

PROJECT NO. 28971

PUC EVALUATION OF THE	§	PUBLIC UTILITY COMMISSION
READINESS OF THE EL PASO AREA	§	
FOR RETAIL COMPETITION IN	§	OF TEXAS
ELECTRICITY	§	

**PROPOSAL FOR PUBLICATION OF NEW §25.421
AS APPROVED AT THE JUNE 9, 2004 OPEN MEETING**

The Public Utility Commission of Texas (commission) proposes new §25.421, relating to the transition to competition for an area outside of the Electric Reliability Council of Texas (ERCOT) region. The proposed new rule addresses El Paso Electric Company's (EPE) readiness to offer retail competition at the expiration of its rate freeze in August 2005 and defines the process and the sequence of events for the introduction of retail competition in the portions of Texas served by EPE. In this rule, if adopted as proposed, the commission would determine, pursuant to the Public Utility Regulatory Act, Texas Utilities Code Annotated §39.103 (Vernon 1998, Supplement 2004) (PURA), that the power region in which EPE is located is unable to offer fair competition and reliable service to all retail customer classes in Texas; therefore, customer choice will not commence in this area upon the expiration of EPE's rate freeze in August 2005. The proposed rule also provides that EPE's rates would be regulated under traditional cost-of-service regulation until the date on which the commission authorizes EPE to implement full customer choice. Finally, the proposed rule specifies that EPE would be subject to the energy efficiency and renewable energy requirements set forth in PURA §39.904-.905, beginning in 2006. Project Number 28971 is assigned to this proceeding.

The commission's proposal to determine that the power region in which EPE is located is unable to offer fair competition and reliable service to all retail customer classes in Texas is based on its

experience in introducing retail competition in the ERCOT region, its attempts to introduce retail competition in other regions in Texas, and the characteristics of the El Paso region. The commission's successful efforts to establish retail competition in ERCOT began after the passage of Senate Bill 7 in 1999. In order to transition to retail competition in accordance with the statutory timelines of PURA, the commission and the market participants engaged in various proceedings to restructure the existing electric utilities, develop protocols for the market, and establish ERCOT as an independent regional transmission operator. These steps were completed before the commission opened a pilot project in ERCOT and determined that the market was ready for retail competition. These necessary preliminary steps have not been taken in EPE's territory because EPE was exempted from participation in such processes prior to the expiration of its rate freeze and because the establishment of a regional transmission organization is subject to voluntary action by other utilities in the Southwestern United States and regulatory approval of the Federal Energy Regulatory Commission. Because of the lack of proper preparation, the commission believes that it is not feasible to open a pilot project immediately upon the expiration of EPE's rate freeze. Instead, the commission proposes to require that the necessary preliminary steps be taken before opening the pilot or proceeding to subsequent steps on the path to retail competition.

The commission's proposed determination that the EPE region is not able to offer fair competition and reliable service to all retail customer classes in Texas is supported by the commission's experience in attempting to establish retail competition in other areas of Texas outside the ERCOT service area. The commission conducted pilot programs for retail

competition in the non-ERCOT service areas of Entergy Gulf States, Southwestern Public Service Company (SPS), and Southwestern Electric Power Company (SWEPCO). In two of these areas, no retail electric providers (REPs) offered service during the pilot projects, and no customers switched their service from the utility to a REP. As a result, the commission delayed the beginning of retail competition in the Entergy and SWEPCO areas, and the legislature enacted a law to delay competition in the SPS area. Recently, a single REP served a small number of commercial customers under the Entergy pilot project, but it has discontinued its service to these customers.

One of the key elements of the legislation that calls for the introduction of retail competition in Texas is an independent organization to provide transmission service, ensure reliability, and settle wholesale accounts. In general, independent organizations have not developed in the non-ERCOT areas of Texas, and today there is no independent organization in the Entergy or El Paso areas. (The Federal Energy Regulatory Commission has recently conditionally approved the Southwest Power Pool as a regional transmission organization that could meet the criteria for an independent organization in the SWEPCO and SPS service territories.)

Other factors that lead the commission to propose a determination that the power region in which EPE is located is unable to offer fair competition and reliable service to all retail customer classes in Texas are the characteristics of the El Paso region. These characteristics include the fact that the area represents a small market that is isolated geographically from other large markets in the western electric system, and that the local generation supply is dominated by a

single company, EPE. These factors should be addressed before retail competition begins in the El Paso region. The commission is seeking comments on whether the proposed determination should be adopted, and urges interested persons to provide comments on the prospects for providing reliable, reasonable-cost service, if retail competition were to be instituted in the region.

The new section, if adopted, will establish an orderly transition to full customer choice in EPE's service area. The sequence set forth in this rule would be based upon completing the listed items in each stage before the next stage is initiated. A pilot project would begin after a regional transmission organization is established for the region and retail market protocols are developed to facilitate retail competition. Full retail competition would begin after a number of other actions are completed, as contemplated by Senate Bill 7, Act of May 27, 1999, 76th Leg., R.S., Ch. 405, §39, 1999 Tex. Gen. Laws 2558.

