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APPLICATION OF CENTERPOINT §
ENERGY HOUSTON ELECTRIC, LLC, §
RELIANT ENERGY RETAIL §
SERVICES, LLC AND TEXAS GENCO, §
LP TO DETERMINE STRANDED §
COSTS AND OTHER TRUE-UP §
BALANCES PURSUANT TO PURA §
§ 39.262 §

PUBLIC UTILITY COMMISSION
FILING CLERK

PUBLIC UTILITY COMMISSION

OF TEXAS

REBUTTAL TESTIMONY

OF

SARAH J. GOODFRIEND, PH.D.

ON BEHALF OF

ALLIANCE FOR RETAIL MARKETS (ARM)

JUNE 14, 2004

1605

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Sarah Goodfriend and my business address is 1500 West 24th Street,
3 Austin, Texas 78703.

4 **Q. ARE YOU THE SAME SARAH GOODFRIEND THAT SUBMITTED**
5 **DIRECT TESTIMONY ON BEHALF OF THE ALLIANCE FOR RETAIL**
6 **MARKETS (ARM) IN THIS PROCEEDING?**

7 A. Yes, I am.

8 **Q. WHAT IS THE SCOPE AND PURPOSE OF YOUR REBUTTAL**
9 **TESTIMONY?**

10 A. I will respond to the direct testimonies of witnesses Bruce Biewald (Gulf Coast
11 Coalition of Cities [GCCC]) and Scott Norwood (City of Houston and Coalition
12 of Cities [COH]) that address issues relating to the excess mitigation credit
13 (EMC), including Issue No. 7 of the Commission’s Preliminary Order: “Should
14 the Commission terminate the EMC upon issuance of a final order in this
15 proceeding?”

16 **Q. BEFORE REBUTTING STATEMENTS IN THESE WITNESSES’ DIRECT**
17 **TESTIMONIES, PLEASE INDICATE WHETHER ANY PARTY HAS**
18 **ACKNOWLEDGED THAT AN ADJUSTMENT OR TERMINATION OF**
19 **THE EMC WOULD REQUIRE AN ADJUSTMENT TO THE PRICE TO**
20 **BEAT BASE RATE, PURSUANT TO P.U.C. SUBST. R. 23.41(g)(3)(B)?**

21 A. Yes. In my direct testimony, I provided primary and alternative recommendations
22 responsive to the question of whether the Commission should terminate the EMC
23 at the end of this proceeding. These recommendations address the timing of any

1 adjustment or termination of the EMC ordered by the Commission; they do not
2 address substantive reasons for or against adjusting or terminating the EMC.
3 Both of my recommendations rely upon P.U.C. SUBST. R. 23.41(g)(3)(B), which
4 requires the Commission to adjust the price to beat (PTB) base rate *on a schedule*
5 *consistent with* any change in the level of non-bypassable charges that results
6 from the adjustment or termination of the EMC. As I explain in my direct
7 testimony, P.U.C. SUBST. R. 23.41(g)(3)(B) requires that this adjustment to the
8 PTB base rate occur at the same time as the adjustment or termination of the
9 EMC. Office of Public Utility Counsel (OPC) witness Mr. Randall J. Falkenberg
10 acknowledges that P.U.C. SUBST. R. 23.41(g)(3)(B) would require an upward
11 adjustment of the PTB base rate if the EMC is terminated, in order “to reflect to
12 the loss of the ongoing level of EMC and the associated reduction of headroom.”¹

13 **Q. WHAT IS THE SOURCE OF YOUR DISAGREEMENT WITH THE**
14 **STATEMENTS IN MESSRS. BIEWALD AND NORWOOD’S DIRECT**
15 **TESTIMONIES?**

16 A. GCCC witness Mr. Biewald and COH witness Mr. Norwood make statements in
17 their respective direct testimonies that reflect misunderstandings about how
18 competitive markets work. They suggest that customers have not fully benefited
19 from the Commission policy that made the EMC part of the initial headroom for
20 competitive REPs in the CenterPoint service territory. I will explain why, indeed,
21 customers have benefited – and have likely benefited in the most valuable way–
22 from the Commission’s EMC policy in the CenterPoint territory. In addressing

¹ Direct Testimony of Randall Falkenberg at Page 39, lines 20-22 (June 1, 2004).

1 these witnesses' statements, I will respond from the vantage point of the
2 residential customers served by competitive REPs.

