruptcy court.

**PUC cannot effectively discover and correct market manipulations before they become severe.**

- The Federal Energy Regulatory Commission notes that “one of the principal goals of market monitoring is to serve as an early warning system for events that are not yet severe.”<sup>2</sup> Under the current monitoring arrangement, PUC cannot discover and correct manipulations until and unless they reach a high level of severity. Undiscovered manipulative activities can cost millions of dollars to



consumers and market participants if the activities are allowed to persist. Also, activities that grow to a high level of severity create significantly higher costs to consumers and market participants than if they were discovered and corrected earlier.

- Based on experiences with market monitoring at PUC and in other states, real-time market monitoring greatly improves the ability to discover market manipulations. Real-time monitoring occurs when monitoring staff observe market transactions as they occur and is most effective when the monitors are located on-site in the control room of the Independent System Operator. On-site, real-time monitoring allows the monitors to observe the actions of control room operators as they communicate with market participants. Through these observations, monitoring staff can learn extensive details about the behavior of market participants in normal and abnormal circumstances, and can develop leads on potentially manipulative activities through anecdotal conversations and observations as well as data analysis.
- Due to resource limitations, PUC cannot conduct on-site, real-time market monitoring as described above. PUC has only one employee dedicated half-time to monitoring in real-time. This level of effort is not sufficient to analyze the more than 200 indices reflecting transactions in the wholesale market in real-time. Further, because PUC's market oversight staff must also work on wholesale market design, investigations, enforcement actions, and other activities at PUC, stationing them at ERCOT for monitoring purposes is not practical.
- Resource constraints require PUC staff to focus on monitoring a handful of the primary indices of market transactions, leaving consumers and market participants at risk from manipulative activities not measured by the primary indices. For example, PUC has recently received allegations of predatory pricing by a market participant. However, because PUC does not have the resources to monitor and analyze all of the necessary data, it cannot determine whether an investigation of the situation is warranted.
- In recognition of PUC's limited monitoring capabilities, the 78th Legislature allocated \$3 million for this biennium to the agency on a one-time basis to hire a consulting firm to perform on-site, real-time market monitoring. However, funding for the contract came from the System Benefit Fund, which is primarily dedicated for the low-income discount program and cannot be considered a stable source of funding for market monitoring in the future.

**Limited monitoring impairs PUC's ability to prosecute and deter manipulations of the wholesale electric market, potentially increasing electricity costs by millions of dollars.**

- Without on-site, real-time monitoring, PUC staff must rely on delayed data analysis for its investigations and enforcement actions. Reviewing data days or weeks after the events occur is more time and labor intensive, and lacks key contextual elements (such as the conversations between control room operators and market participants) that often provide good evidence of manipulative activities.



*Resource constraints limit PUC's ability to conduct the on-site monitoring needed to effectively uncover and deter market manipulations.*

  
*Texas is the only competitive market state that does its monitoring at a state agency.*

- The reliance on delayed data analysis, coupled with heavy workloads for PUC market oversight staff, has resulted in lengthy investigations and prosecutions of suspected manipulations. For example, PUC took 18 months to conclude its investigative report into possible manipulative activities during the opening of the competitive market in August 2001. PUC also needed 14 months to investigate and negotiate a settlement for possible manipulation of wind energy schedules.
- A comparative study of market monitoring units in other states found that prompt detection and prosecution of market manipulation can be an effective deterrent against future manipulative activities.<sup>3</sup> However, PUC cannot efficiently deter market manipulations without on-site, real-time monitoring due to the length of its investigations and prosecutions. On the contrary, market participants may have a greater incentive to undertake manipulative actions if PUC cannot keep up with its existing enforcement responsibilities.

**Other states have found that market monitoring works best when located at, and funded by, the Independent System Operator.**

- Texas is the only state with a competitive wholesale market that maintains the market monitoring function at a state regulatory agency, funded by the State. In the other four competitive markets, the Independent System Operator (ISO) funds wholesale market monitoring units located at the ISO. These units have access to greater resources than are available to PUC. The chart, *Market Monitoring Units*, compares PUC’s budget and staffing for market monitoring with those of the other four ISOs.

<b>Market Monitoring Units</b>				
<b>States</b>	<b>Location of Market Monitoring Unit</b>	<b>Market Size Based on Peak Demand</b>	<b>FTEs 2003</b>	<b>Budget for Market Monitoring 2003</b>
Texas	Public Utility Commission	60,000 MW	8	\$600,000*
Pennsylvania, New Jersey, Maryland, Delaware	PJM ISO	64,000 MW	12	\$2.7 million
California	California ISO	45,000 MW	13	\$2.7 million
New York	New York ISO	31,000 MW	30	\$6.0 million
Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	New England ISO	25,000 MW	11	\$1.3 million

\* PUC’s Market Oversight Division is responsible for all aspects of market oversight, including market monitoring, investigations, and enforcement actions. In other states, the monitoring units assist the Federal Energy Regulatory Commission with investigations and enforcement actions, but are not primarily responsible for such activities.

- Monitoring staff at other ISOs conduct more sophisticated analyses of the large amounts of data produced by market transactions. Monitoring staff also provide increased vigilance of market participants that can act as a deterrent to manipulative behavior. For example, monitoring staff at the PJM ISO can contact market participants to discuss potentially manipulative activities. PJM has ordered market participants to discontinue suspicious activities discovered through data analysis techniques that are currently beyond the capabilities of PUC.<sup>4</sup>

- Monitoring units in other states maintain their independence from market participants by reporting to ISO governing boards comprised entirely of independent members. The recently-formed Midwest ISO has contracted with a private consulting firm to conduct market monitoring operations once its competitive market opens. The ISO requires the firm to follow ethical standards to maintain the firm's professional and financial independence from market participants.<sup>5</sup>
- Due to the interstate nature of wholesale electric market transactions outside Texas, the Federal Energy Regulatory Commission (FERC) conducts investigations and enforcement actions related to market manipulation in other ISOs, equivalent to PUC's investigation and enforcement functions in Texas. Although monitoring staff at other ISOs assist FERC with investigations and enforcement actions, such actions are not their primary responsibility, and they are able to focus more intensively on market monitoring than are PUC staff.

To prevent market participants from influencing the market oversight process, FERC requires market monitoring units to provide information needed to investigate and prosecute suspected market manipulations. FERC also requires each monitoring unit to prepare an annual State of the Market Report identifying flaws in its wholesale market that could lead to manipulations and recommending changes to fix the flaws. The report gives each market monitoring unit the opportunity to improve the competitive market design for its ISO, which reduces the opportunities for market manipulations.<sup>6</sup>

## Recommendations

### Change in Statute

#### **2.1 Require ERCOT to contract with, fund, and support the operations of a private company to perform market monitoring.**

This recommendation would effectively transfer the market monitoring function from PUC's Market Oversight Division to a monitoring unit based at ERCOT. ERCOT should pay for the monitoring unit through its system administrator fee, and should provide the monitoring staff with full access to the main operations center and other support as needed.

#### **2.2 Require PUC to select the monitoring company, define the company's monitoring responsibilities, and set standards for funding, staff qualifications, and ethical conduct.**

This recommendation would solidify PUC's oversight of the monitoring function. PUC would ensure that the monitoring unit has the resources, expertise, and authority to effectively monitor the wholesale market. To allow ERCOT to provide input on how monitoring funds are spent, PUC should consult with a subcommittee of independent ERCOT board members when setting budget and staffing requirements. The ethical standards should ensure that monitoring staff maintain professional and financial independence from market participants.

### **2.3 Require the market monitoring company to report potential violations of PUC or ERCOT rules or other potential market manipulations to PUC.**

This recommendation would ensure that PUC receives the information it needs to investigate and prosecute suspected market manipulations. Monitoring staff would have unrestricted authority to communicate with PUC staff.

### **2.4 Require the market monitoring company to submit an annual report to PUC and ERCOT identifying market design flaws and recommending methods to fix the flaws.**

This recommendation would allow PUC and ERCOT to improve the wholesale market design based on the extensive experience gained by monitoring staff. Improvements in market design should help to prevent future market manipulations. PUC and ERCOT should review the report and evaluate the need to adopt changes to PUC or ERCOT rules based on the recommendations in the report.

## **Impact**

A wholesale market monitoring unit based at ERCOT would be able to more effectively monitor market participant behavior than market oversight staff based at PUC. Having ERCOT fund the cost of the monitoring would provide a stable funding source, supported by fees assessed to fund the market system. A unit at ERCOT would also bring monitoring and oversight at ERCOT in line with the approach used by the federal government and other states. The unit would maintain its independence from market participants through PUC selection and oversight of the monitoring company. These changes would enable PUC to focus its efforts on improving its investigations, enforcement actions, rulemakings, and other market design activities. PUC would also continue to conduct data analysis as necessary when investigating suspected manipulative activities.

## **Fiscal Implication**

These recommendations would not have a fiscal impact on the State. The recommendations would maintain PUC's current level of funding for market oversight while removing most of its market monitoring duties, thereby increasing resources for investigation, enforcement, and market design functions. Based on two and a half years of experience of monitoring the ERCOT wholesale market, PUC has estimated adequate market monitoring would cost \$1.4 million per year for six to seven FTEs, analytical software, and other capital expenses. The estimated cost, to be paid by ERCOT through its system administrator fee, is equivalent to about 1 percent of ERCOT's budget of \$138 million for 2004.

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<sup>1</sup> Texas Administrative Code, Title 16, part 2, rule 25.503.

<sup>2</sup> Federal Energy Regulatory Commission, *Strawman Discussion Paper for Market Power Monitoring and Mitigation Panel*, Docket No. RMO1-12 (Washington, D.C., February 2002), p. 3.

<sup>3</sup> Lawrence Berkeley National Laboratory, *A Review of Market Monitoring Activities at U.S. Independent System Operators*, by Charles Goldman, Bernie C. Lesieutre, and Emily Bartholomew (Berkeley, California, January 2004), p. 29.

<sup>4</sup> For an example of PJM's market monitoring activities, see Lawrence Berkeley National Laboratory, p. 24.

<sup>5</sup> Midwest Independent Transmission System Operator, Inc., *Open Access Transmission Tariff*, Second Revised Volume No. 1, Attachment S, p. 610A. Filed with the Federal Energy Regulatory Commission on July 1, 2002, Docket No. ER02-108-003.

<sup>6</sup> Federal Energy Regulatory Commission, Office of Market Oversight and Investigations.

*Lack of Clear Authority to Establish and Enforce Wholesale Performance Measures Limits PUC's Ability to Foster Fair Telephone Competition.*

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## **Summary**

### **Key Recommendation**

- Grant PUC clear statutory authority to establish and enforce wholesale performance measures for telecommunications service.

### **Key Findings**

- State and federal law charge PUC with ensuring that incumbent local exchange companies provide competitive access to local telephone networks.
- Without enforcement of wholesale performance measures, ILECs could impair competition.
- PUC's authority to set and enforce wholesale performance measures is unclear.

### **Conclusion**

The Legislature has established a clear goal for the State to achieve a competitive telephone market that will bring the benefits of diverse services and competitive rates to Texans. Unlike the introduction of competition in the electricity markets, Texas telephone markets have single providers that sell both wholesale services to other companies and retail services directly to consumers. This dichotomy places the new competitive providers in the unique role of being the customers and competitors of the Incumbent Local Exchange Companies (ILECs). To prevent ILECs from providing poor wholesale services to preserve strong retail market shares, PUC enforces wholesale performance measures that require ILECs to provide the competitive companies with services that are at least as good as what the ILEC provides to its own retail customers. However, while PUC has general authority to create these performance measures, its strongest authority exists only in a contract that is currently subject to renegotiation.

In reviewing PUC's ability to foster competition in the telephone market, Sunset staff assessed the agency's current authority to enforce wholesale performance measures on the Incumbent Local Exchange Companies. Staff weighed the burden that continued enforcement of the standards would pose to the dominant wholesale provider against the benefits of greater competition. Staff concluded that providing clear statutory authority to PUC would enable the agency to better achieve the legislative goal of fostering competition in the telephone markets.



## Support

### State and federal law charge PUC with ensuring that incumbent local exchange companies provide competitive access to local telephone networks.

- In 1995, the Legislature opened the local telephone market in Texas to competition, establishing the policy of the State to promote diversity of providers, interconnectivity of networks, and a fully competitive telecommunications marketplace. The law allowed new telephone companies (competitive providers) to enter the local telephone market and required the former monopolies – known as incumbent local exchange companies (ILECs) – to allow competitors to access their telephone networks.

  
*New competitive phone companies may enter the market by leasing telephone services from incumbent local exchange companies.*

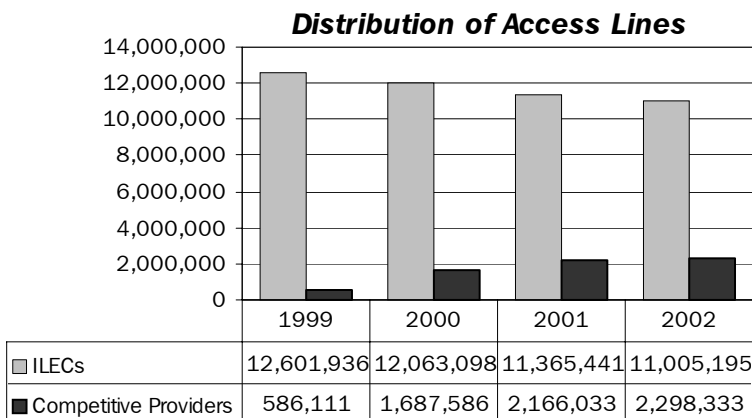
Congress later enacted the Federal Telecommunications Act of 1996 (FTA), opening local telephone markets nationwide to competition. Similar to the Texas law, the FTA contained provisions to facilitate competition by requiring the Bell Operating Companies – the traditional providers of basic local telephone service – to open the local telephone markets to competition. Once the Bell Operating Companies opened their markets to competition, the FTA permitted them to offer long distance services. Southwestern Bell (now SBC) was the Bell Operating Company serving Texas.

- The combined effect of state and federal law grants competitive providers three options for entering the telephone market. The new competitors may build their own network facilities; lease and resell the full services of another telephone company; or lease parts of the network, called unbundled network elements (UNEs), from an ILEC.
- The FTA delegated significant responsibility to the Federal Communications Commission (FCC) and PUC to carry out provisions of the law. For example, the FTA authorizes PUC to approve the terms and conditions of formal interconnection agreements between ILECs and competitive providers. In addition, if the parties cannot agree on interconnection terms, or if they have a dispute about the terms, PUC conducts an arbitration hearing to resolve the issues.

Through authority in the FTA and state law, PUC oversees 63 ILECs and more than 480 competitive providers in Texas. The requirements

established by state and federal laws primarily affect SBC, CenturyTel, Verizon, Sprint, and Valor, as the major ILECs in Texas; and all competitive providers who depend upon these ILECs' wholesale networks to provide services to customers.<sup>1</sup>

- ILECs maintain a significant share of the local retail telephone market. As evidenced by the chart, *Distribution of Access Lines*, ILECs serve 83 percent of the Texas

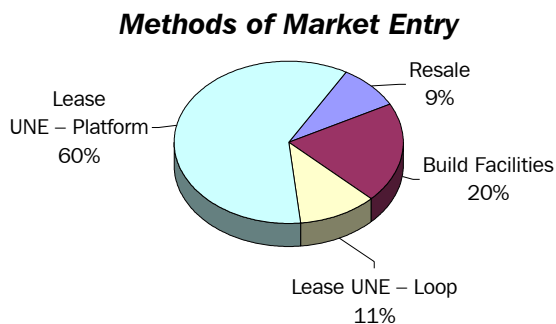


market, while competitive providers serve about 17 percent. Although competitive providers in Texas possess greater market share than the nationwide average (11 percent), competition in Texas is still in the formative stages.

**PUC enforces performance measures established in contract as a means of ensuring fair competition.**

- ILECs function as both wholesale and retail providers of telecommunications service, and most of the new entrants into the telephone market are both the wholesale customers and retail competitors of ILECs. This structure differs from the Texas electricity deregulation plan that structurally divided the incumbent utilities into separate wholesale generators and retail electric providers.

The majority of competitive providers are dependent upon the wholesale services of ILECs. As shown in the pie chart, *Methods of Market Entry*, 60 percent of competitive providers lease unbundled network components (UNE-Platform) from an ILEC, 11 percent lease the last segment to the customer's premise (UNE-Loop), and 9 percent resell the entire service. The remaining 20 percent have chosen to build their own facilities.



- To ensure the ability of competitive providers to access wholesale services from ILECs, PUC approved a standardized interconnection agreement referred to as the Texas 271 Agreement (T2A).<sup>2</sup> The T2A allows competitive providers to enter the local telephone market without needing to negotiate a separate interconnection agreement and ensures that competitive providers have fair access to the network of the primary ILEC in Texas – SBC.

The T2A resulted from negotiations among SBC, competitive providers, and PUC, while SBC was seeking FCC approval to enter the long distance market. SBC agreed to offer the T2A to all competitive providers for four years and used the interconnection agreement to prove to FCC that it had opened its telephone market to competitors.<sup>3</sup> In 2000, SBC received approval to provide long distance service. Since 1999, more than 200 competitive providers have signed interconnection agreements with SBC that are substantially similar to the T2A.

★

*Four out of five competitive phone companies depend on ILECs, who act as both wholesale and retail providers.*

- PUC included a number of safeguards in the T2A, including performance measures relating to all aspects of SBC's wholesale operations, to ensure that SBC maintained the quality of its wholesale services after winning long distance approval. The performance measures assess whether SBC provides its competitors with interconnection, resale, and unbundled network elements on non-discriminatory terms, as required by federal law. The performance measures cover major categories of wholesale service, such as ordering, billing, and provisioning services, as well as maintenance and repair. These categories are further divided into 90 key performance measures, each with numerous submeasures. In addition, the T2A requires SBC

to report its performance by region to ensure that poor performance in one region is not masked by high performance in another.<sup>4</sup> For examples of key requirements, see the chart, *Examples of Performance Measures*.

<b>Examples of Performance Measures</b>			
<b>Category</b>	<b>Requirement on ILEC</b>	<b>Performance Measure</b>	<b>Harm of No Requirement</b>
Interconnection	Allow competitive providers to physically link communications networks to ILEC network. Interconnections may be at any available point in network and must be equal in quality to services provided to ILEC affiliates. Must also provide collocation space to facilities-based competitors seeking to integrate switching equipment into network.	<ul style="list-style-type: none"> <li>● Timeliness and reliability of interconnection</li> <li>● Number of calls that cannot be completed due to related problems</li> <li>● Time to restore service</li> </ul>	Customers of competitors would not be able to call customers served by other phone companies.
Access to Unbundled Network Elements (UNEs)	Must provide competitors with connection to network elements (such as circuit switches, interface devices, and loops) at any technically feasible point with reasonable and nondiscriminatory rates, terms, and conditions. Must offer retail service, at wholesale rates, to competitors for resale.	<ul style="list-style-type: none"> <li>● Installation time</li> <li>● Number of orders processed electronically</li> <li>● Missed due dates</li> <li>● Frequency of trouble</li> <li>● Restoration time</li> </ul>	Competitors would not have access to critical network components or electronic information required to place and install service orders, maintain and repair facilities, or bill customers.
911, Directory Assistance, and Operator Services	Accurate and nondiscriminatory access to emergency services, directory assistance, and operator services.	<ul style="list-style-type: none"> <li>● Timeliness and accuracy of updating information</li> </ul>	Customers who switch to competitors may not have access to 911 or information services; or customer information relayed to service may be inaccurate.
Number Portability	Must provide number portability to competitive providers in a reasonable time frame to enable customers to keep phone numbers when changing companies.	<ul style="list-style-type: none"> <li>● Timeliness and accuracy in porting phone numbers from ILEC to competitors</li> </ul>	Customers who switch phone companies would need to change phone numbers. Slow porting of numbers would prevent customers from receiving incoming phone calls.

- To ensure that the measures continue to capture relevant and useful data, PUC, SBC and competitive providers periodically evaluate the measures to determine whether existing measures are still necessary and if new measures should be added. Over time, PUC has reduced the number of performance measures from 131 to 90. Based upon Texas' success, the T2A has been widely replicated in other states.

**T2A Remedy Plan**

The Remedy Plan includes two types of payments.

**Tier 1:** Damages payable to an individual competitive provider when SBC's wholesale services fail to meet standards, impairing the competitive provider's ability to provide services to customers. Tier 1 damages are assessed monthly.

**Tier 2:** Payments to the State to compensate the citizens of Texas for substandard performance that harms customers and inhibits competition. SBC makes these payments to the Comptroller, for deposit in the General Revenue Fund. Tier 2 assessments apply if SBC misses a standard for three consecutive months.

SBC electronically reports its compliance to PUC each month, calculates the penalties owed, and remits payments to the appropriate parties.

The T2A performance measures establish predefined standards to gauge SBC's wholesale performance. For example, some measures gauge whether SBC provides wholesale services to competitive providers at parity with the services it provides its own retail customers. Where no comparable retail service exists, the service is measured against a benchmark. When SBC fails to meet standards, a performance remedy plan in the T2A outlines the applicable penalty. Details about the penalties are provided in the textbox *T2A Remedy Plan*. Since 1999, SBC has paid \$21 million in damages to competitive providers and \$10 million in payments to the State.



- The T2A expired on October 13, 2003, but has been voluntarily extended by SBC until a successor agreement can be arbitrated and approved by PUC. PUC was conducting the arbitration proceedings at the time of this writing.

**Without enforcement of wholesale performance measures, ILECs could impair competition.**

- As both wholesale and retail providers, ILECs are in a position to limit the ability of competitors to win retail customers by providing substandard wholesale services. In most cases, a new customer of a competitive provider would not know that service problems were the result of poor wholesale service by the ILEC, not the new competitor. If poor service continues, the customer may return to the established former monopoly rather than taking a second chance on a competitive provider. For examples of problems reported to PUC by competitive providers, see the textbox *Complaints About Wholesale Services*.<sup>5</sup>

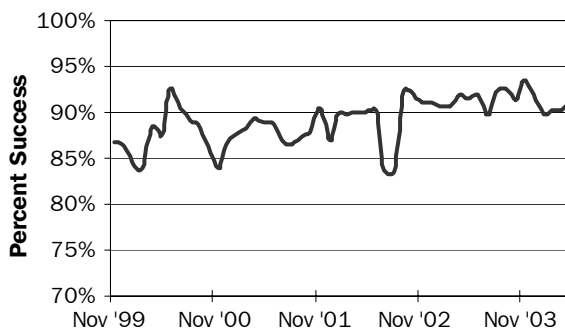
**Complaints About Wholesale Services**

- A competitive provider complained that poor wholesale performance by the ILEC caused customers to receive the wrong long distance carrier or features, outages, and canceled orders.
- A competitive provider's request for a customer's change in service included moving 21 phone lines, with an overlap in service for one week. Because the ILEC claimed that this service could not be provided, the customer canceled the order. After the competitive provider lost the customer to the ILEC, the ILEC provided the requested service.

- Performance measures are an effective tool for ensuring that ILECs, as the dominant wholesale providers, do not restrict competition. Performance measures set clear expectations of service with which ILECs must comply. Knowing that their performance will be monitored monthly, ILECs strive to meet the standards or risk penalties.

Performance measures in the T2A have effectively tracked the quality and timeliness of SBC's wholesale services to competitive providers during the last four years. The chart, *SBC's Wholesale Performance*, shows the percentage of performance measures met by SBC since November 1999.<sup>6</sup> During the first two years, SBC's performance was generally in the 86 to 89 percent range, while SBC's recent performance has been consistently better than 90 percent.

**SBC's Wholesale Performance**




**PUC's authority to set and enforce wholesale performance measures is unclear.**

- General provisions in the Public Utility Regulatory Act (PURA) grant PUC authority to oversee wholesale performance, but the statute does not have a clear, specific grant of authority for PUC to set performance measures. Through PURA, PUC has broad authority to create rules providing each telecommunications utility an equal opportunity to compete, broad authority over the wholesale rates of ILECs to ensure fair competition, and limited authority over wholesale competition to prohibit certain ILEC behavior, as shown in the textbox, *Prohibited Actions*.

**Prohibited Actions**

PURA provides that ILECs may not unreasonably discriminate against other providers by:

- refusing access to the local network;
- refusing or delaying interconnection;
- degrading access or line quality; or
- failing to fully disclose network specifications.

  
*PUC's strongest  
authority to enforce  
wholesale performance  
measures rests in  
contract.*

While these provisions clearly give PUC authority to take enforcement action in response to anti-competitive behavior, authority to take preventive actions, such as monitoring ILEC wholesale performance, is unclear.

- The T2A contract provides PUC's strongest authority to enforce wholesale performance measures. However, as a contract, the authority in the T2A applies only to SBC, and all parties must consent to any changes. The impending expiration of the T2A also threatens the current arrangement through which PUC monitors wholesale performance. Although currently in arbitration, SBC has stated that it is not willing to readopt the remedy plan in successor agreements.<sup>7</sup> The current remedy plan provides penalties designed to ensure compliance with the performance standards.