Jess Totten, Director, Electric Division has determined that for each year of the first five-year period the proposed section is in effect there will be no fiscal implications for state or local government as a result of enforcing or administering the section.

Mr. Totten has determined that for each year of the first five years the proposed section is in effect the public benefit anticipated as a result of enforcing the section will be increased certainty with respect to utility rates and service and the transition to competition in EPE's service area. There will be no adverse economic effect on small businesses or micro-businesses as a result of

enforcing this section. There is no anticipated economic cost to persons who are required to comply with the section as proposed. The introduction of retail competition requires a regulated utility to undertake a number of organizational changes and regulatory activities that may have an economic cost. The proposed rule would sequence these activities in a way that is logical and that should help avoid unnecessary costs. The proposed rule would not impose additional costs on the regulated utility.

Mr. Totten has also determined that for each year of the first five years the proposed section is in effect there should be no effect on a local economy, and therefore no local employment impact statement is required under Administrative Procedure Act (APA), Texas Government Code §2001.022.

The commission staff will conduct a public hearing on this rulemaking, if requested pursuant to the Administrative Procedure Act, Texas Government Code §2001.029, at the commission's offices located in the William B. Travis Building, 1701 North Congress Avenue, Austin, Texas 78701 on Tuesday, August 24, 2004, at 10:00 a.m. The request for a public hearing must be received within 31 days after publication of this proposed rule.

Comments on the proposed new section (16 copies) may be submitted to the Filing Clerk, Public Utility Commission of Texas, 1701 North Congress Avenue, P.O. Box 13326, Austin, Texas 78711-3326, within 31 days after publication. Reply comments may be submitted within 45 days after publication. Comments should be organized in a manner consistent with the

organization of the proposed rule. The commission invites specific comments regarding the costs associated with, and benefits that will be gained by, implementation of the proposed section. The commission will consider the costs and benefits in deciding whether to adopt the section. All comments should refer to Project Number 28971.

When commenting on specific subsections of the proposed rule, parties are encouraged to describe “best practice” examples of regulatory policies, and their rationale, that have been proposed or implemented successfully in other states already undergoing electric industry restructuring, if the parties believe that Texas would benefit from application of the same policies. The commission is interested in receiving only “leading edge” examples that are specifically related and directly applicable to the Texas statute, rather than broad citations to other state restructuring efforts.

This new section is proposed under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002, which provides the Public Utility Commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction; and specifically, PURA §39.051, which requires an electric utility to separate its business functions prior to the introduction of retail competition; PURA §39.102, which specifies that at the expiration of EPE’s system wide rate freeze, the utility shall be subject to PURA Chapter 39, relating to restructuring of the electric utility industry; PURA §39.103, which grants the commission authority to delay competition if a power region cannot offer fair competition and reliable service to all retail customer classes; PURA §39.104, which addresses the retail

competition pilot projects; PURA §39.152 and §39.154, which grant the commission authority to certify a power region and to evaluate market power; PURA §39.201, which addresses unbundled cost-of-service rates; PURA §39.202, which establishes the price-to-beat obligation for affiliated retail electric providers prescribe; and PURA §39.904 and §39.905, which address the state goals for renewable energy development and energy efficiency.

Cross Reference to Statutes: Public Utility Regulatory Act §§14.002, 39.051, 39.102, 39.103, 39.104, 39.152, 39.153, 39.154, 39.201, 39.202, 39.904 and 39.905.

§25.421. Transition to Competition for Certain Area Outside the Electric Reliability Council of Texas Region.

- (a) **Purpose.** The purpose of this section is to address the process and the sequence of events for the introduction of retail competition in the portions of Texas served by El Paso Electric Company (EPE).
- (b) **Application.** This section shall apply to an electric utility that is subject to Public Utility Regulatory Act (PURA) §39.102(c), namely EPE.
- (c) **Readiness for retail competition.** The commission determines that the power region in which EPE is located will be unable to offer fair competition and reliable service to all retail customer classes in Texas upon the expiration of its system-wide rate freeze period in August 2005. Therefore, pursuant to PURA §39.103, the introduction of retail competition for the portions of the power region in Texas is delayed until this region can offer fair competition and reliable service to all retail customer classes.
- (d) **Cost-of-service regulation.** Until the date on which EPE is authorized by the commission to implement retail competition pursuant to this section, its rates are subject to regulation under Chapter 36 of PURA.
- (e) **Transition to competition.** The sequence of events set forth in paragraphs (1) through (5) of this subsection shall be followed to introduce retail competition in EPE's service territory. All the listed items in each stage must be completed before the next stage is initiated. Unless stated otherwise in the rule, each of the activities will be conducted by

the commission in conjunction with EPE and other interested parties. Full retail competition will not begin in EPE's service territory until completion of the fifth stage.