3 **Q. WHAT ARE THE SPECIFIC STATEMENTS MADE BY MESSRS.**
4 **BIEWALD AND NORWOOD WITH WHICH YOU DISAGREE?**

5 A. Mr. Biewald contends that it is only "possible" that prices offered by competitive
6 REPs are lower than they otherwise would be as a result of EMCs.² Likewise,
7 Mr. Norwood states, "While it is likely that many larger retail customers in
8 CenterPoint's service area were aware of the EMC issue and were able to
9 negotiate contracts that required the REP to flow through the EMCs, it is *equally*
10 *likely* that many customers were not aware of the EMCs and, therefore, did not
11 obtain contract terms guaranteeing the flow-through of these credits."³ (Emphasis
12 added) Mr. Norwood also asserts that the EMCs paid to competitive REPs but
13 "not refunded to ratepayers" should be considered by the Commission "as it
14 evaluates other adjustments proposed by Intervenors and the overall
15 reasonableness of Applicants' final stranded cost and true-up claims."⁴

16 **Q. WHAT IS THE FUNDAMENTAL PROBLEM WITH ANY CLAIM THAT**
17 **COMPETITIVE REPS DO NOT REFLECT THE EMC IN THEIR**
18 **COMPETITIVE RATE OFFERINGS TO RESIDENTIAL CUSTOMERS?**

19 A. Such a claim presumes irrational or anti-competitive behavior by competitive
20 REPs in pricing and marketing their retail products and services, and rests upon
21 the premise that the retail market is failing to function in a workably competitive
22 way.

² Direct Testimony of Bruce Biewald, Page 22, line 22; Page 23, lines 1-2 (June 1, 2004).

³ Direct Testimony of Scott Norwood, Page 33, lines 2-6 (June 1, 2004).

⁴ *Id.*, Page 35, lines 18-19.

1 **Q. DOES IT APPEAR THAT THE RESIDENTIAL RETAIL MARKET IS**
2 **FUNCTIONING COMPETITIVELY?**

3 A. Yes. To demonstrate how well it is functioning competitively, I have attached
4 Rebuttal Exhibit SJG-1, which reproduces relevant slides from a recent
5 presentation by Commission Chairman Paul Hudson to the Texas Senate in April,
6 2004.⁵ This presentation shows that from the opening of the retail market to
7 competition in January 2002 through May 2003, the CenterPoint service area had
8 experienced the greatest residential market penetration when compared to other
9 transmission and distribution utility (TDU) service areas in ERCOT.⁶ At the time
10 of Chairman Hudson's presentation, the CenterPoint service area was also the
11 region in ERCOT where the greatest discount off the PTB was being offered by
12 competitive REPs.⁷

13 **Q. ARE THESE DATA CONSISTENT WITH A CONCLUSION THAT THE**
14 **COMMISSION'S INCLUSION OF THE EMC AS PART OF INITIAL**
15 **HEADROOM IN THE CENTERPOINT AREA HAS CONTRIBUTED**
16 **TOWARDS FOSTERING VIGOROUS COMPETITION?**

17 A. Yes, they are consistent with that conclusion.

18 **Q. EARLIER YOU STATED THAT CLAIMS THAT REPS DO NOT**
19 **REFLECT THE EMC IN THEIR COMPETITIVE RATE OFFERINGS TO**
20 **CUSTOMERS PRESUMES IRRATIONAL BEHAVIOR BY THOSE REPs.**
21 **PLEASE ELABORATE.**

⁵ See http://www.puc.state.tx.us/about/commissioners/hudson/present/pp/senateelec_042704.pdf. The presentation is entitled: "State of the State – A Brief Review of Electric Competition, Senate Business and Commerce Committee, April 27, 2004."

⁶ Rebuttal Exhibit SJG-1, Page 1 of 3.

⁷ *Id.*, Page 2 of 3.

1 A. Competitive REPs have not entered the market in hopes of winning the Texas
2 lottery. Rather, starting with a market share of zero, they have incurred non-
3 recoupable costs in an effort to make profits by growing market share and by
4 obtaining sufficient market share to reap the benefits of size-related economies in
5 production costs. Competitive REPs who simply “pocket” the EMC will lose
6 market share to the PTB and to other REPs.

