

- SUBJECT:** Returning “negative stranded costs” to electric utility ratepayers
- COMMITTEE:** State Affairs — favorable, without amendment
- VOTE:** 8 ayes — S. Turner, Bailey, Counts, Craddick, Danburg, D. Jones, Longoria, McClendon
- 6 nays — Wolens, Brimer, Hunter, Marchant, McCall, Merritt
- 1 absent — Hilbert
- WITNESSES:** For — Janee Briesemeister, Consumers Union; Carol Galloway; Geoffrey Gay, Steering Committees of Cities served by TXU, CPL, and TNMP; Alton Hall, Jr., City of Houston; *Registered but did not testify:* Carol Biedrzycki, Texas Ratepayers Organization to Save Energy; Candice Carter, American Association of Retired Persons; Bobby Deike, Sheila Jocho, Carla Landrum, Shelly Stone, and Glen Summers, Economic Opportunity Advancement; Kelly Franke and Darlene Stange, Combined Community Action; Richard Landry, Paper Allied Industrial, Chemical and Energy Workers International Union; Kerrin Lemieux, Texas Alliance for Human Needs; Paula Littles, Texas AFL-CIO; Lara Mardiros and Stella Rodriguez, Texas Association of Community Action Agencies; Mark Smith, Texas Industries; Tom “Smitty” Smith, Public Citizen
- Against — Thomas Baker, TXU and Association of Electric Companies of Texas; Mark Roberson, American Electric Power; Steve Schaeffer, Reliant Energy and Association of Electric Companies of Texas
- On — Brett Perlman and Pat Wood, Public Utility Commission of Texas; *Registered but did not testify:* Jack Bornsheuer, IBEW Local 716; Rick Levy, Texas State Association of Electric Workers and IBEW; Danny Tilley, Texas Building and Trades Council
- BACKGROUND:** SB 7 by Sibley, enacted by the 76th Legislature, restructured the electric utility industry in Texas to provide retail competition in power generation and customer choice of electricity providers, beginning January 1, 2002. Utility companies were required to freeze electric rates from September 1, 1999, through December 31, 2001. After that, residential and small commercial customers will receive a rate cut of 6 percent, called the “price

to beat.” A retail electricity provider affiliated with a former monopoly utility will not be allowed to charge these customers rates higher than the price to beat for five years, except to reflect major fuel-price fluctuations. Transmission and distribution utility rates will remain regulated by the Public Utility Commission (PUC).

A significant part of the debate over SB 7 focused on the costs that utilities had incurred for long-term investments under regulation, which were expected to be unrecoverable in a competitive market. These potential “stranded costs” included long-term debt obligations for investments in nuclear and coal-fueled power plants. At the time, low natural gas prices and other factors had made electricity generated by natural gas-fueled power plants the cheapest electricity on the market. In a competitive market, the market value of coal-fueled and nuclear power plants was expected to drop because these plants would have to sell electricity at a loss to compete with the lower-priced electricity generated from natural gas. A utility’s stranded costs were the estimated excess of the costs it had agreed to pay for these facilities over their expected value in a competitive market — calculated in a PUC model as “excess costs over market” (ECOM). In 1998, the ECOM model predicted \$4.4 billion in stranded costs.

SB 7 allows utilities to recover 100 percent of their stranded costs. The act provides mitigation tools — including allowing utilities to keep excess earnings and to accelerate depreciation of generating-plant assets — to allow a utility to minimize any stranded costs at the onset of competition. After competition begins, a utility may recover any estimated remaining stranded costs through a surcharge called a competition transition charge (CTC). After January 10, 2004, utilities will participate in a “true-up” proceeding to finalize any stranded costs and to reconcile those costs with the estimated costs used to develop the CTC.

Since enactment of SB 7, natural gas prices have increased, causing an increase in the price of electricity generated by natural gas-fueled power plants. The market value of coal-fueled and nuclear power plants also has increased, because their electricity can be sold at a more competitive price. As a result, the costs for coal-fueled and nuclear power facilities may not be “stranded” in a competitive market. In fact, a “negative stranded cost” would occur if the market value of these facilities exceeded their historic cost.

Latest results of the ECOM model indicate \$5.9 billion in negative stranded costs. In a recent decision, the PUC directed utilities to return the money they have collected through mitigation so far, about \$3.9 billion. This would occur through a reduction in transmission and distribution rates. The PUC does not have the authority to reduce the “price to beat” to reflect the reduction in the transmission and distribution rates. The PUC’s decision also would not require utilities to eliminate any negative stranded costs.

