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The 2015 Texas Legislature: Issues to Watch for Electric and Utility Markets

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As the upcoming Texas legislative session approaches, Husch Blackwell's Public Policy, Regulatory & Government Affairs team expects to track several proposals on behalf of our clients relating to the competitive Texas energy market and utility service. The restructured Texas electric industry has seen dramatic growth in both generation capacity and demand, and expanded market participation. We anticipate these and other changing conditions will lead to legislative proposals during the coming session. The Public Utility Commission (PUC) itself has proposed a number of legislative changes to existing law.

In our view, the key proposals for state legislative action or review are outlined below.

1. **Costs Related to Subsynchronous Oscillation (SSO) in the Electric Reliability Council of Texas (ERCOT)**

SSO is a potentially harmful phenomenon involving fluctuation between two or more transmission elements or generation resources at frequencies lower than normal. ERCOT has reported increasing SSO problems arising from increased West Texas wind generation development near lengthy new Competitive Renewable Energy Zone (CREZ) transmission lines. The PUC and ERCOT have been reviewing means to resolve these issues, while the PUC has proposed assigning related costs to generators. This breaks from the normal rule that transmission utilities pay all costs associated with transmission-related facilities. The issue represents a possible subject to address through legislation. Proposals and resulting legal changes could affect electric transmission utilities and wind generation owners and developers.

2. **Oncor Battery Storage Proposal**

In the face of challenges, the energy storage industry has encountered in developing economical storage applications, Oncor has announced a proposal to install approximately 5,000 megawatts of battery energy storage throughout the Texas electric distribution system. Oncor claims that its proposal would increase the grid's reliability, and also increase the amount of generating capacity available to help meet peak summer electric demand. Part of this proposal includes a new regulatory framework that enables utilities to auction excess energy storage capacity (not needed for protecting reliability) to market participants such as power marketers. Utility involvement in wholesale electric sales may require legislative action, so some may advocate bills that would permit this aspect of the proposal to go forward. The resulting statutory changes, if enacted, may affect a wide variety of electric market participants, including utilities, power marketers, electric generators, retailers and customers.

3. **Commission Finding that New DC Ties are in the Public Interest**

Several entities have proposed building new large DC ties between ERCOT and adjacent regions. The additional import capacity could influence prices, resource dispatch, reliability, and resource adequacy within ERCOT. They could also provide ERCOT-area generators with the opportunity to sell electricity in additional markets. However, building more ties and exchanging more power across state lines could lead to the Federal Energy Regulatory Commission (FERC) exercising jurisdiction over ERCOT wholesale markets. In light of the substantial potential impact on the ERCOT region, the Commission could be given greater authority to review such DC tie proposals and their impacts on the public interest. This could include conferring the authority to set conditions for interconnecting a new DC tie to the ERCOT system, or denying such interconnection. Legislative proposals on this issue could ultimately affect utilities, retailers, power marketers and generators, and customers.

4. **T-Lines Built by a Municipally-Owned Utility (MOU) Outside of its Service Area**

Texas law generally prohibits a "retail electric utility" such as an MOU from providing any service outside its certified service area. While ERCOT may designate an MOU to build regional transmission lines that run outside its service area, an MOU is exempt from the normal rule that a utility must obtain a certificate of convenience and necessity (CCN) from the PUC to construct transmission lines. This exception may result in landowners affected by such new lines having no input on the routing of such major new transmission lines. The Commission has suggested that the legislature clarify that MOUs should obtain a CCN before building any transmission facilities outside of their service area. Legislation on this subject could affect utilities, landowners and potentially customers.

5. **Distribution Cost Recovery Factor (DCRF)**

The DCRF is a distribution utility rate factor that allows a utility to recover newly- incurred distribution capital costs on an interim basis. The PUC's DCRF rule allows a utility to change its rates in part between base rate cases. A utility may adjust its DCRF no more than once per year and not more than four times between rate cases. Also, a utility may not pursue a DCRF adjustment while it is involved in a pending rate case. In a filing with the PUCT, a group of electric utilities has expressed its desire to allow DCRF changes while a rate cases is pending, due to the lengthy time some rate cases can take. The legislature may well decide to address this issue itself. Legislation in this area could affect utilities, retailers and customers.

6. **Protecting Chapter 313 Tax Incentive**

Texas Tax Code Chapter 313 defines an appraised value limitation (LAVA) as an agreement in which a taxpayer agrees to build or install property and create jobs in exchange for a limitation on the taxable property value for school district maintenance and operations tax (M&O) purposes. These LAVA agreements create an economic development program that allows renewable energy companies to apply for a temporary reduction in property taxes in exchange for a major capital investment commitment in the applicable county. Attainment of a LAVA agreement has become imperative to wind energy developers attempting to attract financial capital and investment. Proponents of 313 argue that it creates jobs and helps to rejuvenate rural economies.

Recently, the Texas Comptroller criticized this provision. A September 2014 report characterized wind energy programs such as LAVA school property tax exemptions as unfair "subsidies." Representatives from the solar and wind industries have already met individually with the Comptroller's office to address the issue, but there is concern that the Legislature may seek to alter the application of 313 to renewables in the coming session. The PUC has also begun to review the assignment of system costs related to renewable resources. Parties involved in the renewable space may make efforts to preserve Chapter 313 against this backdrop. Preserving this section would affect wind developers, generators, utilities and local governmental entities.

