
SENATE COMMITTEE ON BUSINESS & COMMERCE

TEXAS SENATE

INTERIM REPORT 2018

A REPORT TO THE

TEXAS SENATE

86TH TEXAS LEGISLATURE

KELLY HANCOCK

CHAIRMAN



Senate Committee On
Business & Commerce

December 3, 2018

The Honorable Dan Patrick
Lieutenant Governor
Members of the Texas Senate
PO Box 12068
Austin, Texas 78711

Dear Governor Patrick and Fellow Senators:

Thank you for the opportunity to address important issues facing Texas today through your charges for interim study. The Senate Committee on Business & Commerce, having conducted public hearings and received public and invited testimony, is pleased to submit its final report with recommendations for consideration by the 86th Texas Legislature.

Respectfully submitted,

Handwritten signature of Brandon Creighton in black ink.

Brandon Creighton, Vice-Chair

Handwritten signature of Donna Campbell in black ink.

Donna Campbell

Handwritten signature of Craig Estes in black ink.

Craig Estes

Handwritten signature of Robert Nichols in black ink.

Robert Nichols

Handwritten signature of Kelly Hancock in black ink.

Kelly Hancock, Chairman

Handwritten signature of Charles Schwertner in black ink.

Charles Schwertner

Handwritten signature of Larry Taylor in black ink.

Larry Taylor

Handwritten signature of John Whitmire in black ink.

John Whitmire

Handwritten signature of Judith Zaffirini in black ink.

Judith Zaffirini

Vice Chair, Natural Resources
and Economic Development
Texas Judicial Council
Chair, Eagle Ford Shale
Legislative Caucus



Judith Zaffirini
State Senator, District 21
President Pro Tempore, 1997

Committees
Administration
Business and Commerce
State Affairs

November 27, 2018

The Honorable
Senator Kelly Hancock, Chair
Senate Committee on Business and Commerce
Sam Houston Building 370
209 West 14th Street
Austin, TX 78701

Dear Chair Hancock:

Thank you for your effective leadership as Chair of the Senate Committee on Business and Commerce. Serving with you is a privilege and honor, and I appreciate the opportunity to share my perspective regarding the Committee's Interim Report to the 86th Legislature. I am delighted to sign the report, which includes many fine recommendations for improving disaster recovery efforts and ending the practice of revoking or refusing professional licenses to persons in default on their student loans, among others. This letter, however, is to express my concerns regarding the sections pertaining to municipally owned utilities and renewable energy, contained in charges 5 and 9, respectively.

Many constituents in my senatorial district are served by public power, so I am glad the committee highlighted the value and stability that municipally owned utilities (MOUs) bring to the ERCOT market, noting they often even outperform the competitive market. Because the MOUs in my district continually strive to be transparent and accountable to their customers, I believe the recommendation to expand the Public Utility Commission's (PUC) review of larger MOUs operating under the direct control of their city governments is not only unwarranted, but also could increase costs and add barriers to MOUs serving their communities.

Austin Energy, an affected MOU mentioned frequently during the committee's deliberations, for example, has taken numerous steps in recent years to improve transparency and accountability, including by establishing affordability goals and an independent rate review process that resembles PUC rate cases. It has proven

responsive to the demands of the Legislature, including recently undergoing a public review of financial data; responding to numerous discovery questions; and completing a public hearing examining its operations, costs, and rates. This process resulted in an agreement reached with large manufacturers, building owners, and out-of-city customers to reduce rates significantly. Accordingly, subjecting the utility to an additional review that could drive up costs seems unnecessary at this time.

What's more, despite plentiful evidence and expert testimony to the contrary, the report misrepresents the effect of wind power on power price reductions and negative pricing in its "Grid Reliability" section. While acknowledging that lower natural gas prices have caused some of the overall price reductions for electricity, the report downplays this fact and instead overemphasizes the role of renewable energy producers. It also links wind power producers to increased use of negative electricity pricing. These assertions, however, are not supported by the available data or the testimony heard by the committee during the interim. Renewable energy is a fixture of Texas' electricity market and essential to the continued prosperity of our state and nation. Although I have no objection to the committee's recommendations for this charge, I am concerned that mischaracterizing the effects of renewable energy production on the market could misinform the public regarding its value to the Texas economy.

Thank you for your dedication to the many important issues we examined during the 85th Interim. I truly enjoy working with you and look forward to continuing to collaborate with you and other committee members during the next legislative session.

May God bless you.

Very truly yours,

A handwritten signature in black ink that reads "Judith Zaffirini". The signature is written in a cursive, flowing style.

Judith Zaffirini

Z/cw

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INTERIM STUDY CHARGES BACKGROUND, FINDINGS AND RECOMMENDATIONS

- 1. Study infrastructure security and energy restoration post weather events. Identify ways state government entities can help utilities more effectively stage pre- hurricane mobilization crews for managing resources before an event.**

BACKGROUND

Hurricane Harvey made its initial Texas landfall at San Jose Island near Port Aransas, around 10 PM Central Time on August 25, 2017 as a Category 4 storm. Harvey later made landfall as a Category 3 storm near the Texas-Louisiana border, then as a tropical storm in Cameron, Louisiana. The maximum sustained winds were 130 miles per hour at initial landfall, causing significant damage to electric infrastructure.¹

According to the National Hurricane Center, Harvey was “the most significant tropical cyclone rainfall event in United States history, both in scope and peak rainfall amounts” in recorded history. Nederland, Texas, reported 60.58 inches of rainfall, while Groves, Texas, reported 60.54 inches, both exceeding the previous tropical storm rainfall record of 52 inches, reported in Hawaii in 1950.²

At Hurricane Harvey’s peak, about 300,000 customers were without power, with additional customers losing power as others were restored. The greatest long-term impediment to restoration was flooding, and 13 million Texans were under flood watch at some point during the storm. The PUC summarized the impacts and response, shortly after the storm, which included initial response efforts:³

¹ National Hurricane Center Tropical Cyclone Report on Hurricane Harvey, May 9, 2018, https://www.nhc.noaa.gov/data/tcr/AL092017_Harvey.pdf

² Ibid.

³ Public Utility Commission, Hurricane Harvey Impact on Electric Utilities, Staff Report, Project 47552, August 30, 2017, Corrected on September 8, 2017, http://interchange.puc.texas.gov/Documents/47552_25_954234.PDF

As of September 8

Company Name	AEP Texas	CenterPoint	Entergy	TNMP
Peak	220,000 / 133,600	100,000 / 79,611	82,000 / 64,191	18,000 / 6,088
Outages/Outages as of 4 PM on Wednesday				
Damaged Structures	2,100 utility poles and 55 transmission structures	Assessment still ongoing due to flooding conditions.	Assessment still ongoing due to flooding conditions.	Assessment still ongoing due to flooding conditions.
Restoration	55 transmission lines and 21 substations restored.	A detailed assessment will be available when water recedes.	A detailed assessment will be available when water recedes.	A detailed assessment will be available when water recedes.
Restoration Crews	3,600 personnel Additional 1,000 within a few days.	3,300 personnel	1,453 personnel	530 personnel

A final assessment by the North American Electric Reliability Council found over 2.02 million consumers were affected by the storm at some point; over 850 transmission structures and 6,200 distribution structures were damaged; and at least 90 substations were damaged.⁴

During the event, nearly 11,000 MW of generation capacity was unavailable, largely due to flooding. The South Texas Project nuclear plant remained operational during the storm and did not experience any storm damage from wind or rain. A storm crew was sequestered on site.⁵

Large retail electric providers offered aid to victims of the storm. TXU Energy pledged \$500,000 in aid, waived late fees, extended payment due dates, and reduced down payments for affected customers.⁶ Reliant Energy, which is based in Houston, provided \$2 million in disaster relief resources and offered payment extensions and deferred payment plans.⁷

As of August 29, 2017 more than 10,000 utility personnel from 20 states were helping to restore electric infrastructure damaged by Harvey.⁸

TESTIMONY

The storm had different effects on different parts of the state. In the Victoria and Corpus Christi areas, AEP Texas crews faced the effect of wind with over 2,000 utility poles downed. The damage in the Houston and Golden Triangle areas was driven by rain and flooding as the storm moved slowly along the coast. Overall, AEP Texas stated it had 68 damaged substations, 1, 400 damaged transformers, 5,000

⁴ North American Electric Reliability Council, Hurricane Harvey Event Analysis Report, March 2018, https://www.nerc.com/pa/rrm/ea/Hurricane_Harvey_EAR_DL/NERC_Hurricane_Harvey_EAR_20180309.pdf

⁵ Ibid.

⁶ TXU Energy, "TXU Energy Pledges \$500,000 to Aid Hurricane-Impacted Customers and Communities," August 30, 2017

⁷ NRG Energy, "NRG Energy and Reliant to Provide Over \$2 Million in Relief for Hurricane Harvey," August 30, 2017

⁸ Edison Electric Institute, "Harvey Response: More Than 10,000 Workers Are Dedicated To Restoring Power," August 29, 2017

damaged poles, and replaced 4 million conductor feet of wire due to the heavy sustained winds. AEP Texas listed 78 entities that had participated in the restoration effort as of October 2017.⁹

Other Participants in the Restoration Effort

AEP Ohio	Disaster Resource Group	Pike Electric
AEP Appalachian Power	Empire District	Plaska
AEP Indiana Michigan Power	Evers Electric	Powerline Services
AEP Kentucky Power	Excel Energy	Power Secure
AEP Public Service Company of Oklahoma	Great Southwestern	ProForce
AEP Southwestern Electric Power Company	Hargrave Power Inc.	QUALITY POWER LINE
5 Star	Higher Power	Quanta Utility Services
Ameren Illinois	Hugo Garcia Electric	Quantum Hargrove
Ameren Missouri	INTREN Inc.	R&J Environmental
Asplundh	Irby Construction	RS Electric Utility Services
Associated Diversified Services	J F Electric Inc.	Safety Management Group (SMG)
Austin Energy	James Power Line	SAM Flight Operations
B&B Utility Contractors	Kansas City Power & Light	Service Electric Company
BBC Electric	Lewis Tree Service	SEC - Southern Electric Corp.
BHI Energy	LineTec	Storm Services
Base Logistics	Louisville Gas & Electric - Kentucky Utilities	Sumter Utilities
Bird Electric	LPE, Inc.	Sun Coast Resources
Bison Electric	Mammoth	SUN TECH ELECTRICAL
CANFER	MasTec	T&D Solutions LLC
Centerpoint	Mesa Line Services	Tech Serv Consulting
Chain Electric Company	MYR Group	Texas New Mexico Power
City Public Service	OG&E Electric Services	UC Synergetic
CT Drilling & Construction	Oncor Electric Delivery	Westar
Davey Resource Group	One Source Restoration	Willbros T&D Services
Davey Tree Company	One Source T&D	William E Groves Construction Inc.
David H. Elliot Company	Par Electrical Contractors	Wright Tree Services

Also, many thanks to Midwest Mutual assistance Group, Texas Mutual Assistance Group and Southeastern Electric Exchange

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CenterPoint Energy testified that the company experienced the equivalent of 3 years of outages in 10 days. Seventeen substations were out of service and 6 substations were lost during the storm. CenterPoint Energy also reported that investments in technology allowed the company to remotely isolate outages and provide more detailed notifications to customers, thanks to its advanced metering systems. The company also built a temporary substation to support restoration efforts.¹¹

Entergy Texas reported that the storm directly affected its service territory for 15 days, creating significant flooding and logistical challenges. About 186,000 of its customers experienced a sustained interruption, representing 41% of its customers. Six substations were completely flooded, while 17 others faced minor

⁹ Direct testimony from Tom Coad, Vice President of Distribution Operations, AEP Texas, to the Texas Senate Committee on Business & Commerce, November 1, 2017

¹⁰ Written testimony submitted by Tom Coad, Vice President of Distribution, AEP Texas, to the Senate Committee on Business & Commerce, November 1, 2017

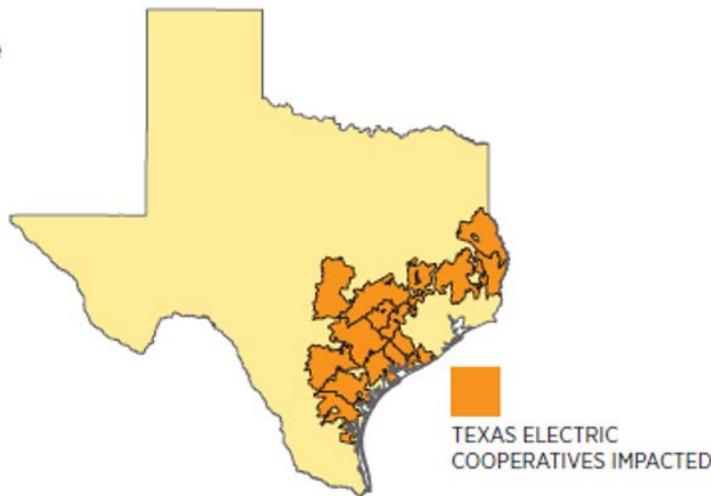
¹¹ Direct testimony from Kenny Mercado, Senior Vice President of Electric Operations, CenterPoint Energy, to the Senate Committee on Business & Commerce, November 1, 2017

substation damage. Oncor, Cleco and Entergy affiliates provided mobile substations to support restoration.¹²

Concurrent to the impact on areas served by the larger electric utilities, municipal utilities and electric cooperatives were actively engaged in restoration and recovery efforts in the aftermath of the storm. Affected municipal utilities experienced approximately 160,000 customer outages as a result of the storm. Cooperatives located in coastal areas were in the more immediate path of the storm experienced approximately 190,000 customer outages to include Victoria and Jackson Electric Cooperatives being totally without power.¹³

Co-ops Affected by the Storm

- Bluebonnet EC, Bastrop
- Deep East Texas EC, San Augustine
- Fayette EC, La Grange
- Guadalupe Valley EC, Gonzales
- Jackson EC, Edna
- Jasper-Newton EC, Kirbyville
- Karnes EC, Karnes City
- Mid-South Synergy, Navasota
- Nueces EC, Robstown
- Pedernales EC, Johnson City
- Sam Houston EC, Livingston
- San Bernard EC, Bellville
- San Patricio EC, Sinton
- Victoria EC, Victoria
- Wharton County EC, El Campo



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These power service providers were assisted in their recovery through mutual assistance agreements with other cooperatives and nearby utilities. During the course of active recovery efforts, 25 cooperatives unaffected by the storm sent warehouse staff and line crews to assist power restoration efforts.¹⁵ Similarly, municipal utilities like CPS dispatched 52 employees to assist AEP South as part of a mutual aid coordination effort. Rudy Garza with CPS Energy noted that during high intensity recovery efforts his company experienced hazards to line crews and bucket trucks by drivers failing to yield lanes to utility crews. He highlighted how modifications of the "Texas Move-Over Law" could be expanded to utility crews as they are trying do their jobs.¹⁶

Key planning provisions essential to recovery efforts for many of the affected utilities was access to predictive software that is available to more accurately forecast where the storm will actually hit. Additionally the pre storm preparedness was essential to expeditious recovery. Supplies were staged based

¹² Direct testimony from Sallie Rainer, President & CEO of Entergy Texas, to the Senate Committee on Business & Commerce, November 1, 2017

¹³ Direct testimony from Eric Craven, Texas Electric Cooperative Association, to the Senate Committee on Business & Commerce, November 1, 2017

¹⁴ Written testimony submitted by the Texas Electric Cooperative Association to the Senate Committee on Business & Commerce, November 1, 2017

¹⁵ Ibid.

¹⁶ Direct testimony from Rudy Garza, CPS Energy, to the Senate Committee on Business & Commerce, November 1, 2017

on the predictive storm forecasts, tents were put on retainer for restoration crews, fuel was stockpiled, and water supplies staged. Pre-storm coordination with emergency operations centers in each county and local leaders was critical for storm preparedness and restoration.¹⁷

As an area for improvement, Eric Craven with the Texas Electric Cooperative Association highlighted the practice of county by county credentialing for people coming into their areas after a storm. As Mr. Craven put it, "that requires our crews to get credentials from six different counties, and it would be helpful if we could get one credential for the entire storm area."¹⁸

DeAnn Walker, Chair of the Public Utility Commission of Texas, discussed the value of mobile substations and potential benefits of stockpiling such equipment for future disaster relief. She noted potential improvements in taxonomy for outage reporting and suggested evaluating the mutual assistance programs to ensure the most effective deployment of utility resources.¹⁹

RECOMMENDATIONS

The restoration efforts following Harvey's landfall and progression along the Texas coast were effective. Aside from electric consumers whose homes were lost to the storm, there were few who faced long-term outages. Electric utilities engage in frequent planning and preparation scenarios which proved to be reasonably effective. Several of the electric utilities that have adopted advanced metering systems were able to use that technology to more accurately pinpoint outages and restore power safely.

- Utilities would benefit from greater access to spare transformers and substations, due to the impact of flooding on electrical devices. In addition, communications between utilities and federal, state & local leaders is critical, and it is appropriate to reassess the nomenclature used among all agencies to ensure those communications are accurate.
- The Texas Department of Emergency Management should develop a standardized credential for essential utility service providers to cross jurisdictional boundaries in federal and state declared disaster areas to speed essential service recovery efforts.
- The Legislature should consider expansion of the "Texas Move Over / Slow Down" Law to include operating utility trucks that would require drivers to vacate the lane closest to the applicable vehicles, or slow down.

¹⁷ Direct testimony from Eric Craven, Texas Electric Cooperative Association, to the Senate Committee on Business & Commerce, November 1, 2017

¹⁸ Direct testimony from Eric Craven, Texas Electric Cooperative Association, to the Senate Committee on Business & Commerce, November 1, 2017

¹⁹ Direct testimony from DeAnn Walker, Chair, Public Utility Commission of Texas, to the Senate Committee on Business & Commerce, November 1, 2017

2. Examine state mortgage requirements regarding the notification of homebuyers on their need for flood insurance in flood plains and flood pool areas and make recommendations on how to better inform consumers.

BACKGROUND

Currently, the notices and insurance provisions for flood insurance are all found in federal law: the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act (1973). Before 1950 flood insurance was part of a standard homeowners' insurance policy. During the 1950s, due to losses many insurance companies began excluding flood coverage from standard insurance policies and sold flood insurance policies separately. Over time, insurance premiums collected were insufficient in covering payouts after major flooding events.²⁰

The National Flood Insurance Program (NFIP) is a program created in 1968 through the National Flood Insurance Act of 1968. The NFIP is administered by the Federal Emergency Management Agency (FEMA). The NFIP enables property owners in participating communities to purchase insurance protection, administered by the Federal government via private contracted insurance company subsidiaries, against losses from flooding. It also requires flood insurance for all loans or lines of credit that are secured by existing buildings, manufactured homes, or buildings under construction, that are located in a community that participates in the NFIP. In sum, the NFIP is designed to provide an insurance alternative to disaster assistance to meet the escalating costs of repairing damage to buildings and their contents caused by floods.²¹

Following the passage of the National Flood Insurance Act in 1968, the Flood Disaster Protection Act of 1973 (Act) was the first-time Congress placed a requirement on financial institutions to develop “mandatory purchase” rules on flood insurance. The Act requires banks to determine whether improved real property that secures a consumer or commercial loan is located in a Special Flood Hazard Area (SFHA). The Act prohibited financial institutions from making, increasing, renewing, or extending loans to real property in the SFHA without the procurement of flood insurance for the term of the loan if National Flood Insurance Program (NFIP) insurance was available.²²

If a property is determined to be located in a SFHA, the bank must further determine whether the community participates in the NFIP. If both are true, then the bank must require the borrower to obtain flood insurance on the improvements within the requirements of the NFIP. The borrower must receive a notice regarding the SFHA and the obligation to obtain flood insurance within a reasonable time before

²⁰ United States Government Accountability Office, Flood Insurance - Comprehensive Reform Could Improve Solvency and Enhance Resilience, April 27, 2017 <https://www.gao.gov/products/GAO-17-425>

²¹ Ibid

²² Written testimony submitted by Joshua Stuckey, Chief Administrative Officer, Harris County to the Texas Senate Committee Business & Commerce, November 1, 2017

consummation of the loan (usually ten days). If the borrower does not obtain the insurance (or fails to renew it), then the bank must force place it.²³

Texas Finance Code, Chapter 307 relates to collateral protection insurance and provides that when a debtor has failed to purchase the required collateral protection insurance (e.g. flood insurance), the lender shall give notice to the debtor that the lender has purchased or will purchase collateral protection insurance at the debtor's expense as provided by the credit agreement.²⁴

Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance

We are giving you this notice to inform you that:

The building or mobile home securing the loan for which you have applied is or will be located in an area with special flood hazards.

