GCPA Keynote Speech
"Ten Years of Electric Choice in Texas: Challenges, Opportunities, and Successes"
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Public Utility Commission of Texas
October 5, 2011

Introduction

Good morning and thanks for the invitation to speak today. As I was preparing for the speech (and trying to come up with something new, because I speak to largely the same group of people almost monthly), I thought a retrospective would be interesting. The next panel will discuss perspectives on the nodal market as we approach the first anniversary of the nodal go-live. I would like to step back a bit further than that. This year will be the tenth year of full wholesale competition and retail choice in Texas, and I thought it might be useful at this juncture to look back over the past ten years at some of the highlights.

2001 – Technical problems threaten to delay market open

Following the passage of Senate Bill 7, the Commission and market participants worked together on a flurry of projects to implement the vision of electric competition. Among those projects, the Commission adopted a host of market rules; unbundled the traditional integrated utilities and began the process of determining their stranded costs (wait – we're still working on that!); we also set rates for TDU charges, POLR service, and the price to beat; approved the ERCOT protocols; certified retail electric providers; and embarked on a sweeping customer education campaign. And indeed, for a year or two before go-live, the

Commission poured over detailed technical issues at virtually every open meeting associated with the market open. Many decisions were made during this period, and most of them were controversial, particularly from the standpoint of those that opposed electric competition in the first place. Fast forward ten years—nothing has changed—we still make cuts that are often controversial and many of those who assail our decisions argue that they either illustrate the flawed market or foreshadow its fall.

And remember, at the same time that the electric market was going through a metamorphosis, so was the Commission. Chairman Pat Wood and Commissioner Judy Walsh worked with the legislature in crafting SB 7. Commissioner Walsh's last Open Meeting was on February 22, 2001, and Chairman Wood's last Open Meeting was on May 24, 2001. If you recall, Commissioner Perlman presided over the June 14th Open Meeting alone. By the June 28th Open Meeting, Chairman Max Yzaguirre joined Commissioner Perlman, as did Commissioner Rebecca Klein, two new commissioners at an Open Meeting during a time of incredible change.

And let's not forget the market opening that almost wasn't: (1) the fully competitive wholesale market operated by ERCOT within a single control area and (2) retail choice were both scheduled to open on January 1, 2002. But let's step back a few more months. If you remember, there was some last minute uncertainty about whether the market would even open on time. Leading up to the market open, the utilities implemented a pilot project that allowed up to 5% of electric load within each utility's service area to choose an electricity provider beforehand. The purpose of the pilot was to ensure that ERCOT and market participant systems and processes would operate as intended when competition was opened to the market as a whole.

The pilot brought to light a number of (expected) technical problems with the systems and processes used for switching customers to new providers and for customer billing. These technical problems included issues with data quality, programming defects, connectivity issues, and system capacity constraints. As a result of these issues, ERCOT and market participant systems could process only a fraction of the switch requests that they were expected to be able to process. While significant problems arose, the pilot project did serve its stated purpose, which was to identify and help resolve problems associated with the new market structure and systems.

Some called for a delay to the opening of the retail market, but the Commission decided that the market should open on time. The Commission wisely predicted that many problems could not be identified until the full market opened, and so a delay would not help. Furthermore, the Commission was concerned that a delay would have required customers, REPs, and generators to renegotiate contracts that had been executed assuming a January 1, 2002 start date. As John Wayne said, “Courage is being scared to death but saddling up anyway.” Of course, with the right cowboy, the right saddle, the right horse and the right spurs. The Legislature had a vision for how the competitive electric market would work, and the Commission embraced that vision and made it happen. And that took courage.

After the opening of the full retail market, the systems used to switch a customer to a new retail provider continued to have problems. A number of customers that had submitted switch requests were instead automatically transferred to the affiliated REP upon market open. In many cases, there was a substantial difference between the price the customer negotiated with a new REP and the default rate of the affiliated REP. The ERCOT Board determined that the appropriate solution to that problem was to backdate the switches of affected customers so that the customer would be billed as if the switch had been completed appropriately. The backdating for affected customers was completed by November 2002.

