

**PROJECT NO. 26556**

**RULEMAKING TO AMEND PUC           §       PUBLIC UTILITY COMMISSION**  
**SUBST. R. 25.41, RELATING TO       §**  
**PRICE TO BEAT                           §   OF TEXAS**

**PROPOSAL FOR PUBLICATION OF AMENDMENTS TO §25.41  
AS APPROVED AT THE NOVEMBER 7, 2002 OPEN MEETING**

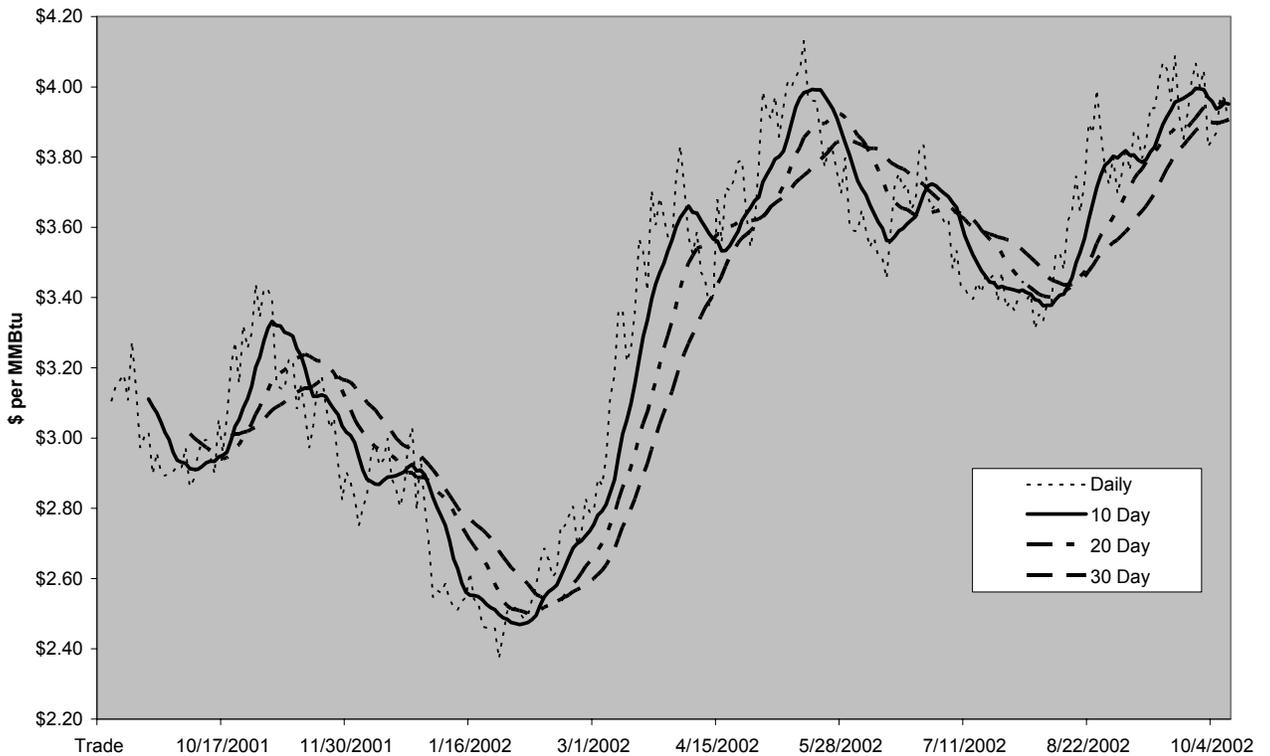
The Public Utility Commission of Texas (commission) proposes amendments to §25.41, relating to Price to Beat. The commission has recently completed the first set of fuel factor adjustments requested by affiliated retail electric providers (REPs) pursuant to subsection (g) of the rule. As a result of experience gained in those proceedings, the commission has determined that several improvements to the rule could potentially benefit retail customers and the development of the retail electricity market. The proposed amendments will amend certain requirements related to adjustments to the price to beat, including: the number of trading days used to calculate the natural gas price average for fuel factor adjustments; the threshold of price changes needed to justify an adjustment to the fuel factors; the criteria that apply in order to substitute an electricity price index for the natural gas price index; the specific adjustments to the price to beat that will be considered following the true-up proceedings conducted under Public Utility Regulatory Act (PURA) §39.262; and the processing guidelines for price to beat adjustments. The amendments also make other minor changes that are intended to clarify other aspects of the rule. Project Number 26556 is assigned to this proceeding.