**By comparison, PUC has clear authority to enforce quality of service standards for retail telecommunications services.**

- PUC has statutory authority to establish and enforce quality of service standards in the retail telecommunications market that are similar to the wholesale performance measures. PURA grants PUC authority to adopt standards for telephone utilities to follow when providing services to customers. PUC has established these standards in rule and set minimum service quality benchmarks applicable to ILECs. Pursuant to its administrative penalty authority, PUC has established a penalty matrix outlining the penalties for non-compliance with service standards.

## Recommendation

### Change in Statute

#### **3.1 Grant PUC clear statutory authority to establish and enforce wholesale performance measures for telecommunications service.**

This recommendation would clarify PUC's statutory authority to establish wholesale performance measures for ILECs in rule, and to enforce those measures. Within the boundaries of this authority, PUC would have the ability to add, remove, or modify wholesale performance measures as necessary to ensure fair access to the network by competitive providers, address acts of noncompliance by ILECs, and respond to the changing telecommunications market by modifying standards as competition progresses. PUC should ensure that any rules adopted do not conflict with federal laws. Further, the recommendation would not affect current exemptions for certain rural telephone companies under state and federal laws. PUC would be able to address violations of wholesale performance measures through its administrative penalty authority and would establish, in rule, a penalty matrix to link violations of wholesale performance measures to appropriate penalties.

### Impact

This recommendation would ensure that PUC has clear authority to effectively oversee the wholesale telecommunications market. Providing clear authority in statute would reduce PUC's reliance on contractual terms in interconnection agreements, and provide PUC with the tools it needs to properly monitor the wholesale telecommunications market. PUC needs clear statutory authority in this area to carry out state and federal mandates relating to fair competition.

Because ILECs serve as providers of both wholesale and retail services, PUC's oversight is critical to preventing wholesale market power abuse against competitive providers. With the authority to establish wholesale performance measures, PUC would ensure, through predefined standards, that ILECs grant competitive providers equal access to the telephone network, and when performance does not meet standards, that ILECs resolve problems as soon as possible. This clarifying language would not prevent PUC from approving interconnection agreements with terms similar to those in the T2A, but would instead provide PUC with added authority over the wholesale services of ILECs. Outside the confines of a contract, PUC would have the ability to ensure that ILECs meet performance measures necessary to preserve competition, and to adjust regulation as competition progresses. These changes would not have any impact on pending litigation.

## **Fiscal Implication**

Clarifying PUC's authority in statute would not have a fiscal impact to the State. However, since 1999, under terms outlined in the current contract, SBC has paid approximately \$10 million to the State for its failure to meet certain performance measures in the T2A. Because the future compliance of SBC and other ILECs cannot be predicted, the gain or loss to the State from future penalties could not be determined for this report.

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<sup>1</sup> Public Utility Commission, *Self-Evaluation Report*, submitted to the Sunset Advisory Commission (August 2003), p. 37.

<sup>2</sup> 271 refers to the section of the Federal Telecommunications Act which allows a Regional Bell Operating Company to enter the long distance market after it has opened its local network to competition. After lengthy proceedings and negotiations at the state and federal levels, the Federal Communications Commission granted SBC section 271 approval in June 2000, and SBC began providing long distance service in Texas in July 2000.

<sup>3</sup> Public Utility Commission of Texas, *Report to the 78th Legislature, Scope of Competition in Telecommunications Markets of Texas* (Austin, Texas, January 2003), p. 47.

<sup>4</sup> SBC must meet performance measures in each of the following geographic regions of Texas: Houston; Dallas/Fort Worth; Central and West Texas; and South Texas.

<sup>5</sup> *Informal Dispute Resolution For Issues Relating to Operational Support Systems*, Public Utility Commission, Project No. 21000, Item No. 13 (June 26, 2000); *Section 271 Compliance Monitoring of Southwestern Bell Telephone Company*, Public Utility Commission, Project No. 20400, Item No. 596 (May 8, 2003).

<sup>6</sup> Public Utility Commission of Texas, *Report to the 78th Legislature, Scope of Competition in Telecommunications Markets of Texas* (Austin, Texas, January 2003), p. 50.

<sup>7</sup> Letter from SBC to Competitive Local Exchange Carriers (CLECs), No. CLEC04-038, January 29, 2004; *Arbitration of Non-Costing Issues for Successor Interconnection Agreements to the Texas 271 Agreement*, Public Utility Commission, Docket No. 28821, note 4 (March 1, 2004).



## *PUC Requires Telephone Utilities to File Reports That May Not Be Needed in Today's Regulatory Environment.*

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### **Summary**

#### **Key Recommendations**

- Eliminate the requirement for telecommunications utilities to file the *Report of Certain Expenses*.
- Require PUC to conduct a one-time review of its reporting requirements for telecommunications utilities to determine the ongoing need for the required reports.
- Require PUC to consider the burden of new reporting requirements on telecommunications utilities before adopting new rules regarding reporting.

#### **Key Findings**

- Many of PUC's reporting requirements are burdensome to telecommunications companies, may result in increased costs to consumers, and are not needed under incentive regulation.
- The Legislature has shown interest in reducing unnecessary regulatory burdens on companies.
- Other federal and state agencies have successfully worked with the industries they regulate to reduce unnecessary regulations and cut costs.

#### **Conclusion**

PUC, through its statutory authority to make and enforce rules, requires telecommunications utilities to submit numerous reports covering a broad range of information. Many of the reporting requirements were initiated during the era of rate regulation when PUC needed a great deal of information about the earnings and spending patterns of companies.

The Sunset Act requires Sunset staff, when assessing an agency's functions, to consider alternative or less restrictive methods of regulation. In its review of PUC, Sunset staff assessed the continued need for the agency's reporting requirements in a competitive telecommunications environment that PUC controls with rule-based regulation. Although PUC staff state that many of these reports provide information that may be useful under certain circumstances, Sunset staff weighed the value of this information against the need to reduce the regulatory burdens on the industry. While many of the reporting requirements are still necessary, Sunset staff identified outdated requirements that could be eliminated or reduced without impairing PUC's ability to monitor the companies.

## Support

### **PUC requires numerous reports from telecommunications utilities.**

- The Public Utility Regulatory Act (PURA) contains a number of specific reporting requirements for telephone companies. For example, PURA requires certain telecommunications utilities to file with PUC tariffs and explanations of rates charged to consumers, accounts of profits and losses, and plans to achieve workplace diversity and increased business opportunities for historically underutilized businesses.
- State law grants PUC permissive authority to require telecommunications utilities to file annual reports about expenditures relating to business gifts, entertainment, advertising and public relations.<sup>1</sup> PURA also authorizes PUC to require utilities to submit copies of reports filed with federal or state agencies.<sup>2</sup>
- The Legislature has also granted PUC general authority to require information about utility transactions subject to PUC jurisdiction. Using this authority, PUC has established a number of specific reporting and filing requirements for telecommunications utilities in rule.<sup>3</sup> These rules require some 40 reports from telephone companies, although not all reports are consistently required of every provider. For example, only incumbent local exchange companies (ILECs) that have elected into incentive regulation are required to file infrastructure reports with PUC, and only those companies that interrupt services to customers for more than four hours are required to file a report about the occurrence.

Although PUC has broad authority to require reports from all telecommunications utilities, far fewer reporting requirements are imposed on newer, competitive companies than are required of dominant ILECs. The chart, *Telecommunications Reports*, provides information about the general categories and number of required reports.

<b>Telecommunications Reports</b>	
<b>Category</b>	<b>Number of Reports</b>
Area Code	2
Equal Employment Opportunity and Historically Underutilized Businesses	3
Financial Reports	6
Municipal Right-of-Way	3
Service Provider Information	4
Service Quality and Customer Protection	6
Universal Service Fund	8

### **Many of PUC's reporting requirements are burdensome to telecommunications companies, may result in increased costs to consumers, and are no longer needed under incentive regulation.**

- Telephone companies believe that excessive reporting requirements require them to focus limited resources on outdated or unnecessary regulations and result in significant costs that may be passed through to consumers. These regulations are especially onerous on smaller companies that average from nine to 38 employees per company. The

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*PUC rules require about 40 reports from various telephone companies.*

★

*Excessive reporting requirements are especially hard on small companies.*



chart, *Examples of Required Reports*, list reports that are frequently cited as burdensome on ILECs, along with the average number of hours spent by small and large companies in preparation.

<b>Examples of Required Reports</b>			
<b>Report</b>	<b>Company</b>	<b>Frequency</b>	<b>Average Number of Hours per Company to Complete</b>
Report of Certain Expenses	ILECs	Annual	18 to 120
Earnings Report	Telephone Utilities	Annual	40 to 240
Cost Allocation Manual	ILECs	Annual	10 to 16

- Some reporting requirements are unnecessary holdovers from the era when PUC regulated the rates and services of monopoly utilities. For example, under rate regulation, the Legislature granted PUC permissive authority to require telephone companies to file annual earnings reports. These reports contain information that PUC needed to determine whether telephone companies were earning excessive profits on regulated rates. Today, however, a number of ILECs have elected into incentive regulation, a statutory structure designed to reduce the degree of regulation and exempt the company’s earnings from PUC review. Despite this change in regulation and a reduced need for PUC to collect earnings information, PUC continues to require annual earnings reports from all telephone companies.
- PUC does not always use the information from reports that it continues to require companies to file. For example, PURA permits PUC to require a *Report of Certain Expenses*, which requires telecommunications utilities to annually report expenditures for business gifts, entertainment, advertising, and public relations.<sup>4</sup> PUC staff indicate that these reports were necessary for ratesetting proceedings. However, now that many companies are not under rate regulation, PUC only uses the information to respond to occasional information requests from legislative staff and the public.

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*Some required reports are holdovers from the era of rate regulation.*

**The Legislature has shown interest in reducing unnecessary regulatory burdens on companies.**

- During a number of sessions, the Legislature has directed agencies to review regulatory requirements that create unnecessary burdens on private businesses. For example, the Sunset Act charges the Sunset Commission and its staff, when conducting agency reviews, to assess ways that the agency’s regulation could be less burdensome and still adequately protect the public.

In a second example, the Legislature, in establishing the Administrative Procedure Act, directed all agencies to establish a process and timetables for reviewing administrative rules.<sup>5</sup> Agencies are specifically directed to assess whether the reasons for initially adopting the rule continue to exist and to remove unnecessary rules. Under this procedure, PUC will begin its review of telecommunications rules in 2006, after completing reviews of administrative, procedural, and electric rules.<sup>6</sup>

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*The Sunset Act requires a review of ways to reduce the burden of regulation and still protect the public.*


- The Legislature has also recognized the burdens that PUC places on public utilities by directing PUC to adjust its regulation to match the degree of competition in the marketplace.<sup>7</sup> Although this requirement does not address reporting requirements on telecommunications

utilities, it does direct PUC to reduce the cost and burden of regulation. Other statutory provisions require PUC to incorporate an appropriate mix of regulatory and market mechanisms when adopting rules for ILECs.<sup>8</sup>

**Other federal and state agencies have successfully worked with the industries they regulate to reduce unnecessary regulations and cut costs.**

- The Federal Communications Commission streamlined and modified its financial and operating data reporting requirements on ILECs in 2001.<sup>9</sup> Reforms included consolidating and streamlining accounting requirements, eliminating cost allocation manuals and biennial audits for mid-sized carriers, and streamlining the amount of information required in reports. As part of its *Annual Performance Plan*, the FCC is continuing efforts to eliminate outdated or unnecessary accounting and reporting regulations.<sup>10</sup>
- In 1995, the Texas Department of Insurance revamped its regulatory processes to better respond to its customers, which included the Legislature, insurance companies, agents, other regulated entities, and consumers. TDI streamlined processes and cut costs by eliminating unnecessary functions. For example, TDI adopted rules to simplify ratemaking and rulemaking processes, eliminate unnecessary reviews of routine corporate and holding company transactions, streamline rate filing reviews, and implement electronic transfers of data. These efforts allowed TDI to eliminate the processing of about 2,000 reports per year.<sup>11</sup>

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*The Texas  
Department of  
Insurance successfully  
eliminated the  
unnecessary  
processing of about  
2,000 reports.*

## Recommendations

### Change in Statute

#### **4.1 Eliminate the requirement for telecommunications utilities to file the *Report of Certain Expenses*.**

This recommendation would eliminate the statutory provision that authorizes PUC to require telecommunications utilities to annually report expenditures relating to business gifts, entertainment, advertising, and public relations. As part of this recommendation, PUC should also repeal any related rules. Eliminating this provision would relieve telecommunications utilities – such as ILECs that have elected into incentive regulation – from the burden of preparing and submitting this report to PUC on an annual basis, but would not prevent PUC from collecting this information from rate regulated companies using the agency’s general statutory authority.

#### **4.2 Require PUC to conduct a one-time review of its reporting requirements for telecommunications utilities to determine the ongoing need for the required reports.**

This recommendation would require PUC to conduct a one-time, comprehensive review of all reporting requirements in PUC rules and in statute. The review should include an examination of the continuing necessity and use of the information collected, and should be completed by September 2006. During this process, PUC, with the assistance of interested parties, would establish criteria for how and when reports would be used, and would ensure requested information does not duplicate



other reports. PUC would be directed to eliminate unnecessary reports that are required in rule and to streamline requirements for reports that continue to be needed. For example, PUC could waive reporting requirements for companies during the years the data would not be used, or allow companies to report some information biennially. PUC would also be charged with identifying reports required in statute that are no longer necessary for regulation of the industry. PUC would make its recommendations on eliminating these outdated requirements to the Legislature in the agency's existing *Scope of Competition Report*.

## **Management Action**

### **4.3 Direct PUC to consider the burden of new reporting requirements on telecommunications utilities before adopting new rules regarding reporting.**

This recommendation would require PUC, when writing new rules, to weigh the need for new reporting requirements against the burden imposed upon the utility. While this recommendation would not prevent PUC from adopting necessary rules, it would require PUC to carefully consider the burden of new reports and would provide utilities with information on the purpose of the new requirements.

## **Impact**

These recommendations are intended to reduce the burden of PUC's reporting requirements on telecommunications utilities while still adequately protecting the public. Because the majority of the requirements are in agency rule, these recommendations require PUC to review its rules, searching for opportunities to eliminate or reduce outdated or unnecessary requirements, without sacrificing customer protection. Because the agency has an existing rule review process, these recommendations would ensure the review is conducted with the goal of tailoring the rules to the degree of regulation needed in today's competitive telephone market. These recommendations would also reinforce the Legislature's directive to PUC to adjust its regulation as competition progresses. While Sunset staff did not find evidence of unnecessary regulatory burdens in general, staff did find that reporting requirements could be reduced without decreasing PUC's ability to oversee the market.

## **Fiscal Implication**

These recommendations would have no fiscal impact to the State, as PUC can carry out its review of existing rules using current staff and within the rule review process that the agency already plans to conduct. The recommendation should also have the benefit of slightly decreasing the workload on PUC staff to process the required reports.

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<sup>1</sup> Texas Utilities Code, sec. 52.254.

<sup>2</sup> Texas Utilities Code, sec. 14.003(5)(B).

<sup>3</sup> Texas Administrative Code, Title 16, part 2, ch. 26.

<sup>4</sup> Texas Utilities Code, sec. 52.254.

<sup>5</sup> Government Code, sec. 2001.039.

<sup>6</sup> *Revised Plan for Review of Agency Rules for Fiscal Years 2004 - 2007*, Public Utility Commission, Project No. 27816, Item No. 6 (Austin, Texas, August 22, 2003).

<sup>7</sup> Texas Utilities Code, sec. 51.001(e).

<sup>8</sup> Texas Utilities Code, sec. 52.051.

<sup>9</sup> "FCC Modernizes Accounting and Reporting Requirements," Federal Communications Commission, October 11, 2001 (news release). Online. Available: [http://ftp.fcc.gov/Bureaus/Common\\_Carrier/News\\_Releases/2001/nrcc0139.html](http://ftp.fcc.gov/Bureaus/Common_Carrier/News_Releases/2001/nrcc0139.html). Accessed: March 5, 2004.

<sup>10</sup> Federal Communications Commission, *FY 2004 Annual Performance Plan*, Goal 2 - Promote Competition in All Communications Markets: Performance Goal - Appropriate Deregulation. Online. Available: [http://ftp.fcc.gov/Reports/fcc2004budget\\_section\\_2.pdf](http://ftp.fcc.gov/Reports/fcc2004budget_section_2.pdf). Accessed: March 5, 2004.

<sup>11</sup> Texas Department of Insurance, *Turning the Corner*, Elton Bomer, Commissioner of Insurance (Austin, Texas, May 1995), p. 265.

### *PUC's Administrative Penalty Authority Is Inadequate to Address Violations of PURA by Wholesale Electricity and Telecommunications Providers.*

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## Summary

### Key Recommendation

- Increase PUC's maximum administrative penalty from \$5,000 to \$25,000 per day, per violation.

### Key Findings

- PUC's administrative penalty authority is inadequate to address violations in the competitive wholesale electric and telecommunications markets.
- Other state public utility commissions have greater administrative penalty authority.
- Other Texas state agencies have greater administrative penalty authority.

### Conclusion

The Public Utility Commission seeks to protect consumers through enforcement of the Public Utility Regulatory Act and agency rules. In recent years, the Legislature has introduced competition into the former monopoly industries of electric utilities and telecommunications service providers. This change has necessitated a shift in the agency's primary means of enforcing the Act from approval of rate changes by individual companies to taking enforcement actions. While the Legislature increased PUC's maximum administrative fine from \$1,000 to \$5,000 as part of the introduction of competition into the telephone industry in 1995, this fine may not be an adequate deterrent to wholesale electricity and telecommunications providers. In view of the fact that actions by wholesale electric and telecommunications companies can result in millions of dollars in costs to consumers, Sunset staff assessed whether the current administrative fine is adequate to deter and redress violations. Sunset staff found that recent major cases, settled informally, may not have resulted in adequate fines if the agency had been forced to rely on its current maximum penalty. As other major states with competitive public utility markets, such as Florida, New York, and California, have administrative penalties far in excess of Texas, Sunset staff recommend that PUC's maximum penalty be raised from \$5,000 to \$25,000 per day, per violation.

## Support

### **PUC uses administrative penalties as one means of enforcing the Public Utility Regulatory Act.**

- In creating PUC and Texas' system of utility regulation in 1975, the Legislature granted PUC broad authority to make rules to protect consumers of electricity and telecommunications services, and to levy administrative penalties to enforce the rules. Although most state regulatory agencies rely primarily on administrative penalties to achieve compliance with law and rules, PUC primarily policed the monopoly companies under its jurisdiction through approval of rates. This regulatory authority provided utilities with a strong incentive to comply with laws and rules to receive requested rate increases.

<b>PUC Administrative Penalties</b>			
<b>Fiscal Year</b>	<b>Type of Violation</b>	<b>Number of Violators</b>	<b>Penalties</b>
2002	Failure to comply with customer service standards for retail telecommunications provision (slamming and cramming complaints). <sup>1</sup>	4	\$900,000
2003	Failure to respond within 21 days to a PUC request to settle a customer complaint.	15	\$17,750
	Failure to accurately report telecommunications right-of-way access information	3	\$6,000
	Misrepresentation of demand schedules in the wholesale electric market.	1	\$6,500,000
<b>Total</b>		<b>23</b>	<b>\$7,423,750</b>

- Using its maximum administrative penalty of \$5,000 per day, per violation, PUC imposed more than \$7 million in administrative penalties during the past two fiscal years, as shown in the chart, *PUC Administrative Penalties*. These penalty totals exclude payments made to the State under terms of the Texas 271 agreement, an interconnection agreement relating to wholesale telecommunications services, as those penalties are set in contract and are not collected under the PUC's administrative penalty authority.

### **PUC's administrative penalty authority is inadequate to address violations in the competitive wholesale electric and telecommunications markets.**

- Under rate regulation, PUC did not rely on administrative penalties as its primary tool to achieve enforcement. However, in 1995, the Legislature began transitioning PUC from rate regulation to rule-based regulation by allowing competition in local telephone and wholesale electric markets. The Legislature took further steps in this direction in 1999 by introducing competition in the retail electric markets and pricing flexibility and consumer protections in the telecommunications markets. Acknowledging PUC's need for greater penalty authority, the Legislature raised PUC's maximum administrative penalty from \$1,000 to \$5,000 per day, per violation with the passage of the telecommunications bill in 1995.
- PUC's maximum penalty of \$5,000 per day, per violation allows the agency to take action against retail violations where cases typically affect many individual consumers and thus constitute multiple violations. However, the penalty may not be significant enough to prevent wholesale violations by electric and telephone companies as examined in the following material.



*PUC needs stronger penalty authority under rule-based regulation than was needed under rate regulation.*

**Wholesale Electric Market** – PUC cannot effectively enforce wholesale market rules with a maximum administrative penalty of \$5,000 because, in the multibillion-dollar electric industry, a single violation of market rules could result in millions of dollars in illegal profits and only a single, \$5,000 penalty. For example, suspected market manipulations during the ice storm of February 2003, described in Issue 2 of this report, led to the overcharge of Texas electricity consumers by an estimated \$60 million in excess electricity charges. If PUC charges a company with market manipulation, the company may offer to return the profits and pay the administrative penalty as part of the cost of doing business, without substantial financial impact to the company. Under such circumstances, a \$5,000 penalty is not substantial enough to deter the illegal behavior from occurring in the first place, or to deter future violations.

PUC has issued one administrative penalty of \$6.5 million for competitive wholesale market violations. Because the penalty was part of an informal settlement with the company, the fine is much larger than PUC could likely have obtained through formal enforcement action. As part of the settlement, PUC and the violating company agreed to count each 15-minute interval of illegal activity as a separate violation, allowing PUC to generate a substantial administrative penalty based on multiple violations per day. However, if the company would not have agreed to the informal settlement, the penalty could not have exceeded \$5,000 for each violation per day.

**Wholesale Telecommunications Market** – Federal and state laws charge PUC with ensuring fair competition in the wholesale telecommunications market, where Incumbent Local Exchange Companies (ILECs) still have significant control over the telephone network. PUC currently relies on performance measures established in contract as its primary means of monitoring the largest ILEC in the wholesale telephone market. Because the contract includes a self-executing penalty plan, PUC has never had to exercise its enforcement authority for wholesale market violations. Since 1999, the ILEC has paid more than \$10 million to the State, pursuant to contractual terms.

However, the impending expiration of the contract threatens the current arrangement. PUC may now be forced to rely on its administrative penalty authority to address wholesale market violations. These violations have a direct impact on competition by decreasing the quality of services that competitors are able to offer customers. In Issue 3, Sunset staff recommends clarifying PUC's statutory authority to establish and enforce wholesale performance measures for ILECs. Along with this authority, PUC will need an adequate penalty to deter violators.

**Other state public utility commissions have greater administrative penalty authority.**

- Public utility commissions in other states have higher administrative penalties than the Texas PUC. California may impose a penalty up to \$20,000 per day, while Florida's cap is \$25,000 per day.

In New York, a violation of the Public Service law is a civil penalty punishable by a fine not to exceed \$100,000 per day. However, if the



*A \$5,000 penalty  
may provide little  
deterrence or redress  
of violations resulting  
in millions of dollars of  
profit.*

utility company violated a law or order that was designed to protect the overall reliability and continuity of electricity service, the maximum penalty is \$500,000.

### **Other Texas state agencies have greater administrative penalty authority.**

  
*The Legislature recently increased administrative penalties to better address and deter accounting fraud.*

- In 2003, the Legislature raised the Texas State Board of Public Accountancy's administrative penalty from \$1,000 to \$100,000 per violation. With the increased penalty authority, the Board is better able to enforce the Public Accountancy Act by tailoring the penalty to the severity of the violation. The higher cap should assist in the prosecution of firms involved in accounting fraud cases, like the recent scandals involving Arthur Andersen, Enron, and WorldCom.
- The Commissioner of Insurance may impose an administrative penalty up to \$25,000 per offense, for violations of the Insurance Code, a state insurance law, rule or order. The amount of the penalty imposed is based on the seriousness of the violation.
- For specific violations involving the storage of hazardous liquids, the Railroad Commission may impose a penalty up to \$25,000 per day, with a maximum penalty of \$500,000. The Commission has established a penalty matrix to help guide its use of monetary penalties.

## **Recommendation**

### **Change in Statute**

#### **5.1 Increase PUC's maximum administrative penalty from \$5,000 to \$25,000 per day, per violation.**

This recommendation to increase the statutory cap on administrative penalties would permit the Commission to take stronger action, but would not mandate these penalties in every case. To ensure that all parties are aware of what violations may merit potential penalties, PUC would need to pass rules adopting a penalty matrix and specifying which violations are serious enough to merit higher penalties.

### **Impact**

The current penalty cap was put into law in 1995, before the electric and telecommunications industries fully transitioned to competition. Along with the benefit of competition came new opportunities for violations. With this broader range of monetary penalties, PUC could more effectively address and deter violations by electric and telecommunications utilities operating in a deregulated environment.

### **Fiscal Implication**

This recommendation may result in a fiscal gain to the State. However, because the number of violations and the degree of seriousness varies depending on the circumstances in each enforcement situation, an exact fiscal impact could not be estimated for this report.