7. **Repeal of PURA 39.904(h) Regarding Treatment of CREZ Lines**

The CREZ program entailed an extensive West Texas transmission system buildout to support wind energy development. The PUC approved these new lines as part of an overall transmission plan, as authorized by SB20 in 2005. State law exempted the utilities who built these lines from establishing that a "need" existed for them when they applied for CCNs, unlike most other cases in which the utility must establish that a need exists. Now that wind energy developments and expanded local electric demand have fully utilized these lines, utilities will need to build additional lines connecting to the existing CREZ lines to maintain adequate transmission capacity. This raises the issue of whether these utilities must demonstrate a "need," as they arguably are CREZ lines. Requiring utilities to establish a need would potentially lengthen the time required to build the new lines. The PUC has recommended that the Legislature clear up its intent through repeal of or clarification of PURA 39.904(h). Legislation on this subject would affect utilities, landowners and generators.

8. **Sale of Oncor During the Legislative Session**

Energy Future Holdings (EFH), the parent company of Oncor Electric Delivery (Oncor), TXU Energy and Luminant ET Services (Luminant) filed for Chapter 11 bankruptcy earlier in the year. Oncor is a poles and wires company that provides electric transmission and distribution service within Texas. Luminant is a power generation company operating in Texas, and TXU Energy is one of the largest retail electric providers in the state. In addition to selling its interest in Oncor, EFH currently plans to spin off its Luminant power generation business and its TXU Energy retail supply business to its senior lenders who are currently owed over $20 billion. It remains to be seen how the EFH restructuring of its debt obligations will affect Luminant's fleet of 15,400 megawatts of generation and whether the legislature will become involved in the process. Spinning off assets could trigger large capital gains taxes and the government would likely oppose any deal that would create a large tax liability. Legislative leaders will no doubt follow the EFH bankruptcy closely, and could enact legislation to address the impact of any adopted restructuring plan or sell-off.

9. **The Effect of Dropping Oil Prices on the State Economy**

Oil prices have declined nearly drastically since summer 2014, posing a threat to the Texas economy in 2015. Oil production in Texas drives much of the state's economic growth. There is fear that capital investment could suffer in the same fashion as it did in the economic crisis of late 1980s. The current downturn in prices to about $80 per barrel is not even close to the $20 per barrel prices during that time, when the legislature approved billions in new taxes to make up for the shortfall. Texas has also diversified its economy since then and is no longer so heavily reliant on short-term oil revenues.

According to a Legislative Budget Board report, the state expects oil and gas production taxes to make up 4.5 percent of its total revenue during the 2014-15 biennium and 9.6 percent of its total tax collections. Considerable amounts of Texas oil and gas revenue is being housed outside the budgeting process, flowing instead to the Economic Stabilization Fund, also known as the Rainy Day Fund. State policymakers can also take comfort in the fact that Texas budget writers have relied on conservative estimates of oil prices for 2015 which are actually anticipated to be lower than the current rate, although some outside experts are predicting as much as a $12 drop in prices per barrel. Though falling oil prices undoubtedly decrease state revenue, Texas is likely to be far less susceptible than it was in the late 1980s due to its differentiated economy and has altered budgeting practices.

10. **Possible Restructuring of the Measurement System for Capacity Demand Reserve (CDR)**

Recently the Commission launched a comprehensive review of ERCOT's traditional "target" reserve margin approach. Staff has been asked to evaluate the disadvantages of the current system and the benefits of alternative approaches for measuring reliability. The Commissioners responded to Staff's request for comments questioning whether they overlooked several threshold items. The Commissioners noted that each reliability standard under consideration should be defined, its rationale clearly explained, its advantages and disadvantages and its cost benefits set out, and, finally, its practical effect on electric consumers within ERCOT established. The Commissioners suggested side-by-side comparisons with various reliability standard methods to determine what is best for ERCOT.

Additionally, the Commissioners noted that the Brattle Group made a compelling case for abandonment of the current loss-of-load events (LOLE) standard in their report, "*Estimating the Economically Optimal Reserve Margin in ERCOT*." In that report, Brattle recommended replacing the LOLE standard of measurement with the normalized Expected Unserved Energy (EUE) system because it is a more robust and meaningful measure of reliability that can be compared across systems of many sizes, load, shapes, and other uncertainty factors. Staff is currently revisiting the issue with these comments in mind. Legislative leaders will likely follow the reserve margin issue closely, and could enact legislation to suggest reform to the current measurement system.

How We Can Help

Husch Blackwell's team of energy regulatory and policy experts provides lobbying, regulatory and legal services to public and private entities in Austin, the state's capitol. Our efforts in Texas are led by Steve Carman, one of the foremost corporate energy attorneys in the central United States; Chris Hughes, who has 25 years of energy legislative advocacy experience including various staff positions with the Texas Governor's Office and the Texas State Senate; Chris Reeder, a non-lobbyist who has wide-ranging experience in the regulatory space representing clients in numerous areas of the utilities industry. The firm's local energy team also includes Texas lawmakers, including State Representative Trey Martinez Fischer and Senator Kirk Watson.

In addition to our Texas team, our federal regulatory team, led by Richard Martin, includes former members of the U.S. Congress; top staff aides to current and former members of congressional leadership, as well as leaders of key legislative and oversight committees; a former presidential cabinet member and head of the Office of Management and Budget; a former chairman of the Federal Trade Commission and the Federal Surface Transportation Board; former staff members at a wide range of federal agencies, including the Central Intelligence Agency, the Office of Management and Budget, the Department of Justice and the Federal Highway Administration; and many individuals with extensive political and campaign management experience in support of current members of Congress.

Over the past few years, our group has represented clients in all sectors of the industry, including renewable and conventional generators, investor-owned and public power utilities, marketers, customers, investors and landowners.

Contact Us

We will continue to track these and other pertinent legislative issues throughout the session. If you have any particular client needs or questions, please contact Steve Carman at 512.370.3451.