The commission set the initial price to beat fuel factors in the fall of 2001, in part based upon a ten day average of New York Mercantile Exchange (NYMEX) Henry Hub natural gas futures prices for each month of 2002 of approximately \$3.11 per million British thermal unit (MMBtu). Section 25.41(g)(1) permitted the affiliated REPs to request adjustments to those fuel factors if the ten-day average of the closing forward twelve months diverged from the \$3.11 per MMBtu price by more than 4.0%, as the commission had previously determined that such a change would be reflective of a "significant change in the market price of natural gas and purchased energy used to serve retail customers." (*See Rulemaking relating to Price to Beat*, Project Number 21409; Order adopting §25.41, relating to Price to Beat, March 20, 2001 at 64-65) During the spring of 2002, all of the affiliated REPs requested adjustments to the price to beat fuel factors citing increases in the natural gas price average from 16.8% to 22.69%. The commission ultimately approved the requests, albeit at slightly lower levels of increases than requested in some cases.

The following chart shows the 12-month forward natural gas price average on a daily, ten-day, 20-day, and 30-day basis for each day from September 4, 2001 through October 10, 2002. Generally, natural gas futures prices remained at or below the \$3.11 per MMBtu embedded within the original price to beat fuel factors until March of 2002. After that point in time, prices have stayed consistently higher than \$3.11 per MMBtu. Gas price futures did fall for several months after the adjustment requests were made by the affiliated REPs, but have since risen back to the level they were at the time of the adjustment requests. This evidence suggests that §25.41(g)(1) has worked as intended by permitting the affiliated

REPs to adjust the price to beat fuel factors to recognize significant changes in the price of natural gas and purchased energy.

**NYMEX Natural Gas Futures Prices Averages - 9/2001 through 10/2002**



While the commission believes it to be highly unlikely that an affiliated REP can "game" the adjustment process outlined in §25.41(g)(1) through the timing fluctuations in the NYMEX futures market, the commission is concerned that use of a ten-day average may inadvertently lead to a case where an affiliated REP may capture a temporary spike in the market. The commission notes that during a two-week period in June 2002, daily futures prices and the ten-day average of futures price both reflected a temporary increase in natural gas prices that subsequently reversed as gas prices continued a decline for the next seven weeks. In order

to prevent a transitory change in gas prices such as this from being reflected in the fuel factor, the commission proposes to amend subsection (g)(1)(A)-(D) such that future adjustments will be based on a 20-day average. The commission also proposes to amend subsection (g)(1)(A) to remove the flexibility in what days prior to a filing for adjustment an affiliated REP can be used to calculate the gas price average by stating that the 20-day period must end the day before the filing is made by the affiliated REP.

The commission also proposes altering the threshold in subsection (g)(1)(C) and (D) for a significant change from 4.0% to 5.0% in order to harmonize the threshold with the threshold to adjust provider of last resort rates contained in §25.43(l)(1), relating to Provider of Last Resort (POLR). Additionally, the commission noted in the Order Adopting §25.41 that the "fact that affiliated REPs may only request fuel factor changes twice per year together with the materiality threshold...should guard against unnecessary fuel factor adjustments." However, the commission notes that, if an affiliated REP retains the ability to request one or both adjustments near the end of a calendar year, there may be less restraint in requesting an adjustment because the affiliated REP would gain the ability to make another adjustment in January of the next year. The commission proposes to raise the threshold in subsection (g)(1)(C) and (D) to 10% for adjustments requested after November 15th of a calendar year.

During the recent fuel factor adjustment cases, the commission found it difficult to complete processing of the cases within the 45-day time period prescribed by subsection (g)(1)(D). The commission proposes to amend subsection (g)(1)(D) and (E) to give more flexibility in

the processing of the cases, as well as permit the parties in the cases to mutually agree to extend the timelines and/or agree upon interim rate relief.

The commission continues to believe that it is appropriate to allow affiliated REPs to request changes in the price to beat fuel factor based upon changes in the price of electricity, once a sufficiently liquid and reliable index exists. However, the commission notes that such an index has yet to develop, and there appears to be a lack of standardized products traded in Texas that would aid in the development of such indices. In order to facilitate and encourage the development of liquid electricity indices in Texas, the commission proposes an amendment to subsection (g)(1)(F) to encourage the development of liquid trading hubs in Texas, and proposes to remove the requirement that the power generation company affiliated with the affiliated REP must have finalized its stranded cost determination before the affiliated REP may transition to the use of electricity prices to adjust the price to beat fuel factor.