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<sup>1</sup> Each individual complaint addressed numerous violations. For example, one complaint, which resulted in a \$500,000 fine, resolved 759 slamming and cramming violations committed against customers.

## *Texas Has a Continuing Need for the Public Utility Commission.*

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### **Summary**

#### **Key Recommendation**

- Continue the Public Utility Commission of Texas for 12 years.

#### **Key Findings**

- Texas has a clear and continuing interest in regulating the electric and telecommunications industries.
- PUC effectively accomplishes its mission in overseeing public utilities.
- PUC is the most appropriate agency to regulate electric and telephone utilities.
- Most other states regulate the telecommunications and electric industries through a structure similar to the Public Utility Commission.

#### **Conclusion**


The Public Utility Commission's mission – to protect customers, foster competition, and promote high quality infrastructure in the electric and telecommunications industries – is important to the State. As the Legislature has transitioned these industries from single, integrated monopolies with defined service areas to a competitive environment, PUC's role in enforcing state laws and rules is important in ensuring that companies compete fairly and obey state and federal law and rules. The Sunset review evaluated the continuing need for an independent agency to oversee the electric and telecommunications industries. Sunset staff assessed whether the agency's functions could be successfully transferred to another agency, and looked at how other states administer public utility regulatory programs. While other recommendations in this report identify changes in PUC's focus and statutory authority needed to complete the agency's transition from a rate-setting role to rule-based regulation of public utilities, Sunset staff found that the agency is generally effective in its current role and should be continued by the Legislature.



## Support

### **The Public Utility Commission is primarily responsible for regulating electric and telephone utilities in Texas.**

- The Public Utility Commission achieves its mission of protecting customers and fostering competition in the electric and telecommunications industries through the regulatory tools of rulemaking and enforcement. PUC is overseen by a full-time, three-member Commission, and operates with a staff of 210 full-time employees and a budget of \$113 million.
- In 1975, the Legislature created PUC to regulate the monopoly electric and telecommunications industries through approval of rate changes. PUC played an adjudicative role in these rate cases and made its determinations in the public interest. The concept of public interest required recognition of the interests of both consumers and the regulated industries – the public interest would be found in keeping rates low for consumers, but high enough to ensure that utilities made a fair return on their investment and were encouraged to continue conducting business in Texas.
- In the past decade, both the Legislature and U.S. Congress have introduced competition into large segments of both electric and telephone industries. Today PUC oversees these industries and protects the public primarily through the traditional regulatory means of rulemaking, administrative enforcement, and investigation of customer complaints.
- Although the scope of regulation varies considerably, PUC licenses or registers more than 3,000 companies in the electric and telecommunications industries. The extent of this regulation ranges from simple registration of payphone providers based upon information submitted by the providers, to extensive authority to prescribe the rates, terms, and conditions of the services provided by the five remaining, integrated electric utilities. The chart, *Companies Regulated by PUC*, lists the industries, type, and number of companies overseen by PUC, while the textbox, *Telephone Services Not Overseen by PUC*, lists some of the major telecommunications services that PUC does not have a role in overseeing.
- Although PUC does not regulate telemarketers, the agency does maintain a list of names of telephone customers who object to receiving unsolicited telemarketing calls. Unless exempted by law, telemarketers may not contact any of the 980,000 names on the list. PUC investigates complaints and assesses administrative penalties for violations of the Texas No Call List.
- PUC administers two public benefit programs designed to ensure that Texans have access to affordable electricity and telephone services. The Low-Income Discount Program, operated with a budget of \$97 million, provides a 10 percent discount on electricity rates for low-income customers in the parts of Texas that have access to competitive retail electric providers. The Legislature has funded this program through an assessment on ratepayers in competitive electric markets, which accrues to the System Benefit Fund.

  
*The Legislature  
created PUC in 1975  
to rate regulate  
monopoly electric and  
telephone industries.*

#### **Telephone Services Not Overseen by PUC**

- Long Distance Services
- Cellular Services
- Paging Services
- Yellow Pages
- Cable Television
- Wireless Services

<b>Companies Regulated by PUC</b>				
<b>Industry</b>	<b>Type of Company</b>	<b>Explanation</b>	<b>PUC's Function</b>	<b>Number</b>
Electric Companies	Integrated Utilities	Traditional monopoly electric utilities that exist only in parts of Texas that have not been deregulated by the Legislature.	Fully regulates rates and services.	5
	Transmission and Distribution Utilities (TDUs)	Monopoly utilities that provide transmission services in otherwise deregulated parts of Texas.	Fully regulates rates and services.	6
	Retail Electric Providers (REPs)	Competitive electric companies that purchase wholesale electricity from generators and directly bill consumers.	Regulates through rules and enforcement actions.	80
	Power Generation Companies	Competitive generators that sell electricity to Retail Electric Providers.	Registers but otherwise has limited regulatory authority.	105
	Electric Cooperatives	Non-profit, integrated utilities owned by customers. (May choose to allow other companies to compete within its service area.)	Authority 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 terms and conditions for open access to distribution facilities.	27
	Municipal Utilities	City-owned, integrated utilities. (May choose to allow other companies to compete within its service area.)	Authority to regulate transmission services provided to other utilities. No authority over retail rates and services for Municipal Utilities, except to review rates charged to customers who live outside the municipality. For Municipal Utilities that opt into competition, PUC has jurisdiction over terms and conditions for open access to distribution facilities.	12
	Power Aggregators	Companies that contract with multiple customers to purchase and distribute electricity at bulk rates.	Registers but otherwise has limited regulatory authority.	170
	Power Marketers	Companies that purchase and resell wholesale electricity.	Registers but otherwise has limited regulatory authority.	121
Telephone Companies	Incumbent Local Exchange Companies (ILECs)	Traditional phone companies that provide local service to businesses and residences, and wholesale services to competitive local exchange carriers.	Utility laws require ILECs to offer telecom services for resale at wholesale rates and provide for the interconnection of telephone networks, but ILECs are otherwise granted pricing flexibility for basic retail services under a price cap.	63
	Competitive Local Exchange Carriers (CLECs)	Newly formed competitors that provide local service to businesses and residences in competition to ILECs.	Utility laws give authority to CLECs to change retail rates or services by filing notice with PUC, but prohibits them from charging excessive access charges.	487
	Interexchange Carriers	Intrastate, long distance service providers.	Registers companies to facilitate enforcement of statutory provisions.	1,316
	Pay Phone Providers	Pay phone providers other than local exchange carriers.	Registers companies to facilitate enforcement of statutory rate caps.	511
	Automatic Dialing 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.	249

PUC also oversees the Universal Service Fund (USF) that is designed primarily to offset the high cost of telephone service in rural areas of the state. USF, funded by an assessment on most telecommunications providers, currently has an annual budget of about \$600 million, although these funds are held outside the State Treasury.

**Texas has a clear and continuing interest in regulating the electric and telecommunications industries.**


- Both industries regulated by PUC – electric and telephone – provide services essential to all Texans. The inability of individual citizens to have electricity or phone services might have severe consequences for their health and safety. In addition, the inability of regions of the state to secure service would have dramatic economic results for the state as a whole. PUC has traditionally operated to ensure that all citizens of Texas, and all parts of the state have access to providers of these services.
- Despite the introduction of competition into the industries that PUC oversees, the State has a continuing interest in overseeing the companies involved. While the changes made by the Legislature and Congress to introduce competition into the markets are often referred to as deregulation, the reality is that the industries remain regulated. The shift in the State’s approach to overseeing the industries has primarily been to replace the high degree of control involved in rate regulation with more flexible, rule-based regulation.

Although a competitive environment should benefit consumers by creating incentives for companies to lower prices, improve services, and offer new products, the State still needs to regulate companies to ensure that they compete fairly and obey state and federal laws and rules. This regulation is particularly needed in areas where incumbent providers still have large market shares, which raises the possibility of market power and the ability to control prices. In response to the transition from rate-setting to rule-based regulation, PUC has expanded the size of its legal and enforcement and customer protection staff to better police the regulated industries’ adherence to laws and rules.

**PUC effectively accomplishes its mission in overseeing public utilities.**

- As PUC transitions the industries it oversees to a rule-based regulatory environment, its ability to create effective rules to enforce state and federal laws has become an increasingly important function. PUC has established an effective means of creating rules based upon its staff presenting a preliminary strawman proposal as a basis for discussion by working groups made up of affected parties and interested individuals. Although short of its performance target, PUC, in its implementation of major legislative reforms, created 51 new rules in fiscal year 2003. These rules are broad-based and encompass major policy initiatives.
- Taking strong action against companies that violate state law and rules is necessary for regulatory agencies to properly enforce state law. PUC is proactive in its responsibility to identify and penalize companies that fail to comply with the Public Utility Regulatory Act or agency rules. In fiscal year 2003, PUC enforcement actions resulted in \$6.5 million in administrative penalties and \$2.7 million in credits and refunds for consumers, exceeding its targeted performance.
- With so much change in how public utilities are structured, PUC’s role in educating and informing the public of their rights and protections

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*While the Legislature has shifted the electric and telephone industries from rate regulation to rule-based regulation, PUC’s oversight is still needed.*

regarding electricity and local telephone service, and assisting customers with complaints has become a key function. PUC effectively performs these public education functions. In fiscal year 2003, PUC fielded some 121,000 calls from the public about their utility providers, and its customer protection Web site received 231,000 hits. In that same year, the agency received and resolved informally about 31,000 customer complaints and was able to conclude these complaints, on average, within 35 days – well under its target performance of 55 days.

- While PUC's traditional regulatory strategy of setting utility rates through rate cases has declined dramatically in number and scope due to the introduction of competition to the electric and telephone markets, rate cases are still an important part of its duties. Despite the decline, PUC continues to effectively complete rate cases, having done 20 in fiscal year 2003 with its major electric cases taking an average of 346 days.

**PUC is the most appropriate agency to regulate electric and telephone utilities.**

- The Railroad Commission of Texas (RRC) regulates natural gas utilities that provide service to many of the same customers as the electric utilities regulated by PUC. In fact, a number of regulated companies provide both gas and electric service. However, the nature of the regulation performed by the state agencies is significantly different: RRC rate-regulates retail gas providers as monopoly utilities, while the Legislature is transitioning PUC's regulation of the electric industry to a competitive environment under rule-based regulation.

The Legislature, on a number of occasions, has debated the merits of consolidating RRC and PUC. For example, in the 78th legislative session, the Legislature considered the State Comptroller's proposal to abolish both RRC and PUC and transfer the functions of the agencies to a proposed Texas Energy and Communications Commission and other state agencies. The major debate centered on the potential cost savings and compatibility of the functions of the respective agencies. Much of the cost savings were found to be dependent on a reduction in the level of services provided by the agencies. Ultimately, the Legislature did not approve this approach to consolidating RRC and PUC.

Sunset staff analyzed this consolidation in light of the Legislature's decision. Since potential cost savings were not significant, staff examined the potential for better coordination. RRC and PUC coordinate on cases important to the business of both agencies. For example, in 1999, the two agencies conducted joint monitoring of coal deliveries by the Union Pacific Railroad. While the agencies could benefit from closer coordination, Staff concluded that consolidation of RRC and PUC was not warranted at this time.

- The Texas Commission on Environmental Quality (TCEQ) also regulates utilities – water and wastewater providers – that have functions similar to PUC. In fact, PUC regulated these same utilities from 1975 to 1985, when the Legislature transferred the regulation to the Texas Water Commission. Today, the nature of the regulation performed by



*Last year PUC  
resolved 31,000  
customer complaints  
in an average of 35  
days per complaint.*

TCEQ differs from PUC in that TCEQ regulates the rates of water utilities as monopolies while PUC uses rule-based regulation for electric and telecommunications companies. Due to the different nature of this regulation, consolidation of these functions would not result in any significant cost savings since a similar number of staff and resources would continue to be needed to perform the tasks.

- The State could have federal agencies such as the Federal Communications Commission or the Federal Energy Regulatory Commission administer federal regulation for electric and telecommunications utilities. In fact, PUC and FCC currently share authority for Texas' telecommunications market. In contrast, Texas is the only state that has authority independent of FERC to manage its transmission network because the service area of the Electric Reliability Council of Texas is wholly within the state. Abdicating Texas' local control over its electric and telecom markets, however, would pre-empt local control and dilute the State's ability to design state-specific solutions to its programs.

**Most other states regulate electric and telecommunications industries through a structure similar to the Public Utility Commission.**

- All other states have regulatory agencies that oversee electric and telephone service providers through either rate regulation or rule-based oversight of competitive markets. Most other states have also structured their public utility commissions similar to Texas' composition. Thirty-seven states have public utility commissions that are appointed like Texas, while 13 states use elected commissioners. Twenty-eight states have a three-member commission, as in Texas, while 19 states have a five-member commission and the three remaining states have commissions made up of four, six, and seven commissioners.<sup>1</sup>

## Recommendation

### Change in Statute

#### 6.1 Continue the Public Utility Commission of Texas for 12 years.

### Impact

This recommendation would continue PUC as an independent agency, responsible for protecting electricity and telephone consumers and enforcing the rules of competition for these industries. The agency would also continue its effort to bring the benefits of competition in the electric and telecommunications industries to the citizens of Texas.

### Fiscal Implication

If the Legislature continues the current functions of the Public Utility Commission, using the existing organizational structure, the agency's annual appropriation of about \$113 million from the General Revenue Fund would continue to be required for its operation.

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<sup>1</sup> National Conference of State Legislatures, [www.ncsl.org/programs/esnr/puccomp.htm](http://www.ncsl.org/programs/esnr/puccomp.htm). Accessed: February 27, 2004.

**ACROSS-THE-BOARD  
RECOMMENDATIONS**

**Public Utility Commission**

<b>Recommendations</b>	<b>Across-the-Board Provisions</b>
Already in Statute	1. Require public membership on the agency's policymaking body.
Update	2. Require provisions relating to conflicts of interest.
Already in Statute	3. Require unbiased appointments to the agency's policymaking body.
Already in Statute	4. Provide that the Governor designate the presiding officer of the policymaking body.
Update	5. Specify grounds for removal of a member of the policymaking body.
Modify	6. Require training for members of the policymaking body.
Update	7. Require separation of policymaking and agency staff functions.
Already in Statute	8. Provide for public testimony at meetings of the policymaking body.
Modify	9. Require information to be maintained on complaints.
Apply	10. Require the agency to use technology to increase public access.
Apply	11. Develop and use appropriate alternative rulemaking and dispute resolution procedures.





## **AGENCY INFORMATION**

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# **PUC Agency Information**

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## **Agency at a Glance**

The Public Utility Commission (PUC) oversees electric and telecommunications companies to ensure Texas consumers have access to high-quality, competitive utility services. Established by the Legislature in 1975, PUC was originally created to regulate rates and services of monopoly utility service providers. Significant changes in both industries have shifted PUC's primary focus towards oversight through rulemakings and enforcement, and away from regulation of rates and services. PUC's major functions include:

- overseeing and fostering fair competition in the wholesale and retail electricity and telecommunications markets;
- regulating the rates and services of investor-owned electric utilities in areas of the state not subject to retail competition, transmission and distribution utilities in competitive areas, and incumbent local exchange companies that have not elected incentive regulation;
- helping consumers resolve complaints, and enforcing compliance with statutory requirements, agency rules and policies;
- administering discount electricity and telephone service programs for certain low-income and rural customers; and,
- monitoring and participating in federal activities that affect the regulation of the electricity and telecommunications industries in Texas.



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*On the Internet:  
Information about PUC is  
available at  
[www.puc.state.tx.us](http://www.puc.state.tx.us).*

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## **Key Facts**

- **Funding.** PUC received a total of \$180.4 million in fiscal year 2003. Of this total, \$12.1 million went to support the operations of the agency. The large majority of the funds, more than \$165 million, passed through the agency to utilities to provide discounts for low-income electricity consumers in areas with competition. These discounts are funded through fees charged to customers in those same areas.
- **Staffing.** The Commission has 210 employees, all based in Austin.
- **Electric Companies.** In the 75 percent of the state open to competition, PUC has registered 105 power generation companies, licensed 80 retail electric providers, and regulates the rates and services of six transmission and distribution utilities. PUC also oversees the Electric Reliability Council of Texas (ERCOT) – the independent system operator that coordinates activities of these participants in the deregulated electric market. In areas of the state not yet open to competition, PUC regulates the rates, services, and service quality of investor-owned electric utilities. In fiscal year 2003, PUC conducted 20 electric rate cases.

- **Telephone Companies.** PUC certifies providers of local telephone service, ensures that competitive companies have equal access to the telephone network, and monitors the quality of telephone services provided by Incumbent Local Exchange Companies, or ILECs. Currently, 63 companies operate as ILECs and 487 operate as Competitive Local Exchange Carriers, or CLECs. PUC also continues to regulate the rates and services of ILECs that have not elected into incentive regulation. However, PUC conducted no telephone rate cases in 2003.
- **Rulemaking, Arbitrations, and Contested Cases.** PUC establishes rules for the electric and telephone markets and settles disputes between companies through arbitrations and contested case proceedings. In fiscal year 2003, PUC adopted 51 new or modified rules, issued final orders for 39 contested cases, and conducted nine arbitration proceedings.
- **Customer Protection and Enforcement.** PUC educates the public about electricity and local telephone services, and assists customers with complaints. In fiscal year 2003, PUC received about 121,000 customer calls, and informally resolved about 31,000 complaints. PUC also takes formal enforcement action against violators of the Public Utility Regulatory Act and PUC rules, including violators of the Texas No Call List. In fiscal year 2003, PUC assessed \$6.5 million in penalties against electric and telecommunications companies in Texas.
- **Assistance Programs.** PUC administers several programs to help ensure access to basic utility services. The Low-Income Discount Program provides discounts for about 700,000 low-income electricity customers in areas open to competition, funded through fees charged to customers in those areas. The Universal Service Fund offsets the high cost of telephone service in rural areas of the state, and is funded through fees on telecommunications providers. Relay Texas provides telecommunications services for people with speech and hearing impairments.

## Major Events in Agency History

- 1975** The Legislature created the Public Utility Commission to regulate various types of utilities, including telephone, electric, water and sewer, and enacted the Public Utility Regulatory Act (PURA).
- 1985** The Legislature transferred water and sewer utility regulation from PUC to the Texas Water Commission (now the Texas Commission on Environmental Quality).
- 1987** The Legislature took the first step towards telecommunications deregulation by requiring PUC to determine the existence, impact, and scope of competition in the telecommunications industry.
- 1988** PUC established the Universal Service Fund to assist telephone companies in providing basic local service at reasonable rates in high cost areas, and to allow low-income consumers to receive basic telephone service at reduced rates.

- 1989 The Legislature created Relay Texas, a statewide telephone interpreting service for persons with hearing and speech impairments, and placed it under the jurisdiction of PUC.
- 1995 The Legislature enacted House Bill 2128, which encouraged local competition for telecommunications services by removing barriers to entry, decreased regulation of small local exchange companies and cooperatives, provided incentive regulation for certain companies willing to make infrastructure commitments, and maintained commitments for universal service.
- 1995 The Legislature enacted Senate Bill 373, which encouraged competition in the wholesale electric market by allowing flexible pricing for wholesale power rates, requiring comparable transmission access and pricing, and allowing companies independent of the integrated monopoly utilities to build and operate power generation facilities.
- 1996 Congress enacted the Federal Telecommunications Act, which, similar to Texas' own statute, opened local telephone markets to competitive entry, promoted increased competition in markets that were already open to competition (including the long distance market), and reformed the federal system of universal service.
- 1999 The Legislature enacted Senate Bill 7, which initiated the transition to a competitive retail electric market while maintaining regulation of transmission and distribution utilities, implementing consumer safeguards, and requiring discounts for low-income customers.
- 2001 The Legislature enacted the Texas Telemarketing Disclosure and Privacy Act, which authorized PUC to create the Texas No Call List.

  
*The Legislature's introduction of competition into the electric and telephone industries has shifted PUC from rate regulation to rule-based regulation.*

## Organization

### Policy Body

The Public Utility Commission is governed by three full-time Commissioners who represent the general public and are not permitted to have financial ties to the regulated industries. The Governor appoints Commissioners for six-year terms and designates a Chair. Each Commissioner is based in Austin. The chart, *PUC Commissioners*, provides information about each Commissioner. The Commission meets about every other week to set rules for competition in the electric and telecommunications markets, issue final orders for contested cases, consider the outcome of arbitration hearings that resolve disputes between telecommunications providers, and adopt rules for agency programs and services. Staff members from the Policy Development Division serve as advisors to the Commission in contested case proceedings, and thus must abide by ex parte communication rules when serving in this capacity.

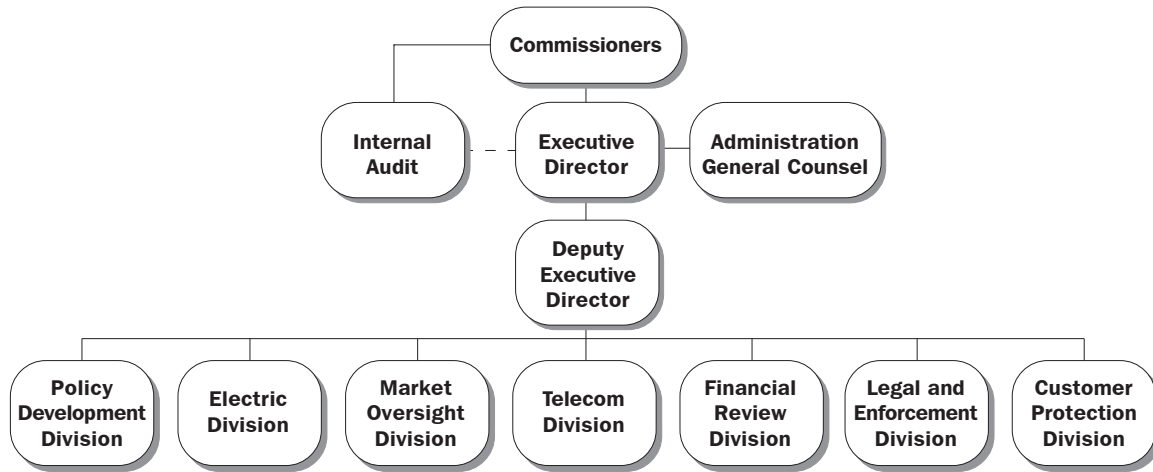
<b>PUC Commissioners</b>	
<b>Name</b>	<b>Term Expires</b>
Paul Hudson, Chair	2009
Julie Parsley	2005
Vacancy	2007

The Commission appoints an Executive Director to administer the daily operations of the agency and coordinate the activities of agency staff.

### Staff

The *Public Utility Commission Organizational Chart* depicts the agency's structure. The agency uses inter-departmental teams, drawing on employees from across the agency to carry out major Commission projects, contested cases, and rulemakings. The agency's 210 employees are located at the headquarters in Austin.

### Public Utility Commission Organizational Chart



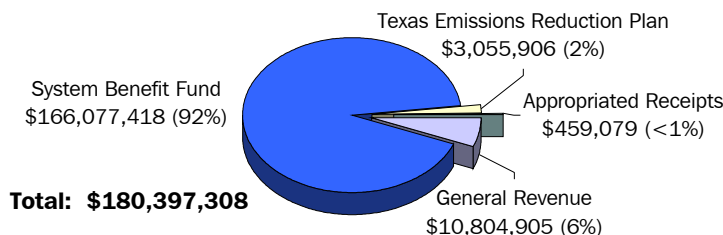
Appendix A compares the agency's workforce composition to the civilian labor force for the past three years. The agency has had some difficulty meeting the statewide civilian labor force percentage for African Americans and Hispanics in some categories.

### Funding

#### Revenues

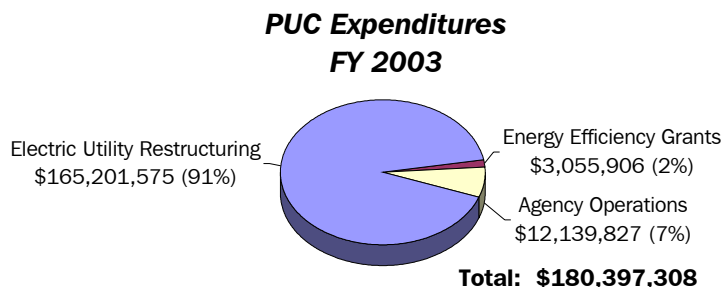
PUC received more than \$180 million in revenue for fiscal year 2003, as shown in the pie chart, *PUC Sources of Revenue*. The System Benefit Fund accounted for 92 percent of the agency's total revenue, while General Revenue accounted for 6 percent. The System Benefit Fund is funded by a fee paid by electricity consumers in areas with retail competition. Within the last fiscal year, legislation took effect that converted the System Benefit Trust Fund to a General Revenue Dedicated Fund. The Texas Emissions Reduction Plan (TERP) funds are derived from a tax on certain diesel and gas-powered equipment, to fund programs to promote cleaner air.