7 **Q. DOESN'T COH WITNESS MR. NORWOOD CLAIM THAT SOME**
8 **CUSTOMERS DON'T KNOW ABOUT THE EMCS AND, THEREFORE,**
9 **CANNOT EFFECTIVELY BARGAIN FOR THEM?**

10 A. Mr. Norwood's claim is flawed for two reasons. First, every competitive REP has
11 an incentive to get information about its offerings to potential customers.
12 Competitive REPs spend money to do this.⁸ In the residential market, where
13 regulated rate designs in the past did not encourage price-sensitivity, creating
14 price-sensitivity and increasing customer responsiveness to competitive offerings
15 is particularly necessary for REPs, since the ability to gain meaningful market
16 share depends upon creating this responsiveness. Consistent with this necessity,
17 Chairman Hudson's presentation indicates that customer awareness of customer
18 choice has increased significantly since market opening.⁹ Thus, if some
19 customers lack knowledge of competitive opportunities, it is due to the relative
20 youthfulness of the retail market in Texas. It would be counter-productive for
21 competitive REPs to act to limit information available to residential customers.

⁸ A good example of this are the two large TXU Energy Services billboards guaranteeing lower rates than those offered by the affiliated REP in the CenterPoint service area (Reliant Energy Retail Services) that I saw when driving recently on the west side of Houston.

⁹ Rebuttal Exhibit SJG-1, Page 3 of 3.

1 Moreover, the Commission has taken steps to facilitate customer education and
2 knowledge about retail choice. A residential customer in Houston can access the
3 *Power To Choose* website and find 13 competitive offers against the PTB from
4 which to choose. The website also provides access to individual REP websites,
5 more information about customer choice, and a variety of promotional offers.
6 Those residential customers who choose to switch service providers do so because
7 they find value in at least one competitive REP's offer, and that value is
8 sufficiently attractive to encourage them to switch service.

9 Second, the beauty of competitive markets with posted prices is that each
10 individual customer does not have to be a knowledgeable bargainer to effortlessly
11 obtain the benefits of competition. Competition can be counted on to pass the
12 benefits of competition on to even "uninformed" customers in the CenterPoint
13 residential market. This occurs because the behavior of price-sensitive customers,
14 *i.e.*, the most informed customers, inures to the benefit of all. Just as in more
15 highly developed markets, arbitrage works here too to create a unified market
16 among competing products: price-sensitive customers willingness to change
17 providers in tandem with REPs efforts to regain them as customers can be relied
18 on bring prices back to levels reflecting differences in value.

19 **Q. WHAT DO RESIDENTIAL SERVICE OFFERS IN THE CENTERPOINT**
20 **SERVICE AREA SHOW WITH RESPECT TO HOW COMPETITIVE**
21 **REPS USE HEADROOM MADE AVAILABLE BY THE EMC?**

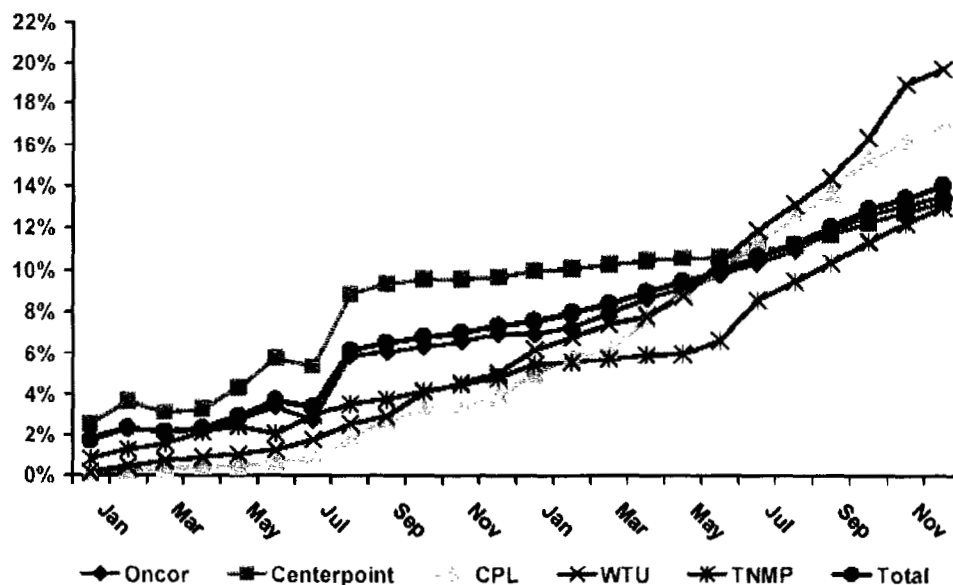
22 A. A comparison among offers reflects significant differences in prices *and* diversity
23 in terms and conditions of service. Unlike the requirements of most commercial

1 customers, whose decision to switch service is primarily driven by the price of
2 generation they must pay, residential customers' demands cannot be characterized
3 solely in terms of prices, or in the level of price discounts. The 13 offers I found
4 for Houston residential customers in CenterPoint's service area give residential
5 customers choices by providing products with different combinations of price
6 discount, term of service, conditions of service, simplicity of rates, structure of
7 rates, environmental attributes of power, and risk bearing. Successful REPs will
8 fashion and tailor those packages of product attributes and promotional items that
9 are attractive to residential customers.