In order to provide more certainty to both retail customers and REPs, the commission also proposes amendments to subsection (f)(3) of the rule to provide more specificity as to what adjustments to the price to beat the commission will consider to following the true-up proceedings. The commission proposes to adjust the fuel factor downward following the true-up, if natural gas and/or purchased energy prices are lower than that the prices used to calculate the then-current fuel factors. Additionally, the commission proposes to adjust the base rate portions of the price to beat to account for changes in non-bypassable charges.

The commission also proposes several other clarifying changes and corrections of typographical errors in subsections (c), (g), and (l).

Brian Lloyd, Director, Retail Market Oversight Section, 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. Lloyd 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 to clarify the requirements related to adjustments to the price to beat, reduce the potential that transient fluctuations in the market price of natural gas and purchased power will be reflected in permanent adjustments to the fuel factors, and provide more certainty to retail customers and market participants as to how the price to beat may change following the true-up proceedings. There will be no adverse economic effect on small businesses or micro-businesses as a result of enforcing this section. There may be an anticipated economic cost to persons who are required to comply with the section as proposed as it alters the methodology under which an affiliated REP can request adjustments to the price to beat; however, such costs are difficult to project as they are largely dependent upon changes in the market prices of natural gas and purchased energy. However, it is believed that the benefits accruing from implementation of the proposed section will outweigh these costs.

Mr. Lloyd 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, Texas Government Code Annotated §2001.022 (Vernon 2000 & Supplement 2002).

When commenting on specific subsections of the proposed amendment, 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 only interested in receiving "leading edge" examples which are specifically related and directly applicable to the Texas statute, rather than broad citations to other state restructuring efforts.

In addition to comments on the specific subsections of the rule, the commission requests specific comments on the following questions.

1. The current rule provides for the use of a ten-day rolling average of NYMEX natural gas futures prices in order to determine whether or not a significant change in the market price of natural gas and purchased energy has occurred. While it does not appear that the recent adjustments to the price to beat fuel factors have captured a temporary change in natural gas price, but instead appear to have reflected significant and long-term price change, a review of natural gas prices over the course

of 2002 suggests that there is a potential for capturing temporary changes in gas price due to the use of a ten-day average. Does the proposed change to a 20-day average, combined with the changes in the significance threshold reduce or minimize the potential for such an occurrence?

2. In order to provide more certainty to both retail customers and the marketplace, the commission has proposed additional detail as to what factors will be considered with respect to adjustments to the price to beat following the stranded cost true-up proceedings pursuant to the commission's authority under PURA §39.202. Is the proposed methodology appropriate, or should a different adjustment mechanism be used? If the commission instead ordered that the price to beat be adjusted (either up or down) such that initial headroom that existed on January 1, 2002 was achieved, what would be the proper method of distributing adjustments to the price to beat, between the base rate components and the fuel factor component of the price to beat?
3. What objective criteria should the commission consider adopting with respect to what constitutes a "sufficiently liquid" electricity commodity index or trading hub? The commission desires comments on specific criteria, such as volume of trades, number of participants, spread between bid and ask prices, etc.

Comments on the proposed amendment (16 copies) may be submitted to the Filing Clerk, Public Utility Commission of Texas, 1701 North Congress Avenue, PO Box 13326, Austin, Texas 78711-3326, within 21 days after publication. Reply comments may be submitted within 28 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 amendments. The commission will consider the costs and benefits in deciding whether to adopt the amendments. All comments should refer to Project Number 26556.

The commission staff will conduct a public hearing on this rulemaking under 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, January 7, 2003 at 10:00 a.m. in the Commissioners' Hearing Room.

This amendment is proposed under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (Vernon 1998, Supplement 2002) (PURA), 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 PURA §39.202 which establishes the price to beat obligation for affiliated retail electric providers.

Cross Reference to Statutes: PURA §§14.002, 39.202, and 39.262.

**§25.41. Price to Beat.**

(a) - (b) (No change.)

(c) **Definitions.** The following words and terms, when used in this section, shall have the following meanings, unless the context indicates otherwise:

(1) - (2) (No change.)