The area has been identified by the Director of the Federal Emergency Management Agency (FEMA) as a special flood hazard area using FEMA's *Flood Insurance Rate Map* or the *Flood Hazard Boundary Map* for the following community: _____. This area has at least a one percent (1%) chance of a flood equal to or exceeding the base flood elevation (a 100-year flood) in any given year. During the life of a 30-year mortgage loan, the risk of a 100-year flood in a special flood hazard area is 26 percent (26%).

Federal law allows a lender and borrower jointly to request the Director of FEMA to review the determination of whether the property securing the loan is located in a special flood hazard area. If you would like to make such a request, please contact us for further information.

____ The community in which the property securing the loan is located participates in the National Flood Insurance Program (NFIP). Federal law will not allow us to make you the loan that you have applied for if you do not purchase flood insurance. The flood insurance must be maintained for the life of the loan. If you fail to purchase or renew flood insurance on the property, Federal law authorizes and requires us to purchase the flood insurance for you at your expense.

- Flood insurance coverage under the NFIP may be purchased through an insurance agent who will obtain the policy either directly through the NFIP or through an insurance company that participates in the NFIP. Flood insurance also may be available from private insurers that do not participate in the NFIP.

- At a minimum, flood insurance purchased must cover *the lesser of*:

- (1) the outstanding principal balance of the loan; or
- (2) the maximum amount of coverage allowed for the type of property under the NFIP.

Flood insurance coverage under the NFIP is limited to the overall value of the property securing the loan minus the value of the land on which the property is located.

- Federal disaster relief assistance (usually in the form of a low-interest loan) may be available for damages incurred in excess of your flood insurance if your community's participation in the NFIP is in accordance with NFIP requirements.

____ Flood insurance coverage under the NFIP is not available for the property securing the loan because the community in which the property is located does not participate in the NFIP. In addition, if the non-participating community has been identified for at least one year as containing a special flood hazard area, properties located in the community will not be eligible for Federal disaster relief assistance in the event of a Federally-declared flood disaster.

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²³ Written testimony submitted by Karen Neeley, Senior Counsel, Independent Bankers Association of Texas to the Texas Senate Committee Business & Commerce, November 1, 2017

²⁴ Written testimony submitted by Caroline Jones, Commissioner, Texas Department of Savings & Mortgage Lending to the Texas Senate Committee Business & Commerce, November 1, 2017

²⁵ Written testimony submitted by Karen Neeley, Senior Counsel, Independent Bankers Association of Texas to the Texas Senate Committee Business & Commerce, November 1, 2017

Homeowners can acquire up to \$350,000 of flood coverage through NFIP, with \$250,000 for the building itself and another \$100,000 for its contents. Owners of residential properties with five or more units can purchase \$500,000 of structural coverage and \$100,000 for the structure's contents. Commercial property owners can purchase \$500,000 of structural coverage and \$500,000 of coverage for contents.²⁶

Property owners outside of high-risk areas should know 26 percent of all NFIP claims come from areas considered to be at low or moderate risk for floods. In those lower-risk areas, property owners may qualify for a Preferred Risk Policy, which provides the same level of coverage as a standard policy but at a lower cost.²⁷

Here is the standardized process of compliance lenders must follow when issuing a loan:

- Based on a “in or out” concept, the lender determines horizontal geography of structure to make a Flood Hazard Determination
- Lender must provide notice to the borrower that the property is located in a SFHA
- Lender discloses (1) the mandatory purchase requirement, (2) flood insurance availability, and (3) availability of federal disaster relief
- The coverage amount determination of a structure: lesser of the loans outstanding principle; or, the max \$250,000 offered by the NFIP²⁸

The NFIP plays a critical role in federal efforts to improve resilience to flooding (the ability to absorb and recover from such events), but it faces a number of financial and management challenges. Competing aspects of NFIP—keeping flood insurance affordable while making the program fiscally solvent—have made it difficult to reform the program. Specifically, it has been challenging to promote participation in the program while at the same time attempting to fund claim payments with premiums paid by NFIP policyholders.²⁹

To help promote the purchase of flood insurance, Congress has authorized the NFIP to charge discounted premium rates to many policyholders but no Federal appropriations have been made available to make up for that discount. As a result, premium revenue has been insufficient to pay claims over the long term, and FEMA has had to borrow from the U.S. Department of the Treasury to pay losses resulting from major natural disasters (such as Hurricanes Katrina, Rita, and Wilma in 2005, Superstorm Sandy in 2012, and Hurricane Harvey in 2017).³⁰

²⁶ Federal Emergency Management Agency, "Texans Can avert Financial Disaster with Flood Insurance", May 2, 2018 <https://www.fema.gov/news-release/2018/05/02/texans-can-avert-financial-disaster-flood-insurance>

²⁷ Federal Emergency Management Agency, "Texans Can avert Financial Disaster with Flood Insurance", May 2, 2018 <https://www.fema.gov/news-release/2018/05/02/texans-can-avert-financial-disaster-flood-insurance>

²⁸ Written testimony submitted by Joshua Stuckey, Chief Administrative Officer, Harris County to the Texas Senate Committee Business & Commerce, November 1, 2017

²⁹ United States Government Accountability Office, Flood Insurance - Comprehensive Reform Could Improve Solvency and Enhance Resilience, April 27, 2017 <https://www.gao.gov/products/GAO-17-425>

³⁰ Ibid

The total number of NFIP policies nationally dropped by about 10 percent over the last 5 years, to about 4.9 million. The drop came after Congress required a premium hike in 2012 and about a half million homeowners elected to drop their coverage.³¹

Flood Insurance Written Premium (\$M)			
State	Private Coverage		NFIP
	2017	2016	Jan. 2018
Florida	84.5	47.8	961.9
California	72.0	48.8	189.6
Texas	53.5	31.8	399.2
New York	47.7	27.4	206.1
New Jersey	28.9	17.0	221.3
Pennsylvania	18.8	13.2	65.7
Louisiana	17.9	11.5	357.2
Massachusetts	15.3	9.0	78.2
Ohio	14.2	5.6	33.5
Illinois	14.0	9.8	42.2

SOURCES: S&P Global, FEMA

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Ahead of Hurricane Harvey making landfall in August 2017, the NFIP was \$24.6 billion in debt to the U.S. Treasury. FEMA and Congress have made limited progress in making the program more fiscally self-sustaining.³³

In October 2017, Congress forgave \$16 billion of NFIP debt and on August 2nd, 2018 a four-month extension of NFIP was signed into law. This was the seventh time Congress has had to reauthorize the program since September 2017.³⁴

³¹ Associated Press, "FEMA Insurance Chief: Harvey losses could top \$11 billion", September 13, 2017

<https://apnews.com/1d29f6c7277847a998e773d2d2a26a2c>

³² Insurance Journal, "Private Flood Insurance Market is Getting Bigger, More Competitive, Less Profitable", March 18, 2018

<https://www.insurancejournal.com/blogs/right-street/2018/03/18/483689.htm>

³³ Dallas Morning News, "Senate reauthorizes Harvey-depleted flood insurance program hours before expiration", July 31, 2018 <https://www.dallasnews.com/news/politics/2018/07/31/senate-reauthorizes-flood-insurance-program-just-hours-before-set-expire>

³⁴ Tampa Bay Times, "Trump signs bill extending National Flood Insurance Program", July 31, 2018

<https://www.tampabay.com/florida-politics/buzz/2018/07/31/trump-signs-bill-extending-national-flood-insurance-program/>

Lawmakers and industry groups alike agree that the NFIP needs vital reforms, but ultimately a short-term reauthorization was decided upon in place of having the program lapse in the absence of reform. "The NFIP does not accurately measure or charge for flood risk, which means that tens of thousands of its policyholders are lulled into a false sense of security when they are really in harm's way," U.S. Rep. Jeb Hensarling, R-Texas, told Congressional colleagues after the recent extension of the program. "The program also creates perverse incentives to build and rebuild homes in flood-prone areas."³⁵

The U.S. market for privately written flood insurance grew by 51.2 percent last year, with state-level markets growing both more competitive and less profitable, according to 2017 statutory insurance filings compiled by S&P Global Market Intelligence. The S&P data stem from statutory filings made to state regulators and the National Association of Insurance Commissioners. The figures include both residential and commercial policies.³⁶

Comparing S&P's data with that of NFIP, as reported in January 2018 by FEMA, private coverage now represents nearly 15 percent of all flood premiums nationwide. There was \$623.8 million of private flood insurance written in 2017, up from \$412.6 million in 2016. By contrast, the NFIP had \$3.57 billion of in-force premium as of January 2018.³⁷

After Hurricane Harvey, more than 91,000 Texans filed flood insurance claims, and as of May 2018 NFIP has paid out an estimated \$8.68 billion in flood claims. Nearly 676,000 Texans are now covered by flood insurance, including more than 90,000 who have signed up since Harvey and that number continues to rise.³⁸

TESTIMONY

On November 1st, 2017, the Senate Committee on Business & Commerce convened to study this charge with invited testimony from industry stakeholders.

Karen Neeley, representing the Independent Bankers Association of Texas, discussed federal requirements for notifying homebuyers of their need for flood insurance. Ms. Neeley explained that if a consumer were to receive a loan from a federally regulated entity, the mortgage lender would be required to make a flood determination. "Once the lender gets the certification on the property as to the flood zone determination, then if the property is in a participating community, meaning that they participate in NFIP, National Flooding Insurance Program, there is a requirement to have the flood insurance placed."³⁹

Neeley stressed the importance of Congress extending NFIP and also urged outside-the-box thinking to come up with a better solutions, "Floods occur, for example, on Onion Creek in Austin. So that you have

³⁵ Tampa Bay Times, "Trump signs bill extending National Flood Insurance Program", July 31, 2018

<https://www.tampabay.com/florida-politics/buzz/2018/07/31/trump-signs-bill-extending-national-flood-insurance-program/>

³⁶ Insurance Journal, "Private Flood Insurance Market is Getting Bigger, More Competitive, Less Profitable", March 18, 2018
<https://www.insurancejournal.com/blogs/right-street/2018/03/18/483689.htm>

³⁷ Ibid

³⁸ Federal Emergency Management Agency, "Texans Can avert Financial Disaster with Flood Insurance", May 2, 2018
<https://www.fema.gov/news-release/2018/05/02/texans-can-avert-financial-disaster-flood-insurance>

³⁹ Direct testimony from Karen Neeley, Senior Counsel, Independent Bankers Association of Texas to the Texas Senate Committee Business & Commerce, November 1, 2017

houses that have been torn down and their land bought, so nobody will build a house there again. So it could be on a creek, it could be on a lake, it could be on a river. It's not just a coastal issue, it is a national concern. The more we can spread the cost over more responsible homeowners and commercial property owners, let me add, then the better off the entire system would be."⁴⁰

John Fleming, representing the Texas Mortgage Bankers Association, testified that federal notification requirements regarding the need for flood insurance apply to all federally regulated mortgage loans, which comprise nearly every residential home loan made in the US. "This requirement is imposed on any federally related mortgage loan. That virtually means almost every loan on a residence generated in this country." Fleming testified.⁴¹

Expressing concerns over the future of the NFIP, Fleming noted that the NFIP lost \$1.6 billion in 2016 because premiums were insufficient to cover revenue. He also testified that NFIP has run a deficit of \$25 billion over the last 7 years because premiums again were insufficient to cover total losses. "The [U.S.] Government Accountability Office considers the National Flood Insurance Program to be a high risk program in the sense that it has significant internal structural weaknesses." Fleming added.⁴²

Fleming concluded, "There are several claims that have been made under the National Flood Insurance Program, where homeowners, over a course of a number of years, have received four times the value of their home because it's flooded four times, been destroyed four times, and been rebuilt four times. So I think they're a very serious public policy issue that are out there for that. And as of today, no one has come up with a consensus solution."⁴³

Joshua Stuckey is the Chief Administrative Officer for Harris County Public Infrastructure and a subject matter expert for the technical mapping Advisory Committee, a group that is appointed by the White House to work with FEMA. In addition, Stuckey is the Chairman for Flood Plain Management for NAFSMA, National Association of Flood and Stormwater Management Agencies and has been the Flood Plain Administrator for Harris County the past for five years along with serving as a Building Official.

Stuckey testified that with Harvey 73% of flooded homes in the unincorporated areas of Harris County were outside of a floodplain and that the owners of those homes would not have received any flood insurance notification under federal requirements: "Notice it [the Federal flood insurance form] says, are you in or are you out. It doesn't say, how deep you are in the flood plain. So if I'm in the flood plain with my neighbors that might be a little bit closer to the creek. I could be five feet up, but geographically I'm in the flood plain, I'm more protected than they are. They're going to get potentially in a 100 year event or 1% chance in any given year. They're going to get five feet of water, I might get six inches. There's a huge difference in risk between those two scenarios. So there's a little bit of that about how do we articulate the risk to the constituents. But at the end of the day, a lot of folks aren't building in the flood plain anymore and we really need to look at the people that live outside the flood plain when there are transactions."⁴⁴

⁴⁰ Direct testimony from Karen Neeley, Senior Counsel, Independent Bankers Association of Texas to the Texas Senate Committee Business & Commerce, November 1, 2017

⁴¹ Direct testimony from John Fleming, Texas Mortgage Bankers Association to the Texas Senate Committee Business & Commerce, November 1, 2017

⁴² Ibid

⁴³ Ibid

⁴⁴ Direct testimony from Joshua Stuckey, Chief Administrative Officer, Harris County to the Texas Senate Committee Business & Commerce, November 1, 2017

Stuckey expressed the need for the market to produce a cheap flood insurance product for homes in low risk areas and that including less risky properties in the insurance pool could further spread the cost of repairs during extreme weather events like Harvey. Stuckey concluded, "The only people that buy flood insurance are individuals that pretty much know they are going to flood. So you have an entire risk pool of bad risk. And that is why they [NFIP] were, at one point, \$32 billion in debt."⁴⁵

Caroline Jones, Commissioner of the Texas Department of Savings & Mortgage Lending (DSML), discussed consumer complaints received by DSML, specifically that too few consumers understand the process by which flood insurance benefits are disbursed and many complain when they do not receive their benefit all at once while, in reality, an insurance provider deposits the benefit into an escrow account that disburses money as repairs are made to the home. "We're receiving complaints from consumers whose flood insurance check has arrived. As is typical, it's made payable to the lender and to the borrower. The lender puts the proceeds into a restricted escrow fund and disperses them as payments are made. As repairs are made, they make sure the repairs are made. They make sure the subcontractors have been paid. But what we're getting is consumers who don't understand that process. And so they're filing a complaint with us, wanting to get all of those funds at the same time. So what we've done when that occurs is to check with the mortgage servicer, make sure the process, the issue I just described is, in fact, the issue that's going on. And then we explain to the consumer what that process is so that their expectations going forward can be more realistic." Jones testified.⁴⁶

RECOMMENDATIONS

The Committee believes Hurricane Harvey and its aftermath highlighted a glaring issue with the validity of the flood maps, specifically the issue of under-inclusion. With Harvey, many of the areas that were inundated with flood water were (correctly, under Federal law) not identified as Special Flood Hazard Areas (SFHAs) in securing a loan. Many Texans in reviewing their mortgage requirements were never advised to obtain flood insurance as it was not required given their home's location on the flood maps. All communities do not participate in the NFIP, therefore properties in SFHAs in such communities are not eligible for federal flood insurance. The market for private insurance exists, but costs for coverage are extremely high compared to the heavily subsidized NFIP and often high-risk policies are not written as they are not seen as economically viable by private insurers.

Notices are required under current Federal law when loans are made by regulated lending institutions, which includes banks, savings banks, credit unions, farm credit bank, production credit association, and similar entities subject to supervision by a federal regulator.⁴⁷

Insurance companies, academics, consumer advocates, and others have proposed a number of options for reforming NFIP, including: changes to NFIP premium rates, increased involvement of private-sector

⁴⁵ Direct testimony from Joshua Stuckey, Chief Administrative Officer, Harris County to the Texas Senate Committee Business & Commerce, November 1, 2017

⁴⁶ Direct testimony from Caroline Jones, Commissioner, Texas Department of Savings & Mortgage Lending to the Texas Senate Committee Business & Commerce, November 1, 2017

⁴⁷ 42 USC Chapter 50; 12 CFR 22 (OCC), 208 (Fed), 339 (FDIC), 614 (FCA), and 760 (NCUA)

insurers, new roles for the federal government, and revisions to requirements for the purchase of flood insurance.

- The Committee recommends urging FEMA to update SFHA maps so that an expanded consumer segment would be eligible to participate in the NFIP, thus spreading risk mitigation costs over a larger population.
- The Committee recommends promoting flood risk resilience while minimizing fiscal exposure to the federal government.
- The Committee also recommends continued encouragement of consumer participation in the private flood insurance market which could help drive down premiums.
- The Texas Finance Code does not address requirements to notify borrowers about flood insurance. The Committee notes that to do so would be duplicative of federal law and could be burdensome and inconsistent.

3. Examine local government regulations, including occupational licenses, as related to Hurricane Harvey and determine if any are a detriment to rebuilding efforts.

BACKGROUND

On September 7th, 2017 Governor Greg Abbott announced the Governor's Commission to Rebuild Texas, which will be led by Texas A&M University System Chancellor John Sharp. The Commission oversees the response and relief effort between the state and local governments to ensure victims of the storm get everything they need as quickly as possible. The Commission has been involved in the rebuilding process, focusing on restoring roads, bridges, schools and government buildings in impacted communities.⁴⁸

In coordination with the Governor's Harvey disaster proclamation, the Texas Department of Licensing & Regulation (TDLR) implemented fast-track licensing procedures for all eligible TDLR licensees to help them recover and return to work as quickly as possible. The following procedures took effect September 1st, 2017 and remained in effect for the duration of the declared disaster period and any extensions:

- License expiration dates automatically extended - All licensees in the affected counties currently in the renewal period will have their license expiration dates automatically extended by 60 days.
- Late fees and license replacement fees automatically waived - TDLR will waive renewal late fees and offer replacement licenses at no cost for all eligible licensees in the affected counties.
- Continuing education (CE) requirements automatically waived - All eligible licensees in the affected counties may renew without completing continuing education requirements. Not all licensing programs require continuing education. In the Licensing Programs with Extended Expiration Dates list below, an asterisk (*) marks each program where continuing education requirements are waived.
- Extended grace period for expired licenses - Licensees in the affected area with licenses expired beyond the usual expiration limits will be allowed to renew.⁴⁹

⁴⁸ Office of Texas Governor Greg Abbott, "Governor Announces Commission to Rebuild Texas", September 7, 2017 <https://gov.texas.gov/news/post/governor-abbott-announces-commission-to-rebuild-texas>

⁴⁹ Written testimony submitted by Brian Francis, Executive Director, Texas Department of Licensing & Regulation to the Texas Senate Committee Business & Commerce, November 1, 2018

Licensing Programs with Extended Expiration Dates:

Air Conditioning & Refrigeration Contractors*	Elevators, Escalators & Related Equipment ^{2,*}	Property Tax Consultants*
Architectural Barriers*	Hearing Instrument Fitters & Dispensers*	Property Tax Professionals*
Athletic Trainers*	Industrialized Housing & Buildings	Service Contract Providers
Auctioneers*	Legal Service Contracts	Speech-Language Pathologists & Audiologists*
Barbers	Licensed Breeders	Tow Trucks ^{3,*}
Boilers ¹	Midwives*	Used Automotive Parts
Combative Sports	Orthotists & Prosthetists	Recyclers
Cosmetology*	Podiatrists*	Vehicle Storage Facilities
Dietitians*	Polygraph Examiners*	Water Well Drillers & Pump Installers*
Driver Education & Safety*	Professional Employer Organizations	Weather Modification
Dyslexia Practitioners & Therapists*		
Electricians*		

¹ For the Boilers Program, TDLR is not extending licensing expiration dates for boiler equipment to ensure public safety. In addition, TDLR is not extending licensing expiration dates for authorized inspection agency licensees because the license's expiration date is connected with the national board certification date. Boiler inspector licensing expiration dates are extended.