These systems issues were certainly important and needed to be resolved. They **were** resolved, and today, ten years later, ERCOT and market participant systems are able to process most switch requests seamlessly. And, with the deployment of advanced meters, customers will be able to switch providers on the same day as the request is made, in most cases.

I believe that the Commission's decision to move forward was important from the perspective of regulatory certainty. While there were clearly some start up issues, and I think it is naïve to think that Texas could flip a switch and go from a largely regulated electric market on December 31, 2001 to a fully competitive central controlled, wholesale and retail market on January 1, 2002, without some issues, the Commission made the correct decision to open the market; the Texas legislature had directed us to open the market on January 1, 2002; stakeholders had invested millions and had entered into contracts with certain expectations regarding the date of the market open. I strongly believe that market participants should be able to enter into transactions without the constant threat of regulatory decisions making those transactions uneconomic.

2001-2002 – Enron's bankruptcy

One month before the retail market was scheduled to open, while the Commission and stakeholders were working to ensure that the mechanisms were in place to allow the seamless transfer of customers that would take place under retail choice, Enron declared bankruptcy. The massive nature of the company's collapse sent reverberations throughout the economy. Within the Texas electricity market, Enron controlled a REP known as New Power Co. While Enron declared bankruptcy just before the market opened, New Power did not file for bankruptcy protection until the summer of 2002. By that time, the company was already serving approximately 80,000, which at that time was a substantial number for a competitive REP.

But Enron's collapse, and New Power's bankruptcy, did not mean the collapse of the Texas retail electricity market. Indeed, in an article on January 30, 2002 (by Jennifer Coleman in the Berkeley Daily Planet), an energy market researcher predicted that electricity deregulation could be "dead in the water" for a few years due to the bad publicity surrounding the Enron collapse. "Texas, which opened its energy market to competition this month, shows that deregulated markets can work, (Michael) Reid said. Enron was expected to be a big player in that market, and despite its bankruptcy, their customers are being served. 'It appears that the Texas market is working as planned,' he said." And we see that trend has continued as well. The Texas restructured electric market is lauded throughout the world as an example of a successful restructured market. Those who find fault with the Texas electric market are usually those who live in the Lone Star state.

And, in the end, New Power was able to transfer its customers to other REPs, and after ensuring that New Power had fulfilled its obligations to the market, the Commission revoked New Power's REP certification.

2003

In early 2003, another retail provider found itself in trouble. Extreme cold weather made it difficult for generators to keep their units online and caused higher than normal electricity demand. Taken together, these factors caused wholesale power prices in the balancing energy market to rise to $990 per MWh. One REP, Texas Commercial Energy (TCE), purchased all of its electricity on the balancing energy market rather than procuring energy ahead of time through bilateral contracts. TCE's costs increased significantly as a result of the high wholesale prices, and the company declared bankruptcy only weeks after the cold snap.

TCE subsequently sued a number of market participants, alleging that hockey-stick bidding and other market manipulation caused the high winter prices. Based on TCE's allegations, some skeptics described the Texas electricity market as nothing more than a rogue's gallery. The Commission subsequently determined that the high winter prices were not caused by market manipulation.

The winter 2003 event presented challenges to reliability and to the wholesale and retail markets. In response to that event, the Commission adopted new rules to mitigate the impact of hockey-stick bidding.

2004

In 2004, critics of the restructured electric market declared the competitive market a failure because customers had been slow to switch away from the incumbent retail providers. At the end of 2003, two full years after the retail market opened, 14% of residential customers had switched to a competitive REP. And by the fall of 2004, 18% of residential consumers had switched. In addition, consumer complaints to the PUC increased significantly following deregulation. Almost 35,000 consumer complaints were filed in the first two and a half years after retail choice began. Critics of deregulation claimed that the state had not focused on consumers but rather focused on promoting competition. Finally, the Dallas Morning News stated in a December 30, 2004 article: "Heralded as an end to waste and inefficiency, Texas' leap into electric competition was promoted with a shining promise: Customers would pay less for their electricity. Today that promise is dead." To paraphrase Mark Twain, "Rumors of its death were greatly exaggerated."