(3) **Headroom** — The difference between the average price to beat (in cents per kilowatt hour (kWh)) and the sum of the average non-bypassable charges or credits approved by the commission in a proceeding pursuant to PURA §39.201, or PURA Subchapter G (in cents per kWh) and the representative power price (in cents per kWh). Headroom may be a positive or negative number. A separate headroom number shall be calculated for the typical residential customer and the typical small commercial customer. The calculation for the typical residential customer shall assume 1,000 kWh per month in usage. The calculation of the typical small commercial customer shall ~~assume~~ assumer 35 kilowatts (kW) of demand and 15,000 kWh per month in usage.

(4) **Nonaffiliated REP** — Any competitive retailer conducting business in a transmission and distribution utility's (TDU's) certificated service territory that is not affiliated with that TDU unless the competitive retailer is a successor in interest to a retail electric provider affiliated with that TDU.

(5) - (8) (No change.)

(9) **Representative power price** — The simple average of the results of:

(A) a request for proposals (RFP) for full-requirements service of 10% of price to beat load for a duration of three years expressed in cents per kWh; and

(B) the price resulting from the capacity auctions required by PURA §25.381 of this title (relating to Capacity Auctions) for baseload capacity entitlements expressed in cents per kWh. The calculation of the price resulting from the capacity auctions shall assume dispatch of 100% of the entitlement and shall use the most recent auction of a 12-month forward strip of entitlements, or the most recent aggregated forward 12 months of entitlements. [Alternatively, the affiliated REP may conduct an RFP or purchase auction for equivalent products for 10% of its price to beat load.](#)

(10) (No change.)

(11) **Small commercial customer** — A non-residential retail customer having a peak demand of 1,000 kilowatts (kW) or less. For purposes of this section, the term small commercial customer refers to a metered point of delivery. Additionally, any [non-residential](#), non-metered point of delivery with peak demand of less than 1,000 kW shall also be considered a small commercial customer.

(12) (No change.)

(d) - (f) (No change.)

(g) **Adjustments to the price to beat.**

(1) **Fuel factor adjustments.** An affiliated retail electric provider may request that the commission adjust the fuel factor(s) established under subsection (f)(3) of this section not more than twice in a calendar year if the affiliated retail electric provider demonstrates that the existing fuel factor(s) do not adequately reflect significant changes in the market price of natural gas and purchased energy used to serve retail customers. As part of a filing made pursuant to this paragraph, an affiliated REP may also request an adjustment to the seasonality imparted to the fuel factor in accordance with subsection (f)(3)(C) of this section. Alternatively, the commission may, as part of its approval of an adjustment to the fuel factor, impose a change in the seasonality imparted to the fuel factor. The methodology for calculating the adjustment to the fuel factor(s) shall be the following:

(A) For each ~~business~~-day of the ~~20 trading-day~~~~ten-day~~ period ending ~~the day no more than ten business days~~ before the filing of a fuel factor adjustment application, an average of the closing forward 12-month NYMEX Henry Hub natural gas prices, as reported in the *Wall Street Journal*, is calculated.

- (B) The average forward price for each ~~business~~-day calculated in subparagraph (A) of this paragraph will then be averaged to determine a ~~20 trading-day~~~~ten-day~~ rolling price.
- (C) The percentage difference between the averaged ~~20 trading-day~~~~ten-day~~ rolling price calculated under subparagraphs (A) and (B) of this paragraph and the averaged ~~ten-day rolling~~-price used to calculate the current fuel factor(s) is calculated. If the current fuel factor was calculated through an adjustment under subparagraph (E) of this paragraph, then the averaged ~~20 trading-day~~~~ten-day~~ rolling price calculated concurrent with that adjustment shall be used. If the percentage difference is ~~5.0%~~~~4.0%~~ or more, then the current fuel factor(s) may be adjusted, unless the filing is made after November 15 of a calendar year, in which event the percentage difference must be 10% or more.
- (D) If the percentage difference calculated in subparagraph (C) of this paragraph exceeds 5.0% (or 10% if applicable), then the current fuel factors are deemed to be unreflective of significant changes in the market price of natural gas and purchased energy. To adjust the current fuel factor(s), the percentage difference is added to one and then multiplied by the current factor(s). The results are the adjusted fuel factor(s) that will be implemented according to the procedural schedule in clause (i) and (ii) of this subparagraph:

- (i) if no hearing is requested within 15 days after the petition has been filed, a final order shall be issued within 20 days, or as soon as practicable thereafter, after the petition is filed;
  - (ii) if a hearing is requested within 15 days after the petition is filed, a final order shall be issued within 45 days, or as soon as practicable thereafter, after the petition is filed. The 45 day timeline for issuance of an order may be extended upon mutual agreement of the parties. Such agreement may provide for interim rate relief.
- (E) In addition to the adjustment permitted under subparagraphs (A)-(D) of this paragraph, an affiliated REP may also request an adjustment to the fuel factor if the headroom under the price to beat decreases as a result of significant changes in the price of purchased energy. In making a request under this subparagraph:
- (i) an affiliated REP shall demonstrate that:
    - (I) the representative power price has changed such that the headroom under the price to beat has decreased;  
and
    - (II) the adjustment to the fuel factor is necessary to restore the amount of headroom that existed at the time that the initial price to beat fuel factor was set by the

commission using then current forecasts of the representative power price.