² For the Elevators, Escalators & Related Equipment Program, TDLR is not extending licensing expiration dates for elevator equipment to ensure public safety. All other licensing expiration dates for the program are extended.

³ For Tow Trucks, TDLR is not extending licensing expiration dates for incident management, consent, and private property tow truck licenses to ensure public safety. All other licensing expiration dates for the program are extended.

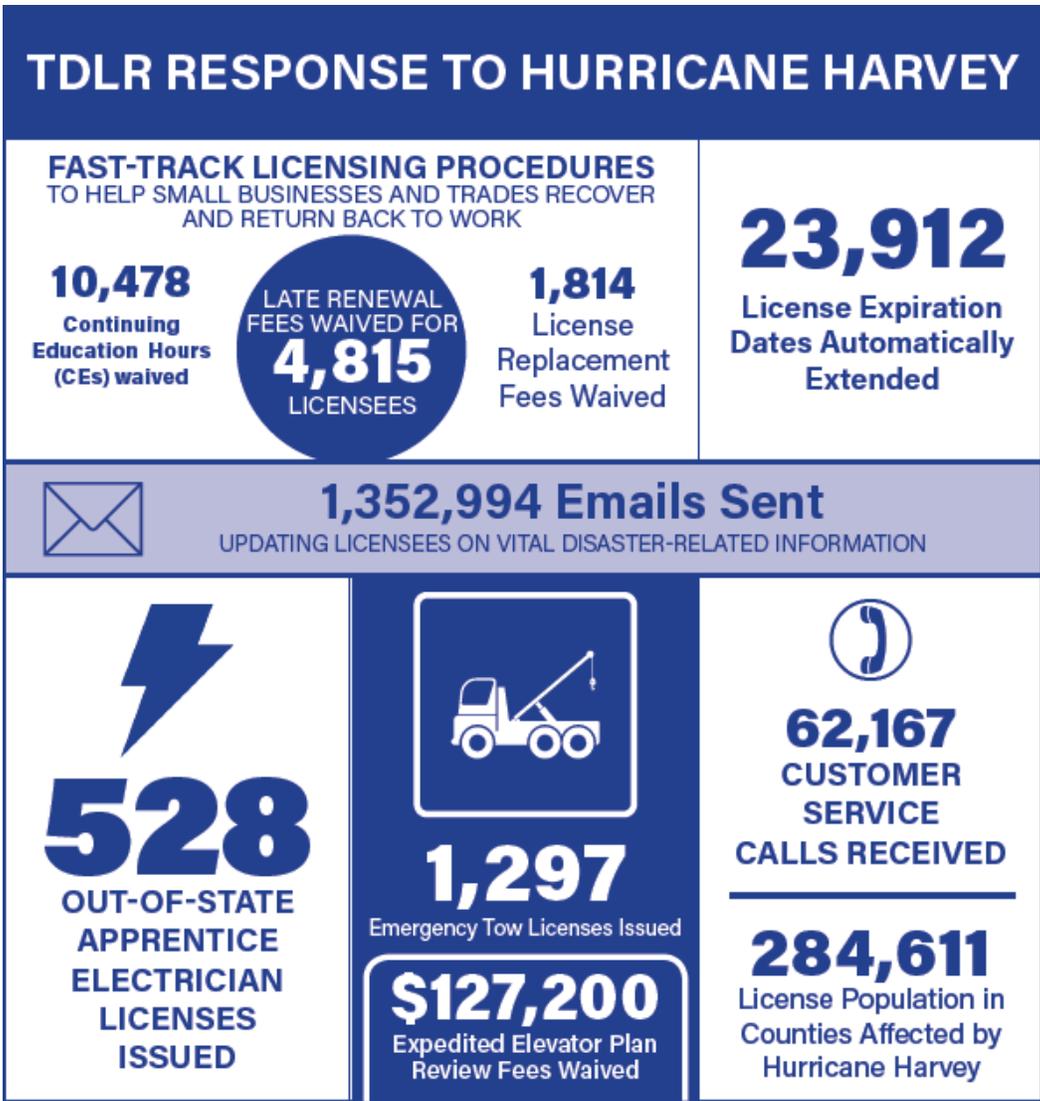
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In addition, during the disaster proclamation period TDLR fast-tracked all state-required plan reviews and inspections for:

- Elevators
- Boilers (internal extension requests)
- Tow Trucks and Vehicle Storage Facilities
- Barber and Cosmetology Schools
- Licensed Breeders (pre-license inspection)⁵¹

⁵⁰ Written testimony submitted by Brian Francis, Executive Director, Texas Department of Licensing & Regulation to the Texas Senate Committee Business & Commerce, November 1, 2018

⁵¹ Ibid



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In conjunction with the state-level response, local government-focused efforts to rebuild following a disaster are paramount to the survival of a community and this was especially true following Hurricane Harvey. Not only were residents displaced as they struggled with the devastation, affected local governments encumbered enormous expenses followed by extreme drops in property values and sales taxes. Rapid and deliberate reconstruction of infrastructure, housing, and commerce is paramount and the only way that these communities will be able to return. The effects of the event are still being felt throughout entire affected communities; homes, businesses, economies and schools that all suffered extensive damage and local governments continue to work hard to make a comeback.⁵³ Still, local officials in affected areas do not expect a full recovery for 3-5 years (2020 to 2022).⁵⁴

⁵² Written testimony submitted by Brian Francis, Executive Director, Texas Department of Licensing & Regulation to the Texas Senate Committee Business & Commerce, November 1, 2018

⁵³ Written testimony submitted by Jim Olk, Statewide Disaster Response Team, Building Officials Association of Texas, to the Texas Senate Committee Business & Commerce, November 1, 2018

⁵⁴ Written testimony submitted by Charles Wax, Mayor, City of Rockport, Texas to the Texas Senate Committee Business & Commerce, November 1, 2018

A number of affected municipalities set consumer protection of their residents as a primary goal in the recovery/rebuilding efforts by thoroughly vetting the contractors, builders, and tradesmen that were performing work within the jurisdiction of the municipality. As has been seen time and time again in Texas following natural disasters, the number of predatory, fly-by-night contractors arriving into a community skyrockets. Over the years the Texas Legislature has heard horror story after horror story about these bad actors that arrive following a disaster, making promises to those in need, and then taking money up front to then do only minimal work, if not abandoning the project entirely. The reputable and reliable contractors are then burdened with overcoming the distrust and skepticism created by unscrupulous or inexperienced contractors.⁵⁵

Affected cities like Rockport register all contractors working in the community, review their qualifications, ensure the proper certifications and insurance coverages, and often issues city identification name plates. This was needed as numerous contractors from all over Texas as well as from other states arrived to assist in the recovery effort, but were unfamiliar with the specific requirements of local governments. Expedited permitting in Rockport allowed the city to issue 941 building permits between August 28th, 2017 and October 24th, 2017 with a total value of the work from those permits estimated at \$19.3 million. In addition, over this same period 158 demolition permits were processed and 190 electrical permits were pulled.⁵⁶

Local governments have the same goal as the State, to make sure their citizens have safe, efficient, and fair construction activity to meet their recovery needs. With Harvey, local governments worked hard to make sure that the permit process ensures that all builders and support trades (e.g. - electrical, plumbing, etc.) working in their cities are well-trained, perform quality work, and are provided with the best information and service available. In addition, local governments worked to ensure that all state and local rules protecting the health, safety, and welfare of our citizens were being applied. All this was accomplished with very minimal impediment to contractors working diligently to rebuilding our affected communities.

TESTIMONY

On November 1st, 2017, the Senate Committee on Business & Commerce convened to study this charge with invited testimony from elected officials in Harvey-affected areas of the state as well as industry stakeholders.

Charles Wax, Mayor of Rockport, testified that the entire city of Rockport sustained extensive damage and that repairs will take at least 3-5 years to complete. Mayor Wax stated unequivocally that the occupational licensing process in Texas has not impacted any aspect of Rockport's recovery options thus far.⁵⁷

⁵⁵ Written testimony submitted by Jim Olk, Statewide Disaster Response Team, Building Officials Association of Texas, to the Texas Senate Committee Business & Commerce, November 1, 2018

⁵⁶ Written testimony submitted by Charles Wax, Mayor, City of Rockport, Texas to the Texas Senate Committee Business & Commerce, November 1, 2018

⁵⁷ Direct testimony from Charles Wax, Mayor, City of Rockport, Texas to the Texas Senate Committee Business & Commerce, November 1, 2018

"Our goal as a municipality is the same as the State of Texas. We want quality, skilled labor to engage in our construction efforts as soon as possible. The city registers all contractors in working in the community. Reviews their qualifications, ensures the proper certifications and insurance coverages, and issues them a city identification plate. We established this process to protect our citizens from expenses that would not meet proper code levels, especially those associated with one star requirements. This was needed as we had multiple contractors from all over Texas and other states ascending on our community who are unfamiliar with some of those specific requirements. We do not charge a fee for this service to our community and we often, barring complication, issue contractor permits the same day. We also turn around permits, such as roofing, electrical, plumbing, framing, and so forth, in one to two business days." Wax testified.⁵⁸

Wax explained that the process for verifying licensing credentials in Rockport is made simple so that crews can begin work immediately. He said that occupational licensee's qualifications are reviewed by the city within one to two business days at no charge to ensure public safety and code compliance. Rockport is working with FEMA and the Texas General Land Office (GLO) to ensure that there is sufficient housing for the influx of new labor in the rebuilding effort, in addition to Rockport's current population. Wax said that Rockport will need long-term assistance from the state and federal government to make a full recovery. Rockport issued 941 building permits between August 28th and October the 24th of 2017. Total value of that work was approximately \$19.3 million.⁵⁹

Wax continued, "Our staff works hard to make sure that the permit process ensures that all builders in support trades, electrical, plumbing, framing, working in our city are well trained, perform quality work, and are provided with the best information service available. In this way, we are doing our part in the recovery operation and do not impede the construction and redevelopment process. No significant issues regarding occupational licenses or permitting issues have been brought to my attention or to city management."⁶⁰

Wax detailed the vetting process conducted by their trained building and development officials which helps assure their citizens that they are not falling prey to suspicious or out of state contractors without the appropriate credentials. In addition, Mayor Wax and his team worked to ensure that all state and local rules protecting the health, safety, and welfare of our citizens are being applied. All of this was being accomplished with very minimal impact to contractors.⁶¹

Wax continued, "We're moving rapidly towards rebuilding our community from the devastating impacts of Harvey. We are also working on a long-term recovery plan. The key elements of that plan in priority order for our team are as follows. Debris removal, safety and cleanup, housing, short and long-term, economic recovery of key industries, stabilization of critical government services. Public communication,

⁵⁸ Direct testimony from Charles Wax, Mayor, City of Rockport, Texas to the Texas Senate Committee Business & Commerce, November 1, 2018

⁵⁹ Written testimony submitted by Charles Wax, Mayor, City of Rockport, Texas to the Texas Senate Committee Business & Commerce, November 1, 2018

⁶⁰ Direct testimony from Charles Wax, Mayor, City of Rockport, Texas to the Texas Senate Committee Business & Commerce, November 1, 2018

⁶¹ Written testimony submitted by Charles Wax, Mayor, City of Rockport, Texas to the Texas Senate Committee Business & Commerce, November 1, 2018

short and long-term, and management of donation resources. As we rebuild from Harvey, both the city and the county will use those principles to guide our next steady progress in our recovery efforts."⁶²

When asked by the Committee whether Rockport had worked with other communities to address recovery issues, Mayor Wax said that adjacent municipalities have provided such assistance as police manpower and vehicles to provide basic security to the city. E.g. - Texas Task Force 1 arrived on-site and commenced operations immediately after the storm.⁶³

Wax added that Rockport predicts that it will lose 35% of its property tax base as a result of Harvey and that Rockport has sufficient funds for 147 days of normal operations. Mayor Wax and his team were currently looking for a solution before those funds are exhausted, after which either the level of service that the city is able to provide citizens will decline or the city will increase property taxes to an, "unimaginably high level."⁶⁴

Wax concluded by reiterating that Rockport does not license at the local level and that the state should change nothing about its occupational licensing with respect to its response to storm recovery.⁶⁵

Jimmy Sims, Mayor of Orange, testified that the City of Orange received a quick response from the state and federal government and that the city had removed approximately 4,000 containers worth of debris, spent \$1.8 million on debris removal, and completed approximately 60% of a "first pass debris removal."⁶⁶

Mayor Sims continued, "We have removed 4,692 containers [of debris], which relates to almost 190,000 cubic yards of material that we have to dispose of. And, as a small community of Orange, we're almost 2,000 people, but we're the largest city in our rural county. Most little cities don't have any money at all to be able to recover, so they have to rely on FEMA. We formed a multi aid agreement with the county to pick up all the debris. And we'd meet as if we were one city. And that has really been the nucleus to help us recover, instead of in the past where we were kind of on our own."⁶⁷

Mayor Sims said that flooding was the primary cause of damage in Orange, as the city received 62 inches of rain, which affected 80% of homes and destroyed all of the city's schools. The damage to Orange was so extensive that Mayor Sims could not predict how long recovery would take. He added that only two of every ten residents has flood insurance and expressed concern that few people affected will return to live in Orange.⁶⁸

The Committee asked Mayor Sims about wage theft and fly-by-night contractors and he testified that such activity did not occur to any significant degree in Orange, adding that local protections were effective on

⁶² Direct testimony from Charles Wax, Mayor, City of Rockport, Texas to the Texas Senate Committee Business & Commerce, November 1, 2018

⁶³ Ibid

⁶⁴ Ibid

⁶⁵ Ibid

⁶⁶ Direct testimony from Jimmy Sims, Mayor, City of Orange, Texas to the Texas Senate Committee Business & Commerce, November 1, 2018

⁶⁷ Ibid

⁶⁸ Ibid

this occasion. Mayor Sims concluded that the state needs to modernize its disaster response to avoid multiple entities providing duplicated or uncoordinated relief.⁶⁹

Scott Norman, representing the Texas Association of Builders, testified that the response by local governments has been commendable, especially considering the difficult circumstances, and estimated that between 100K and 200K homes would be affected in some way, "I have nothing but compliments to give to the local governments."⁷⁰

Norman noted that the home building industry was suffering from a labor shortage before Harvey, and that damage from Harvey will significantly increase the demand for home building and repairs. Norman testified that unaffected areas are not experiencing departures of subcontractors but that subcontractors' crews are departing for the Gulf Coast in search of work, which, he contended, will indirectly affect all other areas of the state.⁷¹

When asked by the Committee about alternative options for meeting labor demands, Norman suggested that construction trade programs should be re-implemented in schools and discussed the programs that currently exist.

Regarding fly-by-night contractors, Norman said that some fly-by-night scammers have appeared in the region but that local media and the Texas Association of Builders have raised awareness of these scams.

Brian Francis, representing the Texas Department of Licensing & Regulation, testified that they had identified emergency responses with the Governor before Harvey had hit land and discussed waiving several license renewal fees. "Before the storm touched ground we had already coordinated with the Governor's office and identified some emergency provisions that were going to help immediately. And that was putting in emergency tow operator and tow company licenses. Making sure that when those vehicles are stranded, we know the numbers are 300,000 plus vehicles were stranded during this event, we had more than 1,050 individuals come in from other states. They were able to do that online and immediately get up and running. To put that in context, the last event that we had there were 93 individuals that came to Texas to help out. So having 1,050 of those folks up and running who made the difference." Francis testified.⁷²

Francis testified that TDLR needs to develop a suite of rules and responses for the next emergency, including putting fee waivers and certain exemptions into TDLR rules, which would help the agency to tailor nimble responses to each unique event. Francis also suggested creating a clearinghouse of resources for people affected by the next disaster. "We waived the fees for duplicate and replacement licenses...Similarly, we waived the late renewal portion. So, anyone who was renewing late during that time period, we waived that fee for those individuals. There were 23,912 licenses that we extended. So

⁶⁹ Direct testimony from Jimmy Sims, Mayor, City of Orange, Texas to the Texas Senate Committee Business & Commerce, November 1, 2018

⁷⁰ Direct testimony from Scott Norman, Executive Director, Texas Association of Builders to the Texas Senate Committee Business & Commerce, November 1, 2018

⁷¹ Written testimony submitted by Scott Norman, Executive Director, Texas Association of Builders to the Texas Senate Committee Business & Commerce, November 1, 2018

⁷² Written testimony submitted by Brian Francis, Executive Director, Texas Department of Licensing & Regulation to the Texas Senate Committee Business & Commerce, November 1, 2017

those individuals did not have to worry about getting renewed. We were able to update their information online and their licenses were still active." Francis continued.⁷³

Francis concluded by stressing the importance of developing a full suite of emergency rules ahead of the next natural disaster, "Whether it's an extension of an expiration dates, waiving licensee fees, duplicate license fees, replacement license fees, we now are looking at exploring putting those into emergency rules, so the next time a disaster hits we're able to move very quickly with the governor's office and say let's enact this provision as opposed to identifying the specific number of the items we need to waive in coordinate with local building officials."⁷⁴

Jim Olk, representing the Statewide Disaster Response Team for the Building Officials Association of Texas (BOAT), testified that local regulations relating to occupation licensing do not hinder or slow the reconstruction process, but rather hasten recovery efforts by preventing project failures and avoiding time lost fixing mistakes.

"I can tell you that local government regulations do not slow or hinder reconstruction process. As a matter of fact, they can accelerate the rebuilding efforts with valuable insight and information regarding reconstruction expectations, contractor selection, and hurdles that may be encountered with the rebuilding process. This approach speeds rebuilding by navigating pitfalls earlier rather than later when they're more expensive and time-consuming to fix the mistakes." Olk testified.⁷⁵

Olk stressed that all disasters start and end locally and that local regulations helped the City of Garland make a full recovery after tornado damage in 2015. "In Garland we're coming up on our second anniversary of our tornado, and we have 95% of the buildings reoccupied, which is actually quite impressive given that one third of the damaged structures were completely destroyed and no individual assistance was provided by FEMA. Local government focused efforts on rebuilding following disaster are paramount to the survival of the community."⁷⁶

Olk discussed the BOAT Disaster Response Team and said that certain revisions that protect architects and engineers under a Good Samaritan law would help those professionals respond to disasters. Olk concluded by again affirming his belief that occupational licensing standards have not impeded the Harvey recovery efforts.

JD Rimann, representing the Texas Public Policy Foundation, testified that occupational licensing exemptions for out-of-state Good Samaritans would make it easier for those professions to provide immediate assistance after a disaster and that even following a disaster plumbers have to give notice 30 days before planned work begins. He discussed certain volunteer exemptions from licensing requirements. When so many professionals arrive at once to assist in recovery efforts they should not have to go through the whole licensing process.