Beginning in 2004 and continuing through 2005, illegal conduct by several ERCOT employees and an outside contractor that ultimately resulted in scrutiny by Attorney General Greg Abbott, indictments by a grand jury, and finally jail time, caused many, including the PUC, to question ERCOT's oversight of the competitive market.

2005

Hurricanes Katrina and Rita struck the Gulf Coast in August and September 2005. Those storms caused massive shut-ins of natural gas production, and the resulting gas shortage increased prices of both natural gas and electricity to historical highs. Natural gas prices increased from around $6 per MMBtu earlier in the year to the $10 to $12 range for much of September through December. Similarly, balancing energy prices in the ERCOT market exceeded $100/MWh for much of that time. By the summer of 2006, however, electricity prices in ERCOT were lower than they were in 2005.

Just to clear up any misconceptions out there, hurricanes are outside the control of the PUC. Nevertheless, we must prepare for them and respond to them. In particular, our market participants should be prepared for high electricity prices, whether caused by high natural gas prices or unusually strong demand. If this summer is any indication, I think that most market participants have learned this lesson.

In 2005, the PUC reiterated its commitment to move forward with the transition to a nodal wholesale market.

2006

In April 2006, unseasonably hot temperatures, planned maintenance outages, and unplanned forced outages resulted in insufficient generating capacity to serve load. As a result, ERCOT initiated rolling outages to prevent an uncontrolled outage throughout ERCOT. In response to this event, the Commission adopted a rule requiring ERCOT to establish an Emergency Interruptible Load Service, or

EILS, that allows ERCOT to interrupt service to electricity users that agree to be interrupted in exchange for monetary compensation. ERCOT deployed EILS twice this year, and the deployment of EILS on August 4th was the last tool available to ERCOT that day to avoid the need for rolling outages.

<u>2007</u>

The price to beat rates for incumbent REPs expired on January 1, 2007, and all customers began to be served at rates set by market forces. Approximately 35% of residential consumers took service from a competitive REP as of that date. That represents more than two million customers. Some feared that removal of the price to beat rates would cause retail rates to skyrocket, which did not happen.

<u>2008</u>

During the summer of 2008, natural gas futures closed above $12 per MMBtu, which was more than five times the closing price in January 2002, when the retail market opened. These very high gas prices, combined with high temperatures, generation and transmission outages, and transmission congestion, resulted in very high wholesale electricity prices and for customers on variable priced products, high retail electric prices.

As a result of the high wholesale electricity prices, four REPs were unable to satisfy their obligations to the market and the customers of those four REPs were transferred to POLR providers. Customers of the failed REPs were transferred to providers of last resort at very high rates. In addition, the very high wholesale prices caused high retail prices for many other customers and many retail customers' rates doubled over a billing period.

In response to the REP defaults, mass transitions, and the confusion caused by lack of price disclosure in the market, that summer, the Commission undertook three retail rulemakings: REP certification standards, provider of last resort service, and REP disclosure requirements. As a result of those three rulemakings, retail customers today purchase electricity from more qualified REPs, receive clearer disclosures, and benefit from POLR rules that provide better protection during a mass transition.

In May of 2008, ERCOT notified the Commission that nodal would not go live December 31, 2008, as promised but would be delayed almost two years. The Commission approved budget for nodal was also grossly inadequate to bring nodal live, according to ERCOT officials. Those are my words paraphrasing ERCOT. September of 2008, Hurricane Ike hit Texas knocking out power to over 90 percent of the Houston area.

<u>2009</u>

In late 2008, 2009 we saw prices of natural gas fall from a high of $12 to $13 to the $3 to $4 dollar range and we saw retail electric prices decline as well. Those who opposed the competitive electric markets nonetheless complained about "high electricity prices" despite concrete evidence to the contrary.

2010

In the spring of 2010, a number of Oncor customers began complaining about their newly-installed advanced meters. The customers, many of whom showed up at PUC open meetings accompanied by television cameras, attributed very high electricity bills to the new meters. The Commission asked Navigant Consulting to perform a thorough study of the accuracy of the new meters. Navigant determined that the meters met all industry standards for accuracy and we much more accurate than the old electromagnetic meters. It appears that many of the high bills may have been the result of cold temperatures and electric heating systems.