(III) an affiliated REP making an adjustment under this subparagraph shall also file the gas price calculation in subparagraphs (A) and (B) of this paragraph for purposes of subsequent adjustments to the fuel factor based on changes in natural gas prices.

(ii) the commission will issue a final order on an application filed under this subparagraph within 60 days, or as soon as practicable thereafter, after the application is filed. The 60 day timeline for issuance of an order may be extended upon mutual agreement of the parties. Such agreement may provide for interim rate relief.

(F) The commission shall, upon a showing made by an interested party, that a sufficiently liquid electricity commodity trading hub (or hubs) or index has developed for the affiliated REP's relevant geographic or power region, allow an affiliated REP to transition to the use of an electricity commodity prices at that hub or index to adjust the fuel factor for significant changes in the price of purchased energy. The commission shall only allow the use of the index after the power generation company affiliated with the affiliated REP has finalized their stranded cost determination. After the commission has made a

finding that a sufficiently liquid electricity commodity trading hub or index has developed, the affiliated REP shall be required to perform an additional adjustment under subparagraphs (A) through (D) or (E) of this paragraph before utilization of the prices at that trading hub or index to change the fuel factor so that a benchmark electricity index price can be established. Subsequent changes to the fuel factor shall be based on the percentage change in the electricity commodity index using the same methodology for the natural gas price adjustment under subparagraphs (A) - (D) of this paragraph.

(2) (No change.)

(3) **True-up adjustment.** The commission may adjust the price to beat following the true-up proceedings under PURA §39.262. The commission may consider the following adjustments to the price to beat on a schedule consistent with the processing of the TDU rate adjustment application pursuant to §25.263(n) of this title (relating to True-up Proceeding):

(A) **Fuel factor adjustment.** A 20 trading-day rolling price shall be calculated in accordance with paragraph (1)(A)-(D) of this subsection. If the 20 trading-day rolling price is less than the price used to calculate the then-current fuel factor (i.e. the percentage difference is negative), then the price to beat fuel factor shall be adjusted downward by the percentage difference in the prices.

(B) **Base rate adjustment.** Using the typical residential and small commercial usage calculations described in subsection (c)(3) of this subsection, the base rate components of the price to beat shall be adjusted such that the difference between the average price to beat base rate and the average non-bypassable charges that exist following the proceeding pursuant to §25.263(n) of this title is the same as existed on January 1, 2002. Each component of the base rates shall be adjusted in the same proportion in complying with this section.

(C) **Filing by affiliated REP.** An affiliated REP shall make filings necessary to implement subparagraphs (A) and (B) of this paragraph on a schedule to be determined by the commission.

(h) - (k) (No change.)

(l) **Filing requirements.**

(1) - (2) (No change.)

(3) No later than December 31, 2001, each transmission and distribution utility shall determine the power consumption threshold targets under subsection (i) of this section for residential and small commercial customers within its certificated service area and shall file this information with the commission and shall also make this information publicly available through its Internet website. Each transmission and distribution utility, together with its

affiliated REP, shall update the small commercial power consumption threshold as needed to reflect additional small commercial load that has met the requirements of subsection (h)(3) of this section and therefore is appropriately ~~appropriate~~ removed from the calculation of the threshold target. Concurrent with this update, the transmission and distribution utility, together with its affiliated REP, shall provide, for each group of aggregated customers that have been removed from the calculation of the threshold target, the customers' names, electric service identifiers, size of the customers' loads (individually and in the aggregate), and how the customers meet the requirements of subsection (h)(3). Such information may be filed under confidential seal. All certificated REPs shall be deemed to have standing to review such filings.

(4) - (5) (No change.)

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

**ISSUED IN AUSTIN, TEXAS ON THE 8th DAY OF NOVEMBER 2002 BY THE  
PUBLIC UTILITY COMMISSION OF TEXAS  
RHONDA G. DEMPSEY**