⁷³ Direct testimony from Brian Francis, Executive Director, Texas Department of Licensing & Regulation to the Texas Senate Committee Business & Commerce, August 28, 2018

⁷⁴ Written testimony submitted by Brian Francis, Executive Director, Texas Department of Licensing & Regulation to the Texas Senate Committee Business & Commerce, November 1, 2017

⁷⁵ Written testimony submitted by Jim Olk, Statewide Disaster Response Team, Building Officials Association of Texas, to the Texas Senate Committee Business & Commerce, November 1, 2018

⁷⁶ Direct testimony from Jim Olk, Statewide Disaster Response Team, Building Officials Association of Texas to the Texas Senate Committee Business & Commerce, August 28, 2018

Rimann testified, "We really should strive to make it simple and straightforward for volunteers coming from Oklahoma, Arkansas, Louisiana with, faith-based, non-faith-based, nonprofit organizations to use their skills to help rebuild communities. Currently, this is really not the case. You can have electricians come in, but they still are required to have a license, even if they are licensed in another state. They still have to go through the process that can take up to 90 days, even with the governor's disaster proclamation. Even reducing that might be better, and we would suggest putting in place an exemption, so that if they have a license in Oklahoma, and they come here to do that volunteer work, then they're good to go. Maybe they have to register, but they don't have to go through the entire process."⁷⁷

Arif Panju, representing the Institute for Justice, testified that Harvey recovery efforts have demonstrated how occupational licensing standards can be detrimental during a disaster recovery, such standards restrict the services that can be provided, reduce the quality of work, and increase prices, "Hurricane Harvey, like many of its predecessor super storms in other states, has really lifted the veil here in Texas on how damaging, especially long-term but also in the immediate term, how damaging occupational licensing laws can be. First, people who want to earn an honest living and go to work during this trying time are forced into a web of red tape and have to instead stay on the sidelines or else risk oftentimes civil penalties, criminal penalties. And second, people who are simply trying to rebuild, simply trying to pick up the pieces are also hurt. Because occupational licensing laws restrict the amount of services and the supply of people available for hire, reduce consumer choice and then as a result increase prices at the worst time possible."⁷⁸

Texas requires 4 years of work experience before an applicant is eligible to sit for the HVAC licensure examination, whereas an emergency medical tech who learns life-saving skills, must undergo 30 days of training. Panju also stated his belief that licensing standards do not prevent fly-by-night scams.⁷⁹

Panju expounded further in his testimony, "[With Harvey] there are tens of thousands of homes that are going to need work done on the HVAC systems, maintenance. And in Texas, if you have skills to repair or maintain these systems, it is illegal for you to go out and work on your own and do this type of work, unless you have a special HVAC contractor's license from TDLR. Now TDLR has to do this, this is under the Occupations' Code. And in Texas to qualify for this license, you must spend four years and prove to the government that you have four year's experience working for someone who already has one of these licenses, before you ever qualify to sit for the exam. By contrast, becoming an emergency medical technician, someone trained to save lives requires 33 days of education and experience. And so, while you're trying to work in this area and doing HVAC maintenance and repair, you're actually considered a technician, because you don't have a contractor's license. You have to register with TDLR, which is fine. But even though you've done all this, and you have experience, and you're registered, it's still illegal for you to go out on your own. It's illegal for you to advertise. In fact, it's a criminal misdemeanor under the code to do any of those things. And it's not surprising that the failure to recognize this for what it is, which is a barrier to entry in an occupation, leads to really perverse outcomes."⁸⁰

⁷⁷ Direct testimony from Jim Olk, Statewide Disaster Response Team, Building Officials Association of Texas to the Texas Senate Committee Business & Commerce, August 28, 2018

⁷⁸ Direct testimony from Arif Panju, Managing Attorney, Institute for Justice to the Texas Senate Committee Business & Commerce, August 28, 2018

⁷⁹ Ibid

⁸⁰ Direct testimony from Arif Panju, Managing Attorney, Institute for Justice to the Texas Senate Committee Business & Commerce, August 28, 2018

RECOMMENDATIONS

- The Committee recommends the creation of Regional Recovery Directors to coordinate with the Texas Department of Emergency Management for essential service remediation (e.g. - debris & waste removal) during a federal or state-declared state of emergency.
- The Committee recommends changing state law to allow automatic suspension of local Homeowners Association covenants and restrictive bylaws during the period of a federally or state-declared state of emergency and continuing through a recovery period of 1 year post-declaration.
- The Committee recommends revisions to state law offering Good Samaritan protections to members of response teams requested by a local officials following a disaster, without regard to the status of the declaration. This would increase recovery team membership, aiding reconstruction in the event of a natural disaster.

4. Examine and make recommendations on the need for changes to the Texas Constitution for home equity lenders to offer various forms of relief to Texas homeowners affected by natural disasters including, among others, the authority to enter into deferment agreements. This examination should include a study of home equity rules regarding negotiation, modification and refinancing and whether constitutionally established time periods can be waived in times of disasters.

BACKGROUND

Historically, Texas has viewed a homestead as property to be protected from creditors. This notion started with Castilian law, evolving then from acts by the Republic of Texas, and finally was codified in the Texas Constitution.⁸¹

Home equity loans allow homeowners to borrow against their home’s equity and make monthly payments on the loan. If you borrowed money to buy your home, the lender still has an interest in the property until the loan is paid off. Your equity is the part of the property that you own. To calculate equity, subtract any outstanding loan balances from the property’s market value. For example, you took a \$150,000 loan to buy your home. You’ve paid back \$45,000 of it and the home is now worth \$200,000. You have \$95,000 of equity. Home equity loans may be helpful to homeowners who want to take on a home-improvement project, send a child to college, pay off high-interest debt, pay medical bills, or address other life expenses.⁸²

MECHANISMS FOR CHANGE

Constitutional Amendment

The only method of amending the Texas constitution prescribed by Article 17 is through the Legislature, subject to voter approval. The constitution does not provide for amendment by initiative, constitutional convention, or any other means. Once an amendment passes it is compiled into the existing framework, text is either added or deleted, unlike the United States Constitution.

An amendment is proposed in a joint resolution that can originate in either house of the Legislature during a regular or special session. A joint resolution specifies the election date and may contain more than one amendment. The joint resolution must receive a vote of two-thirds of each house before it is presented to the voters. The governor cannot veto a joint resolution.

⁸¹ Texas Bankers Association, Texas Home Equity and SJR 60/Prop 2 <https://www.texasbankers.com/docs/TX-HE-Prop-2.pdf>

⁸² Written testimony submitted by Karen Neeley, Senior Counsel, Independent Bankers Association of Texas to the Texas Senate Committee Business & Commerce, November 1, 2017

Interpretation

The Texas Finance Code provides that the Finance Commission and the Credit Union Commission may, on request of an interested person or on its own motion, issue interpretations of Article XVI of the Texas Constitution. (Texas Finance Code § 11.308 and 15.413)

Request for Interpretation (7 TAC § 151)

- The Texas Administrative Code provides the rules for the home equity lending interpretation procedures.
- It provides five requirements to be followed when submitting a formal request for an interpretation and provides how the request will be evaluated.
- The requestor will be notified in writing whether the request has been denied, accepted, or rephrased (to ensure clear and concise formal interpretations).
- If the Finance Commission and the Credit Union Commission propose an interpretation, notice of the proposed interpretation will be published in the Texas Register for 30 days for public comment.
- The Finance Commission and the Credit Union Commission may adopt or decline to adopt the proposed interpretation or remand the proposed interpretation for modification, revision, or additional comment.⁸³

REFORM EFFORTS

In 1997, Texas Legislature and voters passed the approval of constitutional amendments to permit home equity lending. Since then, there were just a few necessary revisions made to the Texas Constitution (reverse mortgages in 1999, Home Equity Lines of Credit in 2003, designation of property for agricultural use in 2007) to insure that home equity lending in Texas was the best in the United States.

- Home Equity— borrowers are borrowing against equity established in their homes
- Equity—difference between fair market value and the total balance of all debts secured by the home



Jim's House is worth \$400,000.
He currently owes \$100,000
on his mortgage.

That would mean he holds
\$300,000 in equity in his home.

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⁸³ Written testimony submitted by Caroline Jones, Commissioner, Texas Department of Savings & Mortgage Lending to the Texas Senate Committee Business & Commerce, November 1, 2017

⁸⁴ Texas Bankers Association, Texas Home Equity and SJR 60/Prop 2 <https://www.texasbankers.com/docs/TX-HE-Prop-2.pdf>

With the Great Recession (December 2007 - January 2009), the positive ramifications of stringent Texas Home Equity lending practices aided the Texas economy. Our current home equity law has been the envy of many states, especially during times of national economic downturn when foreclosure rates were extremely high across the country.

Relatively stable housing prices in Texas brought fewer incidences of “underwater mortgages” as compared to the national average. Federal Housing Finance Agency index fell 20% nationally, while Texas' over the same time period fell less than 1%. Texas' 80% cap on a home's market value restrained mortgage debt growth and consumer spending during the boom time which allowed borrower's during the recession to avoid negative equity and default.⁸⁵

Texans who take out home equity loans benefit from strong consumer protections, enshrined in the Texas Constitution. Those protections include:

- The 80% loan-to-value ratio: A homeowner cannot take out a home equity loan that equals more than 80 percent of their home value – so if your house is worth \$200,000, you cannot get a home equity loan of more than \$160,000. This means that 20 percent of the equity in your home is always protected.
- Non-recourse loans: A home equity loan in Texas is considered a “non-recourse” loan. This means that if you default on your home equity loan and the bank forecloses, but the house is now worth less than the total loan amount, the bank cannot hold you personally liable for the remaining outstanding balance.⁸⁶

PRIMARY REQUIREMENTS FOR VALID LIENS ON HOME EQUITY LOANS

- Home equity loans cannot exceed 80% of fair market value of homestead on date extension is made
- Must be the only home equity loan issued against a homestead at one time
- Only one home equity loan on homestead per year
- Specific foreclosure requirements for lenders
- Limiting fee caps
- Must be fully amortizing and repayable without penalty—prohibits balloon and prepayment premiums, open-ended accounts (See Texas Finance Code Ann. 301.002) and home equity secured credit cards
- 12-day Disclosure and Closing Requirements
- Right of rescission

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⁸⁵ Texas Bankers Association, Texas Home Equity and SJR 60/Prop 2 <https://www.texasbankers.com/docs/TX-HE-Prop-2.pdf>

⁸⁶ Ibid

⁸⁷ Ibid

The home equity protections in the Texas Constitution are important safeguards for both homeowners and lenders. Since its inception, Texas home equity lending has been crafted to (1) preserve equity in Texans' homesteads, (2) insure that consumers are protected, and (3) ensure that lenders could and would make such loans for borrowing consumers.

SJR 60/PROPOSITION 2

During the 85th Legislative Session, SJR 60 by Senator Hancock was introduced with the intent to modernize the home equity lending process in Texas while ensuring the strong constitutional protections for borrowers remain in place. SJR 60 was enthusiastically passed by the Texas House and Senate with overwhelming bipartisan support. SJR 60 was then added to the November 2017 ballot for consideration from Texas voters. On November 7th 2017, Texans approved Proposition 2 by a more than 2-1 majority.⁸⁸

The constitutional amendment does the following:

- Redefines what is and is not included in the calculation of the cap on fees associated with a home equity loan to make home equity lending available for properties of both high and lower values.
- Lowers the cap on fees to 2% of the total loan value
- Maintains the 80% loan-to-value provision that has ensured Texans' real estate investments are protected.
- Allows for an option to refinance a seasoned home equity loan into a non-home equity loan, which may offer better rates and opportunities to access equity in the future.
- Eliminates the current prohibition against additional draws on a home equity lines of credit loan if the principal amount exceeds 50%, while still maintaining the requirement that each draw be at least \$4,000. The total maximum indebtedness would remain at 80% of the fair market value.
- Allows farm and ranch property owners to obtain home equity loans while maintaining the agricultural valuation of their properties, which had previously only been available to dairymen.⁸⁹

HOME EQUITY POST-HARVEY

As a result of Hurricane Harvey, the focus of certain sectors of our state's banking community has turned once again to Texas' home equity laws. It is asserted that our current Constitutional protections on home equity lending leaves bankers and borrowers little room for negotiation, modification, and/or refinance after natural disasters, and that the Texas Finance Commission and Credit Union Commission are similarly unable to offer guidance.⁹⁰

While it may still be years before we know the true impact of Hurricane Harvey on Texas homeowners, existing home equity borrowers in the disaster areas have limited and narrowly-defined options to

⁸⁸ Pepper Hamilton LLP, "Texas' Proposition 2 Expands Home Equity Loan Market for Lenders and Consumers", November 21, 2017 <https://www.pepperlaw.com/publications/texas-proposition-2-expands-home-equity-loan-market-for-lenders-and-consumers-2017-11-21/>

⁸⁹ SJR 60 Bill Analysis, 85th Texas Legislature

⁹⁰ Written testimony submitted by Karen Neeley, Senior Counsel, Independent Bankers Association of Texas to the Texas Senate Committee Business & Commerce, November 1, 2017

accessing their homes' equity. However, by design the many protections of the Texas Constitution on home equity lending prevent against potential abuse and help keep Texas homeowners in their homes.

TESTIMONY

The Senate Committee on Business & Commerce convened on November 1st, 2017 to study this charge with invited testimony.

Michael O'Neal, Texas Bankers Association, testified that changes are needed to the Texas Constitution to clarify a lender's ability to offer relief, including mortgage deferments, to customers. O'Neal continued, "Many lenders have looked at ways to offer relief including deferments in light of Harvey. The relief included whether they could offer deferments. In connection with deferments, that just basically means allowing homeowners to defer certain payments, whether two or three or whatever, until later time to pay them. Unfortunately, in the language of the Texas constitution, it's not clear whether that deferment is permissible in connection with a home equity loan or a Home Equity Line of Credit (HELOC)." ⁹¹

The Texas Finance Commission and Credit Union Commission have issued "safe harbor" interpretations that set forth conditions for a modification to a home equity. These "safe harbor" interpretations do not address all of the issues relating to mortgage modifications and other advisories and constitutional interpretations either no not address issues or do not have the force of law.

"So there's been guidance issued in the form of the advisory bulletin, in the form of these industry notices, recognizing various ways to modify home equity loan. But unfortunately for lenders, and for consumers they don't go far enough because our protections are all based in the constitution. And there's only either judicial decisions, or an interpretations that will have the force of law to provide the certainty and clarity in connection with various types of modifications and deferments." O'Neal continued. ⁹²

O'Neal explained to the Committee the 12-day cooling off period after a consumer applies for a home equity loan or home equity line of credit, stating that no exception exists to shorten or waive this period in connection with an emergency. The 3-day rescission period after a consumer obtains a loan or line of credit cannot be waived under the Texas Constitution in connection with a personal finance emergency.

When asked how waiving the 3-day rescission period would help loan applicants, O'Neal said that applicants who are in dire need of emergency funds would benefit from this waiver because it would allow them to access those funds sooner. O'Neal continued, "In connection with a home equity loan, or HELOC [Home Equity Line of Credit], the [Texas] Constitution sets forth a three day right of rescission. So that means, is after you close your home equity loan there's three days before funding in which a borrower or customer can rescind that home equity loan, so they have that right. That right is also granted under federal law. There's the Truth in Lending Act...It sets forth a three day right of rescission too. But that three day right of rescission under federal law has a waiver for a personal financial emergency. So the borrowers, if they have a personal financial emergency could waive that three day right of rescission under federal law.

⁹¹ Direct testimony from Michael O'Neal, Texas Bankers Association to the Texas Senate Committee Business & Commerce, November 1, 2017

⁹² Ibid

The Texas Constitution does not grant a similar waiver. So even though they could waive it under federal law, they would still have to wait the three days under the Texas Constitution."⁹³

John Fleming, representing the Texas Mortgage Bankers Association, testified that the Texas Finance Commission and Credit Union Commission have interpretive authority on this issue, which they have not yet exercised. Legal protections could be provided to financial institutions that wish to offer mortgage modifications without amending the Texas Constitution if the Finance Commission and Credit Union Commission were to exercise their interpretive authority in light of the Texas Supreme Court case *Sims v. Carrington Mortgage Services*.

"I think that comfort could be given short of a constitutional amendment on many of these items if the joint regulatory agencies would exercise their interpretive authority to interpret the constitution in light of *Sims* and I think there's wide latitude under that opinion to cover most, if not all, the issues that need to be covered. And that would provide us a way to do it without a constitutional amendment in 2019 and a vote of the citizens." Fleming testified.⁹⁴

Karen Neeley, representing the Independent Bankers Association of Texas, testified that while the law is unclear regarding which mortgage modifications can be made to home equity loans, modifications can be made to home improvement loans. Lenders making these modifications to home improvement loans are subject to the Federal Deposit Insurance Corporation Improvement Act of 1991, which requires certain loan-to-value ratios.

Neely continued, "I think we have all agreed, candidly, that the 80% loan to value was a major factor in protecting homeowners in Texas during the downturn of 2008. People did not do stupid things because they had that cushion built into the home equity law. So I think we've got a real strong consensus that having appropriate loan to value ratios in place is good for the homeowner."⁹⁵

Ms. Neely discussed how such ratios are determined and how they protect lenders and borrowers but that applying different standards that allow modifications to home equity loans in such extraordinary circumstances as a catastrophic weather event could be appropriate. Neely concluded, "Now, the question then becomes, in a limited scenario, a federally declared disaster where we really have a need to help people rebuild and tap into the equity in their homes. Would it be appropriate to use the same standard that the federal law permits on construction loans when you build your home for the first time or do improvements?"⁹⁶

Caroline Jones, Commissioner of the Texas Department of Savings & Mortgage Lending, explained to the Committee the interpretive authority of the Texas Finance Commission and Credit Union Commission, stating that requests for legal interpretations can be made by stakeholders or can be initiated by the agencies. Interpretations on this subject are a few years old because no request has been made during the

⁹³ Direct testimony from Michael O'Neal, Texas Bankers Association to the Texas Senate Committee Business & Commerce, November 1, 2017

⁹⁴ Direct testimony from John Fleming, Texas Mortgage Bankers Association to the Texas Senate Committee Business & Commerce, November 1, 2017

⁹⁵ Direct testimony from Karen Neeley, Senior Counsel, Independent Bankers Association of Texas to the Texas Senate Committee Business & Commerce, November 1, 2017

⁹⁶ *Ibid*

intervening time. Discussion regarding modifications to home equity loans has been raised in light of lenders trying to provide relief to borrowers affected by Harvey.⁹⁷

RECOMMENDATIONS

By design the many protections of the Texas Constitution on home equity lending prevent against potential abuse and help keep Texas homeowners in their homes. The Committee believes that our current home equity lending protections are the best in the country, a fact which was made abundantly clear during the Great Recession when foreclosure rates were extremely high across the country.

With the passage of SJR 60 in the 85th Texas Legislature and the subsequent passage of Proposition 2 by Texas voters in November of 2017, the people of Texas have demonstrated a willingness to make changes to our home equity lending practices (i.e. amend the Texas Constitution) to satisfy the needs of Texas homeowners and lenders alike. With Hurricane Harvey it became abundantly clear that the value of homeowner's most important asset—their home—is likely decreased as a result of a natural disaster. Thus, the chance of obtaining a home equity loan is diminished. However, many of these Constitutional safeguards were put in place through careful deliberation, and ultimately put up to a vote by all Texans, to protect both homeowners and lenders alike.

While there certainly are valid concerns over these constitutional protections encumbering Texas homeowners' ability to rapidly access the equity in their homes following a natural disaster, these same carefully-deliberated constitutional protections offer the best protection in the country for Texas homeowners seeking to access their home's equity.

- The Committee believes it to be in the state's best interested to monitor how Texans use these new home equity lending options afforded to them through SJR 60/Proposition 2, specifically how these new options are utilized by Texans accessing their home's equity to help rebuild from Hurricane Harvey.
- The Committee encourages the Finance Commission to assess and issue opinions on the flexibility of current Texas home equity lending standards.