In 2010, even though retail prices were at a historic low and customers could enter into one and sometimes two year contracts at prices below the last regulated rate in 2001, opponents of electric restructuring continued to complain about high electric prices.

And, in December of 2010, the wholesale electric market within ERCOT successfully transitioned from a zonal market to a nodal market.

2011

2011 will forever be remembered as the summer of oppressive heat and drought, the summer where Austin experienced 90 days of 100+ weather, the summer that seemed to go on forever, and the summer of the EPA. Someone said to me recently, “Just think, someday you’ll be able to look back at this and say “Remember that hot, dry spell we had in 2011.”

The ERCOT region set a demand record on August 3 of 68,294 MW, and ERCOT narrowly avoided rolling outages on August 4th by deploying EILS. ERCOT should be commended for how it handled this summer. Like the competitive market itself, ERCOT has had some growing pains, has struggled at times, but they've fine-tuned things, changed cowboys a time or two and they're moving forward.

2011 also brought unprecedented cold and windy weather throughout the state in early February, with many areas of Texas experiencing below freezing temperatures for several days. Many electric generators were unable to keep their plants online or were unable to bring their plants online. As a result, ERCOT was forced to institute rolling outages. In response to the February outages, the Commission has, among other things, opened a project to address curtailment and restoration priority. Staff has scheduled a workshop on November 3rd to consider these issues, and I expect that the workshop will lead to one or more related rulemakings.

2011 is also the summer of CSAPR, the ill-conceived EPA rule that threatens our state's electric reliability.

And, yes, 2011 was also the year where the PUC's sunset bill failed to pass, setting the stage for interesting discussions in 2013.

Conclusion

This week, a story came out that cited stranded costs as evidence that electricity deregulation has failed in Texas. I guess after everything that I just discussed, it shouldn't surprise me that critics continue to look for any way to describe Texas's restructured electric market as a failure. Without commenting on the specifics of that case, I would like to note that as of Monday, customers in the Dallas/Fort Worth could choose from several different 12 month fixed price offers at 8.4

cents per kWh. Similarly, customers in the Houston area could choose from several 12 month fixed price offers at 9.1 cents per kWh. Those rates are 13% below the 2001 last regulated rate in both the Dallas/Fort Worth and Houston areas. And that is without accounting for the fact that we've had 10 years' worth of inflation since the competitive market opened.

In addition to the lower rates customers are seeing in every TDU service area, electricity consumers today have also benefited in the following ways:

- All customers have an opportunity to be served by a REP of their choice, rather than a government-sanctioned monopoly. Well, except for me because I live in a coop area, a coop that has not elected to enter into the competitive market, a coop that has established a renewable mandate of 30 percent by 2020!   As of the end of 2010, 55% of residential load had exercised that choice to select a competitive REP or product.
- Private companies have invested $36.5 billion of at risk capital in new generation since 1999. This is in contrast to the days of regulation in which ratepayers bore the risk of building new generation.
- Texas retail customers have benefited from a competitive retail market that received a ranking of "Excellent" in the 2010 ABACCUS report and was described as the best retail market in the country.
- 4 million customers have received advanced meters, and a total of almost 7 million will have advanced meters by the end of 2013.
- Texas has more than 10,000 MW of installed wind generating capacity, which is more than any other state and all but a handful of other countries.

So, we’ve changed cowboys a few times, tightened the saddle, we’ve even fallen off the horse, but we got back on the horse, we fine-tuned things, and we moved forward. There will of course continue be challenges in the future. For example, one of our primary challenges today is ensuring that we have enough generation built to meet future electricity demand in our growing state. While this and other challenges are significant, they also present opportunities. I am excited about responding to these challenges and embracing the opportunities. But I must say that, so far, I most excited about the fact that I haven’t seen a headline reading: “Texas competitive electric market doomed to fail as South Dakota farm girl is named chairman of the PUC.” Not that I have anything against farmers. Thank you for your attention.