- (1) The first stage consists of the following activities:
 - (A) Develop and obtain approval of a regional transmission organization for the EPE region by the Federal Energy Regulatory Commission and commence independent operation of transmission network under the approved regional transmission organization.
 - (B) Develop retail market protocols to facilitate retail competition.
 - (C) Complete an expedited proceeding to develop non-bypassable delivery rates for the customer choice pilot project to be implemented under paragraph (2)(A) of this subsection.
- (2) The second stage consists of the following activities:
 - (A) Initiate the customer choice pilot project pursuant to PURA §39.104 and §25.431 of this title (relating to Retail Competition Pilot Projects).
 - (B) Develop a balancing energy market, market for ancillary services, and market-based congestion management system for the wholesale market in the region in which the regional transmission organization operates.
 - (C) Implement a seams agreement with adjacent power regions to reduce barriers to entry and facilitate competition.
- (3) The third stage consists of the following activities:
 - (A) EPE shall:

- (i) Prepare and file with the commission an application for business separation pursuant to PURA §39.051 and §25.342 of this title (relating to Electric Business Separation);
 - (ii) Prepare and file with the commission an application for unbundled transmission and distribution rates pursuant to PURA §39.201 and §25.344 of this title (relating to Cost Separation Proceedings);
 - (iii) Prepare and file with the commission an application for certification of a qualified power region pursuant to PURA §39.152; and
 - (iv) Prepare and file with the commission an application for price-to-beat rates pursuant to PURA §39.202 and §25.41 of this title (relating to Price to Beat).
- (B) The activities to be completed by the commission in the third stage are to:
- (i) Approve a business separation plan;
 - (ii) Set unbundled transmission and distribution rates;
 - (iii) Certify a qualified power region, which includes conducting a formal evaluation of wholesale market power in the region, pursuant to PURA §39.152;
 - (iv) Set price-to-beat rates for EPE; and
 - (v) Determine which competitive energy services must be separated from regulated utility activities pursuant to PURA §39.051 and §25.343 of this title (relating to Competitive Energy Services).

- (C) The activities to be completed by the regional transmission organization, the statewide registration agent and market participants in the third stage are testing of retail and wholesale systems, including those systems necessary for switching customers to the retail electric provider of their choice and for settlement of wholesale market transactions.
- (4) The fourth stage consists of the following activities:
 - (A) The commission shall evaluate the results of the pilot project pursuant to §25.431 of this title.
 - (B) EPE shall initiate capacity auction pursuant to PURA §39.153 and §25.381 of this title (relating to Capacity Auctions) at a time to be determined by the commission.
 - (C) EPE shall separate competitive energy services from its regulated utility activities, in accordance with the commission order approving the separation of competitive energy services.
 - (D) EPE shall complete the business separation and unbundling, in accordance with the commission order approving the unbundling.
- (5) The fifth stage consists of the commission evaluating whether the power region can offer fair competition and reliable service to all retail customer classes. If the commission concludes that the power region can offer fair competition and reliable service to all retail customer classes, it shall issue an order initiating retail competition.

- (f) **Applicability of energy efficiency and renewable energy requirements.** No later than January 1, 2006, EPE shall be subject to the energy efficiency requirements under PURA §39.905 and §25.181 of this title (relating to Energy Efficiency Goal) and the renewable energy credit requirements under PURA §39.904 and §25.173 of this title (relating to Goal for Renewable Energy).
- (1) EPE shall begin administering the energy efficiency programs prescribed in §25.181 of this title no later than January 1, 2006. EPE shall meet, at a minimum, 5.0% of its growth in demand through energy efficiency savings resulting from these programs by January 1, 2007 and 10% of its growth in demand by January 1, 2008, and each year thereafter.
 - (2) EPE shall obtain, at a minimum, renewable energy credits in an amount sufficient to meet the requirements for the compliance period beginning January 1, 2006, and for each compliance period thereafter.
- (g) **Applicability of other rules.** This section governs the implementation of PURA Chapter 39 requirements as applied to EPE. If there is an inconsistency or conflict between this section and other rules in this Chapter (relating to Substantive Rules Applicable to Electric Service Providers), the provisions of this section shall control.
- (h) **Good cause.** Upon a finding of good cause, as determined by the commission, the sequence for retail competition set forth in subsection (e) of this section may be modified by commission order.

This agency hereby certifies that the proposal has been reviewed by legal counsel and found to be within the agency's legal authority to adopt.

**ISSUED IN AUSTIN, TEXAS ON THE 10th DAY OF JUNE 2004 BY THE
PUBLIC UTILITY COMMISSION OF TEXAS
ADRIANA A. GONZALES**

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