⁹⁷ Direct testimony from Caroline Jones, Commissioner, Texas Department of Savings & Mortgage Lending to the Texas Senate Committee Business & Commerce, November 1, 2017

5. Free Market Electricity: Examine the competitive nature of the Texas retail electric system and what government competitive intrusions in the free energy markets may have in distorting those markets. Review the impact of competitive versus noncompetitive retail electricity markets across the state in terms of price and reliability. Consider the projected impact of establishing competitive electric retail markets statewide.

BACKGROUND

Since the late 19th century electric utilities in Texas have followed the rest of the United States in an evolution of the energy marketplace. That progression tracked national trends until 1999 with passage of Senate Bill 7 by the 76th Legislature. The bill imposed an energy-only market design, carving out roles for electric generators, transmission and distribution providers, and retail electric providers in competitive areas of the state, while codifying the vertically integrated monopoly status of public power systems and cooperatives.

Public power is an established means by which municipal governments provide an essential service on the one hand; while on the other, ensure that the benefits of a "natural monopoly" will flow directly to the people. In the electricity supply business, customers would enjoy lower rates as the city-owned utility exploited economies of scale and increased sales to greater numbers of people and businesses. Since cities have no stockholders demanding dividend payments or returns on investment, they could pass on savings directly to their citizens.⁹⁸ Many of the public power utilities we see today were formed with the advent of industrial scale electricity production. As an example, Dallas Electric Lighting Company, the public utility system for the City of Dallas was founded in 1882, eventually privatized and became Texas Utilities Corporation (TXU), which at the time of deregulation was the largest utility in State of Texas.⁹⁹

Electric Cooperatives function in much the same way as envisioned under the Rural Electrification Act (REA) of 1936 passed by Congress as part of the New Deal. The REA allowed the federal government to make low-interest loans to non-profit cooperatives (farmers who had banded together) for the purpose of bringing electricity to much of rural America. The need for the REA in 1936 was driven by similar market dynamics that we see today. At the time, privately owned utility companies, which provided power to most of the country, were not eager to serve rural populations due to the higher per-customer costs associated with maintaining services.¹⁰⁰

Prior to 1975 in Texas all rates for electricity were set and appealed either at the municipal level of government or by electric cooperatives in the rural areas of the state. In 1975, the Legislature enacted the Public Utility Regulatory Act (PURA) and created the Public Utility Commission of Texas (PUC) to

⁹⁸ The Smithsonian Institute, National Museum of American History, "Powering the Past", <http://americanhistory.si.edu/powering/past/h1main.htm>

⁹⁹ TXU Energy, About Us, "Powerful roots, Bright Future", <https://www.txu.com/company/why-txu-energy/about-us.aspx>

¹⁰⁰ The Living New Deal, Rural Electrification Act of 1936, <https://livingnewdeal.org/glossary/rural-electrification-act-1936/>

implement state regulation of electric utility service and rates. Cities still retained original jurisdiction over rates within their city limits.¹⁰¹

Reasons for deregulation in Texas were numerous, but, primarily driven by inflation, volatile fuel costs and the need for new generating capacity that continued to increase electricity rates. Additionally, larger customers (industrials primarily), concerned with subsidizing other ratepayers, sought opportunities to bypass regulated rates and obtain a choice for suppliers. In 1995, through the enactment of Senate Bill 373, the Legislature created wholesale competition within the independent system operator administering market controls through most of the state, the Electric Reliability Council of Texas (ERCOT). In 1997 full deregulation as passed under Senate Bill 7 gave municipally owned utilities, cooperatives, and certain river authorities the option to opt-in to competition, but they were not required to do so.¹⁰² This segment of utilities operating within ERCOT are known as Non Opt-in Entities (NOIEs).

Conditions for Electric Deregulation in Texas:

Incumbent utilities in deregulated areas of the state were required under the conditions of SB 7 to separate business activities into power generation companies, transmission and distribution utilities (TDU), or retail electric providers (REP). Generation companies in the competitive system are not traditionally regulated, however they may not own more than 20% of the generation capacity within the system, and must abide by all rules of the PUC and ERCOT. REPs must be certified by the PUC and are bound to abide by certain consumer protection rules. TDU companies are still regulated on a cost of service basis as determined by the PUC.¹⁰³

For consumers in the competitive areas of Texas they have a choice for every aspect of their electric service needs with the exception of the transmission and distribution provider serving their area. As previously discussed, this segment of the market is still fully regulated, and if consumers feel that transmission and distribution rates do not accurately reflect the actual cost of service then they have recourse at the PUC. Under Chapter 35 and 36 of PURA, affected consumers and or an affected city may petition the PUC staff to initiate a comprehensive rate proceeding to determine whether a regulated utility's rates are just & reasonable.

State Oversight of NOIEs

State appeal mechanisms enjoyed by consumers in competitive areas are not generally available to those consumers served by a municipally owned utility (MOU) who reside within its municipal boundaries, or are in an electric cooperative service territory. In these territories services are bundled into one all-encompassing rate that includes fuel costs, retail service expenses, and transmission and distribution cost of service. River Authorities do not provide retail service, and simply act as a wholesale generator and "transmission only" wires company in the deregulated context. River Authority rates are subject to PUC review under Chapter 35 of PURA, which governs wholesale transmission rates throughout Texas.

As a general matter, the Public Utility Commission of Texas has limited jurisdiction over municipally owned utilities and electric cooperatives. Chapter 40 of the Utilities Code specifies the Commission's jurisdiction as it relates to MOU regulation. Key features of these limited powers include PUC review of

¹⁰¹ Public Utility Commission of Texas, "History of Electric Deregulation in ERCOT", Electric and Gas Reliability Workshop, April 17, 2012, https://www.puc.texas.gov/agency/topic_files/101/PUC-History_Dereg_ERCOT.pdf

¹⁰² Ibid.

¹⁰³ Ibid.

wholesale transmission rates and services within ERCOT, retail service area boundaries, and appeals by outside-city customers.¹⁰⁴ State jurisdiction over electric cooperatives is similarly limited. Specifically, the PUC has power to regulate a cooperative's ability to extend electric service to retail customers, define retail service territories, regulate wholesale transmission rates, and approval over transmission construction projects.¹⁰⁵

Consistent with the policy of municipal and cooperative autonomy, the Office of Public Utility Counsel (OPUC), which was created to safeguard and represent the interests of residential and commercial consumers in Texas, has no authority under law to advocate in municipal and cooperative areas.¹⁰⁶

As discussed, most customers of a municipally owned utility or a cooperative must petition their locally elected city council or cooperative board for a remedy to rates they feel are not just and reasonable. The exception to this rule are ratepayers served by a municipal utility who reside outside of the city limits in what may be designated as an extra territorial jurisdiction (ETJ). PURA stipulates that the lesser of 10,000 or 5% of the customers outside the city limit are able protest their rates to the PUC who may then determine a final rate for the affected ratepayers after a comprehensive review.¹⁰⁷

Scale of Public Power & Electric Cooperative Service:

Today there are 72 municipal utilities serving 5.1 million customers and administering 23,872 miles of distribution lines.¹⁰⁸ Additionally, the state has 75 electric cooperatives serving approximately 3 million customers while maintaining more than 320,000 miles of distribution lines within their certificated service territories.¹⁰⁹

Within the public power segment nearly 24% of the total number of meters served by all municipal utilities are concentrated and served by either CPS Energy (owned by the City of San Antonio) or Austin Energy (owned by the City of Austin). CPS serves approximately 810,000 meters, while Austin Energy serves over 484,000 meters. The next largest municipal utility is Lubbock Power and Light serving approximately 103,475 meters followed by Garland Energy with 69,262 meters. Of note, Lubbock Power & Light has initiated a proceeding at the Public Utility Commission, Docket #47576, to investigate unbundling their municipal utility and going into competition within the ERCOT market. Lubbock may become the first MOU to opt-in to competition since deregulation in 1999.¹¹⁰

The stratification of scale seen among large MOUs and the rest of its segment is also apparent among the electric cooperatives. Pedernales Electric Cooperative operating in central Texas is the largest electric cooperative in the nation serving more the 295,644 meters, followed by CoServ Electric Cooperative in

¹⁰⁴ Texas Utilities Code §40.004

¹⁰⁵ Texas Utilities Code §41.004

¹⁰⁶ Texas Utilities Code §13.003

¹⁰⁷ Texas Utilities Code §33.101

¹⁰⁸ Texas Public Power Association, "Municipally Owned Electric Utilities (MOUs) Hometown Service, Stability Success", <http://www.tppa.com/wp-content/uploads/TPPA-4-Page-General-Brochure-012715.pdf>

¹⁰⁹ Texas Electric Cooperatives, History, <http://www.texas-ec.org/about/history>

¹¹⁰ Direct testimony from David McCalla, General Manager, Lubbock Power & Light, to the Senate Committee on Business & Commerce, May 1, 2018.

North Texas with 218,563 meters. The next largest cooperative in Texas is Magic Valley Electric Cooperative with 111,934 meters served.¹¹¹

State Competition within ERCOT Retail Market:

The Texas General Land Office (GLO) was founded in 1836 to manage public lands in the state. The Permanent School Fund was established in 1876 to create a sustainable source of school funding, initially through interest from proceeds of land sales. Today, the GLO uses mineral resources, leases and sales of public lands to generate revenue for deposit into the Permanent School Fund.¹¹²

As modified by the passage of Senate Bill 7 in 1999, the Texas Utilities Code authorizes the Texas General Land Office (GLO) to sell electricity to “public retail customers that are military installations of the United States, agencies of this state, institutions of higher education, or public school districts.”¹¹³ Surplus power “may be sold to public retail customers that are political subdivisions of [Texas] or to a United States Department of Veterans Affairs facility.”¹¹⁴ This program is better known as the State Power Program.

Because the GLO does not own electric generation facilities, it contracts with a retail electric provider (REP) to leverage the GLO’s natural gas holdings into electricity, which is sold to the authorized customers listed above. The current REP administrating the State Power Program is Cavallo Energy Texas, a subsidiary of Calpine Corporation.¹¹⁵

According to reporting by the Associated Press, the program cost the state at least \$2.7 million more than it made between 2002 and 2004, the first three years of the competitive market.¹¹⁶ The program was promoted as a way of raising money for Texas schools, according to a review of records by the Galveston County Daily News.¹¹⁷

Today, the competitive electric market in ERCOT has more than 100 certificated REPs listed by the Public Utility Commission of Texas.¹¹⁸ Ninety-eight percent of large non-residential customers and 94% of small non-residential customers have made an observable choice in the market, demonstrating significant activity among consumers to find lower rates.¹¹⁹ Because the State Power Program is an outlier, with a state-supported participant competing with private companies, it is unclear whether the entities taking part in the State Power Program are receiving the lowest cost service.

¹¹¹ Written testimony submitted by Texas Electric Cooperative Association, to the Senate Committee on Business & Commerce, May 1, 2018.

¹¹² Texas General Land Office overview <http://www.glo.texas.gov/the-glo/about/overview/index.html>

¹¹³ Tex. Utilities Code §35.102(b)

¹¹⁴ Ibid.

¹¹⁵ State Power Program web site <http://texasstatepowerprogram.com/About.html>

¹¹⁶ Associated Press, “Newspaper reports power program a money loser for state,” August 22, 2005 <https://newspaperarchive.com/port-arthur-news-aug-22-2005-p-2/>

¹¹⁷ Galveston County Daily News, “Records: Program costs hidden millions,” August 21, 2005 <https://newspaperarchive.com/port-arthur-news-aug-22-2005-p-2/>

¹¹⁸ Public Utility Commission of Texas, “Alphabetical Directory of Retail Electric Providers” https://www.puc.texas.gov/industry/electric/directories/rep/alpha_rep.aspx

¹¹⁹ ERCOT, “Observed Selection of Electric Providers,” May 2018 http://www.ercot.com/content/wcm/key_documents_lists/89277/Observed_Selection_of_Electric_Providers_May_2018.ppt.pptx

Moreover, because the State Power Program is administered by the GLO, it is not subject to the Public Utility Commission tax assessment, nor is it subject to the Gross Receipts Tax, imposed under Chapter 192 of the Tax Code.¹²⁰ This represents a 2% reduction in overhead from the GLO administered program. Additionally, having a governmental entity competing with private companies creates an inequity where schools that have chosen to choose a new REP are paying the Public Utility Commission tax assessment and the Gross Receipts Tax that currently are funneled back into support the State Power Program, while those remaining with the State Power Program are not.

The 85th Texas Legislature passed Senate Bill 736, which requires the GLO to report to the legislature the following information on the State Power Program for each year the program has been in place:

- (1) number of participants;
- (2) aggregate rates;
- (3) general contract terms; and
- (4) the extent of any fiscal impact on state resources of administering the program.¹²¹

The competitive electric market is now over 16 years old, and it has proven to be popular among all customer classes. The following report offers a competitive analysis on the effects of government involvement within Texas electric markets, and whether competitive systems offer greater benefit for Texas consumers.

TESTIMONY

The Senate Committee on Business and Commerce heard extensive testimony from ERCOT market participants representing both competitive and non-competitive perspectives regarding value offered to Texas energy consumers. Testimony from all invited witnesses uniquely addressed the competitive design of the electric market segment that they operate within.

The State Power Program:

As previously discussed, the State Power Program administered by the General Land Office provides retail power service to approximately 494 government customers as of February 2018. This is a dynamic number since contracts are continually being entered into with qualifying government consumers. A further 114 contracts have a future start date, which brings the total number of commitments to 608.¹²² The terms of the contracts range from 1 year, 3 year, and 5 year contracts, the latest of which is scheduled to begin in 2021. During a question and answer exchange between Senator Robert Nichols and Robert Hatter, Director of Energy Resources for the General Land Office, it was determined that at the time of the hearing, 174 school districts were under contract with the GLO, or 15% of all school districts in Texas.

¹²⁰ Christian, Adina. Letter from Tax Policy Division of Texas Comptroller's Office to General Land Office. September 16, 2002.

¹²¹ 85th Texas Legislature, Senate Bill 736 as Enrolled

¹²² Written testimony submitted by Robert Hatter, Director of Energy Resources, General Land Office, to the Texas Senate Committee on Business & Commerce, May 1, 2018.

Since GLO through the SPP is exempted from collecting or remitting the 2.16 % Gross Receipts Tax (GRT), as is required of all other market participants that they compete against, the opportunity to maximize revenue deposited into the Permanent School Fund was created by the State. Mr. Hatter testified that during FY2017 contributions to the PSF were approximately \$5,019,866.¹²³ He further estimated that if the SPP were to be eliminated, using current contracts, the PSF would experience an annual reduction of approximately \$4.3 million going forward.¹²⁴

This was contrary to information that was provided by GLO during the 85th Regular Session to the Legislative Budget Board as they formulated a fiscal note for Senate Bill 736, which as filed would have eliminated the SPP. The associated fiscal note projected an annual loss estimate of approximately \$10 million after the current contracts roll off at the conclusion of their term. Both Mr. Hatter and Ursula Parks, Director of the Legislative Budget Board, were unable to explain the discrepancy, but did confirm that LBB estimates were solely based on GLO data.

Ms. Parks explained that in the context of the State Power Plan contributions to the PSF, even using the \$10 million figure originally provided to her office, would only constitute a small fraction of PSF funding which is directed into the multi billion dollar Available School Fund (ASF). The ASF then makes a \$1.2 billion distribution annually to schools around the state. In her own terms, "this would not be considered a significant amount".¹²⁵

Transparency in bidding was an open topic of discussion for the Committee relating to GLOs ongoing contract with Cavallo Energy. Concern was raised on how REPs are able to bid for the contract, how transparent the terms of the contract are for purposes of legislative and public oversight, and on what basis the final determination is made on the awarded contract. Mr. Hatter testified that a low price bid is not the determining factor, but that various metrics including customer satisfaction were. Mr Hatter did agree with Senator Nichols assertion that with price as a non-factor, the award determination was based on a "beauty contest" approach.¹²⁶

Beyond the vendor relationship between Cavallo and GLO, the Committee pressed both Mr. Hatter and David Roylance, Vice President for Sales & Marketing for Cavallo Energy, on the opportunities for competitive bidding for a qualifying government facility power contract. Mr. Roylance testified that "of the approximately 200 agreements signed by the GLO in the last 18 months, 90% were publicly bid."¹²⁷ When asked how the GLO goes about winning a bid, Mr. Hatter stipulated that the terms and conditions of the agreements are held confidential in most cases depending on the stipulations of the individual contracts.¹²⁸

¹²³ Written testimony submitted by Robert Hatter, Director of Energy Resources, General Land Office, to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹²⁴ Direct testimony from Robert Hatter, Director of Energy Resources, General Land Office, to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹²⁵ Direct testimony from Ursula Parks, Director of the Legislative Budget Board, to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹²⁶ Direct testimony from Robert Hatter, Director of Energy Resources, General Land Office, to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹²⁷ Direct testimony from David Roylance, Vice President for Sales & Marketing, Cavallo Energy, to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹²⁸ Direct testimony from Robert Hatter, Director of Energy Resources, General Land Office, to the Texas Senate Committee on Business & Commerce, May 1, 2018.

Senator Larry Taylor pressed the remaining witnesses on the panel as to what their principal objection to the GLO administered State Power Program might be. For both Julia Rathgaber, President and CEO of the Association of Electric Companies of Texas, and Gabe Castro, Vice President of Retail Markets at TXU Energy, the gross receipts tax exemption for a state backed competitor was highlighted as the primary point of opposition.

MOU Comparison to Competitive Markets:

The public power segment of ERCOT contains a diverse group of market participants who do not fit within a one size fits all construct. Some MOUs are completely vertically integrated, owning assets operating in each step of the supply chain from electric generation to retail sale of power. Others may own their own wires and poles, and act as the single source retail provider within their service territories. Overall, MOUs in Texas own nearly 7,500 MWs of dispatchable gas, coal and nuclear generation. In addition, all MOUs rely at least in part on long term power supply contracts with wholesale providers including river authorities, joint action agencies, private companies, and other MOUs to serve their customers' needs.¹²⁹

MOUs who own their own generation:¹³⁰

- Austin Energy
- CPS Energy
- Greenville Electric Utility System
- Garland Power & Light
- Denton Municipal Electric
- Brownsville Public Utility Board
- Bryan Texas Utilities

MOUs with High Voltage Transmission Assets:

MOUs own approximately 6% or 3,000 of the 40,500 miles of the high voltage transmission lines that deliver bulk power in ERCOT.¹³¹ MOUs with significant transmission assets include:

- Austin Energy – 623 miles
- Brownsville PUB – 51 miles
- Bryan Texas Utilities – 168 miles
- Denton Municipal Electric – 30 miles
- Garland Power & Light – 200 miles
- GEUS (Greenville) – 32 miles
- Lubbock Power and Light (non-ERCOT) – 105 miles
- CPS Energy (San Antonio) – 1,515 miles
- Texas Municipal Power Agency – 231 miles

¹²⁹ Written testimony submitted by the Texas Public Power Association, to the Senate Committee on Business & Commerce, May 1, 2018.