**PUC Sources of Revenue  
FY 2003**

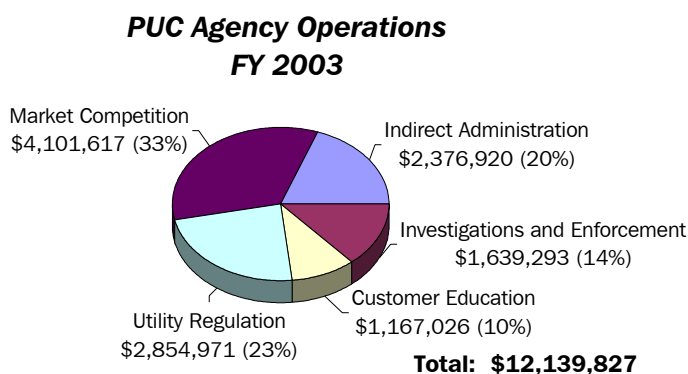


## Expenditures

The pie chart, *PUC Expenditures*, depicts the agency's primary expenditures. The largest single category, Electric Utility Restructuring, used \$165 million from the System Benefit Fund to provide discounts for low-income electricity consumers. PUC also received \$3 million as part of TERP to fund energy efficiency grants. The remaining \$12 million pays for the agency's operations.



The pie chart, *PUC Agency Operations*, breaks out in greater detail how the agency allocates its funding across its core functions. PUC devoted considerably more than half of its funding to competitive market oversight and utility rate regulation. Investigations and enforcement, along with customer education, received about another fourth of the budget, with the remaining 20 percent covering indirect administration.



The agency's use of Historically Underutilized Businesses (HUBs) in purchasing goods and services is detailed in Appendix B. Although the agency has fallen short of statewide goals in some categories, its HUB spending for commodities far exceeded the goal each year.

## Agency Operations

To best understand PUC's functions, the material below first describes changes in each industry – electric and telecommunications – and PUC's shifting role in regulating them. The industry overviews are then followed by a description of certain key PUC functions, such as contested case proceedings, rulemaking, and customer protection, that relate to both industries.

### Electric Industry

#### *State of the Industry*

Texas businesses and residents consumed about \$24 billion worth of electricity in 2003. Residential consumers account for about 40 percent of the demand for electricity, while commercial and industrial consumers account for about 60 percent. Consumers receive electricity from an investor-owned utility, a retail electric provider, a municipally-owned utility, or an electric cooperative.

Utilities operating in the transmission network managed by the Electric Reliability Council of Texas (ERCOT) supply electricity to 75 percent of the geographic area of Texas (accounting for 85 percent of the demand for electricity). ERCOT, one of 10 regional reliability councils in North America,



*Texas consumed \$24 billion worth of electricity in 2003 with residential consumers using 40 percent, and business and industry using the rest.*



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*Until 1995, investor-owned utilities generated, transmitted, and billed customers as vertically integrated monopolies under PUC rate regulation.*

oversees the transmission of electricity within its network. While the Federal Energy Regulatory Commission oversees all nine other councils, PUC has exclusive regulatory authority over ERCOT because it operates solely within Texas. Appendix C explains ERCOT in greater detail and shows a map of the ERCOT service area.

Until 1995, all investor-owned utilities generated, transmitted, and billed electricity to consumers as vertically integrated monopolies, and PUC regulated all aspects of these monopoly operations, including rates and services. In 1995, the Legislature opened the wholesale market in the ERCOT area to competition by allowing new companies, independent of the integrated utilities, to build and operate power generation facilities. In 1999, the Legislature initiated the deregulation of the retail electric market in the ERCOT area by requiring investor-owned utilities in ERCOT to divide into separate companies for power generation, transmission and distribution, and retail service provision. Municipal utilities and electric cooperatives in the ERCOT area were permitted, but not required, to opt in to deregulation of their retail markets.

In the ERCOT area, retail electric providers (REPs) compete to buy electricity from power generators at wholesale rates and sell to large and small consumers at retail rates. Changes in the law encouraged competitive REPs, unaffiliated with the previously integrated utilities, to enter the retail market to compete against the affiliated REPs, which retained the vast majority of small consumers at the start of competition. The Legislature directed PUC to fix the rates an affiliated REP could charge residential and small commercial consumers to protect those customers during the transition to a competitive retail market. The rate, called the Price to Beat, may only be adjusted by PUC to reflect changes to the price of natural gas. This fixed rate allows competitive REPs to compete with affiliated REPs by charging lower prices for the same amount of electricity. When the Price to Beat fully expires on January 1, 2007, all REPs will be free to change their retail rates based on competitive market forces.

The utilities in the areas of Texas outside ERCOT connect to multi-state transmission networks, do not have competitive retail markets, and are rate regulated. PUC and the Federal Energy Regulatory Commission jointly regulate the utilities in those areas. Once the non-ERCOT areas overcome financial, organizational and technical hurdles, they may also transition to competition.

#### *Competitive Electric Market*

The chart, *Competitive Electric Market Sectors*, describes the various sectors of the market and the regulatory activities performed by PUC for each sector. PUC has varying degrees of oversight over the sectors, from registering power generation companies and licensing retail electric providers to full rate regulation of transmission and distribution utilities. PUC's key responsibilities related to the oversight of the wholesale and retail markets are described below.

- **Wholesale Market Oversight.** PUC monitors activities of participants in the ERCOT wholesale market to ensure that all participants are obeying PUC and ERCOT rules. PUC investigates activities that may

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*In the ERCOT competitive market, electric utilities divided into separate companies for generation, transmission, and retail sales.*

<b>Competitive Electric Market Sectors</b>				
<b>Type of Entity</b>	<b>Function</b>	<b>Number</b>	<b>Examples</b>	<b>PUC Role</b>
Electric Reliability Council of Texas (ERCOT)	Ensures the safety and reliability of the transmission network. Acts as the Independent System Operator (ISO) to ensure fair access to the network by competing market participants.	1	N/A	Reviews and approves ERCOT operating rules on appeal. Authorizes changes to ERCOT fees. PUC Chair serves as a non-voting member of the governing board.
Power Generation Company (PGC)	Generates electricity. Operates in a competitive wholesale market.	105	TXU Energy Production, Texas Genco Holdings, FPL Energy	Registers each company. Monitors each company to ensure that no single company owns more than 20 percent of generating capacity statewide. PUC does not regulate rates, monitor service quality performance, or siting of facilities.
Transmission and Distribution Utility (TDU)	Delivers electricity from generators to consumers. Operates as a monopoly in its service area.	6	Oncor, CenterPoint, AEP Texas Central	Regulates wholesale transmission rates in areas open to retail competition. Ensures open access to all PGCs and REPs. Monitors performance in meeting service quality and customer protection standards. Approves siting of new transmission facilities and changes to service area.
Retail Electric Provider (REP)	Purchases wholesale electricity from generators to resell to retail consumers. Bills consumers for use of electricity and functions as the point of contact for electricity consumers. Operates in a competitive retail market.	80	TXU Energy Retail, Reliant Energy, Green Mountain Energy	Licenses each company. Reviews financial, managerial, and technical capacity before approving a license. Monitors performance in meeting service quality and protection standards. Authorizes changes to the Price to Beat rates (unique to each REP) until 2007. PUC does not regulate rates other than the Price to Beat.
Power Marketer	Purchases wholesale electricity for resale at wholesale rates, without owning power generation or transmission and distribution capacity.	121	Coral Power LLC, Mirant Energy Marketing	Registers each company.
Power Aggregator	Negotiates bulk purchases of electricity from REPs on behalf of multiple customers.	170	Cities Aggregation Power Project	Registers each company.

be in violation of the rules, and takes formal and informal actions to enforce the rules if violations are found. PUC also participates in ongoing changes to the design of the market undertaken by ERCOT.

- **Retail Market Oversight.** PUC participates in the development of retail market rules for the ERCOT area, and ensures that retail market participants comply with the rules. PUC also designates a Provider of Last Resort (POLR) in each transmission and distribution service area within ERCOT to serve customers if a retail electric provider can no longer provide service, and sets the rates charged to POLR customers.
- **Low-Income Discount Assistance.** As part of the deregulation of the electric industry, the Legislature charged PUC with administering an assistance program for low-income electricity customers in the ERCOT area. The program, funded by the System Benefit Fund, provides discounts to customers with incomes equal to or lower than 125 percent of federal poverty guidelines. Customers are automatically enrolled if they receive food stamps from the Department of Human Services (DHS) or medical assistance from any State health and human service agency; customers may also self-enroll in the program if they

  
*The System Benefit Fund provides discounts to low-income customers in areas with electric competition.*

meet the income threshold. In FY 2003, PUC spent \$165 million to provide a 17 percent discount on the rates charged to about 700,000 customers. Based on current appropriations, PUC has reduced the discount to 10 percent.

- **Customer Education – Texas Electric Choice.** PUC administers a customer education program, funded by the System Benefit Fund, to inform Texas residents of their rights and opportunities in a competitive electric market. Before the opening of retail competition in the ERCOT area in 2002, PUC implemented an extensive advertising campaign, including television and radio commercials, to establish customer awareness of the competitive market. Today, PUC networks with community groups and funds a Web site [[www.powertochoose.org](http://www.powertochoose.org)] and call center to provide consumer information in English and Spanish.
- **Energy Efficiency.** To promote energy efficiency among electricity consumers, PUC requires transmission and distribution utilities in the ERCOT area and integrated utilities outside ERCOT to provide incentives for energy efficiency activities in their service areas. Utilities offer fixed rate incentives to customers or to energy service companies to install energy efficient equipment or renovate facilities. In FY 2002, utilities spent \$35 million on energy efficiency incentives to reduce growth in demand by 276,000 megawatt hours, enough to power about 20,000 homes for one year.


#### *Non-Competitive Electric Markets*

- **Integrated Utilities Outside ERCOT.** PUC regulates rates and monitors service quality standards for the four investor-owned utilities operating as integrated monopolies outside the ERCOT area. PUC sets rates through contested case proceedings, as described in the section entitled *Contested Case Proceedings*. When setting rates, PUC must determine an appropriate cost of service and rate of return for a utility, and allocate rate costs by customer class. PUC also reviews and approves proposals for new transmission facilities by the utilities.
- **Municipal Utilities and Electric Cooperatives.** PUC does not regulate the rates or service standards for municipal utilities and electric cooperatives. However, in the ERCOT area, PUC regulates the wholesale transmission rates charged to utilities and cooperatives by transmission and distribution utilities. While none have done so to date, if a municipal utility or electric cooperative chooses to open its service area to competition, PUC would impose a code of conduct to guide the utility or cooperative through the transition to competition. PUC also hears appeals of rate changes affecting customers of municipal utilities who live outside the limits of the municipality.

#### **Telecommunications Industry**

##### *State of the Industry*

Nearly 95 percent of households in Texas have telephone service. PUC oversees the telephone companies that provide local services to those customers. Local telephone providers fall into one of two main categories: Incumbent Local Exchange Companies (ILECs) – the telephone companies

  
*PUC continues to  
rate-regulate utilities  
outside the ERCOT  
area.*

that held certificates issued by PUC on or before September 1, 1995 – and Competitive Local Exchange Carriers (CLECs) – certificated by PUC to provide local exchange telecommunications service in Texas after September 1, 1995. Currently, PUC oversees 63 ILECs and 487 CLECs. For a list of telecommunications services PUC does not regulate, see the textbox, *Telephone Services Not Overseen by PUC*.<sup>1</sup>

Competition in the telephone market was non-existent until the mid-1980s, when the U.S. Justice Department issued an order breaking up AT&T, the monopoly provider of local and long distance services. The order created Regional Bell Operating Companies, like Southwestern Bell Telephone Company (now known as SBC), authorized them to provide local service subject to state regulation, but prohibited them from providing long distance services outside of defined regions and across state lines.

<p><b>Telephone Services Not Overseen by PUC</b></p> <ul style="list-style-type: none"><li>• Long Distance Services</li><li>• Cellular Services</li><li>• Paging Services</li><li>• Yellow Pages</li><li>• Cable Television</li><li>• Wireless Services</li></ul>
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In 1995, the Texas Legislature opened the local telephone market to competition. The law allowed CLECs to enter the telecommunications market after obtaining a certificate from PUC, and required all telecommunications providers to interconnect their networks with one another. One year later, Congress passed the Federal Telecommunications Act (FTA), which closely paralleled the Texas law by opening local telephone markets nationwide to competition. Among other things, the FTA obligated Regional Bell Operating Companies to open their networks to local competitors, and in return, allowed them to seek approval from the Federal Communications Commission (FCC) to enter the long distance market. Eager to offer one-stop shopping to Texas customers, SBC was the second Regional Bell Operating Company to apply for, and win, long distance approval.<sup>2</sup>

Subsequent Texas legislation further defined the competitive market by affording ILECs the opportunity to elect into a reduced regulatory framework. The law allowed electing ILECs to obtain certain benefits, including flexible pricing of individual services and packages and an expedited review process for the introduction of new services. While several ILECs, known as Chapter 58 and 59 companies, have elected into incentive regulation, many of the smaller ILECs have remained under rate regulation. The chart, *Regulatory Categories for Local Exchange Companies*, outlines the different regulatory designations available to local telephone companies, the number of providers in each category, and the benefits and obligations imposed by the designations.

To date, ILECs have maintained a dominant presence in the Texas local telephone market, continuing to serve about 83 percent of the market and earning \$2.2 billion in revenues in 2002. CLECs' market share totaled 17 percent, with revenues of \$536 million.

### ***Wholesale Telecommunications Market***

The introduction of competition in the telecommunications market placed new responsibilities on PUC. The Federal Telecommunication Act requires telecommunications carriers to interconnect with the facilities and equipment of other carriers. In addition, ILECs must allow competitive carriers access to the telephone network to provide services. Unlike the structural

  
*Incumbent Local Exchange Companies served 83 percent of the Texas market in 2002, earning about \$2.2 billion in revenues.*

**Regulatory Categories for Local Exchange Companies**

<b>Category</b>	<b>PURA Cite</b>	<b>Type of Utility</b>	<b>Number</b>	<b>Rate-of-Return Regulation</b>	<b>Benefit of Category</b>	<b>Other Requirements</b>	<b>Example</b>
Incumbent Local Exchange Companies (ILEC)	Ch. 52	ILECs that have not elected into incentive regulation	44	Yes	May offer new services and exercise pricing flexibility (including packages and promotions) 10 days after filing an informational notice with PUC; new services must be priced at or above the long run incremental cost (LRIC). Each regulated service offered separately or as part of a package must be priced at the tariffed rate or at a rate not lower than LRIC. May exercise Ch. 52 rate increases with PUC approval.	N/A	Comanche County Telephone Company
	Ch. 53	Partially Deregulated Cooperatives	5	No	Extensive latitude to introduce new services, and change rates, terms, and conditions of service.	N/A	Central Texas Telephone Cooperative
	Ch. 58	ILECs electing into incentive regulation	6	No	Basic network services are rate capped until September 1, 2005. May change rates or terms of nonbasic services 10 days after filing an informational notice with PUC; services must be priced above LRIC.  May offer new services and exercise pricing flexibility (including packages and promotions) 10 days after filing an informational notice with PUC; new services must be priced at or above LRIC. Packages containing network and nonbasic services must meet specific criteria.	Provide private network services and meet infrastructure needs of hospitals, educational institutions, and libraries. Other technology-related infrastructure goals.	SBC
	Ch. 59	ILECs electing into incentive regulation	8	No	Each regulated service offered separately, or as part of a package, must be priced at the tariffed rate or at a rate no lower than LRIC. May offer new services and exercise pricing flexibility (including packages and promotions) 10 days after filing an informational notice with PUC; new services must be priced at or above LRIC.	Provide private network services and meet infrastructure needs of hospitals, educational institutions, and libraries.	Kerrville Telephone Co.
Competitive Local Exchange Carriers (CLEC)	Ch. 52	Competitive companies	487	No	May change rates or terms of services by filing a tariff, schedule, or list of prices with PUC; filings not subject to review. Prohibited from charging excessive access charges.	N/A	AT&T



separation of the wholesale and retail markets that occurred with electric deregulation, ILECs serve as both wholesale and retail providers. As a result, PUC must closely monitor the wholesale telecommunications market to ensure that all telephone providers have an equal opportunity to compete. These activities are described below.

- **Approval of Interconnection Agreements.** Federal law requires the terms and conditions of network access to be outlined in formal interconnection agreements and has delegated the approval of negotiated interconnection agreements to PUC. As shown in the table, *Types and Number of Interconnection Agreements*, parties often develop interconnection agreements through voluntary negotiations.

<b>Types and Number of Interconnection Agreements</b>			
<b>Year</b>	<b>Negotiated Agreements/ Contract Amendments/T2A</b>	<b>Requests for Arbitration</b>	<b>Requests for Dispute Resolution</b>
FY 2001	282	16	16
FY 2002	360	9	10
FY 2003	486	4	27

When carriers cannot mutually agree on terms, PUC arbitrates the disputed issues, ensuring that the conditions imposed on parties conform with federal requirements.<sup>4</sup> PUC staff generally serve as the arbitrators in a proceeding. Staff submit a proposed decision to the Commission outlining the disputed issues, parties' positions, arbitrators' decisions and rationale. Any interested party may file written comments about the decision. The Commission must issue a final decision within 30 days and may reject, approve, or modify staff's proposed decision. Parties may appeal the Commission's decision to district court.

- **Wholesale Market Oversight.** The interconnection and network access obligations imposed by the FTA primarily impact SBC, as the leading local telephone provider in Texas. PUC monitors SBC's compliance with network access requirements through performance measures outlined in a contract referred to as the T2A. In accordance with terms of the T2A, SBC provides the Commission and affected CLECs with monthly data for each measure, calculates the monies owed for missed measures, and remits those amounts to the appropriate parties.

A remedy plan, also in the contract, requires SBC to pay damages to a CLEC for non-compliance with customer-affecting measurements (Tier 1 payments); and to make payments to the State for non-compliance, for three consecutive months, with customer and competition affecting measurements (Tier 2 payments). Through the end of 2003, SBC paid \$21 million in Tier 1 payments to CLECs, and \$10.3 million in Tier 2 payments to the State, for a total of \$31.3 million. SBC forwards Tier 2 payments to the Comptroller, who then deposits them in the General Revenue fund. The T2A expired on October 13, 2003, but has been temporarily extended until a new contract can be adopted. Arbitration proceedings to establish a successor agreement are currently in progress.

  
*Unlike electric companies, incumbent telephone companies can provide both wholesale and retail services.*

- **Municipal Rights-of-Way Compliance.** In 1999, the Legislature passed a bill to create a uniform system for compensating cities for use of their rights-of-way (ROWs) by telecommunications providers, and authorized PUC to implement rules to carry out the legislation. PUC established rates, based on a fee-per-access line method, and now monitors telecommunications providers' compliance with line count filing requirements. PUC takes enforcement action against providers that fail to file accurate and timely reports, with penalties ranging from \$500 to \$5,000. Currently, 1,135 of the 1,210 municipalities in Texas, and 530 telecommunications providers are participating in the program.
- **Building Access.** The Public Utility Regulatory Act affords building tenants the right to select the telecommunications provider of their choice, and provides for the non-discriminatory treatment of the telecommunications provider by the property owner. Through rule, PUC ensures telecommunications providers have access to properties to provide telecommunications services upon tenant request. In the event the parties fail to reach consensus, the rule also provides for dispute resolution before PUC.

#### *Retail Telecommunications Market*

PUC oversees retail services to ensure that Texans have access to quality telecommunications services that are reasonably priced. In doing so, PUC oversees the following activities.

- **Market Entry.** Telephone companies, both ILECs and CLECs, must have a certificate issued by PUC to operate and provide telecommunications services in Texas. PUC reviews applications to ensure companies have the proper technical and financial qualifications, as well as the ability to meet retail service quality standards established by the Commission. While staff handle most applications administratively, applications opposed by a party are handled as contested cases. PUC requires CLECs to offer services within four years of certification, and update contact information annually. In 2003, PUC granted 30 applications to new competitors entering the market.
- **Retail Service Quality.** PUC requires ILECs to offer continuous and adequate basic local phone service in their certificated areas, and to meet standards for quality retail service. ILECs must submit quarterly reports detailing monthly performance in categories such as provisioning, maintenance and repair, and transmission quality. A company that falls below the benchmark could be subject to enforcement action if it fails to resolve the deficiency.
- **Information Filings.** Although ILECs electing into incentive regulation are not subject to rate of return regulation, PUC requires them to file price changes to ensure customers are being charged just and reasonable rates. Price caps, established in law, dictate the price of basic network service; however, electing ILECs may offer packages and promotions 10 days after filing an informational notice with PUC. Prices may not be preferential, prejudicial, discriminatory, predatory or anti-competitive, and must be priced at or above the long run incremental cost of providing the service. Tariff filings are presumptively valid, and do not require

  
*PUC can take enforcement action to ensure that phone companies meet PUC's standards for quality retail services.*



PUC consent. However, any affected party, including PUC staff, may file a complaint challenging whether the filing complies with laws and rules.

- **Texas Universal Service Fund.** The Legislature created the Texas Universal Service Fund (TUSF) in 1987 as a competitively neutral mechanism to enable all residents of the state to obtain basic telephone services at an affordable rate, and delegated administration of TUSF to PUC. Telecommunications providers pay into the fund an assessment imposed on all local, long distance, pager, wireless, and other telecommunications services, except pay telephone service. Providers may pass this fee on to their customers. The current assessment equals 3.6 percent of each telecommunications provider’s taxable receipts and the fund contains about \$600 million.

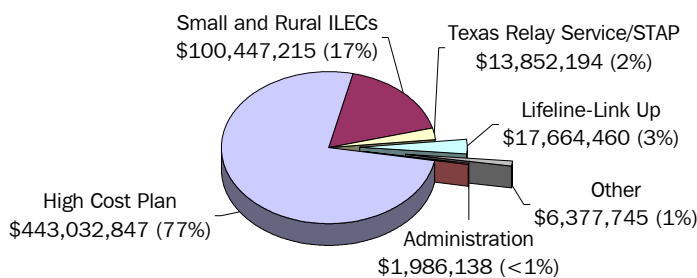
PUC has delegated the day-to-day administration of TUSF to the National Exchange Carriers Association (NECA). Under the contract, NECA collects the assessment from each telecommunications provider and distributes funds to eligible companies. Currently, the fund supports the following key programs:

- High Cost Plan – support for companies that provide basic telecommunications service in high cost rural areas;
- Lifeline and Link Up Programs – provides a discount on monthly local service rates and installation charges to qualified, low-income customers; and,
- Relay Texas and the Specialized Telecommunications Assistance Program (STAP) – support for a telecommunications relay service for persons with hearing or speech impairments, and reimbursement to vendors and service providers that offer reduced rates for telecommunications equipment and services for those customers.

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*The \$600 million  
 Universal Service  
 Fund helps all Texans  
 obtain basic telephone  
 services at reasonable  
 rates.*

As evidenced in the pie chart, *TUSF Disbursements by Program*, the High Cost Plan receives the largest disbursement from TUSF, followed by Relay Texas/STAP, and Lifeline and Link Up. In addition, certain agencies, including PUC and NECA, recover costs incurred in administering the program. SBC, Verizon, and Valor Telecommunications receive the largest portion of TUSF monies, each receiving more than \$100 million in 2002.

**TUSF Disbursements by Program**



**Rate Regulation of Telecommunications Companies**

The degree of PUC rate regulation or oversight of an ILEC depends upon the company’s certification or election under PURA. ILECs that have not elected into incentive-based regulation continue to be subject to full rate of return regulation. PUC determines the amount of revenue the company needs to provide services, including an appropriate rate of return. Once

PUC sets the overall revenue requirement, it then allocates costs across customer classes to produce that level of revenue. For a utility to change rates, it must seek PUC approval. PUC has not held rate cases for any of the 44 rate-regulated ILECs in recent years.

### **Contested Case Proceedings**

PUC uses contested cases to address issues regarding a specific electric or telecommunications company, or to settle disputes between companies and other parties. A contested case may be initiated to contest a company's application for certification, to contest a change in regulated rates or service areas, or to file a formal complaint against the company. PUC also initiates contested cases to enforce administrative penalties against entities under the Commission's jurisdiction.

Administrative law judges at the State Office of Administrative Hearings (SOAH) conduct most contested case proceedings, including all enforcement actions. In fiscal year 2003, SOAH judges heard 34 PUC cases. A SOAH judge presides over a contested case hearing and issues a proposal for decision with a recommendation for how PUC should decide the case. SOAH sends the proposal to the PUC Commissioners, who issue a final decision that may or may not concur, in part or as a whole, with SOAH's recommendation. A party may appeal a final decision by PUC to state or federal court.

In addition, PUC Commissioners may directly preside over some contested cases without sending them to SOAH, such as cases that have important policy implications. In fiscal year 2003, the Commissioners heard five cases. If a formal complaint does not involve a dispute over the facts of the case, a PUC administrative law judge may review the case based on existing laws and rules. The PUC judge would recommend an outcome to the Commissioners, who make the final decision in an open meeting.


In contested case proceedings, PUC staff with legal, financial, or technical expertise participate as a party to the case, on behalf of the public interest. PUC interprets the concept of the public interest, mentioned but not defined in statute, as achieving a balance among the interests of utilities, consumers, and other parties involved in a case. Staff participating on behalf of PUC are not permitted to discuss the case with the Commissioners or staff of the Policy Development Division who assist the Commissioners in making their final decision on the case.