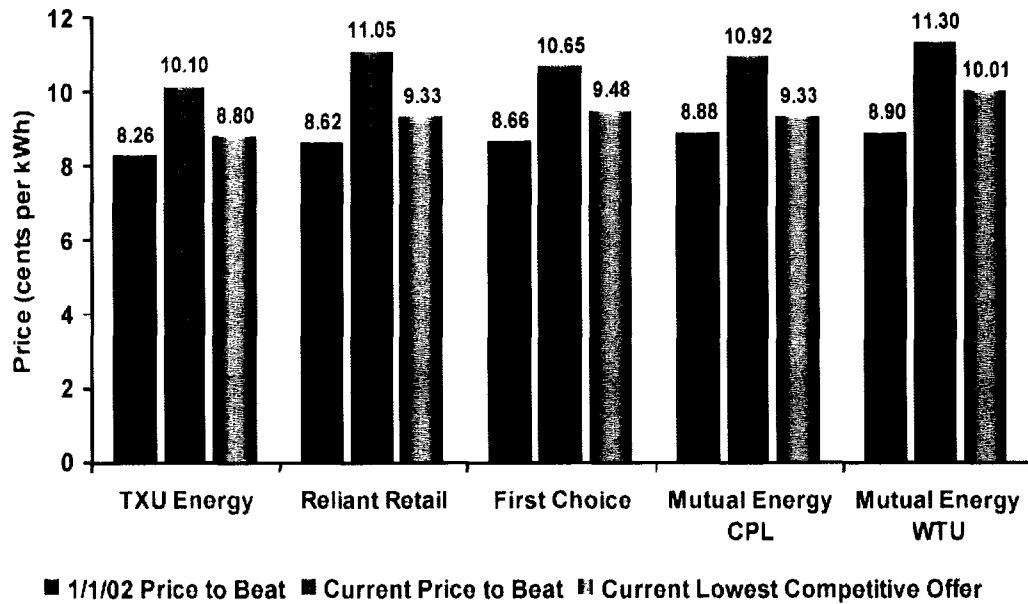
10 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

11 **A.** Yes it does.

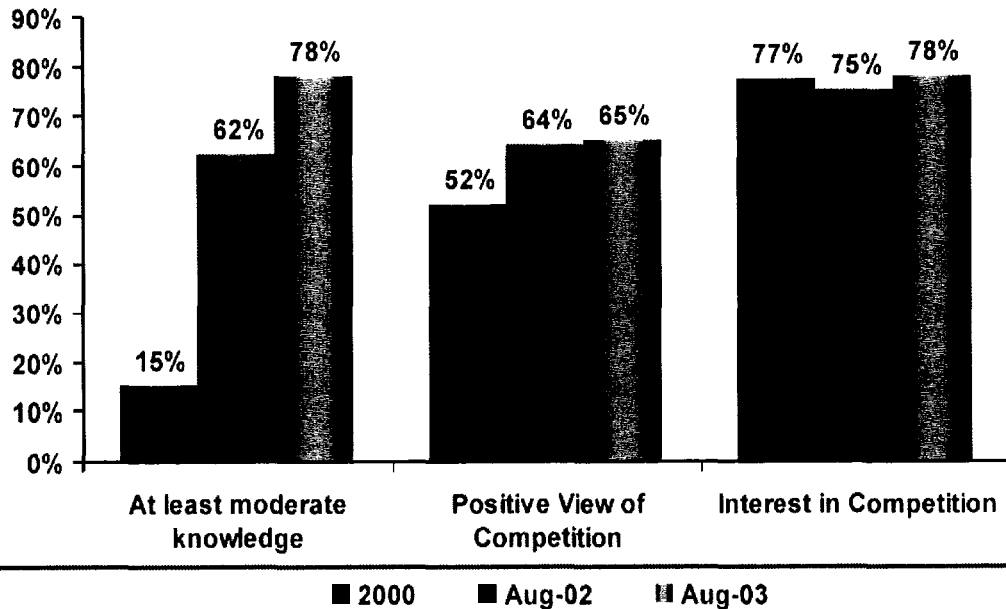
Percentage of Residential Customers Served by Non-Affiliated REPs



Changes in Residential Rates Market Open to Feb 2004



Over Three Years Customer Awareness of Choice Has Increased...



Public Utility Commission of Texas

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