



Legislators' Guide to the Issues

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THE ISSUE

As gasoline prices continue to drift back to \$3 a gallon and Texas electricity prices move in tandem with natural gas prices, how to achieve affordable energy is a highly debated topic. Proposed and enacted solutions run from higher taxes to subsidies to mandated production from renewable sources such as wind, ethanol and biomass. However, these all miss the mark. A long-term solution for securing affordable, reliable energy supplies must rely on a proper understanding of our current situation and market-based innovations.

First, energy prices are not as bad as they are made out to be. Even at \$3 a gallon, the price of gasoline and oil does not surpass historical highs, and American gasoline prices are still well below those found in most of Europe. A recent report by the Texas Public Utility Commission found that increases in electricity prices have been lessened by the deregulation of the market. So while energy prices are high, Texans are in relatively good shape compared to many others.

Second, it must be understood that the energy problems we face today are largely the product of government regulations and interference in the market place. For instance, Texas' heavy reliance on high-priced natural gas to produce electricity came about because environmental laws made it expensive and difficult to build coal and nuclear plants. Similarly, the high price of oil and natural gas can be linked to regulations such as the limitation on exploration and production of domestic reserves of oil and gas, and the mandated use of ethanol for creating boutique gasoline blends for use during summer.

Additionally, efforts to promote energy diversity by mandating electric generation with renewable energy facilities only add to already high energy costs. The 3,000 megawatt increase in the renewable energy portfolio in SB 20, which passed in the 79th Texas Legislature, 1st Called Special Session, will cost Texas utility customers as much as \$536 million annually when fully implemented. That is the equivalent of \$31 per year for the typical consumer.

Finally, the Texas General Land Office reported that for fiscal year 2005, oil and gas revenues for the Permanent School Fund totaled over \$345 million, up from \$269 million in 2004. In the first four months of fiscal year 2006, approximately \$142 million was cleared, up from \$98 million for the same period in 2005. Oil and gas revenues have helped educate Texas schoolchildren, pave our roads, and provide for public safety.

THE FACTS

- ★ The price of oil peaked in late 1979 or early 1980 at around \$90 per barrel in 2005 dollars. This is compared to a price of \$71.58 per barrel of American light crude in May 2006 for July delivery. Oil is still cheaper today than it was 25 years ago.



- ★ In 1918, the price of a gallon of gasoline was about \$3.20 in 2005 dollars. After trending downward for about 50 years, the price spiked again in 1981 at just under \$3.00. The price of gasoline has only reached that level recently because of Hurricane Katrina and new regulations in last year's energy bill.
- ★ The total state and federal subsidies to businesses producing renewable energy could be as high as \$826 million per year when fully implemented.
- ★ The cost of building the transmission capacity needed to support wind energy production is estimated to be \$2.2 billion.

RECOMMENDATIONS

- ★ Maintain the path toward full deregulation of the retail electric markets by allowing the Price to Beat to expire in January 2007 without subsequently adopting any new price regulations.
- ★ Streamline the permitting process for new electrical generating production facilities, including coal and nuclear, in order to promote diversity and reduce reliance on natural gas.
- ★ Let the market determine the best allocation of production capacity; in this way, producers, not consumers, will bear the risk of new investments in production.
- ★ Maintain the renewable energy production mandate at or below the current level of 5,880 megawatts.

RESOURCES

- *"Windfall" Taxes Not the Solution to Energy Challenges* by Bill Peacock, Texas Public Policy Foundation (Feb. 2006) http://www.texaspolicy.com/commentaries_single.php?report_id=1023.
- *Renewable Energy Mandates Cost Texas Consumers* by Bill Peacock, Texas Public Policy Foundation (May 2006) [http://www.texaspolicy.com/pdf/Peacock Renewable Presentation.pdf](http://www.texaspolicy.com/pdf/Peacock%20Renewable%20Presentation.pdf).
- *Mandate for Renewable Energy Costs Consumers* by Bill Peacock, Texas Public Policy Foundation (May 2005) <http://www.texaspolicy.com/pdf/2005-05-energy-533.pdf>.
- *Blowing In The Wind: Is Renewable Energy Affordable Energy?* by Sterling Burnett, National Center for Policy Analysis and Bill Peacock, Texas Public Policy Foundation (Apr. 2005) http://www.texaspolicy.com/commentaries_single.php?report_id=795.
- *An Ill Wind for Consumers: The Energy Bill* by Robert Michaels, California State University-Fullerton (July 2005) <http://www.ncpa.org/pub/ba/ba522/>.