### **Rulemaking**

PUC uses rulemaking proceedings to implement laws, policies, and other agency requirements regarding both the electric and telecommunications industries. Rulemakings may be initiated at the request of the Commission, PUC staff, or any interested party. In FY 2003, the Commission adopted 51 new or modified rules.

PUC follows standard rulemaking procedures established in the Administrative Procedures Act. In addition, PUC has adopted a negotiated rulemaking process, which promotes a consensus-based approach to rulemaking. PUC makes extensive use of workshops and pre-publication 'strawman' proposals, and although not required for all rulemakings, PUC


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*SOAH judges hear most PUC cases, but PUC Commissioners make all final decisions.*

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*PUC promotes a consensus approach to rulemaking, using workshops to solicit input early in the process.*

routinely schedules public hearings on almost all proposed rules to allow an opportunity for oral comments from persons who do not wish to file written comments. PUC publishes notice of all workshops and public meetings in the Texas Register, on the agency's Web site, and in the *PUC Update*, a weekly publication providing information about PUC activities. Interested parties may also subscribe to an online list server to keep current on rulemaking projects.

## Customer Protection

PUC has greatly expanded its customer protection efforts, in both the electric and telecommunications industries, as a result of deregulation. These efforts include:

- informing and educating the public about their rights and safeguards under the law;
- operating a call center to answer questions and respond to complaints; and
- administering a program to help reduce unsolicited telemarketing calls, as described in the textbox, *Texas No Call List*.

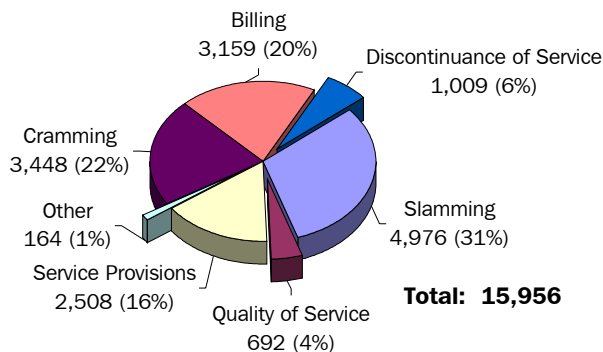
**Texas No Call List**

In 2001, the Legislature created the Texas No Call List and required PUC to compile a database of names and telephone numbers of people in this state who object to receiving unsolicited telemarketing or telephone calls. Telemarketers may not contact people whose names appear on the list, unless they qualify for one of the exemptions allowed by law. As of November 2003, 983,894 phone numbers were registered on the No Call List.

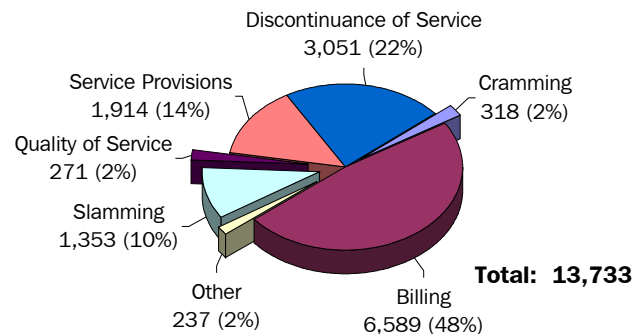
Since the effective date of the first No Call List on July 1, 2002, PUC has received 3,800 complaints. In 2003, PUC referred 33 cases, addressing more than 800 individual complaints, to the Office of the Attorney General for prosecution.

PUC receives, investigates, and helps consumers resolve complaints against telephone and electricity service providers through an informal resolution process. Customers may make inquiries, provide opinions about telephone and electric service, or file complaints through a toll-free customer assistance hotline, or by mail, email, or fax. In fiscal year 2003, PUC received more than 121,000 customer contacts, including almost 30,000 complaints. The pie charts, *Telephone Complaints* and *Electric Complaints*, provide a breakdown of the types of complaints received about each industry, but does not include complaints related to the No Call List.

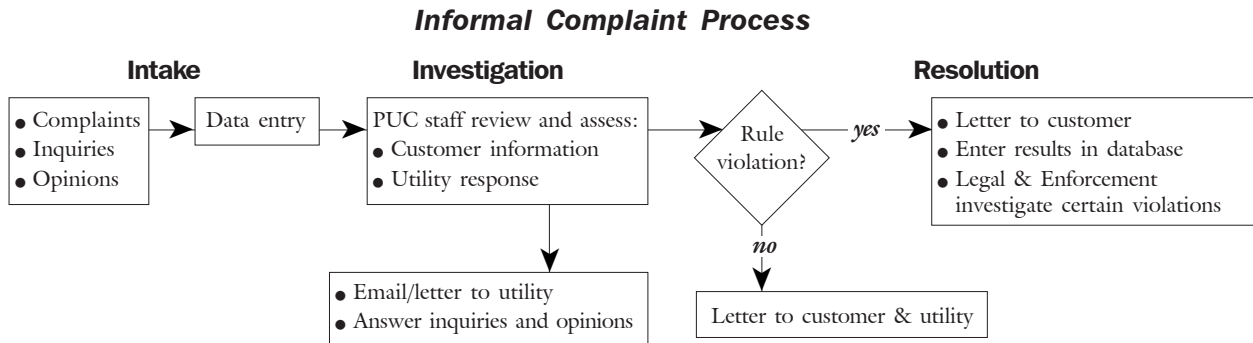
**Telephone Complaints  
FY 2003**



**Electric Complaints  
FY 2003**



As illustrated in the flow chart, *Informal Complaint Process*, PUC tracks all information received from callers. Intake staff forward inquiries and opinions to the appropriate PUC division or service provider for follow-up and forward complaints to staff investigators. The investigators notify the service provider of the complaint and require the company to submit a written response within 21 days. Staff work with the complainant and the service provider to informally resolve the complaint. In 2003, PUC arranged for \$2.7 million in refunds for customers through this process.



PUC seeks to resolve all informal complaints within 48 days. In fiscal year 2003, PUC averaged 35 days. PUC staff resolve 99 percent of complaints through the informal complaint process, either through corrective action taken by the service provider, or a determination by staff that the service provider did not violate laws or rules. Staff advise customers of their findings and of their right to file a formal complaint with PUC if they are not satisfied with the outcome. In fiscal year 2003, customers filed 36 formal complaints. Regardless of the action taken by the service provider or customer, investigators note the outcome in PUC’s database for tracking purposes and possible further investigation by Legal and Enforcement staff.

### Enforcement

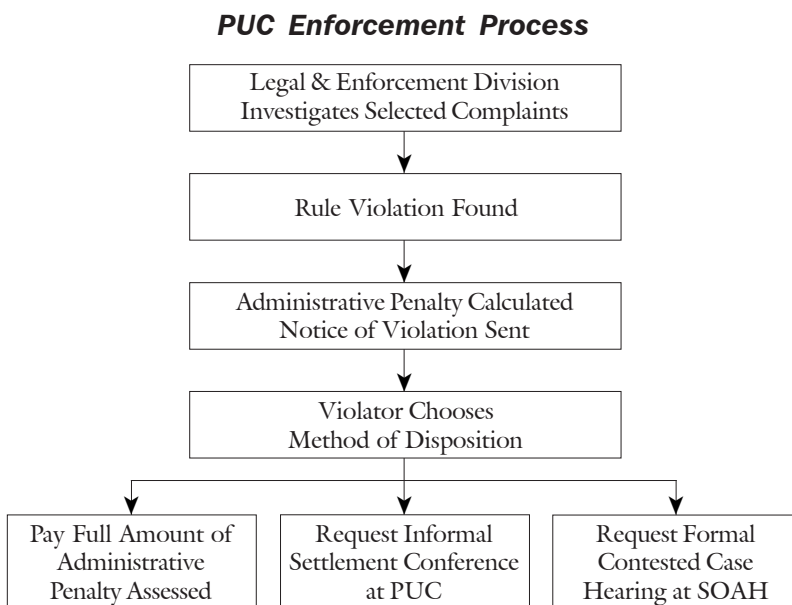
Enforcement staff investigate violations and conduct enforcement actions against electric and telecommunications companies suspected of violating state laws or PUC rules. The flow chart, *PUC Enforcement Process*, illustrates the agency’s enforcement procedures. Enforcement staff follow-up on selected complaints to determine if the company has violated state law or PUC rules. Staff focus on violations that result in serious harm to the customer or market, or that represent a trend of similar violations by a company. Due to resource limitations, enforcement staff do not pursue minor or isolated violations.

To initiate enforcement action, staff send a notice of violation to the company. The notice describes the specific rule violation and administrative penalties approved by the executive director. An administrative penalty may not exceed \$5,000 per day, per violation.<sup>5</sup> The notice gives the accused party three options: pay the penalties, request an informal settlement conference with PUC staff, or request a formal hearing with SOAH. If the company accepts the settlement, the penalties must be paid within 30 days after the Commission’s order imposing the penalties is final.<sup>6</sup>

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*In 2003, PUC  
 arranged for \$2.7  
 million in customer  
 refunds.*

Enforcement staff conduct informal settlement conferences – the most common method of resolution – but the final settlement must be approved by the Commission. If not settled, enforcement cases must go to SOAH for a hearing.<sup>7</sup> The Commission reviews the SOAH ruling, and issues an order imposing a penalty if a violation occurred. If a party disagrees with the Commission order, the party may seek judicial review under the substantial evidence rule.

In 2002 and 2003, enforcement staff issued seven notices of violation, all of which staff resolved through settlement conferences. The violations, which involved thousands of customer complaints, resulted in PUC assessing \$7.5 million in administrative penalties.<sup>8</sup>



<sup>1</sup> Although PUC does not have jurisdiction over long distance services, state law requires the 1,300 long distance carriers operating in this state to register with PUC. PUC uses the registration information for enforcement purposes, primarily to enforce slamming and cramming laws. PUC also has limited regulatory authority over pay telephone providers, operator service providers, and operators of automatic dial announcing devices.

<sup>2</sup> Bell Atlantic, the Bell Operating Company for the state of New York, was the first to gain FCC approval.

<sup>3</sup> Texas Senate Bill 560, 76th Legislature (1999).

<sup>4</sup> While arbitrations relate to new terms or entirely new agreements, post interconnection disputes involve interpretation or enforcement of existing terms and conditions.

<sup>5</sup> Texas Utilities Code, sec. 15.023(b).

<sup>6</sup> Texas Utilities Code, sec. 15.025(a).

<sup>7</sup> Texas Utilities Code, sec. 15.024(f).

<sup>8</sup> The total dollar amount excludes penalties imposed as a result of telecommunications providers noncompliance with right-of-way access line reporting and T2A performance measures.



**ISSUE**



*Due to Significant Changes in Utility Regulation, Texas No Longer Needs a Stand-Alone Agency to Advocate Solely on Behalf of Residential and Small Commercial Consumers.*

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## Summary

### Key Recommendations

- Abolish the Office of Public Utility Counsel.
- Transfer the responsibility for independent representation of residential and small commercial consumers in utility rate cases to the Office of the Attorney General.
- Transfer OPUC's remaining consumer representation functions to the Public Utility Commission.
- Require PUC staff to evaluate and report findings related to the impact on residential and small commercial ratepayers for each decision by the Commission and the Electric Reliability Council of Texas.
- Replace OPUC's role on the Electric Reliability Council of Texas Board with a consumer representative appointed by the Governor.

### Key Findings

- The introduction of competition has dramatically changed PUC's regulation of both the electric and telecommunications industries, as well as OPUC's role in representing residential and small commercial consumers.
- The State has a continuing need to protect consumers, but this protection could be provided in a way that reflects the significant changes in PUC's regulation of competitive utilities.
- OPUC's claims of billions of dollars in savings to customers' utility bills is not an accurate picture of its impact.
- Independent representation of residential and small commercial consumers in the few remaining rate cases could be handled effectively by the Office of the Attorney General.
- The interests of residential and small commercial consumers in rulemakings and other administrative proceedings do not require independent legal representation and would be more effective if performed by PUC.
- Most other states house the utility consumer representation function within existing agencies, not in a stand-alone agency.
- Most other Texas regulatory agencies handle consumer protection as an in-house agency function.

### Conclusion

The introduction of competition in both the electric and telecommunications industries has significantly changed utility regulation in Texas. Rate regulation of monopoly utilities by PUC has shifted largely to oversight of competitive markets through rulemaking, consumer protection, and enforcement. In light of these changes, Sunset staff evaluated the continuing need for a stand-alone agency to

provide independent representation of residential and small commercial consumers in rate case and other regulatory proceedings. Consumer representation addressed early in the process by PUC, the exclusive regulatory agency, would be more effective than the current adversarial role of OPUC. Considering the reduced number of rate cases requiring independent representation and the increased consumer protection role of PUC, the necessity to maintain a separate, stand-alone agency no longer exists.

## Support

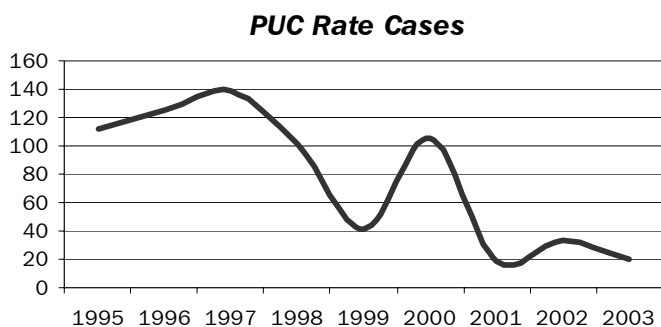
### OPUC represents residential and small commercial consumers to help ensure just and reasonable rates for electric and telephone services.

- The Office of Public Utility Counsel (OPUC) performs a variety of functions to represent the interests of residential and small commercial consumers. The agency appears in rate cases and other contested cases before PUC, participates in rulemakings and projects at PUC, and advocates on behalf of residential and small commercial consumers in federal regulatory proceedings, state and federal court cases, and at the Electric Reliability Council of Texas (ERCOT). The chart, *OPUC Caseload*, describes the number and type of proceedings the agency participated in that year. In fiscal year 2003, OPUC operated on a \$1.6 million budget, and employed a staff of 20, comprised primarily of attorneys and regulatory experts.<sup>1</sup>

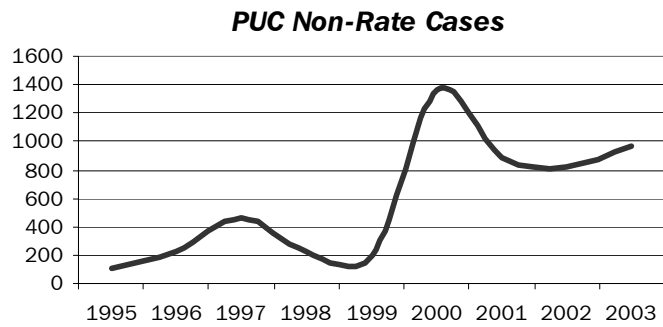
Type of Proceeding	Total
Rate Cases and Contested Cases	82
PUC Rulemakings	38
State Court Cases	50
Federal Regulatory Proceedings	24
Bankruptcy Proceedings	1
ERCOT Protocols	92
<b>Total</b>	<b>287</b>

### The introduction of competition has dramatically changed PUC's regulation of both the electric and telecommunications industries, as well as OPUC's role in representing residential and small commercial consumers.

- The Legislature created the Office of Public Utility Counsel (OPUC) in response to concerns that residential and small business ratepayers were not being adequately represented in utility rate proceedings.<sup>2</sup> With PUC adjudicating rate cases, an independent consumer advocate was necessary to balance the presence of well-represented utilities and industrial and large commercial consumers. The creation of OPUC acknowledged the fact that PUC could not act solely on behalf of any individual stakeholder group in rate proceedings, necessitating a separate, distinct consumer advocate.
- The advent of competition has dramatically changed the regulatory role of PUC. Before competition, PUC regulated utilities through its approval of rate changes. However, in today's competitive environment, regulation is accomplished through rulemaking and contested case proceedings. Over the years, the number of rate cases has declined, as shown in the graph, *PUC Rate Cases*. Competition has also increased the consumer focus at PUC. The Legislature has charged the agency with setting rules to ensure quality services and fair market practices, helping consumers with



complaints, and administering programs to assist low-income and rural customers obtain affordable utility services. The significant increase in rulemakings and other non-rate cases is illustrated in the graph, *PUC Non-Rate Cases*. In fiscal year 2003, PUC completed 20 rate cases and 968 non-rate cases, illustrating the shift in methods of regulation.<sup>3</sup>



- The decline in PUC utility rate cases due to competition has resulted in fewer cases needing OPUC intervention. As the number and complexity of rate cases have declined, OPUC’s authority has significantly expanded into new venues. In 1999, OPUC gained authority to participate in alternative dispute resolution proceedings.<sup>4</sup> The same bill also granted OPUC broad authority to initiate or intervene in any judicial proceeding in which the Public Counsel determines that “residential and small commercial electricity consumers are in need of representation.”<sup>5</sup> In 2003, OPUC’s intervention authority expanded again to include participation in telecommunications bankruptcy cases.<sup>6</sup>

**The State has a continuing need to protect consumers, but this protection could be provided in a way that reflects the significant changes in PUC’s regulation of competitive utilities.**

- According to the Sunset Act, in determining whether a public need exists for the continuation of a state agency, Sunset Commission staff shall consider the need for the agency’s functions, the extent to which the agency’s functions overlap or duplicate those of other agencies, and the extent to which the programs administered by the agency can be consolidated with the programs of other state agencies.<sup>7</sup> To justify continuation, an agency must show the public has a continuing need for the functions provided, and that the current organization structure is needed. The following material evaluates OPUC’s key functions in view of the changed regulatory environment.

**Rate Cases.** OPUC participates in rate cases with other intervenors representing various classes of consumers to reduce the revenue requirement, then advocates specifically for residential and small commercial consumers during cost allocation. In fiscal year 2003, OPUC participated in 38 rulemakings and 77 contested cases, but only five rate cases.<sup>8</sup> Residential and small commercial consumers still require independent representation in rate cases, but the small number of rate cases today does not warrant a separate agency.

**Rulemaking.** PUC’s rulemaking process facilitates consumer input, encouraging early participation when policies are being formed to prevent future litigation. Through its strawman process, PUC provides many opportunities for public input. While OPUC provides input on proposed rules, PUC staff also represents the public interest in each administrative proceeding, evaluating the impact on all affected persons.<sup>9</sup> Having two agencies compiling similar information to evaluate the impact of rules on consumers is duplicative and an inefficient use of

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*To justify continuation, an agency must show a continuing need for its functions and structure.*

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*The small number of rate cases today does not warrant a separate agency.*

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*Effective consumer representation early in the process could prevent costly, unnecessary litigation.*

resources. Consumer involvement in rulemaking is needed, but generally can be provided in a variety of ways that do not require an independent consumer advocacy agency.

**Contested Cases.** Effective consumer representation early in the policy formation process could prevent costly, unnecessary litigation. OPUC participates in various contested cases at PUC involving issues that affect residential and small commercial consumers. In fiscal year 2003, OPUC participated in 66 electric cases and 11 telecommunications cases. Since the majority of PUC contested cases involve applications for certification, formal complaints against a utility, or enforcement actions, and do not directly affect retail rates, the need for an independent consumer advocate is unnecessary.

**State Court Cases.** OPUC participated in 50 state court cases in fiscal year 2003, mainly involving appeals of PUC rules. Sunset staff found OPUC's litigation of such issues to be an ineffective use of its resources. If consumer protection were thoroughly addressed early in the process when the rules are being set, many appeals could be avoided, and consumer interests could be adequately addressed.

**Federal Proceedings.** In federal regulatory proceedings, OPUC advocates, along with PUC and the Office of the Attorney General, on behalf of telecommunications and electricity consumers at the Federal Communications Commission (FCC) and at the Federal Energy Regulatory Commission (FERC). The presence of three state agencies all advocating on behalf of Texas consumers is costly and duplicative.

In addition, both OPUC and PUC have the authority to intervene on behalf of residential and small commercial consumers in telecommunications bankruptcy proceedings.<sup>10</sup> Currently, OPUC has participated in only one federal bankruptcy proceeding. PUC's authority to participate in telecommunications bankruptcy proceedings, along with OPUC's limited involvement, does not warrant an independent agency to perform this function.

**ERCOT Representation.** The Public Counsel represents residential consumers as a voting ex officio member of the ERCOT Board.<sup>11</sup> In addition, OPUC staff participate in Technical Advisory Committee (TAC) meetings, as well as other subcommittees by developing and commenting on proposed ERCOT protocols. PUC is ERCOT's exclusive overseer, ensuring consumer protection through market monitoring and enforcement against market manipulations and approval of ERCOT protocols. In addition, PUC staff have the necessary technical expertise to effectively participate in ERCOT committee meetings. Though continued consumer representation at ERCOT is critical, the existence of a separate agency to provide this representation is not warranted.

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*Texas does not need three state agencies advocating for consumers at the federal level.*

**OPUC's claims of billions of dollars in savings to customers' utility bills is not an accurate picture of its impact.**

- In one of OPUC's performance measures, the agency attempts to quantify its effectiveness by estimating the savings on utility bills to consumers, based on its participation in various utility rate proceedings.<sup>12</sup>

OPUC claimed a savings of \$6.17 billion in fiscal year 2002. Sunset staff evaluated the overall design of the measure, its usefulness in assessing OPUC's impact on consumers, and the accuracy of OPUC's calculations in compiling the numbers. While OPUC claims that it followed the design and intent of the measure, Sunset staff found serious flaws in both the calculation design and its application.

The measure is a compilation of savings from rate cases based on the difference between the Public Utility Commission's final order and the amount initially requested by the utility. This does not accurately depict OPUC's contribution and involvement in rate cases. Clearly, PUC Commissioners and staff play a major role, as well as OPUC, in determining the final rate. In addition, the presence of multiple intervenors advocating similar positions makes it difficult to attribute bill savings solely to OPUC. Finally, as PUC decisions generally involve an overall increase in rates, the reduction from the amount requested by the utility is more accurately described as avoided costs, not actual bill savings realized by residential and small commercial customers.

Beyond these design flaws, Sunset staff also found serious problems with how OPUC calculated the number. See the textbox, *OPUC Bill Savings Problems*, for more detail.

<p style="text-align: center;"><b>OPUC Bill Savings Problems</b></p> <p>Following guidelines for auditing performance measures published by the State Auditor's Office, Sunset staff found the current reported bill savings would be classified as inaccurate.<sup>13</sup> Misrepresented savings to consumers included:</p> <ul style="list-style-type: none"><li>• savings to industrial and large commercial consumers;</li><li>• savings not actually realized in that fiscal year;</li><li>• savings that never went into effect; and</li><li>• savings counted when the original case was withdrawn or dismissed.</li></ul>
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- One major case in which OPUC claims an estimated \$3.8 billion in bill savings – over half its annual total – illustrates how OPUC significantly overstated savings.<sup>14</sup> First, OPUC's calculations in this case included savings for all consumer classes, not just for residential or small commercial consumers. Second, multiple intervenors were involved, including Texas Industrial Energy Consumers, Cities Served by TXU, Consumers Union, Texas Legal Services Center, Nucor Steel, the cities of Mesquite and Garland, and the State of Texas represented by the Office of the Attorney General. The presence of multiple intervenors makes it difficult to fully attribute the bill savings to OPUC, although the agency claimed the full amount. Third, the \$3.8 billion claimed in savings for fiscal year 2003 were not annualized, and in fact were to be recovered over 15 years.

During the review, OPUC indicated that these calculations were correct, given the design of the measure. Sunset staff did not agree with this interpretation of the calculation. However, even if OPUC did calculate correctly, the resulting dollar figure is not an accurate picture of OPUC's impact on customers' utility bills.




*Bill savings cannot be attributed solely to OPUC.*



*Even accepting OPUC's calculations, the savings are not a true picture of its impact.*



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*The Office of the  
Attorney General  
currently participates  
in utility rate cases.*


**Independent representation of residential and small commercial consumers in the few remaining rate cases could be handled effectively by the Office of the Attorney General.**

- Effective consumer representation in utility rate cases requires an entity independent from PUC, with comprehensive knowledge of utility law. Though the number of rate cases has significantly decreased, a few will continue to occur. The Consumer Protection Division of the Office of the Attorney General currently represents large state agencies as a class of consumers in utility rate cases. With appropriate firewalls to prevent conflicts of interest, the duties of the Consumer Protection Division could be extended to include representation of residential and small commercial consumers as well.

**The interests of residential and small commercial consumers in rulemakings and other administrative proceedings does not require independent legal representation and would be more effective if performed by PUC.**

- Since deregulation, PUC's role is being shifted from rate regulation to rule-based regulation, which ensures public protection through rulemaking, enforcement, competitive market oversight, investigation and resolution of customer complaints, and performance measures contained within interconnection agreements. As a result of this transition, the size and funding of PUC's Legal & Enforcement Division, as well as the Customer Protection Division, have significantly increased in recent years. This progression emphasizes the changing role of PUC. With a fully competitive market, PUC's mission is evolving into that of a standard state agency – protecting the public through effective oversight and enforcement. In light of PUC's new role, consumers would best be served by an enhanced consumer focus within PUC, the exclusive regulatory agency.
- The mission of PUC is to protect customers, foster competition, and promote high quality infrastructure. Focused representation of residential and small commercial consumer interests within PUC could result in stronger, more effective consumer protection. While part of their current role, OPUC routinely opposes and appeals the decisions of PUC, creating a unique and costly situation where one state agency is litigating another. In addition, duplicate consumer representation commonly occurs at the federal level.