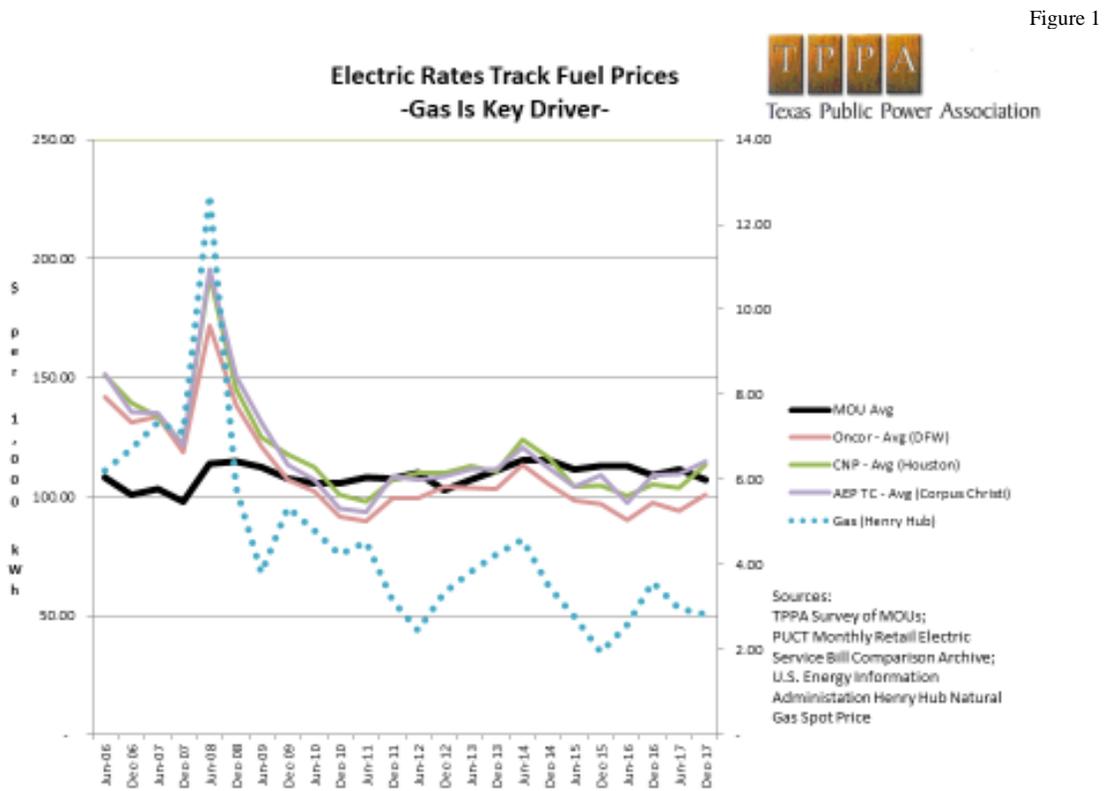
¹³⁰ Ibid.

¹³¹ Ibid.

Smaller MOUs typically own all or portions of the electrical substations that transform high voltage current to distribution level service in their communities.¹³²

The Senate Committee on Business & Commerce requested that municipal utilities provide rate comparisons between the Texas public power segment, and an average of retail rates observed in competitive areas of the state. Both CPS Energy and Austin Energy were asked specifically to provide individual data points since they serve almost a quarter of all consumers affected by public power systems.

The following charts demonstrate the requested comparisons for rates overlaid with fuel costs within ERCOT; as well as system wide, industrial, commercial, and residential rate tier comparisons.



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When managing retail rates in ERCOT energy costs (or fuel costs) associated with wholesale power is a significant driver of electric rates for consumers regardless of where they are located. Beth Garza, the ERCOT Independent Market Monitor charged with assessing price formation, describes the relationship this way:

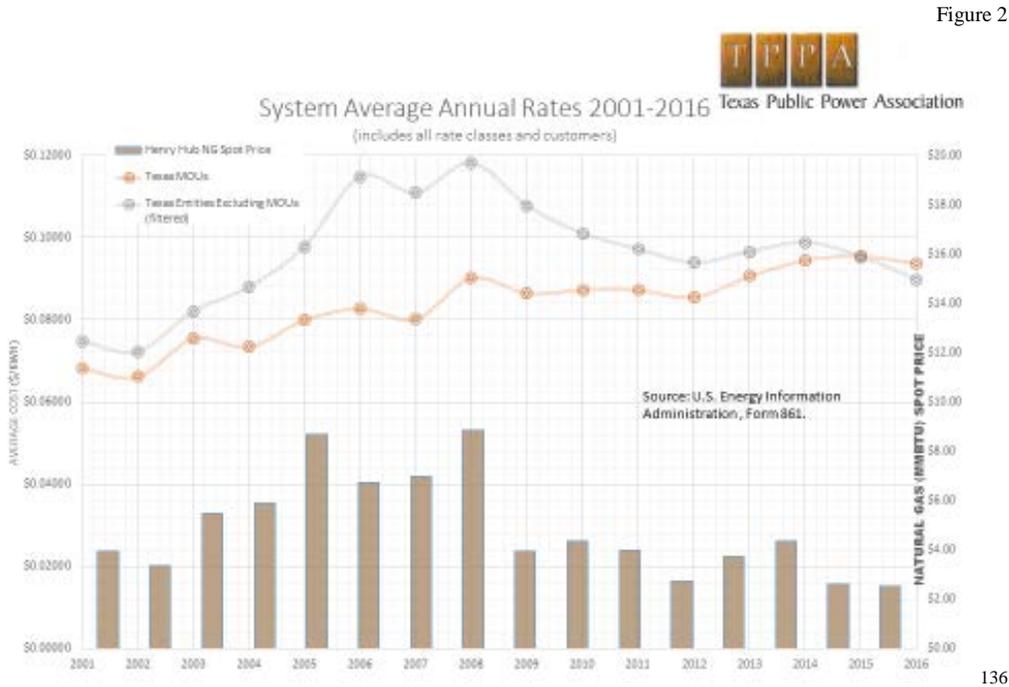
¹³² Written testimony submitted by the Texas Public Power Association, to the Senate Committee on Business & Commerce, May 1, 2018.

¹³³ Ibid.

"The largest component of the all-in price is the energy cost, which continues to be highly correlated with natural gas prices. This correlation is expected in a well-functioning, competitive market because fuel costs represent the majority of most suppliers' marginal production costs. Because suppliers in a competitive market have an incentive to offer supply at marginal costs and natural gas is the most widely-used fuel in ERCOT, changes in natural gas prices should translate to comparable changes in offer prices."¹³⁴

As a result, a REP selling power in a competitive area of Texas has an incentive to hedge against natural gas price volatility. Conversely, many MOUs engage in long term power purchase agreements that act as a hedge since these contracts negate the possibility of price swings catching consumers unaware.¹³⁵

As demonstrated in Figure 1, the greatest price fluctuations in the last 15 years occurred between 2007 and 2010 when natural gas was trading between \$6 and \$13 per MMBtu. MOUs were a source of rate stability during that period, but as gas prices have fallen, they have been unable to experience lower prices compared to competitive areas largely due to the long-term nature of the PPAs.



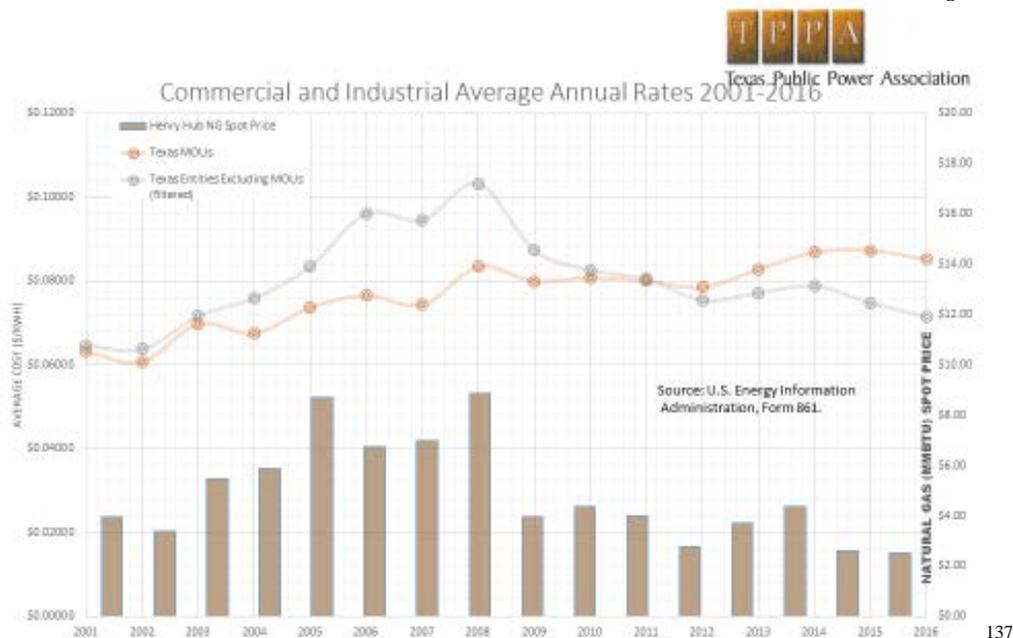
On a system average basis MOUs have outperformed the competitive market 12 of the last 15 years since deregulation was adopted in 2003 (See Figure 2). However, this trend began to reverse in 2014 when natural gas prices began a slow decline in value below \$4 per MMBtu.

¹³⁴ Page iii, Potomac Economics, Independent Market Monitor for ERCOT, "2017 State of the Market Report for the ERCOT Electricity Markets", <https://www.potomaceconomics.com/wp-content/uploads/2018/05/2017-State-of-the-Market-Report.pdf>

¹³⁵ Direct testimony from Walt Baum, Executive Director, Texas Public Power Association, to the Senate Committee on Business & Commerce, May 1, 2018.

¹³⁶ Written testimony submitted by the Texas Public Power Association, to the Senate Committee on Business & Commerce, May 1, 2018.

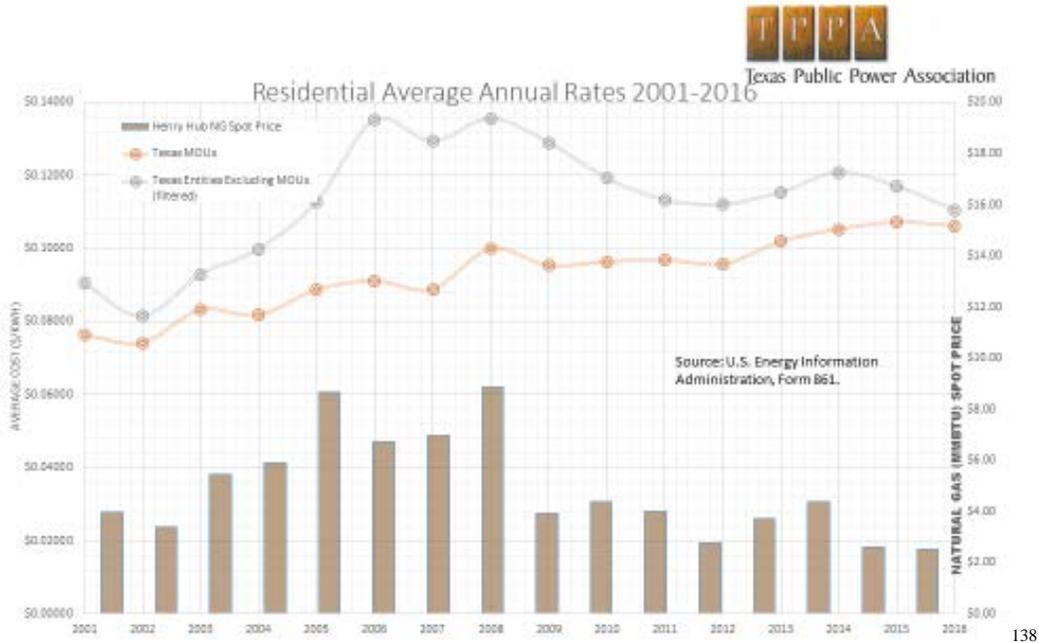
Figure 3



Commercial and industrial consumers shown in Figure 3, on average experienced higher electric rates for 5 of the last 15 years. City governments who ultimately govern municipal utilities, can impose affordability metrics differently depending on rate classes. Great effort is made by these governments to ensure residential rates will be cheaper than those of the commercial and industrial classes, by how much depends on the city.

¹³⁷ Written testimony submitted by the Texas Public Power Association, to the Senate Committee on Business & Commerce, May 1, 2018.

Figure 4

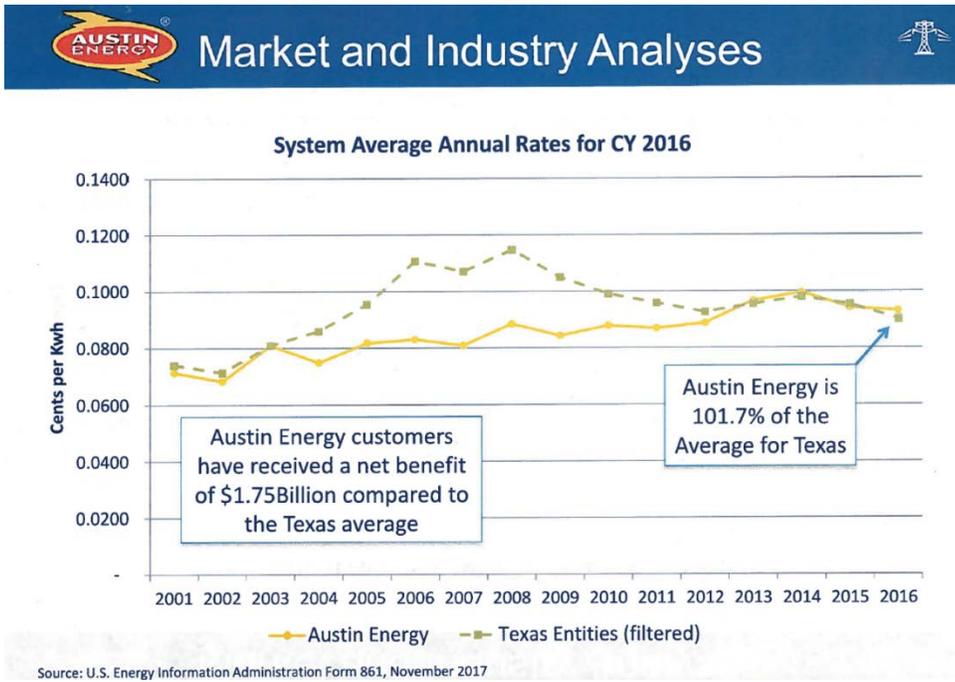


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As noted in Figure 4 residential rates have consistently been lower for consumers in MOU service territories since 2003. The discrepancy observed between the rate classes reflects a public policy preference of the governing municipal leadership from deregulation to now. The following charts from Austin Energy bear out the rate disparity between residential and business rates that correlates to the statewide average.

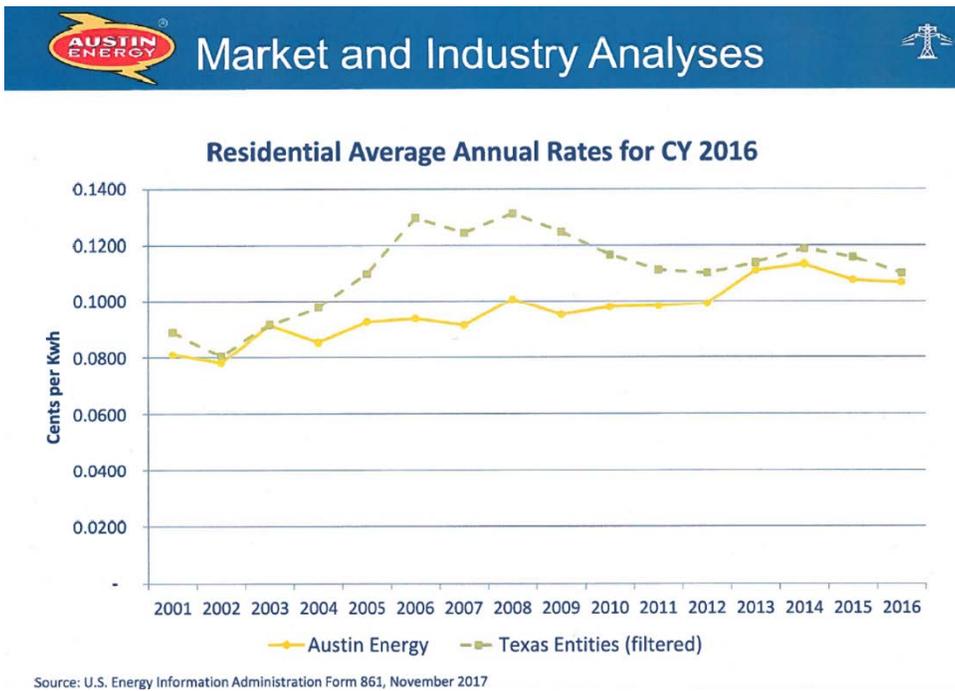
¹³⁸ Written testimony submitted by the Texas Public Power Association, to the Senate Committee on Business & Commerce, May 1, 2018.

Figure 5



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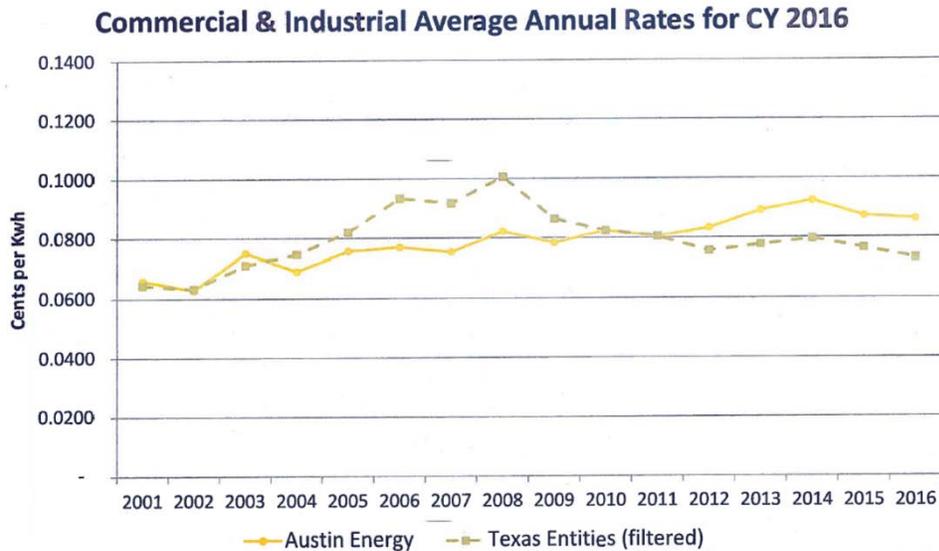
Figure 6



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¹³⁹ Written testimony submitted by Austin Energy to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹⁴⁰ Ibid.



Source: U.S. Energy Information Administration Form 861, November 2017

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The Committee took great interest in how revenues generated by a municipally owned utility may be used, either by the utility or the city. As described by Jaqueline Sargent, General Manager for Austin Energy, "rates are determined by a cost of service study that is then used to determine a base rate." Cost of service, according to Ms. Sargent, does "include additional revenues for a general fund transfer." General fund transfers are then based on a percentage of revenues somewhere between 7% and 14% of overall revenues.¹⁴²

Little is known about how general fund transfer revenues are used by cities once they are redirected from a MOUs rate base to a city government. In recent years the only transparency offered to general fund transfers has been during the instance of Austin Energy's comprehensive rate proceeding before the Public Utility Commission in 2012.

2012 Austin Energy Rate Case:

In 2012, the city of Austin raised the rates of Austin Energy by \$91 million. There were certain customers who had not yet been affected by that rate increase because Austin Energy had agreed to serve those customers under long-term fixed rates. The Austin City Council at the time had made it clear that they intended to raise the rates of these customers by over \$20 million once those contracts had expired. These customers did not have any right to contest these rate increases if they resided within the city limits.

¹⁴¹ Written testimony submitted by Austin Energy to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹⁴² Direct testimony from Jacqueline Sargent, General Manager, Austin Energy, to the Texas Senate Committee on Business & Commerce, May 1, 2018.