THE ISSUE

Regulation came late to Texas, and markets came early. It became the last state to regulate retail rates when the Texas Legislature created the Public Utility Commission (PUC). Texas successfully deregulated wholesale power in 1997, requiring the Electricity Reliability Council of Texas (ERCOT) transmission owners to offer nondiscriminatory access to their lines. The foundation for retail competition was laid in 1997 when the Legislature said the public interest required that electric services and their prices should be determined by customer choices and the normal forces of competition. In 1999, the Legislature passed Senate Bill 7, which required the start of customer choice by Jan. 1, 2002.

SB 7 instituted a Price to Beat (PTB) per kilowatt-hour (kwh) for the customers of the incumbent retail providers, known as affiliated REPs. A REP's PTB was based on its 1999 costs, discounted by 6 percent. Affiliated REPs were required to charge the PTB, while unaffiliated REPs (new retail competitors) were free to set their own prices. One of the primary purposes of the PTB was to temporarily provide headroom for the unaffiliated REPs to earn a profit in order to encourage both unaffiliated REPs and consumers to participate, and thus foster the formation of competitive markets.

The new markets have been largely successful. Industrial and large commercial customers had no price to beat, but hardly needed one—over 65 percent of these customers have switched providers. The switching rate for small commercial and residential customers is lower, but not because of a lack of choice. For instance, residential customers in Houston can today choose from 26 rate plans offered by 14 suppliers—customers across the state have similar choices. A PUC study has shown that retail rates are lower today than they would have been without competition.

THE FACTS

- ★ Consumers have access to a variety of suppliers and plans, as seen in the following examples:

Corpus Christi—15 suppliers and 24 rate plans

San Angelo—13 suppliers and 22 rate plans

Houston—14 suppliers and 26 rate plans

Lewisville—12 suppliers and 23 rate plans

Ft. Worth—14 suppliers and 29 rate plans

- ★ A PUC study found that a residential customer in Houston who switched to a competitive retail electric provider four years ago and then switched each following year to the lowest-cost provider would have saved about \$1,450, compared to the estimated regulated rate; a similar customer in Dallas would have saved about \$800.



- ★ The PUC study also said that for each of the past four years, the average price of the five lowest competitive prices in the Houston and Dallas markets was lower than the estimated regulated price there for each year.
- ★ Rates are higher in Texas than in some other states because more power generators in the state rely on natural gas than other fuels to generate electricity. Companies here have generally had to raise rates in response to rising natural gas prices.
- ★ New coal-fired plants scheduled for construction will bring greater diversity to electric production in Texas and reduce reliance on natural gas.

RECOMMENDATIONS

- ★ Maintain the path toward full deregulation of the retail electric markets by allowing the Price to Beat to expire in January 2007 without subsequently adopting any new price regulations.
- ★ Ensure that other provisions of electric utility laws and regulations are not used as a back door to re-regulate electric rates.

RESOURCES

- *Growing Competitive Electricity: Why Texas Must End the Price to Beat* by Robert J. Michaels, Texas Public Policy Foundation (July 2006) <http://www.texaspolicy.com/pdf/2006-07-PP-electricity-bp.pdf>.
- *Report to the 79th Texas Legislature on Scope of Competition in Electric Markets in Texas* by the Texas Public Utility Commission (Jan. 2005) http://www.puc.state.tx.us/electric/reports/scope/2005/2005scope_elec.pdf.
- Texas Electric Choice <http://www.powertochoose.org/>.