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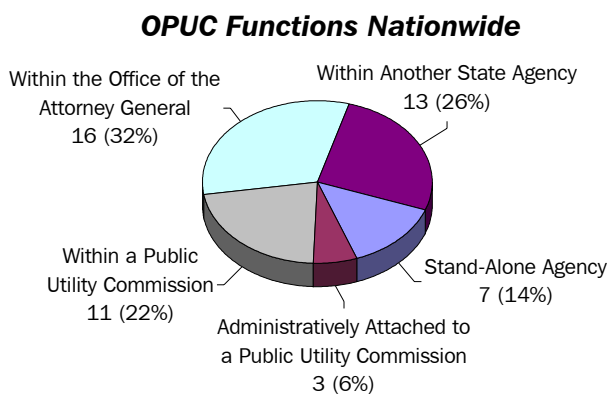
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*Focused  
representation of  
consumer interests  
within PUC could  
result in stronger,  
more effective  
consumer protection.*

Utility cases are inherently complex, requiring experienced attorneys and knowledgeable industry experts. OPUC currently has eight attorneys and five experts on staff, and spent more than \$250,000 in fiscal year 2003 to obtain outside expert testimony. PUC also has many existing resources available to fully address consumer representation cases, including specialized attorneys and industry experts. By placing the consumer protection function within PUC, input on consumer protection could be thoroughly addressed early in the process, reducing duplication and preventing costly litigation.

**Most other states house the utility consumer representation function within existing agencies, not in a stand-alone agency.**

- Sixteen states maintain utility consumer representation at the Office of the Attorney General, while 11 states delegate this function to a public utility commission. Another 13 states perform similar consumer representation functions in other various state agencies. In contrast, only six states other than Texas perform functions similar to OPUC in a completely stand-alone agency, and another three operate independently but are administratively attached to a public utility commission.<sup>15</sup> For more information, see the pie chart, *OPUC Functions Nationwide*.



**Most other Texas regulatory agencies handle consumer protection as an in-house agency function.**

- The fundamental purpose of state regulatory agencies is to protect the public. In most cases, regulatory agency staff advocate on behalf of consumers as part of the agency’s standard function. For example, the Legislature has created at least 38 agencies with regulatory functions that handle consumer protection without the need for a separate agency to perform this function.

In only two cases, utility oversight and insurance, has the Legislature created an independent agency to advocate for consumers. A documented need for complete independence from the exclusive regulatory agency must exist to justify a stand-alone agency to perform consumer advocacy functions. Other than OPUC, the Office of Public Insurance Counsel is the only stand-alone agency in Texas that represents consumers as a class.<sup>16</sup>

- In the area of environmental regulation, the Office of Public Interest Counsel is part of the Texas Commission on Environmental Quality, reporting directly to the Commissioners.<sup>17</sup> The Office of Public Interest Counsel ensures that the general public’s interests in environmental protection are considered in Commission decisions, without the need for a separate entity.

★  
*Texas has only two independent agencies that solely perform consumer advocacy.*

## Recommendations

### Change in Statute

#### 1.1 Abolish the Office of Public Utility Counsel.

This recommendation would abolish the Office of Public Utility Counsel as a separate, stand-alone agency. Additional recommendations below would transfer key functions of OPUC to other existing state agencies. These changes would be effective January 1, 2006, giving the agencies involved four months from the effective date of the bill to complete these transfers. Abolishment of OPUC would also eliminate the gubernatorial appointment of the Public Counsel.



### **1.2 Transfer the responsibility for independent representation of residential and small commercial consumers in utility rate cases to the Office of the Attorney General.**

This recommendation would maintain the independence necessary to advocate on behalf of residential and small commercial consumers before PUC by moving certain rate case functions to the Office of the Attorney General (OAG). OAG would participate in cases having direct impact on retail rates. These cases would be limited to transmission and distribution utility cases within ERCOT, investor-owned utility rate cases outside of ERCOT, fuel reconciliations, and stranded cost true-up cases. Cases affecting wholesale rates would not be included since other intervenors, including large commercial and industrial consumers, participate in these cases, advocating to keep wholesale rates reasonable. Any cases directly involving retail rates that are currently on appeal would transfer to the OAG as well.

At OAG, these utility rate cases would be handled by the Consumer Protection Division, which has the expertise to advocate on behalf of residential and small business consumers. OAG has existing procedures to prevent potential conflicts of interest by creating firewalls between sections or divisions representing different parties in a single case. Any bill savings to residential and small commercial ratepayers should continue to be achieved by OAG. This transfer should occur no later than January 1, 2006.

### **1.3 Transfer OPUC's remaining consumer representation functions to the Public Utility Commission.**

This recommendation would transfer to PUC the remaining consumer representation functions handled by OPUC, including participation in rulemakings, projects, contested cases, federal regulatory proceedings, and ERCOT meetings. Any current appeals by OPUC in this area would be discontinued as of the effective date. This recommendation would require PUC to elevate the consumer representation focus within the agency, in full compliance with its stated mission of protecting customers. This transfer should occur no later than January 1, 2006.

### **1.4 Require PUC staff to evaluate and report findings related to the impact on residential and small commercial ratepayers for each decision by the Commission and the Electric Reliability Council of Texas.**

PUC staff would be required to evaluate the impact on residential and small commercial ratepayers for each Commission decision, and report the findings to the Commission. If PUC staff determines that a decision would directly affect residential and small commercial consumers, it would prepare an impact statement for the proposed decision. The statement must describe in detail the probable effect of the decision on residential and small commercial consumers for each of the first five years the decision will be effective. The consumer impact statements would become part of the formal record for each determination, including contested cases, projects, rulemakings, and any federal regulatory proceedings.

In addition, PUC staff would be required to develop and present consumer impact findings for each proposed ERCOT protocol. PUC staff would evaluate and report the impact of each ERCOT protocol that would affect residential and small commercial consumers as a class. The consumer impact statements would be reviewed by the ERCOT Board before adoption of the protocol, and would provide a record for PUC to review in case of appeal.

### **1.5 Replace OPUC's role on the Electric Reliability Council of Texas Board with a consumer representative appointed by the Governor.**

This recommendation would maintain a residential and small commercial consumer representative on the ERCOT Board to replace the Public Counsel's role as an ex officio member of the ERCOT Board. This representative would be appointed by the Governor, with the advice and consent of the Senate. The appointee would serve two-year terms, and would be eligible for compensation at the same level ERCOT compensates its independent Board members. This change should occur as soon as possible after the effective date of the legislation, but no later than January 1, 2006.

## **Management Action**

### **1.6 Direct PUC to dedicate staff to perform consumer representation functions.**

The Executive Director of PUC should dedicate a high-level staff person, with necessary support, to oversee and coordinate the effective representation of residential and small commercial consumer interests within PUC. Staff would evaluate and report findings related to the impact on residential and small commercial ratepayers, as described in Recommendation 1.4.

### **1.7 The Office of Public Utility Counsel, Public Utility Commission, and Office of the Attorney General should formulate a transition plan for the transfer of functions and property.**

A comprehensive transition plan should be developed as soon as legislation involving the transfer has passed and is signed by the Governor. The plan should include:

- a timetable with specific steps and deadlines needed to complete the transfer effectively by January 1, 2006;
- a method for the transfer of relevant rate case records to OAG;
- a method for the transfer of all remaining consumer-related records to PUC; and
- any other steps necessary to complete transfer of the functions.

This recommendation would help ensure that the transfer of certain OPUC functions is done in accordance with state law and has a minimal effect on consumer representation. The intent of this recommendation is that the transfer of these functions would occur as soon as possible after the effective date of the legislation, but no later than January 1, 2006. Because of this timetable, the standard one-year wind-down period in the Sunset Act would not occur. For more detailed information on where each of OPUC's key functions would be transferred, see the chart, *Disposition of OPUC's Functions*.

<b>Disposition of OPUC's Functions</b>		
<b>OPUC Function</b>	<b>Who Will Perform</b>	<b>Rationale</b>
Rate Cases	OAG	<p>Since PUC adjudicates rate cases, an independent entity is needed to provide effective consumer representation, while preventing conflicts of interest. OAG currently participates in many utility rate cases representing various state agencies as commercial and industrial consumers.</p> <p>The varying classes of consumers are aligned in the first portion of a rate case, where PUC determines the appropriate revenue requirements, setting the overall rate. However, in the cost allocation portion of a rate case, various classes of consumers compete to distribute the portion of the rate paid by each class. OAG would represent competing interests in the cost allocation proceeding, necessitating the use of firewalls within the agency to prevent conflicts of interest.</p> <p>OAG commonly represents two adverse interests, and maintains firewalls to prevent conflicts of interest. Though state agencies represent different ratepayer classes, with appropriate firewalls, the Consumer Protection Division at OAG could effectively represent residential and small commercial consumers as well.</p>
PUC Rulemakings	PUC	<p>Since deregulation, PUC's role of rate regulation is being replaced with rule-based regulation, which ensures public protection through rulemaking, enforcement, competitive market oversight, and prosecution of customer complaints. As a result of this transition, the size and funding of PUC's Legal &amp; Enforcement Division, as well as its Consumer Protection Division, have significantly increased in recent years. This progression emphasizes the changing role of PUC.</p> <p>An increased consumer focus at PUC, along with required consumer impact statements for each Commission decision, would provide residential and small commercial consumer representation initially at the rulemaking and contested case level, preventing costly, duplicative representation at the appellate level.</p>
Contested Cases		
State Court Cases		
Federal Regulatory Proceedings	PUC	PUC's main objective in federal regulatory proceedings is representing Texas consumers. PUC would ensure effective residential and small commercial consumer representation before FCC and FERC.
Bankruptcy Proceedings	PUC	PUC has the authority to intervene and participate in any bankruptcy proceedings that affect customers or providers of telecommunications services in this state. In addition, PUC assists customers when utilities go bankrupt to ensure they maintain continued service and correct billing.
ERCOT Representation	Governor Appointee and PUC	<p>The gubernatorial appointment would maintain an independent residential consumer representative on the ERCOT Board.</p> <p>An increased consumer focus at PUC, along with required consumer impact statements, would provide sufficient consumer input for each ERCOT protocol that directly affects residential and small commercial consumers as a class.</p>

## Impact

Consumer protection needs to evolve to effectively represent residential and small commercial consumers in today's rule-based regulatory environment. PUC's mission statement reflects this new focus: to protect customers, foster competition, and promote high-quality infrastructure. Rule-based regulation encourages participation early in the process, reducing duplicative and costly litigation. These recommendations would continue and improve residential and small commercial consumer representation to coincide with the significant changes in the current regulatory environment.

Having OPUC as a stand-alone agency to protect consumers' interests is no longer justified. The independence necessary to advocate on behalf of residential and small commercial ratepayers before

PUC would be maintained by requiring OAG to assume the rate case intervention functions currently performed by OPUC. In addition, any savings to residential and small commercial ratepayers based on this advocacy should continue to be achieved through the OAG's efforts.

Consumer representation would be enhanced at PUC, the primary regulatory agency. Consumer impact statements would ensure the interests of residential and small commercial consumers are represented in each decision at PUC and ERCOT. Since these findings would be required for every PUC and ERCOT decision that may affect residential and small commercial customers, the consumer perspective would be provided more frequently.

### **Fiscal Implication**

These recommendations would result in a net annual savings of more than \$1 million, including the reduction of 16 full-time equivalent employees. These savings would not be fully realized until fiscal year 2007, following the transition period outlined in the recommendations. As seen in the chart below, the savings to General Revenue in fiscal year 2006 take into account the short transition period.

These recommendations would eliminate OPUC's annual budget of \$1.6 million, and its authorized 23 full-time employees. However, OAG would incur costs to handle the utility rate cases that directly affect retail rates. Based on historical trends of OPUC's participation in rate cases, Sunset staff estimate a cost to OAG of \$197,000 and the need for an additional three full-time employees.

PUC will also incur some costs as a result of increased consumer representation efforts requiring four additional full-time equivalent employees. Sunset staff estimate that the transfer of consumer representation functions from OPUC to PUC will cost \$365,000 per year, including an additional four full-time employees. The current cost of these functions (rulemakings, contested cases, and ERCOT involvement) would be reduced by various factors such as: current resources at PUC would eliminate the need for outside experts, and consumer impact statements would require less time and money than extensive litigation.

ERCOT would incur additional costs for the gubernatorial-appointed Board member representing residential and small commercial consumers. This cost would equal the payment made by ERCOT for independent Board members, which is currently \$75,000, although this cost is assumed in PUC Issue 1.

<i><b>Fiscal Year</b></i>	<i><b>Savings to General Revenue</b></i>	<i><b>Change in FTEs From 2003</b></i>
2006	\$692,000	-12
2007	\$1,038,000	-16
2008	\$1,038,000	-16
2009	\$1,038,000	-16
2010	\$1,038,000	-16

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<sup>1</sup> Office of Public Utility Counsel, *Self-Evaluation Report*, submitted to the Sunset Advisory Commission (August 2003), updated March 2004.

<sup>2</sup> Office of Public Utility Counsel, *Self-Evaluation Report*, submitted to the Sunset Advisory Commission (August 2003), p. 1.

<sup>3</sup> Public Utility Commission of Texas, *FT 2003 Annual Performance Measures Report* (Austin, Texas, October 2003).

<sup>4</sup> Texas Senate Bill 7, 76th Legislature (1999).

<sup>5</sup> Ibid.

<sup>6</sup> Texas Senate Bill 1829, 78th Legislature (2003).

<sup>7</sup> Texas Government Code, sec. 325.011.

<sup>8</sup> This number reflects the PUC performance measure definition of rate case, which includes proceedings which result in adjustments to rates charged customers by telephone and electric utilities regulated by the Public Utility Commission. The PUC definition only includes rate cases completed within that fiscal year. The OPUC rate case definition is much broader, including fuel reconciliations and price to beat fuel factor adjustments. In addition, OPUC calculates the number of active rate cases in which they participate each year, resulting in some cases being counted more than once.

<sup>9</sup> Texas Utilities Code, sec. 11.002.

<sup>10</sup> Texas Utilities Code, sec. 54.305.

<sup>11</sup> Texas Utilities Code, sec. 39.151(g)(2).

<sup>12</sup> The performance measure goal is to represent *residential and small business* consumers aggressively in electric utility matters to ensure that residential and small commercial customers benefit from competition and are protected during the transition to a more competitive market.

<sup>13</sup> State Auditor's Office, *Guide to Performance Measure Management* (Austin, Texas, December 1999) pp. 19-29. A measure is inaccurate when the actual performance is not within five percent of reported performance. A measure is also inaccurate if the agency's calculation deviated from the measure definition and caused a greater than five percent difference between the number reported and the correct performance measure result.

<sup>14</sup> *Joint Application for Approval of Stipulation Regarding TXU Electric Company Transition to Competition Issues*, Public Utility Commission, Docket No. 25230 (June 20, 2002).

<sup>15</sup> The seven states which perform OPUC's functions within a stand-alone agency are: Arizona, Connecticut, Florida, Indiana, Maryland, New Jersey, and Texas. The 11 states which perform this function within an agency similar to PUC include Idaho, Louisiana, Mississippi, Montana, Nebraska, North Dakota, Oregon, Rhode Island, South Dakota, West Virginia, and Wisconsin. Three states perform OPUC's functions within an agency similar to PUC, but maintain independence by being only administratively attached: California, New Hampshire, and Wyoming. The 16 states which perform this function within the Office of the Attorney General include Alabama, Alaska, Arkansas, Iowa, Kentucky, Massachusetts, Michigan, Minnesota, Nevada, New Mexico, North Carolina, Oklahoma, Pennsylvania, Tennessee, Virginia, and Washington.

<sup>16</sup> Texas Insurance Code, ch. 501.

<sup>17</sup> Texas Water Code, sec. 5.271.

## **AGENCY INFORMATION**

# OPUC Agency Information

## Agency at a Glance

The Office of Public Utility Counsel (OPUC) represents the interests of residential and small commercial consumers to help ensure just and reasonable rates for electricity and telephone services. The Legislature created OPUC in 1983 in response to concerns that residential and small commercial ratepayers were not being adequately represented in utility rate proceedings that ultimately affected them. To accomplish its mission, the Office of Public Utility Counsel:

- appears in contested cases before the State Office of Administrative Hearings (SOAH) and Public Utility Commission (PUC);
- participates in rulemakings and projects at PUC;
- advocates on behalf of consumers in federal regulatory proceedings;
- intervenes in state and federal court cases; and
- represents consumers at the Electric Reliability Council of Texas (ERCOT), serving as a voting member of the Board of Directors.

### **Mission Statement**

The mission of the Office of Public Utility Counsel is to provide representation to Texas residential and small commercial consumers in utility proceedings that come before the Public Utility Commission, the Federal Communications Commission, and in state and federal courts, to ensure that utility services are available to them at just and reasonable rates in an increasingly competitive environment.

## Key Facts

- **Funding.** In fiscal year 2003, OPUC operated on a \$1.6 million budget, with \$1.4 million from the General Revenue Fund and \$200,000 from the System Benefit Fund (SBF). SBF is financed by a fee paid by electricity consumers in competitive areas of the state.<sup>1</sup> OPUC's budget for fiscal year 2004 is \$1.7 million.
- **Staffing.** The Office of Public Utility Counsel has 20 employees, all of whom work in Austin.
- **Rate Cases and Contested Cases.** OPUC's participation in contested cases has increased in recent years. However, OPUC's participation in rate cases at PUC has declined due to the advent of competition in the electric and telecommunications industries. In fiscal year 2003, OPUC appeared in 77 contested cases and five rate cases.
- **Rulemakings.** OPUC participates in rulemakings at PUC. OPUC participated in 38 different rulemakings in fiscal year 2003.
- **Court Cases.** Appeals of PUC rulings are held in district court, while federal appeals occur in various circuit courts across the country. In fiscal year 2003, OPUC participated in 50 court cases, all involving electric issues.



- **Federal Proceedings.** OPUC advocates on behalf of telecommunications consumers at the Federal Communications Commission (FCC) and electricity consumers at the Federal Energy Regulatory Commission (FERC). OPUC participated in 22 FCC proceedings and 2 FERC proceedings in fiscal year 2003.
- **ERCOT.** The Public Counsel represents consumers on the ERCOT Board. In fiscal year 2003, OPUC staff spent almost 3,000 hours attending ERCOT meetings and participated in the development of 92 ERCOT protocols.

## Major Events in History

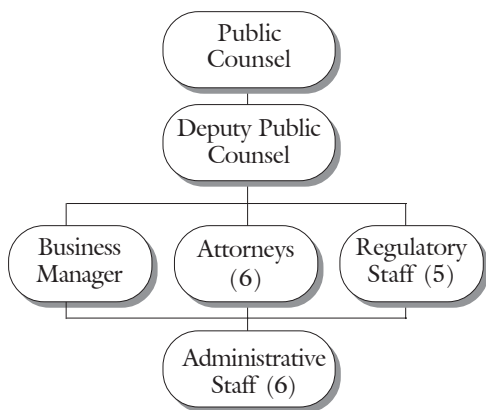
- 1983** The Legislature created the Office of Public Utility Counsel to represent the interests of residential and small commercial consumers in utility rate proceedings at PUC.<sup>2</sup>
- 1995** The Legislature continued OPUC, adopting many of the recommendations developed by the Sunset Commission.<sup>3</sup>
- 1999** The Legislature expanded OPUC’s intervention authority to include alternative dispute resolution proceedings at PUC involving residential and small commercial consumers. OPUC’s authority to intervene was also expanded to include any judicial proceeding in which the Public Counsel determines that residential or small commercial electricity consumers are in need of representation.<sup>4</sup>
- 2003** The Legislature granted OPUC the authority to intervene in telecommunications bankruptcy proceedings on behalf of residential and small commercial consumers.<sup>5</sup>

## Organization

### Policy Body

The Public Counsel heads up this agency, as it does not have a policymaking body. The Public Counsel is appointed by the Governor and confirmed by the Senate for a two-year term. The Public Counsel must be a Texas resident and licensed to practice law in Texas. In addition, the Public Counsel must show a “strong commitment and involvement in efforts to safeguard the

**OPUC Organizational Chart**



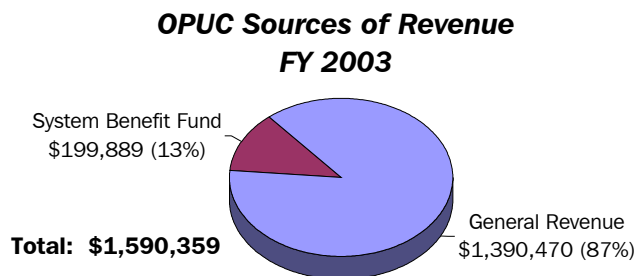
rights of the public” and “possess the experience necessary to practice effectively in utility proceedings.”<sup>6</sup> The Public Counsel establishes agency policy, hires staff, directs the agency’s activities, and approves its budget. OPUC has 20 employees, comprised of attorneys, economists, regulatory analysts, and administrative staff, shown in the *OPUC Organizational Chart*.

Appendix D compares the agency’s workforce composition to the minority civilian labor force. The agency fell short of the statewide percentages for the administration job category, and generally met or exceeded statewide percentages in the professional and administrative support job categories.

## Funding

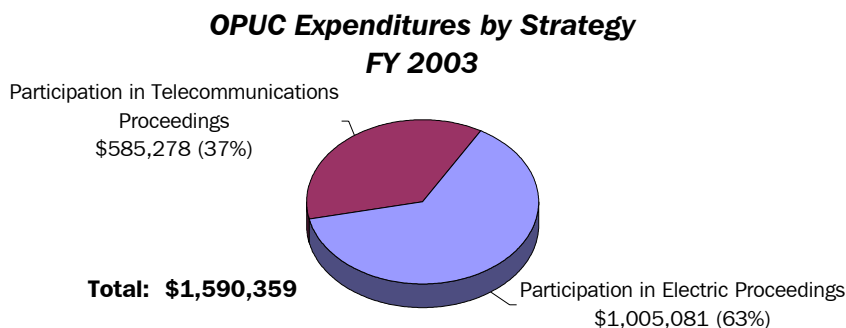
### Revenues

In fiscal year 2003, OPUC received \$1.59 million in funding from the General Revenue Fund. Of this total, OPUC received \$200,000 in General Revenue – Dedicated Funds from the System Benefit Fund, financed by fees paid by consumers where retail electric competition has been implemented. The pie chart, *OPUC Sources of Revenue*, depicts these revenue sources.



### Expenditures

In fiscal year 2003, OPUC expended \$1.6 million, primarily for staff salaries. The pie chart below, *OPUC Expenditures by Strategy*, depicts OPUC's expenditures in telecommunications and electric proceedings. As seen below, participation in electric proceedings accounted for almost two-thirds of OPUC's expenditures in fiscal year 2003.



Appendix E describes OPUC's use of Historically Underutilized Businesses (HUBs) in purchasing goods and services for fiscal years 2000 to 2003. OPUC uses HUBs in the categories of commodities and other services. While OPUC fell below the statewide goal in 2001 and 2002 for other services, it surpassed the goal in 2000 and 2003. In addition, OPUC surpassed the statewide goal in commodities spending every year.

## Agency Operations

OPUC provides legal representation to residential and small commercial consumers in various types of utility litigation and administrative proceedings. The Public Counsel determines the type of proceedings in which to participate, and then provides representation, as would a small law firm. OPUC primarily intervenes on behalf of a class of consumers in cases with the largest financial impact, or proceedings with policies affecting large groups of consumers.

OPUC has three different types of employees: attorneys; economists and regulatory analysts; and administrative staff. Attorneys participate in litigation through discovery, testimony, cross-examination, filing of briefs, oral arguments, negotiations, and appeals. Attorneys also participate in

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*OPUC focuses on cases that have the largest financial impact on residential and small commercial consumers.*

rulemakings by filing substantive expert and legal comments. The economists and regulatory analysts provide technical and scientific support, however OPUC also employs outside expert witnesses to address highly technical issues when necessary. Administrative staff manage the agency's budget and business activities and provide clerical support.

The Office of Public Utility Counsel advocates on behalf of consumers in various types of proceedings: rate cases and contested cases; rulemakings; state and federal court cases; and proceedings before federal administrative agencies, such as the Federal Communications Commission and Federal Energy Regulatory Commission. The 78th Legislature also authorized OPUC to participate in telecommunications bankruptcy cases.<sup>7</sup> A breakdown of OPUC's various proceedings is found in the table, *OPUC Caseload*. Unlike other parties, which must show an interest to intervene, OPUC has statutory authority to intervene in each of these proceedings.<sup>8</sup>

<b>OPUC Caseload – FY 2003</b>			
<b>Type of Proceeding</b>	<b>Electric</b>	<b>Telecommunications</b>	<b>Total</b>
Rate Cases and Contested Cases	69	13	<b>82</b>
PUC Rulemakings	21	17	<b>38</b>
State Court Cases	50	0	<b>50</b>
Federal Regulatory Proceedings	2	22	<b>24</b>
Bankruptcy Proceedings	1	0	<b>1</b>
ERCOT Protocols	92	N/A	<b>92</b>
<b>Total</b>	<b>235</b>	<b>52</b>	<b>287</b>

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<sup>1</sup> Texas Utilities Code, sec. 39.903.