Customers outside the city appealed that rate increase to the PUC. When the staff of the PUC looked at how Austin had set their rates, they ultimately found that nearly \$46 million, or 51% of the increase, was not just and reasonable.¹⁴³ Commission findings included items such as:

- A \$32 million reduction of the transfer of revenues from ratepayers to the city of Austin General Fund. Both the PUC staff and Moody's have noted that Austin Energy transfers a significantly higher level of revenues to the General Fund than similar utilities. Moody's noted that Austin Energy's transfer rate was nearly 40% higher than comparable utilities at the time.¹⁴⁴
- Nearly \$10,000,000 in costs related to the City's "Economic Growth and Redevelopment Services Office" (EGRSO), which funds, among other things, programs for urban regeneration, cultural arts, and the music industry.¹⁴⁵ Prior to the rate case even the city's own Electric Utility Commission had repeatedly recommended that the EGRSO not be part of Austin Energy, saying "requiring Austin Energy to fund a department... is a bad business practice that leads to waste".¹⁴⁶
- \$3.4 million of improperly allocated services that should have been paid by other city departments and not Austin Energy.¹⁴⁷
- The PUC staff also noted that Austin Energy's financial plans involved holding more reserves than is typical for utilities and objected to certain discounted rates including discounts the city gave itself for street light operation.¹⁴⁸

The Commission eventually ruled in its settlement agreement with Austin Energy in 2013 that the utility could only increase rates by an additional \$66 million per year moving forward. The Commission accounted for savings that rate payers in Austin's extra territorial jurisdiction (ETJ) should realize as a result of the proceeding, and the commitment that the utility would realign rates and programs.¹⁴⁹

As a result of the 2012 rate case, Austin Energy initiated a cost of service analysis in 2015 forming a process within the city to bring together stakeholders from residential, commercial and industrial segments

¹⁴³ Lines 5-7, page 3, Direct Testimony of Ruth Stark, Rate Regulation Division, Public Utility Commission of Texas, given February 14, 2013, Docket # 40627 http://interchange.puc.texas.gov/Documents/40627_343_749902.PDF

¹⁴⁴ Lines 25-26, page 28, and Lines 1-4, page 29, Direct Testimony of Darryl Tietjen, Rate Regulation Division, Public Utility Commission of Texas, given February 14, 2013, Docket # 40627, http://interchange.puc.texas.gov/Documents/40627_341_749921.PDF

¹⁴⁵ Lines 8-20, page 4, Direct Testimony of Ruth Stark, Rate Regulation Division, Public Utility Commission of Texas, given February 14, 2013, Docket # 40627 http://interchange.puc.texas.gov/Documents/40627_343_749902.PDF

¹⁴⁶ Lines 19-30, page 7, and Lines 1-4, page 8, Direct Testimony of Ruth Stark, Rate Regulation Division, Public Utility Commission of Texas, given February 14, 2013, Docket # 40627 http://interchange.puc.texas.gov/Documents/40627_343_749902.PDF

¹⁴⁷ Lines 1-22, page 13, Direct Testimony of Ruth Stark, Rate Regulation Division, Public Utility Commission of Texas, given February 14, 2013, Docket # 40627 http://interchange.puc.texas.gov/Documents/40627_343_749902.PDF

¹⁴⁸ Lines 30-35, page 26, and Lines 1-3, page 27, Direct Testimony of Darryl Tietjen, Rate Regulation Division, Public Utility Commission of Texas, given February 14, 2013, Docket # 40627 http://interchange.puc.texas.gov/Documents/40627_341_749921.PDF

¹⁴⁹ Page 6, Final Order, Public Utility Commission of Texas Docket # 40627, "Petition by Homeowners United for Rate Fairness to Review Austin Rate Ordinance No. 20120607-055", http://interchange.puc.texas.gov/Documents/40627_436_755245.PDF

along with the utility to debate what a new long term rate agreement should look like. As a result, the joint agreement entered into by 21 parties (consumer stakeholders) lowered base rates by \$42.5 million.¹⁵⁰

Key reductions in rates included:

Residential

\$5 million of the base rate reduction went to the Residential Class.¹⁵¹

Commercial

Austin Energy's commercial classes saw \$37.5 million of the reduction - about 88% of the total base rate reduction. The breakdown looked like this:

- \$1M reduction to the Secondary < 10kW (small offices, daycares, school portables, billboards)
- \$15.7M to Secondary 10-300 kW (small office buildings, retail, restaurants, small hotels)
- \$5.3M to Secondary > 300 kW (large office buildings, grocery stores, schools, hospitals)
- \$4.5M to Primary < 3,000 kW (office parks, water treatment plants, manufacturing)
- \$5.3M to Primary > 3,000-20,000 kW (large manufacturing, data centers)
- 5.5M to Primary > 20,000 kW (large industrial manufacturing)
- No change to Transmission voltage level 1 (industrial)
- No increase to Transmission voltage level 2 (large industrial)¹⁵²

Not all consumers involved in the negotiations with Austin Energy signed the settlement agreement that was finalized in 2016. Data Foundry is a colocation datacenter with facilities located in Austin and Houston. Edward Henigin, Chief Technology Officer for Data Foundry, testified that his company declined to sign the settlement agreement because it failed to address how the utility's losses experienced by its generation fleet, operating within the ERCOT wholesale power market, were passed through to ratepayers. He asserted that "they are selling power at a loss to other people in Texas - our bill is 30% higher than it should be because we are covering these wholesale generation losses."¹⁵³

This was not the consensus shared among other large consumers as to the reasonableness of the settlement. John Raff, Interim Executive Director of the Texas Facilities Commission, which manages most state power contracts, stated that as result of the agreement "the new Austin Energy rate schedule also discounted base electric rates by 20% in each rate class for all state agency and UT accounts. This discount represented the first beneficial rate for the smaller, and non-contract accounts since October 2012."¹⁵⁴

¹⁵⁰ Written testimony submitted by Austin Energy to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹⁵¹ Ibid.

¹⁵² Ibid.

¹⁵³ Direct testimony from Edward Henigin, Chief Technology Officer, Data Foundry, to the Senate Committee on Business & Commerce, May 1, 2018.

¹⁵⁴ Written testimony submitted by John Raff, Interim Executive Director, Texas Facilities Commission, to the Senate Committee on Business & Commerce, May 1, 2018.

Regardless of conflicting views on the merits of the 2016 settlement agreement it was difficult for the Committee to find consumer segments who participated in negotiations that were able discuss their satisfaction or dissatisfaction with rates because of the agreements terms. As per Austin Energy, "by signing the agreement, the parties agreed to not seek, fund or support an appeal of this rate review before any oversight body including the Public Utility Commission of Texas as well the Texas Legislature until the next rate review or December 31, 2020."¹⁵⁵

MOU Governance

For the public power segment general fund transfers seem to be a ubiquitous means of transferring cash to the city governments who own a utility. Each representative from a municipal utility testifying before the Committee stated that they made a general fund transfer to their governing city. However, direct control by a city council of a municipal utility is not the only available governance model for public power. Of the two largest municipally owned utilities in Texas, CPS Energy is governed by a "separate board" comprised of 5 at large members representing the Bexar County area with the mayor serving in an "ex-officio" capacity. The board of CPS comes from diverse backgrounds and they formulate policies that are then presented to the San Antonio City Council which then acts as the "owner-regulator". The City Council does have the ability to ratify the members appointed to the CPS Board.¹⁵⁶ Conversely, Austin Energy's managing executives report to the city managers office and the city council. This relationship could have a direct impact on how general fund transfers are managed, and how utility revenues could be used for purposes outside of utility maintenance and operations.

Electric Cooperative Comparison to Competitive Markets

When looking at a map of the State of Texas, much of the rural portion of the state is served by either an investor owned utility and a competitive retail power system, or they are served by an electric cooperative. Since rural electrification in the 1930's cooperatives have been organized by so-called "member owners", where each consumer of electricity has a vote in electing the governing board of the cooperative. Cooperatives govern themselves as a "not for profit", where profits if made, are to be returned to the coops members in the form of capitol credits.¹⁵⁷

Electric cooperatives serve a unique role in the Texas power markets in the scale of geographical territory they provide service to. Mike Williams, President and CEO of the Texas Electric Cooperative Association noted in his testimony that "coops serve all but 13 counties in Texas", including 3 million members. As Mr. Williams put it, "one of the defining features of the cooperative model is customer density". The average number of meters served by a rural cooperative is 6 meters per mile of line, whereas in an area served by an urban coop, MOU, or IOU the average is 40 to 70 meters per mile of line. Even in the area served by Pedernales Electric, the largest cooperative in the country (by number of consumers), the consumer density averages only 16 meters per mile of line.¹⁵⁸ For a vertically integrated monopoly, whose economic model is predicated upon its ability to socialize the cost of service among a captive rate base, low consumer density makes the provision of affordable service challenging.

¹⁵⁵ Written testimony submitted by Austin Energy to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹⁵⁶ Direct testimony from Paula Gold-Williams, CEO, CPS Energy, to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹⁵⁷ Direct testimony from Mike Williams, President & CEO, Texas Electric Cooperative Association, to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹⁵⁸ Ibid.

Cooperatives make electricity affordable for the rural populations they serve by entering into agreements with other cooperatives to establish economies of scale, bringing costs down. There are two types of electric cooperatives: Distribution Cooperatives and Generation and Transmission Cooperatives (G&Ts).¹⁵⁹

Distribution cooperatives are the foundation of the electric cooperative network. They are the direct point of contact with consumers in the delivery of electricity and other services. Distribution cooperatives provide the retail service to their member owner customers.¹⁶⁰

G&Ts are owned by groups of distribution cooperatives to provide wholesale power to their distribution cooperative members. They do this either by providing power they generate themselves or by purchasing power in the wholesale market on behalf of their distribution cooperative members, or both. G&Ts also provide high voltage transmission services to their distribution cooperative members.¹⁶¹

Of the 75 cooperatives serving electric customers in Texas, 67 serve retail customers.¹⁶² Thirty-six distribution cooperatives in ERCOT belong to a G&T. Those that are not members of a G&T purchase wholesale power and transmission service from another provider. One such provider is the LCRA, which provides service to five distribution cooperatives.¹⁶³

Since passage of deregulation in 1999 only Nueces Electric Cooperative has opted-in to competition. For the remaining cooperative segment even Pedernales Electric, with the largest consumer rate base, finds servicing the extensive territory they cover a challenge. Julie Parsley, CEO of Pedernales Electric highlighted that her utility serves "8,100 square miles of territory, covering 6 of the 15 fastest growing counties in Texas, and 3 of the fastest growing counties in the nation."

A comparison of the rates can be found in Figure 8 and Figure 9. When looking at cooperatives in the residential rate tier they track very closely with the competitive markets. However, the commercial and industrial rates appear to average 9% higher in coop territories than is seen in the rest of ERCOT for 3 of the last 10 years.

¹⁵⁹ Written testimony submitted by the Texas Electric Cooperative Association to the Texas Senate Committee on Business & Commerce, May 1, 2018.

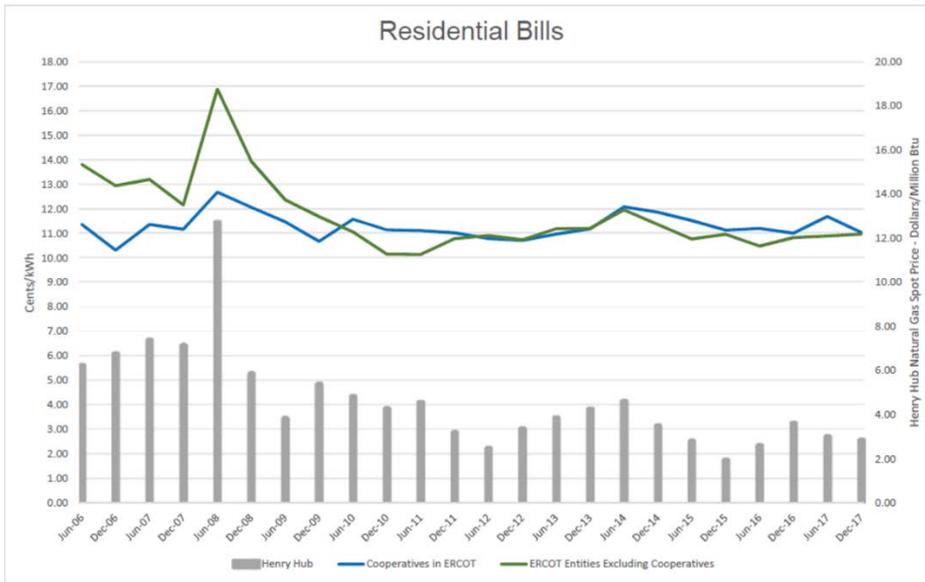
¹⁶⁰ Ibid.

¹⁶¹ Ibid.

¹⁶² Direct testimony from Mike Williams, President & CEO, Texas Electric Cooperative Association, to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹⁶³ Written testimony submitted by the Texas Electric Cooperative Association to the Texas Senate Committee on Business & Commerce, May 1, 2018.

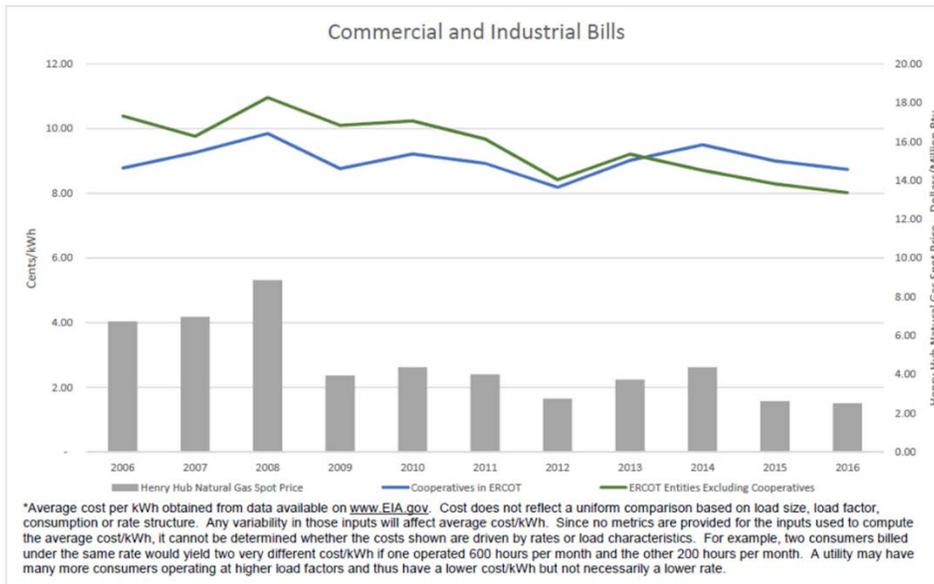
Figure 8



*Average cost/kWh for Cooperatives obtained from TEC bi-annual rate survey. Average cost/kWh for REP obtained from documents available on <http://www.puc.texas.gov>

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Figure 9



*Average cost per kWh obtained from data available on www.EIA.gov. Cost does not reflect a uniform comparison based on load size, load factor, consumption or rate structure. Any variability in those inputs will affect average cost/kWh. Since no metrics are provided for the inputs used to compute the average cost/kWh, it cannot be determined whether the costs shown are driven by rates or load characteristics. For example, two consumers billed under the same rate would yield two very different cost/kWh if one operated 600 hours per month and the other 200 hours per month. A utility may have many more consumers operating at higher load factors and thus have a lower cost/kWh but not necessarily a lower rate.

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Julie Parsley of Pedernales Electric explained that the "vast majority" of cooperative consumers are residential in nature, consequently rates are higher for the commercial and industrial classes.¹⁶⁶ With the

¹⁶⁴ Written testimony submitted by the Texas Electric Cooperative Association to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹⁶⁵ Ibid.

¹⁶⁶ Direct testimony submitted by Julie Parsley, CEO, Pedernales Electric Cooperative, to the Texas Senate Committee on Business & Commerce, May 1, 2018.

vast geographical areas serviced by electric cooperatives the primary cost driver in cost of service may not always be fuel costs.

As Mark Rollans, CEO for Medina Electric Cooperative said, "the wires side of the business is very expensive". Since Medina Electric serves 17 counties, 18,365 members and 32,000 meters, the cost of providing transmission and distribution service for the 9,500 miles of line with a density of 3 meters per mile can be significant.¹⁶⁷ Transmission costs within the ERCOT system do fall more heavily on the industrial consumer segment because wholesale transmission costs are allocated by the state on a volumetric basis through rate tariffs.

CONCLUSIONS

The study undertaken by the Committee on Business & Commerce has looked at two forms of government intrusions within ERCOT energy markets. In the instance of the State Power Program the Committee evaluated a state operated "champion" directly competing in private energy markets for select government contracts, complete with tax exemptions and opaque contracting rules. The benefit for the state and the school children of Texas is difficult to assess when numbers change to a great degree depending on the date of the question.

When evaluating the costs and benefits of public power and electric cooperatives to the consumers of Texas the comparisons to competitive regions become more ambiguous. The Committee found that electric utilities in the State of Texas are not equal when trying to compare their competitiveness with the context of ERCOT, or outside markets. The populations, economic diversity, and territories they serve determine the appropriate application of competitive forces.

As the U.S. Census Bureau reports, 62.7% of the population lives in just 3.5% of the nation's land area.¹⁶⁸ The I-35 Corridor, served by Austin Energy and CPS, is not an exception to this rule and remains one of the most rapidly urbanizing areas in the country. The economic development potential contained within this area is of great importance to the state as a whole, which makes the cost of electricity in this region all the more important to capitalize on untapped potential. As a result, a clear line exists between consumer populations served by Austin Energy and CPS, which will grow exponentially over the coming years.

The Committee found that public power systems and electric cooperatives were established to serve a particular need. For public power the desired outcome was always for a city's ratepayers to benefit from "lower prices" and reliability in service resulting from a natural monopoly. Municipal utilities cost of debt is lower because it is supported by a rate base and tax base simultaneously. Despite having found general fund transfers an arbitrary means of determining how utility revenues are dispersed. The Committee found that the 7 to 14% average transfer rate amongst municipal utilities are similar in effect to the guaranteed rate of return of 9.8% to 10.2% experienced among regulated TDUs in competitive areas of Texas.

¹⁶⁷ Direct testimony from Mark Rollans, CEO, Medina Electric Cooperative, to the Texas Senate Committee on Business & Commerce, May 1, 2018.

¹⁶⁸ <https://www.census.gov/newsroom/press-releases/2015/cb15-33.html>

Cooperatives for their part benefit from the natural monopoly with the objective of serving higher cost rural Texas. Their non-profit status and business practices under the governance of boards elected from their members help ensure profits are returned to "member-owners" as credits on rates. The Committee finds that electric cooperatives are the best means of serving a segment of Texans that private markets may not be interested in serving, with the caveat that this too may change over time as populations shift and industry follows.

As to other intrusions discussed in these pages the Committee shares a common concern that there is a lack of transparency in service and governmental accountability apparent in either the situation of a government institution providing power service through a natural monopoly, or a tax exempt government retail power provider competing with private business.

The Committee finds that city governments owning large scale utilities have a discernable incentive to pass as much utility revenue through to city coffers as possible. These revenues can be used to fund policy initiatives completely outside the scope of the efficient operation of the utility or the affordability of the electricity they supply. Furthermore, a municipal utility's ratepayers are not always voters who are able to object to rate increases through the local election process. The argument that city officials are accountable to their consumers through the electoral system is not true to the extent that it is for cooperatives who's consumers do elect their governing boards.

As a result, those large municipal utilities under the direct governance of a city act as a tremendous revenue generator that is not subject to normal municipal appropriation processes. The Committee finds that this presents an inherent conflict of interest for a municipal government with access to the unlimited resources of an unregulated utility providing essential services to the public.