DIGEST:

HB 2107 would require the PUC to order a utility that did not have positive stranded costs at any time before January 1, 2002, to stop mitigation and to return any money recovered through prior mitigation in an amount sufficient to eliminate any negative stranded costs. The PUC would have to reflect the reversal of prior mitigation in the utility’s transmission and distribution rates. Also, the PUC would have to reduce the affiliated retail electric provider’s “price to beat” sufficiently to pass through any reductions to the transmission and distribution rates.

During the freeze period, the PUC could require an electric utility with negative stranded costs — together with its affiliated retail electric provider and affiliated transmission and distribution utility — to credit the negative stranded costs to customers in a manner prescribed by the PUC. Such a utility and its affiliates would have to finalize and reconcile its stranded costs during the true-up proceeding.

During the true-up, if the PUC determined that a utility and its affiliates had negative stranded costs, it could approve a plan by the utility to use the costs to improve or expand transmission or distribution facilities or to make capital expenditures to improve air quality. An expenditure included in such a plan could not be recovered from ratepayers at any time. Any amount of negative stranded costs not included in the plan would have to be used to reduce the transmission and distribution utility’s non-bypassable delivery rates.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2001.

SUPPORTERS  
SAY:

HB 2107 would return negative stranded costs to ratepayers and give consumers relief from rising electricity bills. The increase in natural gas prices since enactment of SB 7 has eliminated any potential stranded costs for utilities. In fact, it now appears that utilities have negative stranded costs — that is, their coal and nuclear facilities will be worth more in a competitive market than under regulation. However, utilities already have collected almost \$4 billion through mitigation for estimated stranded costs. In essence, they have been “recovering” costs for facilities that actually have increased in value.

As natural gas prices have risen, although retail rates were frozen, utilities have been able to pass their increased fuel costs on to ratepayers through a fuel factor — a portion of the total rate that was not frozen. Estimates show that some utility customers will pay 30 to 40 percent more for electricity this summer than they paid last summer. The same increase in natural gas prices has resulted in utilities having negative stranded costs. If utilities can pass along increased fuel costs to ratepayers, they also should have to return the money they have collected for stranded costs that do not exist.

HB 2107 would return negative stranded costs to ratepayers sooner rather than later. When it was expected that stranded costs would exist, utilities were allowed to recover those anticipated costs immediately. They were willing to collect for the estimated costs before final determination of their values based on market outcomes. Now that it is obvious that stranded costs do not exist — that they are, in fact, negative — utilities want to wait until 2004 to return the money to ratepayers.

Negative stranded costs may be higher than the ECOM model estimates. The model uses conservative estimates of natural gas prices. Using higher and more accurate estimates of natural gas prices would increase the amount of negative stranded costs predicted by the model.

OPPONENTS  
SAY:

HB 2107 is unnecessary because current law already provides for a final reconciliation of stranded costs during the true-up proceeding. At that time, stranded costs will be determined on the basis of actual market outcomes. The difference between the market value of any stranded costs and their estimated value in the ECOM model will be reflected in the transmission and distribution rates. If utilities had to return stranded costs now based on model estimates and if stranded costs ultimately were found to exist during

the true-up, the result could be “rate shock” for consumers as their transmission and distribution rates skyrocketed to make up the difference. HB 2107 could make consumers pay for recovery of stranded costs in the future, rather than allow utilities to minimize stranded costs during the rate freeze.

HB 2107 is predicated on the assumption that negative stranded costs exist. The ECOM model, however, fails to include necessary information. In the case of Texas Utilities, for example, the model does not include a portion of the company’s assets that have been remanded to the company by the Texas Supreme Court, and it fails to include a significant amount of environmental costs that were called for under SB 7. In addition, the model does not use an appropriate price for new generating capacity based on current market value. Any determination of negative stranded costs based on the ECOM model is subject to error. Utilities actually could face positive stranded costs. The true-up proceeding in 2004 will provide a final market-based evaluation of stranded costs.

HB 2107 could require a stranded cost determination for low-cost providers that did not file to recover stranded costs. A finding of negative stranded costs would make it more difficult for these utilities to provide low-cost electric service to their customers. The bill would expose these companies to a potential financial obligation based solely on the ECOM model’s projected values.

**OTHER  
OPPONENTS  
SAY:**

The PUC’s decision to return mitigation costs but not eliminate negative stranded costs is a preferable alternative to HB 2107. The ECOM model estimates are subject to fluctuations in the price of natural gas. HB 2107 would go too far by requiring utilities to reverse mitigation sufficiently to eliminate negative stranded costs. The Legislature should authorize the PUC to reduce the “price to beat” in order to pass returned mitigation through the transmission and distribution rates.