<sup>2</sup> Texas Senate Bill 232, 68th Legislature (1983).

<sup>3</sup> Texas Senate Bill 373, 73rd Legislature (1993).

<sup>4</sup> Texas Senate Bill 7, 76th Legislature (1999).

<sup>5</sup> Texas Senate Bill 1829, 78th Legislature (2003).

<sup>6</sup> Texas Utilities Code, sec. 13.022(a).

<sup>7</sup> Texas Senate Bill 1829, 78th Legislature (2003).

<sup>8</sup> Texas Utilities Code, sec. 13.003(a).

## *The Telecommunications Infrastructure Fund Board Is No Longer Operational and Should Be Allowed to Expire Under the Sunset Act.*

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### **Summary**

#### **Key Recommendation**

- Abolish the Telecommunications Infrastructure Fund Board and the related enabling legislation.

#### **Key Findings**

- The Legislature created the Telecommunications Infrastructure Fund Board to administer grants to stimulate the deployment of telecommunications technology.
- The State's leadership has recently taken action to phase out the Board's functions.
- The Board has fulfilled its role and is no longer needed.


#### **Conclusion**

The Legislature created the Telecommunications Infrastructure Fund Board to oversee the administration of grants and loans from the Telecommunications Infrastructure Fund – a fund that assists public schools, institutions of higher education, public libraries and non-profit healthcare facilities in establishing telecommunications projects, such as broadband services. Funds were raised by assessments on telecommunications providers. The program began in fiscal year 1996 and was originally set to award \$1.5 billion in grants over 10 years. In its 2003 session, the Legislature raised the cap on assessments to \$1.75 billion.

From 1996 to 2002, the Telecommunications Infrastructure Fund Board provided more than 11,000 grants, which among other things, provided computers and high-speed Internet connections to Texas school districts, non-profit hospitals, and health centers. The Fund is now nearing its statutory cap, and the Legislature determined that no new grants be awarded from the Fund. In addition, the Governor eliminated the Board's oversight function and transferred its remaining duties to another state agency. In light of the fact that the Board is no longer operational, and that the assessment used to support the Fund will soon reach its cap, Sunset staff recommend allowing the Board and its enabling legislation to expire under the Sunset Act. Under this approach, no further action would be needed by the Sunset Commission or the Legislature.

## Support

### **The Legislature created the Telecommunications Infrastructure Fund Board to administer grants to stimulate the deployment of telecommunications technology.**

  
*Telecommunications  
Infrastructure Fund  
grants were intended  
to stimulate the  
deployment of  
Internet services  
statewide.*

- In 1995, the Legislature created the Telecommunications Infrastructure Fund (the Fund) to promote technology in public schools, institutions of higher education, libraries, and non-profit healthcare facilities. Grants from the Fund were intended to stimulate the deployment of broadband Internet service by allowing recipients to purchase computer hardware and software; and pay for high-speed Internet connectivity and training, especially in rural and underserved parts of the state.
- To support the Fund, the Legislature authorized the Comptroller of Public Accounts to assess and collect an annual fee from telecommunications utilities and wireless telephone providers, based upon each company's taxable telecommunications receipts. Monies collected were deposited into two dedicated accounts within the General Revenue Fund – the public school account and the qualifying entities account.
- The Legislature also created a nine-member Telecommunications Infrastructure Fund Board (the Board) to oversee the administration of grants and loans from the Fund. The Board, which is no longer active, included six members appointed by the Governor, three of whom were recommended by the Speaker of the House of Representatives, and three members appointed by the Lieutenant Governor. Members served six-year, staggered terms and the Governor appointed the Chair.

The Board met every other month to adopt policies for the agency and determine grant funding allocations. The Board also employed staff to assist in the administration of the Fund. At its inception in 1996, the Board was budgeted nine full-time equivalent (FTE) positions. By fiscal year 2003, the Board's FTE allocation had grown to 29, all located at the headquarters in Austin. The Legislature appropriated the Board pass-through funds for grant purposes, and about \$2.1 million in operating funds.

### **The State's leadership has recently taken action to phase out the Board's functions.**

- In the enabling legislation which created the Fund, the Legislature required the Comptroller to collect assessments totaling \$1.5 billion over 10 years.<sup>1</sup> Recognizing this limited time frame, the Legislature gave the Board and its related legislation a Sunset date of September 1, 2005. Although the Legislature raised the Fund's cap to \$1.75 billion in 2003, it did not extend the life of the Board.
- As the Fund nears its cap, the State's leadership has taken clear action to phase out the Board's oversight responsibilities. For 2004, the Legislature appropriated \$2.08 million to the Board. This amount did not include funding for the issuance of new grants, but instead provided operating funds which would allow the Board to administer and close-out past grants before the Board's Sunset date of 2005. The Legislature did not appropriate any funds to the Board for fiscal year 2005.

In addition, after the close of the session, the Governor line-item vetoed the Board's fiscal year 2004 appropriation and transferred the Board's remaining functions to the Texas Workforce Commission (TWC). The Governor's Executive Order required TWC to complete the process of closing-out any remaining grants, and directed the Board's 24 employees to work with TWC staff through the remainder of calendar year 2003 to accomplish the close-out functions.<sup>2</sup> The Board held its final meeting in early June 2003.

★  
*The Governor vetoed  
 TIF's appropriation  
 and directed the  
 Texas Workforce  
 Commission to close  
 out the remaining  
 grants.*

**The Board has fulfilled its role and is no longer needed.**

- The Board was created to administer grants from the Fund. From 1996 to 2002 (the final year of grant awards), the Board provided more than 11,000 grants to public schools, institutions of higher education, libraries, health centers and other eligible entities. As required by statute, many grants were targeted at rural areas of the state and provided underserved communities with computer and Internet services. The chart *Distribution of TIF Funds*, shows how the Fund, and the earned interest, have been used since the inception of the Fund in 1996.<sup>3</sup>
- After the Fund reaches its cap, the Comptroller will no longer collect fees from telecommunications utilities and wireless providers. The assessment upon telecommunications receipts, which supports the Fund, is expected to expire within this biennium. Current law requires the fee to expire when the total amount credited towards the Fund reaches \$1.75 billion. In fiscal year 2003, the Comptroller collected \$216 million, bringing the total amount collected to \$1.5 billion. The Comptroller estimates that the Fund will reach its statutory \$1.75 billion cap by the end of fiscal year 2005.
- As the life of the Fund comes to an end, the Board's functions are no longer needed. TWC anticipates closing out all remaining grants by March 2004. Although the Comptroller continues to collect and deposit assessments into the dedicated accounts, the Legislature has not appropriated these remaining funds.

<b>Distribution of TIF Funds</b>	
<b>Recipient</b>	<b>Amount (in \$million)</b>
Public Schools	559.5
Texas Education Agency (TEA) Technology Allotment	357.5
Miscellaneous (primarily to TEA)	150.7
Healthcare	110.3
Higher Education	86.4
Community Networking	71.7
Libraries	69.5
Department of Human Services – Texas Integrated Eligibility Redesign System	53.4
Special Projects	51.4
Discovery Grants	44.4
Board Administration	11.1
<b>Total</b>	<b>\$1.57 Billion</b>

**Recommendation**

**1.1 Abolish the Telecommunications Infrastructure Fund Board and the related enabling legislation.**

Under this recommendation, no legislation would be needed to abolish the Board and remove the related subchapter from statute, as it would happen automatically under the Sunset Act. Because the Board is no longer active and its remaining duties were transferred to the Texas Workforce Commission, no further action would be needed to close down the Board's operations. This recommendation would remove the Board's enabling statute from law on its Sunset date of September 1, 2005. The standard one-year, wind-down period for an abolished agency to conclude its affairs would not apply.

## Impact

This recommendation would eliminate from law an agency that the Governor and the Legislature have already taken action to phase out. As the authority for collecting the assessment is in the expiring subchapter, if the Legislature wishes to continue the statutory assessment on telecommunications providers that funded the Telecommunications Infrastructure Fund, legislation would be needed to continue the fee and raise the cap on assessments.

## Fiscal Implication

This recommendation would not have a fiscal impact to the State, as the Governor eliminated the Board's funding for the 2004-2005 biennium.

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<sup>1</sup> Texas House Bill 2128, 74th Legislature (1995).

<sup>2</sup> Governor of the State of Texas, Executive Order RP27, *Relating to the closeout of the outstanding grants of the Telecommunications Infrastructure Fund*, (August 11, 2003). Online. Available: [www.governor.state.tx.us/divisions/press/exorders/rp27](http://www.governor.state.tx.us/divisions/press/exorders/rp27). Accessed: March 30, 2004.

<sup>3</sup> Legislative Budget Board, *Fiscal Size-Up 2004-2005*, Telecommunications Infrastructure Fund Board, p. 206.



## *Remove the Electric Utility Restructuring Legislative Oversight Committee From Sunset Review.*

---

### **Summary**

#### **Key Recommendation**

- Repeal the expiration date for the Electric Utility Restructuring Legislative Oversight Committee.

#### **Key Finding**

- While the Committee has successfully overseen implementation of legislation on electric competition, the Legislature should be free to establish its own committee structure without review by the Sunset Commission.

#### **Conclusion**

During its major restructuring of the electric markets in Texas, the Legislature created the Electric Utility Restructuring Legislative Oversight Committee (the Committee) to oversee the implementation of the legislation. The Committee has acted as a forum for discussions of issues and as a conduit for legislative input to the Public Utility Commission and other agencies involved in the electric market. While the Committee has been effective in its oversight role, the Legislature could create other forums to accomplish the same objectives. Sunset staff considered the appropriateness of a legislative agency evaluating the need for continuance of a legislative committee. Because the Legislature should be free to set its own committee structure, Sunset staff concluded that the Committee should be removed from review by the Sunset Commission.

## Support

### **The Legislature created the Electric Utility Restructuring Legislative Oversight Committee to oversee the introduction of competition to the electric industry in Texas.**

- In 1999, the Legislature created the Electric Utility Restructuring Legislative Oversight Committee and charged it with overseeing the implementation of electric utility restructuring. The Committee monitors the effectiveness of utility restructuring, including the fairness of rates, the reliability of service, and the effect of stranded costs, market power, and regulation on the normal forces of competition. The Committee is required to meet at least annually with PUC and may also comment on proposed PUC rules related to electric utility restructuring.
- The Committee is composed of six members, as modified by legislation in 2003, and includes the Chair of the House Committee on Regulated Industries and two other House members appointed by the Speaker, and three Senators appointed by the Lieutenant Governor. The Chair of Regulated Industries and one Senate member, selected by the Lieutenant Governor, serve as Co-Chairs. Current House Members include Representatives Phil King, Co-Chair, Todd Baxter, and Harold Dutton. Senate appointments to the reconstituted Board had not been made at the time of this report. At times, the Committee has had a small, independent staff, but it does not have any employees at this time. The last formal meeting of the Committee took place in December 2002.



*The Committee has served as an important forum for providing legislative input to PUC and other agencies.*

### **While the Committee has successfully overseen implementation of legislation on electric competition, the Legislature should be free to establish its own committee structure without review by the Sunset Commission.**

- The Committee has successfully discharged its oversight responsibility through public meetings and reports. The Committee's meetings served as an important forum for discussion of problems and as a means of providing legislative direction to PUC and other agencies involved in the electric market. For example, many observers credit the restructuring of the Board of the Electric Reliability Council of Texas (ERCOT) to concerns expressed by the Committee.

In 2000, the Committee issued a major report on the introduction of competition that discussed issues related to the implementation of legislation, transmission network reliability, consumer protections, stranded costs, and operation of the Independent System Operator, ERCOT. This report served as the basis for discussions during the subsequent legislative session.

- The Legislature created the Sunset Commission to regularly assess the continuing need for state agencies. The Sunset Commission does not commonly evaluate the need for continuance of legislative committees or other legislative agencies. In fact, the Committee is the only legislative oversight committee ever reviewed by the Sunset Commission.

- While the Committee has been effective in providing a forum to discuss issues related to electric restructuring, the Legislature could easily create other forums for this same purpose. For example, the oversight functions assigned to the Committee could be assigned to standing committees of either House or could be assumed by a joint committee of both Houses. Because the Legislature is free to set its own committee structure, an independent review of a legislative committee, such as through the Sunset process, is unnecessary.



*Because the Legislature is free to set its own committee structure, a Sunset review is not necessary.*

## **Recommendation**

### **Change in Statute**

#### **1.1 Repeal the expiration date for the Electric Utility Restructuring Legislative Oversight Committee.**

This recommendation would allow the Legislature to determine the proper structure of its committees, without review by the Sunset Commission. The provision making the Committee subject to Sunset if not continued beyond September 1, 2005 would be removed from the Committee's enabling Act. The Legislature could choose to continue using the Electric Utility Restructuring Legislative Oversight Committee as a forum for discussing issues related to the introduction of competition to electric markets, or the Legislature could choose to use joint or independent committees for the same purpose.

### **Fiscal Implication**

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

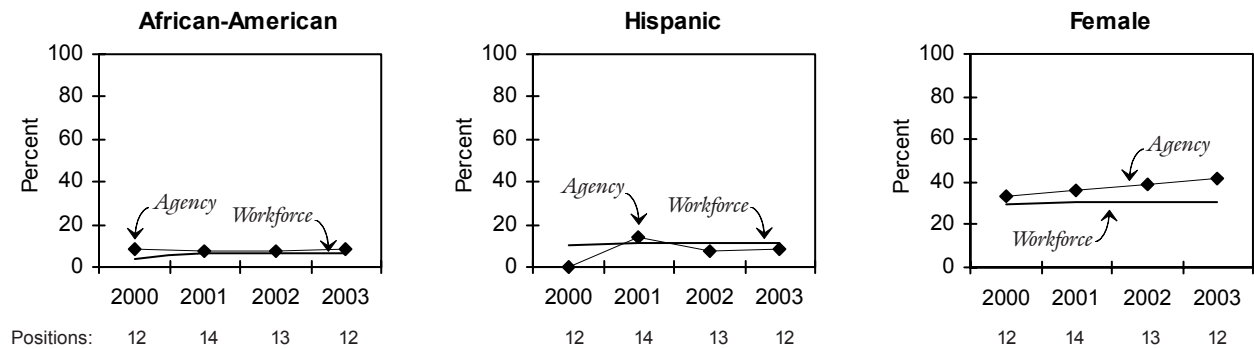


# APPENDICES

## PUC Equal Employment Opportunity Statistics 2000 to 2003

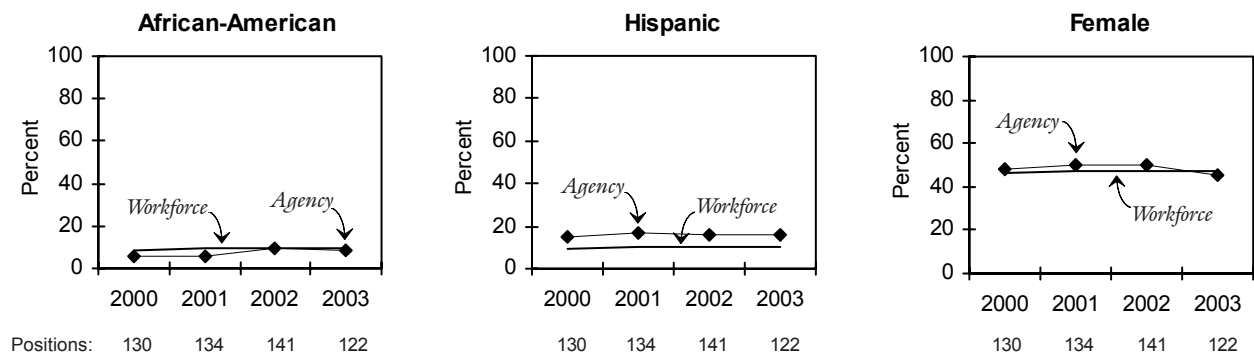
In accordance with the requirements of the Sunset Act, the following material shows trend information for the Public Utility Commission employment of minorities and females in all applicable categories.<sup>1</sup> The agency maintains and reports this information under guidelines established by the Texas Commission on Human Rights.<sup>2</sup> In the charts, the solid lines represent the percentages of the statewide civilian workforce for African-Americans, Hispanics, and females in each job category. These percentages provide a yardstick for measuring agencies' performance in employing persons in each of these groups. The diamond-dashed lines represent the agency's actual employment percentages in each job category from 2000 to 2003. The agency had only one employee in the skilled craft category, so this information was not shown in a graph.

### Officials/Administration



The agency met or exceeded the civilian work force percentage for African-Americans and females in Officials/Administration, but fell short for Hispanic representation in all but one year – 2001.

### Professional

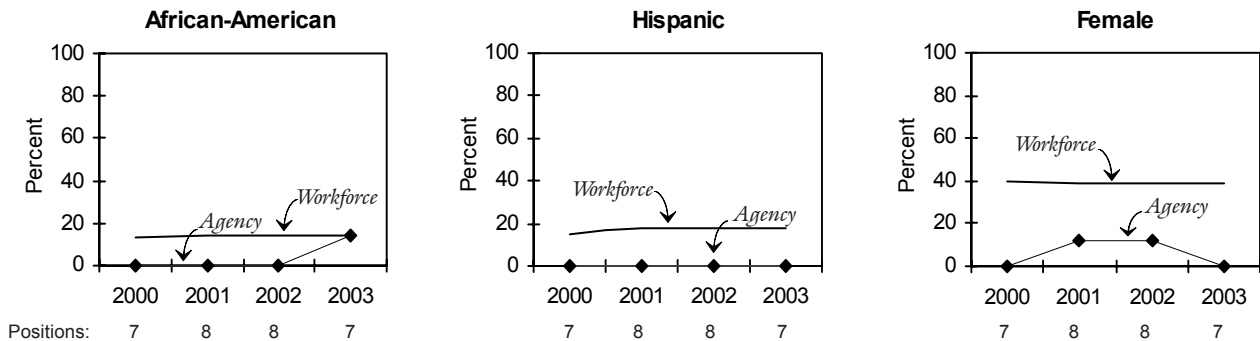


The agency generally exceeded the percentages for Hispanics and females in this category, and made improvement in the percentage of African-Americans.

# Appendix A

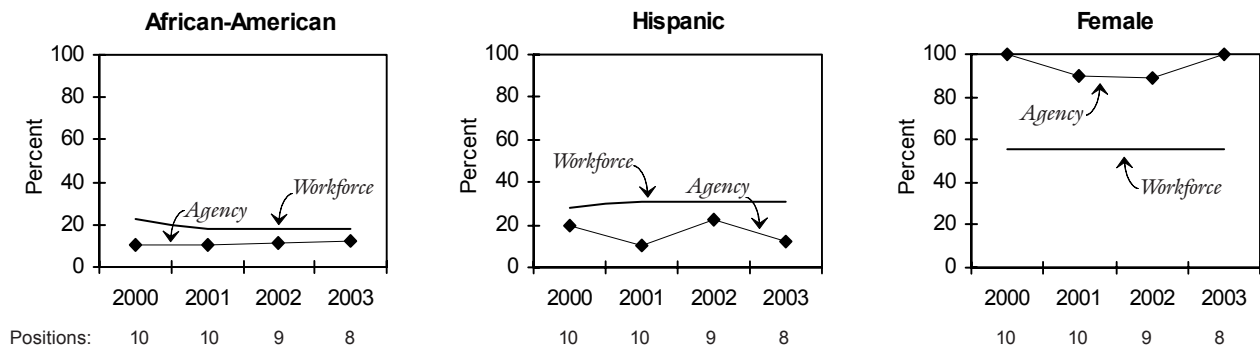
## PUC Equal Employment Opportunity Statistics

### Technical



While the agency met the percentage for African-Americans in 2003, it fell short all other years. Hispanic and female representation also fell below the workforce percentage. However, meeting percentages in this category is difficult due to PUC's limited number of technical positions.

### Para-Professional



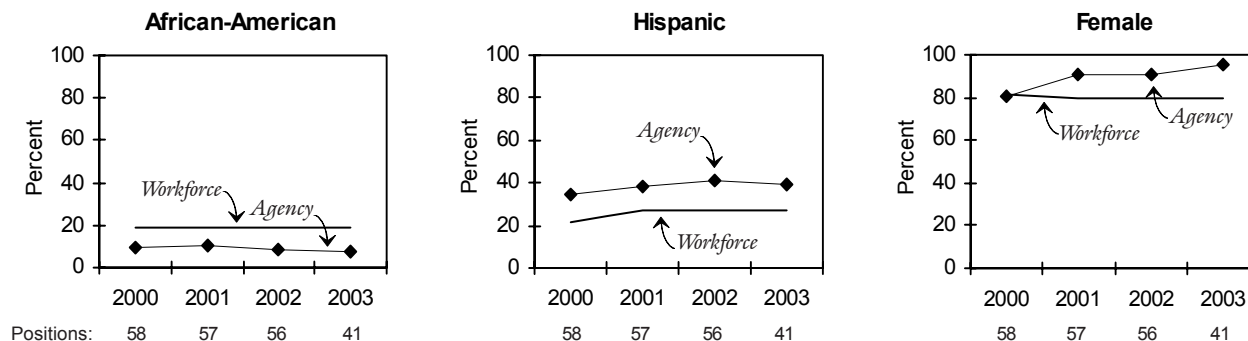
The agency exceeded the percentage for females by a wide margin, but fell short of the percentage for African-Americans and Hispanics each year.



# Appendix A

## PUC Equal Employment Opportunity Statistics

### Administrative Support



The agency exceeded the percentage for Hispanics and females, but continued to be below the percentage for African-American representation in this category.

<sup>1</sup> Texas Government Code, sec. 325.011(9)(A).

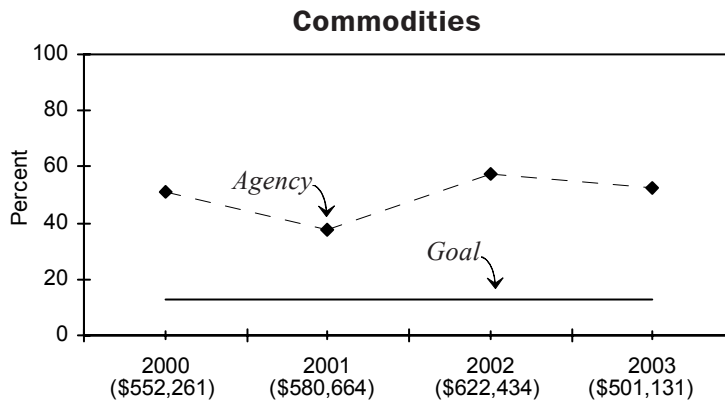
<sup>2</sup> Texas Labor Code, sec. 21.501. The Texas Human Rights Commission (HRC) has been the agency responsible for collecting and distributing EEO data. During the 2003 Session, the Legislature passed HB 2933 transferring the functions of HRC to a new civil rights division within the Texas Workforce Commission (TWC). The legislation is to take effect upon certification of the TWC civil rights division by the appropriate federal agency; no specific date has yet been established.



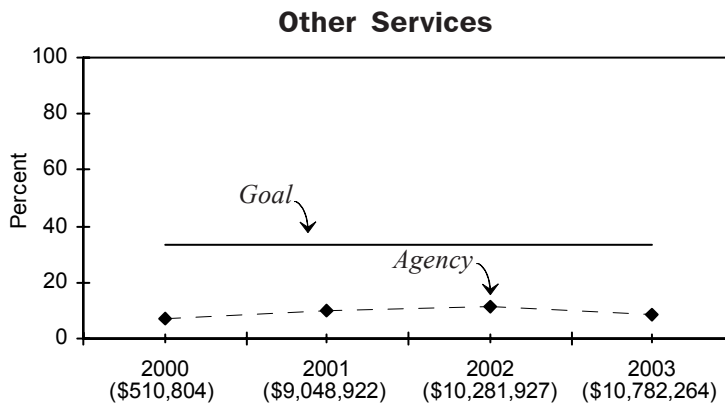
## PUC Historically Underutilized Businesses Statistics 2000 to 2003

The Legislature has encouraged state agencies to increase their use of Historically Underutilized Businesses (HUBs) to promote full and equal opportunities for all businesses in state procurement. The Legislature also requires the Sunset Commission to consider agencies' compliance with laws and rules regarding HUB use in its reviews.<sup>1</sup> The review of the Public Utility Commission revealed that the agency is complying with all state requirements concerning HUB purchasing.

The following material shows trend information for the Public Utility Commission use of HUBs in purchasing goods and services. The agency maintains and reports this information under guidelines in the Texas Building and Procurement Commission's statute.<sup>2</sup> In the charts, the flat lines represent the goal for HUB purchasing in each category, as established by the Texas Building and Procurement Commission. The diamond-dashed lines represent the percentage of agency spending with HUBs in each purchasing category from 2000 to 2003. Finally, the number in parentheses under each year shows the total amount the agency spent in each purchasing category. The agency has not met the State's goals, except for the purchase of commodities.



The agency has greatly exceeded the State's goal of 12.6 percent in this category.

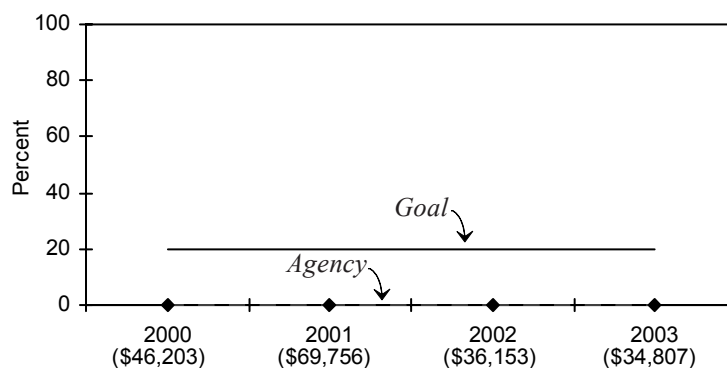


The agency has fallen short of the State's goal in this category all four years examined.

## Appendix B

### PUC Historically Underutilized Businesses Statistics

#### Professional Services



The agency had limited expenditures in this category, but none were with HUBs.

<sup>1</sup> Texas Government Code, sec. 325.011(9)(B).

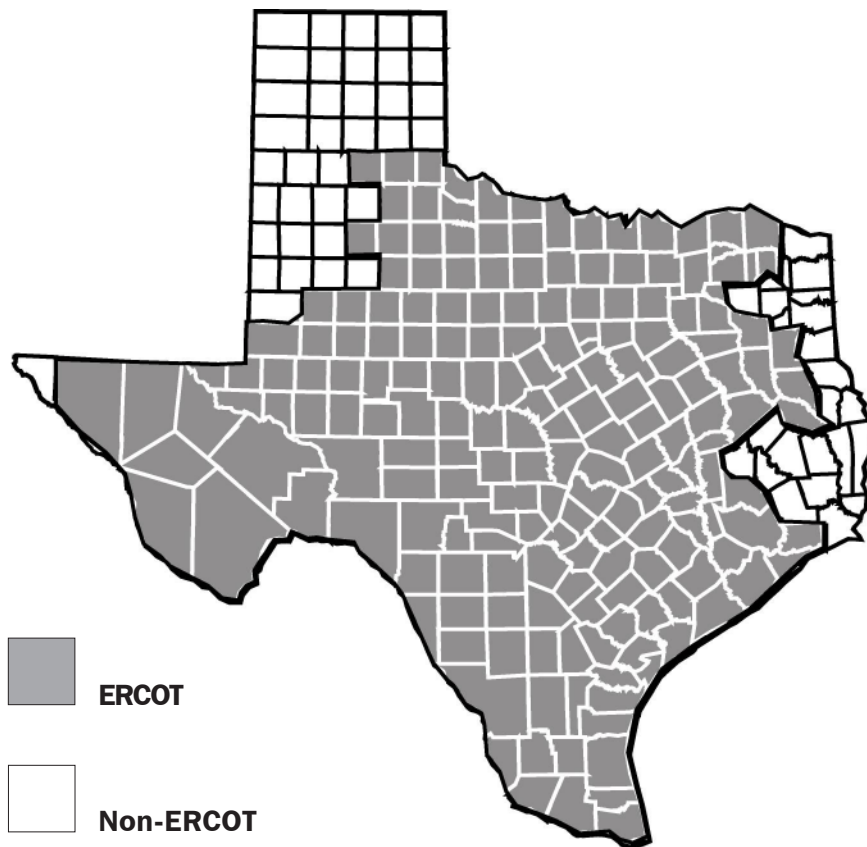
<sup>2</sup> Texas Government Code, ch. 2161.


## **Electric Reliability Council of Texas**

The Electric Reliability Council of Texas (ERCOT) is one of ten regional reliability councils in North America and the Independent System Operator (ISO) for the ERCOT area. The organization serves seven million electricity customers and oversees the operation of more than 78,000 megawatts of generation and 37,500 miles of transmission lines in Texas. As shown in the map, *ERCOT Service Area*, ERCOT serves about 85 percent of the state's demand for electricity and 75 percent of the geographic land area of the state.

ERCOT is the organization responsible for facilitating wholesale electricity transactions among power generators and retailers, ensuring customer information is provided to retailers for billing and switching, maintaining the overall reliability of the transmission network, and ensuring open access to the network. A nonprofit organization, ERCOT's 153 stakeholder members include investor-owned and municipally-owned utilities, electric cooperatives, generators, power marketers, retail electric providers, and consumers.

***ERCOT Service Area***





*ERCOT began as an electric industry group to increase the reliability of the Texas grid, but today has statutory and PUC-assigned responsibilities for the wholesale and retail electric markets.*

## Key Facts

- ERCOT ensures open access and reliability of the transmission network, facilitates market operations, and conveys customer information to retail electric providers.
- ERCOT's 14-member Board of Directors consists of representatives of electric market segments, consumers, unaffiliated members, and ex officio members.
- In 2003, ERCOT had 400 staff located in Taylor and Austin. The organization's annual budget totaled \$98.7 million, which was funded primarily by a statutorily derived fee of \$0.33 per megawatt hour (MWH) applied to demand and passed through to consumers.

## Major Events in ERCOT History

- 1970** A group of major electric power companies created ERCOT to increase the reliability and security of the transmission network in Texas.
- 1990** ERCOT incorporated as a nonprofit corporation in Texas.
- 1995** The Texas Legislature amended the Public Utility Regulatory Act (PURA) to deregulate the wholesale electric market and increase competition.
- 1996** PUC amended its rules to give ERCOT responsibilities over wholesale competition and for ensuring efficient use of the transmission network by all market participants. At this time, ERCOT staff increased from five to 35 full time employees.
- 1999** The Legislature passed Senate Bill 7 creating the competitive retail electric market. Provided that ERCOT amend its governance structure, the legislation allowed PUC to certify ERCOT as the independent organization overseeing network reliability and retail operations in a way that would not allow any particular buyer or seller to gain an unfair advantage in the marketplace.
- 2001** PUC approved ERCOT's Protocols as the rules to ensure reliability and account for the production, management, and delivery of electricity in the new competitive wholesale and retail markets. ERCOT increased its staff to 240 employees to address its new responsibilities.
- 2002** On January 1, competitive retail electricity sales began in the ERCOT area. PUC gave ERCOT the role of implementing customer-selected switching decisions. ERCOT increased its staff to 300 employees.
- 2003** PUC initiated a project to redesign the ERCOT wholesale market to allow for the direct assignment of local congestion costs in 2006. ERCOT increased its staff to 377 employees.

# Organization

## PUC Oversight of ERCOT

With the ERCOT region located entirely within the State, the Public Utility Commission (PUC) serves as ERCOT’s exclusive regulatory authority. All other ISOs in the United States are primarily overseen by the Federal Energy Regulatory Commission, with some oversight by state agencies. PUC must approve any changes in ERCOT’s fees charged to market participants to cover ERCOT’s expenses. In addition, all protocols developed at ERCOT may be appealed to PUC.

## ERCOT Board

The chart, *ERCOT Board of Directors*, lists the current membership of the Board. The six key industry segments participating in ERCOT (investor-owned utilities, generators, power marketers, retail electric providers, municipal utilities, and electric cooperatives) and the industrial consumer participant, each elect a person to represent their interest on the Board. The large-commercial consumer participant is appointed by the outgoing incumbent. These members serve one-year terms.

The ERCOT stakeholder members, voting by segment, select three unaffiliated Board members based on recommendations from an executive search firm and nominations from a Board subcommittee. Under the ERCOT Bylaws, unaffiliated Board members must have experience in

at least one of the following areas: corporate leadership, finance, accounting, engineering, law, utility regulation, risk management, or information technology. They must also be independent of any ERCOT market participants.

The Board of Directors hires the CEO and also appoints ERCOT’s officers, which include the General Counsel, Chief Operating Officer, Chief Financial Officer, Chief of Market Operations, and Chief Information Officer. A Technical Advisory Committee (TAC) consisting of members from each of the industry market segments, large commercial, industrial, and residential consumer representatives, and OPUC makes policy recommendations to the Board of Directors. Four committees assist TAC: Protocol Revisions, Reliability and Operations, Retail Market, and Wholesale Market. In addition, numerous workgroups and task forces assist TAC and its subcommittees.

<b>ERCOT Board of Directors</b>		
<b>Name</b>	<b>Organization</b>	<b>Segment Category</b>
Michael Green, Chair	Oncor Electric	Investor-Owned Utility
Robert Manning, Vice Chair	H.E. Butt Grocery Company	Commercial Consumer
Barry Huddleston	Dynegy	Generator
Dorothea Stockstill	Mirant Americas Energy Marketing	Power Marketer
David Veisesh	Utility Choice Electric	Retail Electric Provider
Bob Kahn	Austin Energy	Municipal Utility
Clifton Karnei	Brazos Electric Cooperative	Cooperative Utility
Tom Payton	Occidental Chemical	Industrial Consumer
Mark Armentrout	MBNA	Unaffiliated
David Baggett	Private Investor	Unaffiliated
Miguel Espinoza	The Riverview Group	Unaffiliated
Thomas Noel	ERCOT CEO	ex officio/voting
Suzi McClellan	Public Utility Counsel	Residential Consumer/ ex officio/voting
Paul Hudson	Chair, Public Utility Commission	ex officio/nonvoting



In recent years, the Board has gone through several changes in size and composition. The statute designates the Board to have a total membership of 18 members representing the market segments of generation, transmission and distribution, power sales, and consumers. In addition, the statute provides for the PUC Chair (nonvoting), ERCOT CEO, and the Public Utility Counsel to be members.

In July 2001, ERCOT's Board consisted of 21 members. By December 2001, this number had grown to 25 members. Many state leaders expressed concern that the Board was too large, which made the governing process too unwieldy, and that it needed some form of independent membership. The Electric Utility Restructuring Legislative Oversight Committee suggested that ERCOT review its Board structure to address these concerns. In 2003, the Board modified its structure to the one described above.

### Staff

The Chief Executive Officer oversees ERCOT's operations. The organization's 377 staff, fall into four major categories: Corporate (13 percent), Technology and IT operations / Development (39 percent), System and Transmission Services (25 percent), and Market Administration and Services (23 percent). As ERCOT has assumed more responsibilities in the market, staff levels have grown significantly. The majority of staff work in the direct operation of the market including control and dispatch operators, market support staff, and market rules and settlement staff.

★

*ERCOT operated on a budget of \$98.7 million in 2003, with 10 percent of its budget going to pay on its \$150 million debt.*

### Funding

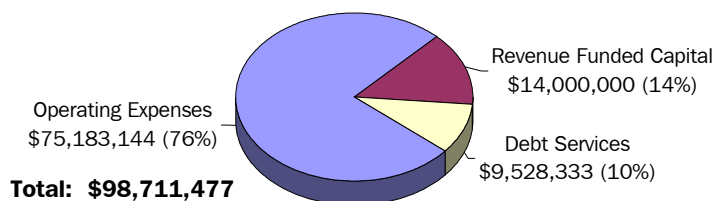
ERCOT received \$98.7 million in revenues in 2003. The system administration fee, paid by all electricity consumers in the ERCOT service area, is the primary source of revenue. For 2003, the system administration fee was \$0.33 per MWH and accounted for 97 percent of ERCOT's total revenue. The other 3 percent derives from membership dues, interest income, and other minor sources.

ERCOT's expenditures include operating expenses, debt service, and revenue funded capital totaling \$98.7 million for 2003. The pie chart,

*ERCOT Expenditures*, shows the three categories of

ERCOT spending. Operating expenses include the categories of labor and benefits, consultant and contractor costs, hardware and software maintenance, and facilities maintenance. ERCOT has historically borrowed funds to pay for such capital expenses as land, buildings, and computer hardware and software.

**ERCOT Expenditures – 2003**



Payments on these borrowed funds make up ERCOT's debt service costs. Currently, ERCOT has a total debt of \$150 million in notes payable and a \$50 million line of credit. ERCOT funds its capital spending using a ratio of 40 percent revenue funded to 60 percent debt funded. Historically this ratio has been 20 percent revenue to 80 percent debt.

## ERCOT Operations

ERCOT oversees the day-to-day operation of the transmission network through complex operating guidelines referred to as protocols. These protocols govern market participants' activities and interactions with ERCOT. Through stakeholder input, ERCOT continually adjusts the protocols in an effort to refine the market.

ERCOT's broad areas of responsibility in Texas' deregulated electric market are to ensure:

- reliability and open access to the transmission network;
- fair market operations; and
- conveyance of market and customer information to market participants.

### Network Reliability and Open Access

ERCOT monitors and analyzes all of the electricity transmission components within its region to ensure the reliable transmission of electricity at every moment. ERCOT uses a sophisticated computer system to monitor the balance between power generation and power demand. ERCOT must answer the following questions on a "real time" basis.

- Does current generation adequately support the load on the network?
- Is transmission capacity adequate to deliver the electricity being generated to the location of the load?
- What additional electricity is needed to support the operating hour balancing of electricity supply and demand?
- What instructions need to be provided to participants to support reliable system operations?

ERCOT also reviews the operational schedules for the transmission network to ensure that all wholesale buyers and sellers of electricity have equal access to the network.

### Market Operations

ERCOT monitors the differences between scheduled electricity and actual demand for electricity, to ensure that each market participant is financially accountable for its activities in the market. ERCOT collects data on the supply and demand for electricity every 15 minutes. Market participants and ERCOT use this information to settle accounts between wholesale buyers and sellers of electricity. When necessary, ERCOT orders generators to increase or decrease power generation to resolve congestion and maintain network reliability. ERCOT then compensates participants for these orders to maintain reliability, and charges the cost of resolving local congestion to market participants based on each participant's level of activity in the market.



*ERCOT operates a sophisticated computer system to monitor the balance between power generation and demand.*

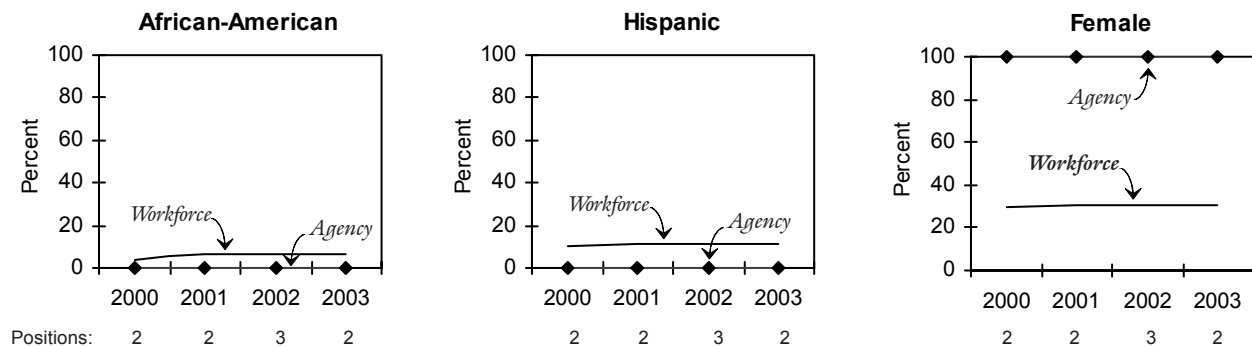
## **Customer Information**

ERCOT provides customer information to retail electric providers to facilitate customer switching and billing. While ERCOT's role is transparent to the customer, it provides a vital information link in the process. ERCOT also maintains the database of all customers including those that are outside the ERCOT deregulated market.

## OPUC Equal Employment Opportunity Statistics 2000 to 2003

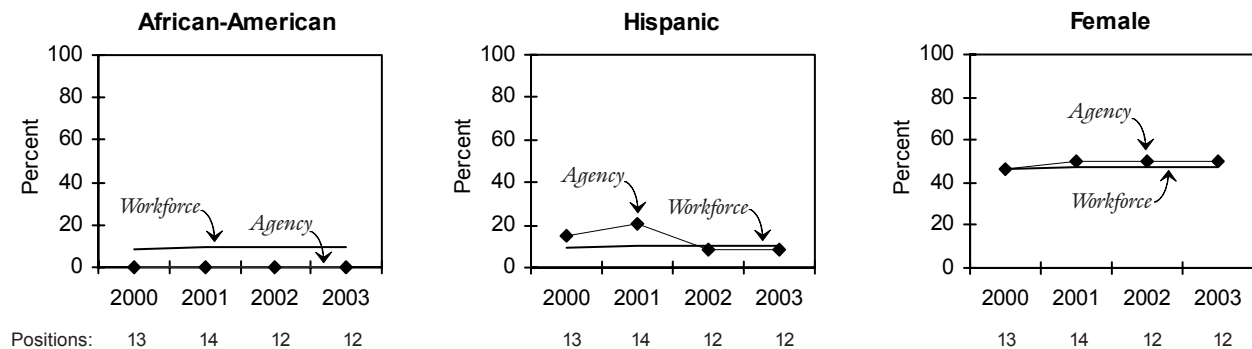
In accordance with the requirements of the Sunset Act, the following material shows trend information for the Office of Public Utility Counsel employment of minorities and females in all applicable categories.<sup>1</sup> The agency maintains and reports this information under guidelines established by the Texas Commission on Human Rights.<sup>2</sup> In the charts, the solid lines represent the percentages of the statewide civilian workforce for African-Americans, Hispanics, and females in each job category. These percentages provide a yardstick for measuring agencies' performance in employing persons in each of these groups. The diamond-dashed lines represent the agency's actual employment percentages in each job category from 2000 to 2003.

### Officials/Administration



The agency fell short of statewide percentages for African-American and Hispanic employment, but exceeded the percentage for female employment.

### Professional

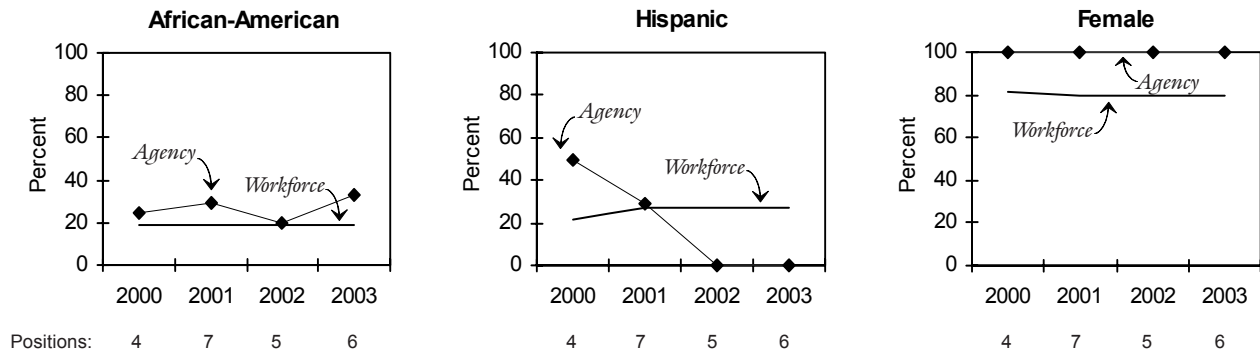


The agency generally met or exceeded statewide percentages for Hispanic and female employment, but fell short of the percentage for African-American employment.

## Appendix D

### OPUC Equal Employment Opportunity Statistics

#### Administrative Support



The agency generally met or exceeded statewide percentages for African-American and female employment, but has had difficulty in meeting the percentage for Hispanic employment.

<sup>1</sup> Texas Government Code, sec. 325.011(9)(A).

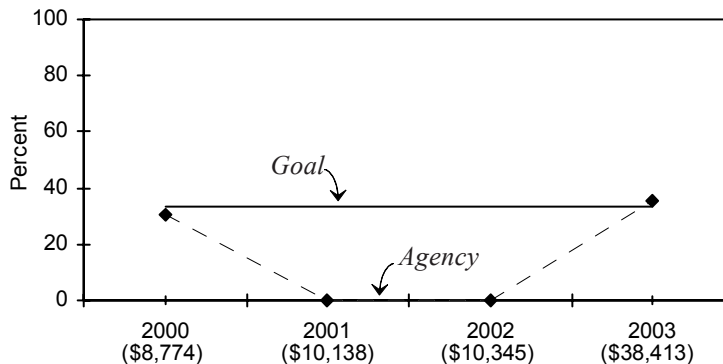
<sup>2</sup> Texas Labor Code, sec. 21.501. The Texas Human Rights Commission (HRC) has been the agency responsible for collecting and distributing EEO data. During the 2003 Session, the Legislature passed HB 2933 transferring the functions of HRC to a new civil rights division within the Texas Workforce Commission (TWC). The legislation is to take effect upon certification of the TWC civil rights division by the appropriate federal agency; no specific date has yet been established.

## OPUC Historically Underutilized Businesses Statistics 2000 to 2003

The Legislature has encouraged state agencies to increase their use of Historically Underutilized Businesses (HUBs) to promote full and equal opportunities for all businesses in state procurement. The Legislature also requires the Sunset Commission to consider agencies' compliance with laws and rules regarding HUB use in its reviews.<sup>1</sup> The review of the Office of Public Utility Counsel revealed that the agency is fully complying with state requirements concerning HUB purchasing by adopting HUB rules and implementing a HUB policy.

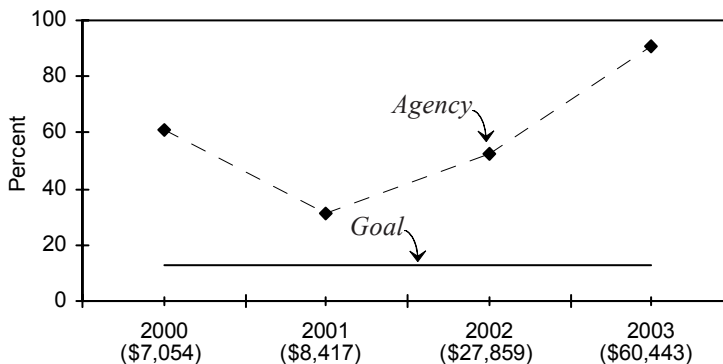
The following material shows trend information for the Office of Public Utility Counsel use of HUBs in purchasing goods and services. The agency maintains and reports this information under guidelines in the Texas Building and Procurement Commission's statute.<sup>2</sup> In the charts, the flat lines represent the goal for HUB purchasing in each category, as established by the Texas Building and Procurement Commission. The diamond-dashed lines represent the percentage of agency spending with HUBs in each purchasing category from 2000 to 2003. Finally, the number in parentheses under each year shows the total amount the agency spent in each purchasing category.

**Other Services**



The agency fell below the statewide goal in 2001 and 2002, but surpassed the goal in 2000 and 2003.

**Commodities**



The agency surpassed the statewide goal in commodities spending every year.

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<sup>1</sup> Texas Government Code, sec. 325.011(9)(B).  
<sup>2</sup> Texas Government Code, ch. 2161.



## Staff Review Activities

The Sunset staff engaged in the following activities during the review of the Public Utility Commission (PUC), Office of Public Utility Counsel (OPUC), Telecommunications Infrastructure Fund Board, and Electric Utility Restructuring Legislative Oversight Committee.

- Worked extensively with PUC Commissioners, Executive Director, management, and staff. Observed Commission meetings and hearings. Reviewed agency documents, reports and publications.
- Worked extensively with OPUC's Public Counsel and staff. Observed OPUC advocate before PUC and the Court of Appeals. Reviewed agency documents, briefs, reports, calculations, and charts.
- Worked with staff of the Electric Reliability Council of Texas (ERCOT). Visited ERCOT facilities in Austin and Taylor. Observed ERCOT Board and committee meetings. Reviewed agency documents, reports and publications.
- Interviewed and received written comments from industry and consumer representatives and other stakeholders.
- Interviewed staff from the Governor's Office, Lieutenant Governor's Office, Speaker's Office, Office of the Attorney General, State Auditor's Office, Legislative Budget Board, State Office of Administrative Hearings, and Legislative committees charged with examining electric and telecommunications issues.
- Attended House Regulated Industries Committee hearings.
- Researched past legislation involving electric and telecommunications issues.
- Interviewed staff and reviewed documents from the Federal Energy Regulatory Commission, Federal Communications Commission, and the National Association of State Utility Consumer Advocates.
- Researched the functions of other state utility commissions and independent system operators, and conducted phone interviews with agency representatives.
- Performed background and comparative research using the Internet, and reviewed literature on utility and consumer protection issues.



**SUNSET REVIEW OF THE  
PUBLIC UTILITY COMMISSION OF TEXAS  
OFFICE OF PUBLIC UTILITY COUNSEL  
TELECOMMUNICATIONS INFRASTRUCTURE  
FUND BOARD**

**AND**

**ELECTRIC UTILITY RESTRUCTURING  
LEGISLATIVE OVERSIGHT COMMITTEE**

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