RECOMMENDATIONS

- The State of Texas should not be in the business of competing against private markets. Extenuating circumstances dictating a deviation from this policy can always be justified for a time, but a return to open markets free of government interventions should always be a goal that guides state policy. As such, the Committee recommends that the State Power Program (SPP) administered by the General Land Office of Texas be phased out over time dependent on the conditions and terms of contracts already entered into by the state and its counterparties.
- Furthermore, to hold the children of Texas harmless as the result of any policy decision made in regards to the SPP, the Committee recommends that all schools be exempted from paying the Gross Receipts Tax when contracting for retail power within the ERCOT areas of Texas.
- To advance the accountability and transparency of Texas' largest municipal utilities who operate under the direct control of their city governments, a competitive threshold should be established in PURA for those municipal utilities reaching a service threshold of 200,000 customers or more. These customers should have a mechanism for appeal to the PUC for review of their bundled (fuel cost, transmission and distribution, and retail) rates.

6. Health Insurance Market Stability: Study the factors affecting health insurance markets in Texas, particularly the individual market, including federal and state law. Make recommendations that would result in increased stability in the markets and enhance value and affordability for individual consumers and businesses. Examine what steps the state needs to take to allow out-of-state health insurance sales. In developing its recommendations, the committee should consider the flexibility afforded to states by 1332 "state innovation" waivers, which allow states to modify or eliminate tax penalties associated with individual and employer coverage mandates; modify requirements for benefits and subsidies; and find alternative ways to provide benefit plan choices, determine eligibility for subsidies, and enroll consumers.

BACKGROUND

The factors impacting the individual market are mainly due to the changing federal landscape, consolidation in many segments of the healthcare marketplace, and the struggle created by network providers bargaining power coupled with the need for health insurers to provide adequate provider networks. The effects of these factors have led to an unpredictable health insurance market for the 1.1 million Texans that do not get their health insurance through their employer and have to purchase it on their own. Based on 2017 data, there are approximately 1.1 million Texans covered in the individual market. Additionally, the 4.8 million Texans estimated to be uninsured are also eligible for individual market coverage.

During 2017, there were multiple attempts by Congress to "repeal and replace" the Affordable Care Act (ACA), and none of them came to fruition. One of the bills, the American Health Care Act (AHCA), which passed the U.S. House but failed in the U.S. Senate, included \$138 billion in new federal funding that could be used for program to stabilize health insurance markets by reducing premiums.¹⁶⁹ At the state level, anticipating the repeal of the ACA, Senate Bill 2087¹⁷⁰ passed during the 85th Regular Session that would allow for the creation of a temporary health insurance risk pool. Federal legislation included provisions to make federal funds available to states to create risk pools to cover individuals with high cost medical conditions, or provide reinsurance, thus allowing carriers to reduce health insurance premiums generally. Some states have successfully implemented reinsurance pools.¹⁷¹

¹⁶⁹ Louise Norris, Texas Health Insurance, Healthinsurance.org (Sep. 10, 2018), <https://www.healthinsurance.org/texas/>.

¹⁷⁰ S.B. 2087, 85th Reg. Sess. (Tx. 2017)

¹⁷¹ David Blumenthal, M.D. et.al., *States Take the Lead on Reinsurance to Stabilize the ACA Marketplaces*, The Commonwealth Fund (May 22, 2018), <https://www.commonwealthfund.org/blog/2018/states-take-lead-reinsurance-stabilize-aca-marketplaces>.

On October 12, 2017, after attempts to "repeal and replace" failed, President Trump signed an executive order¹⁷² that seeks to do three main things: "allow small businesses to form association health plans to provide more leeway to group together when providing or purchasing insurance; increase the availability and duration of short-term health insurance plans; and, widen the use of Health Reimbursement Arrangements, which let employers reimburse employees for health expenses rather than provide insurance themselves. Analysts expect it will increase the availability of cheaper, bare bones plans for the young and healthy and may raise premiums for older and sicker Americans."¹⁷³

Selling Health Insurance Across State Lines

Another policy proposal this interim charge addresses is the sale of insurance across state lines. The intention of the proposal to increase the ability of less costly healthcare with potentially more limited regulation. Currently, health plans in each state are protected from interstate competition by the federal McCarran-Ferguson Act that passed in 1945.¹⁷⁴ This Act allows states to regulate health plans, and all insurance matters, within their borders.

The ACA actually provided states the ability to sell health insurance across state lines. According to a Texas Medical Association Council Report on Socioeconomics, Georgia, Kentucky, and Maine each passed laws in the form of interstate compacts to permit these sales after the passage of ACA to sell qualified health plans to consumers in the compact states.¹⁷⁵ Georgia's law applies to non-group insurance coverage, and other states such as Maine, Connecticut, Rhode Island, Wyoming, and New Hampshire are allowed to sell group insurance across state lines. However, as of May 2018, no health insurance provider has offered a product to sell for this purpose.

One reason that the interstate sale of health insurance has not become ubiquitous is because each state regulates insurance companies a little differently. In addition, each state has its unique demographics and health insurance requires actuarial data based the demographics to properly determine the insurer's risk. TMA's report also mentions that the "chick-and-the-egg" concept creates difficulty because each health plans needs providers to build a successful network. And to attract providers, the health plans also have to show that they have a robust amount of policyholders.

NCSL's state research in 2017 shows that at least 23 state legislators considering this idea during the past ten years. Filed bills have not passed in at least 17 states.

¹⁷² Presidential Executive Order Promoting Healthcare Choice and Competition Across the United States, Oct. 12, 2017, <https://www.whitehouse.gov/presidential-actions/presidential-executive-order-promoting-healthcare-choice-competition-across-united-states/>.

¹⁷³ Executive Order, Presidential Executive Order Promoting Healthcare Choice and Competition Across the United States (Oct. 12, 2017), <https://www.whitehouse.gov/presidential-actions/presidential-executive-order-promoting-healthcare-choice-competition-across-united-states/>.

¹⁷⁴ Nat'l Assoc. of Ins. Comm. (NAIC), McCarran-Ferguson Act Summary (May 2018), https://www.naic.org/cipr_topics/topic_mccarran_ferguson_act.htm.

¹⁷⁵ Report to the TMA Council on Socioeconomics (May 2017), <https://www.texmed.org/InterstateSales/>.

Association Health Plans

As mentioned earlier in this report, President Trump issued an executive order to expand the use of Association Health Plans (AHPs) as a way to avoid or pre-empt existing state mandates and as a way to provide consumer with a potentially more attractive, less costly alternative for health insurance. The new rules for these types of health plans will be phased in starting in September of 2018. However, it is uncertain how soon after that date health plans will be offered.¹⁷⁶ While association health plans have been around awhile, the new federal rules released in June of this year, expand the types of organizations that could offer these group insurance plans.¹⁷⁷ Previously intended for small businesses or groups of employers, the rules allows certain sole proprietors to sign up for association plans, and exempts plans from ACA protections that otherwise apply to plans issued to small employers.¹⁷⁸ Association plans will not be able to turn away individuals due to health status. Kaiser Health Network's article on the topic does explain that consumers should be aware that there could be price differentials by age, and industry risk, by location, and by individuals' age and gender association plans may omit mental and behavioral health coverage and are not required to provide prescription drug coverage. Employers with fewer than 15 employees could also exclude maternity coverage under these rules.¹⁷⁹

AHPs could potentially allow American employers to form groups across state lines through existing organizations, or allow for the creation of new ones for the express purpose of offering group insurance. It could permit employers to band together, where workers could have access to a broader range of insurance options at lower rates in the large group market. Some of these workers could have been using the exchange plans or have gone uninsured.

States will share enforcement authority with the federal government. The rule does not change the guidance and rules for Texas MEWAs (multiple employer welfare arrangement), including the application of state insurance laws to self-funded MEWAs. The final rule emphasizes that states will continue to have significant authority over AHPs, which are a type of MEWA. Just as before the new rule, insurance issued to fully-insured association health plans is regulated by state law, such as traditional association coverage under Chapter 1251 of the Insurance Code and co-op options found in Chapter 1501. States can also regulate self-funded association health plans to the extent the state regulation is not inconsistent with ERISA (e.g., Chapter 846 of the Insurance Code). These state laws are not preempted by ERISA.

Short-term Limited Duration Plans

Short Term Limited Duration plans are holdovers from the pre-ACA individual market that did not satisfy the individual mandate because they offer coverage for only a pre-set, limited period. The Centers for Medicare and Medicaid Services (CMS) August 1, 2018 press release on the final rules for short term

¹⁷⁶ Michele Andrews, Thinking About An Association Health Plan? Read the Fine Print (June 26, 2018), <https://khn.org/news/thinking-about-an-association-health-plan-read-the-fine-print/> .

¹⁷⁷ U.S. Dept. of Labor, About Association Health Plans (Sep. 26, 2018), <https://www.dol.gov/general/topic/association-health-plans> .

¹⁷⁸ Id.

¹⁷⁹ Michele Andrews, Thinking About An Association Health Plan? Read the Fine Print (June 26, 2018), <https://khn.org/news/thinking-about-an-association-health-plan-read-the-fine-print/> .

limited duration plans states that, "[a]ccess to these plans has become increasingly important as premiums have escalated for individual market plans, and affordable choices for individuals and families have dwindled." It goes on to explain that the "average monthly premium for an individual in the fourth quarter of 2016 for a short-term, limited-duration policy was approximately \$124, compared with \$393 for an unsubsidized individual market plan."¹⁸⁰

Short term limited duration plans were most often used as a stop-gap measure when someone needed temporary insurance but expected to be covered again by a different plan soon. CMS explains that plans can provide coverage for people transitioning between different coverage options, such as an individual who is between jobs, or a student taking time off from school, as well as for middle-class families without access to subsidized ACA plans.¹⁸¹ Most plans provide coverage for a three-month period (the new proposal allows them to cover a period of less than a year) for about 20 percent less than an ACA plan. The final federal rules for these plans include that these must "contain important language to help [consumers] understand the coverage they are getting; and may be renewed for up to 36 months."

Short-term plans can also be medically underwritten, meaning customers can be turned away or charged more because of their gender, age, or health status and pre-existing conditions. Plans can also impose annual and lifetime limits on benefits, and do not have to set any limits on out-of-pocket spending by patients.

Federal agencies confirm that states have the authority to regulate short-term coverage and adopt standards that are more stringent than the federal rule. States can, for instance, adopt a definition with a shorter maximum initial duration, prohibit renewals or extensions of short-term plans, or require additional insurer disclosures. Important areas that states can regulate include:

- 1) the maximum length of the initial contract term (up to 12 months);
- 2) the maximum duration of a policy, including renewals and extensions under the same insurance contract (up to 36 months); and
- 3) a notice requirement.

States are free to adopt stronger standards in these three areas and regulate short-term coverage in every other respect. The final rule does not preempt state laws that prohibit the sale of short-term coverage.¹⁸² Longstanding Texas rules permit contract terms up to 12 months but do not permit renewals or extensions that would extend the coverage beyond a year.

The federal agencies acknowledge that the rule "could lead to further worsening of the risk pool by keeping healthy individuals out of the individual market for longer periods of time, increasing premiums for individual market plans and may cause an increase in the number of individuals who are uninsured." They estimate that there will be fewer healthier people in the individual market and that premiums will increase for marketplace enrollees as a result.¹⁸³

¹⁸⁰ HHS News Release: Trump Administration Delivers on Promise of More affordable Health Insurance Options, ACA, Eligibility & Enrollment Leadership, (Aug. 1, 2018), <https://www.cms.gov/newsroom/press-releases/hhs-news-release-trump-administration-delivers-promise-more-affordable-health-insurance-options> .

¹⁸¹ Ibid.

¹⁸² Short-Term, Limited-Duration Insurance Final Rule, Fact Sheet, CMS.gov (Aug.1, 2018), <https://www.cms.gov/newsroom/fact-sheets/short-term-limited-duration-insurance-final-rule> .

¹⁸³ Katie Keith, *The Short-Term, Limited Duration Coverage Final Rule: The Background, The Content, and What Could Come Next* (Aug. 1, 2018), <https://www.healthaffairs.org/doi/10.1377/hblog20180801.169759/full/> .

Legal Challenges to Potentially Impact the Texas Individual Health Insurance Market

There are also two legal challenges that can impact the stability of the Texas healthcare market depending on the outcomes. The Texas Association of Health Plans (TAHP) suit¹⁸⁴ challenging state regulations relating to how carriers handle out of network claims in cases of emergencies or the unavailability of network providers argues that the Texas Department of Insurance rules for reimbursement to out of network providers are not authorized by statute and, if authorized, "unconstitutionally delegate the government's power to regulate private health plan payments".¹⁸⁵

In addition, Texas' federal suit challenging the constitutionality of the Affordable Care Act could also impact health insurance stability. The federal lawsuit filed by Texas along with 20 other state attorneys general and the governors of Maine and Mississippi, argues that since the tax penalty is now zeroed out of the law, the whole law is unconstitutional.¹⁸⁶ Oral arguments were heard on September 5, 2018 in federal court in Fort Worth, and many believe that this is the most high-profile lawsuit against the ACA in part because the federal government is not defending the law.¹⁸⁷ If the guaranteed issue portions of the ACA were struck down, unhealthy individuals would likely be unable to purchase coverage in the individual market, and the Legislature might have to consider re-creating the health insurance pool that existed prior to the ACA.

Patient Protection, the Affordable Care Act and 1332 Waivers

In order to examine the part of the interim charge related to 1332 state innovation waivers, the Texas Department of Insurance provided the following information on Texas ACA statistics. In addition, TDI provided information about 1332 waivers, which are federal waivers that are intended for states to apply for to make certain provisions of the ACA more workable for states.

Some states have opted to apply for 1332 State Innovation Waivers in order to help stabilize their health insurance market. Section 1332 waivers are named for the original section of the Patient Protection and Affordable Care Act (ACA) that provides for waivers for state innovation (subsequently codified as 42 U.S. Code §18052). This 1332 State Innovation Waiver (Waiver) provides the ability, subject to certain constraints, for states to request waivers from certain provisions of the ACA, subject to certain requirements colloquially known as "guardrails." The maximum term of a waiver is five years, which may be renewed for subsequent terms.

¹⁸⁴ Dorrin Shams, TAHP Challenges State Regulations Press Release, TAHP Connect (July 26, 2018), <https://connect.tahp.org/news/410703/TAHP-Challenges-State-Regulations-That-Leave-Texans-Vulnerable-to-Costly-Surprise-Medical-Bills.htm>.

¹⁸⁵ Tex. Ass. of Health Plans v. Tex. Dept. of Ins., Petition for Declaratory Judgment (July 26, 2018), <https://cdn.ymaws.com/connect.tahp.org/resource/collection/EB93519E-8BF7-420C-AE3E-D366047708C2/Petition.pdf>

¹⁸⁶ Abby Goodnough and Jan Hoffman, *A New Lawsuit Threaten Obamacare. Here's What's At Stake and What to Expect in Oral Arguments*, N.Y. Times, Sept. 4, 2018, <https://www.nytimes.com/2018/09/04/health/obamacare-trump-texas-case.html>.

¹⁸⁷ Tim Ciesco and Scott Gordon, *North Texas Judge Hears Arguments in Lawsuit to Repeal Affordable Care Act*, NBCDFW.com (Sep. 5, 2018 at 4:33PM CT), <https://www.nbcdfw.com/news/health/North-Texas-Judge-Hears-Arguments-in-Lawsuit-to-Repeal-Affordable-Care-Act-492523291.html>.

Pass-through funding, authorized by Section 1332 of the ACA, can be a source of funds for states implementing waivers. If a state waiver results in a reduction in federal advance premium tax credit (APTC) and cost sharing reduction (CSR) subsidies, those funds can be transferred to the states. Pass-through funding has been a significant component of several state waiver applications, particularly with respect to high-risk reinsurance programs.

The waivers are limited to specific provisions of the ACA related to qualified health plan standards, establishment of exchanges, subsidies, and the individual and employer mandates. Other requirements, such as guaranteed issue, modified community rating, and coverage for dependents to age 26 may not be waived under Section 1332.

The guardrails require that coverage under any waiver cover at least as many individuals, be at least as comprehensive, and at least as affordable as coverage required without the waiver. A waiver must also not increase the federal deficit. In addition to the statutory guardrails, current CMS and IRS guidance do not allow for waivers that require changes to the federal exchange or federal administration of tax subsidies. These guardrail requirements limit the actual flexibility available to states under the waiver program and may require substantial actuarial support and microsimulation studies to demonstrate compliance. Under current CMS and IRS guidance, Texas may have to assume functions currently performed at the federal level, such as plan management, exchange operations, and subsidy calculation and disbursement, to implement many waiver options.

What can be waived?



What can't be waived?

Provisions and sections of the ACA that are not specifically included in section 1332, such as:

- guaranteed issue;

- rating based on pre-existing conditions;
- annual and lifetime coverage limits; and
- coverage for dependents up to age 26.

Pass-through funding

A major feature of section 1332 is pass-through funding. If, as a result of a waiver, the amount of APTCs and CSRs that individuals and small businesses would otherwise collectively qualify for is less than the amount that would be paid if the state did not receive the waiver, the aggregate amount of the savings may be transferred to the state for purposes of implementing the waiver. The total APTC amount for Texas individuals in 2017 is approximately \$3,315,000,000. In October 2017, cost-sharing reduction payments to issuers were ended but could be resumed depending on the final outcome of litigation. Tax credit amounts for small businesses are not available, but they are expected to be minimal in comparison to APTCs.

Guardrails

Section 1332 has requirements, or “guardrails,” that a waiver application must meet to be approved. Depending on HHS processes these may present significant hurdles to state innovation and add complexity to the waiver application process.

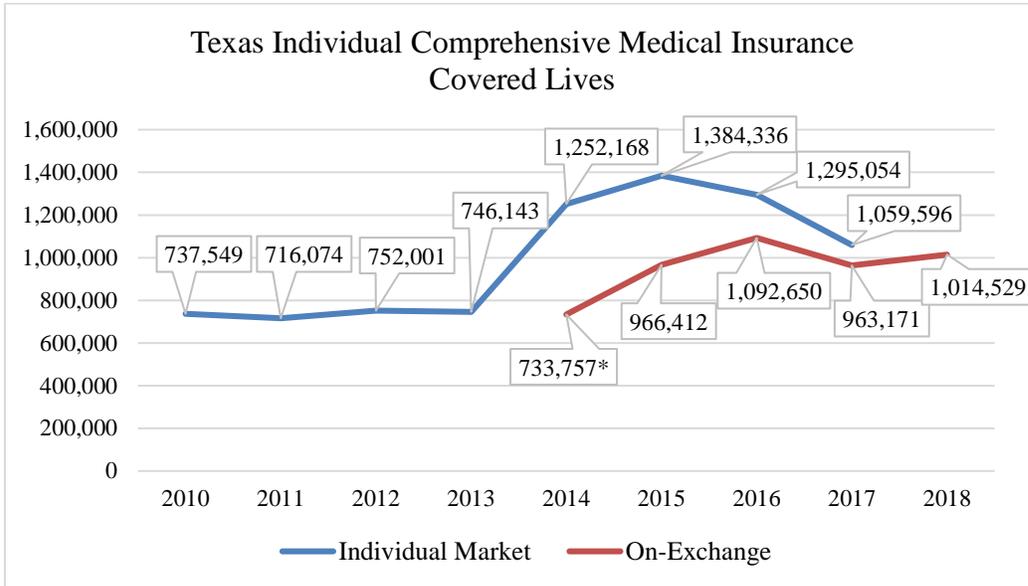
A state innovation program under section 1332 must:

- provide coverage to at least a comparable number of the state’s residents as would be provided without the waiver;
- provide coverage and cost-sharing protections that are at least as affordable as would be provided without the waiver;
- provide for coverage that is at least as comprehensive as would be provided without the waiver; and
- not increase the federal deficit.

In addition to the statutory guardrails, CMS has provided guidance stating that a waiver may not require changes to the FFM exchange platform and operations as these cannot be reasonably modified on a state-by-state basis. The IRS has also stated that tax subsidies cannot be administered differently on a state-by-state basis.

Texas Individual Comprehensive Health Insurance Market Snapshot

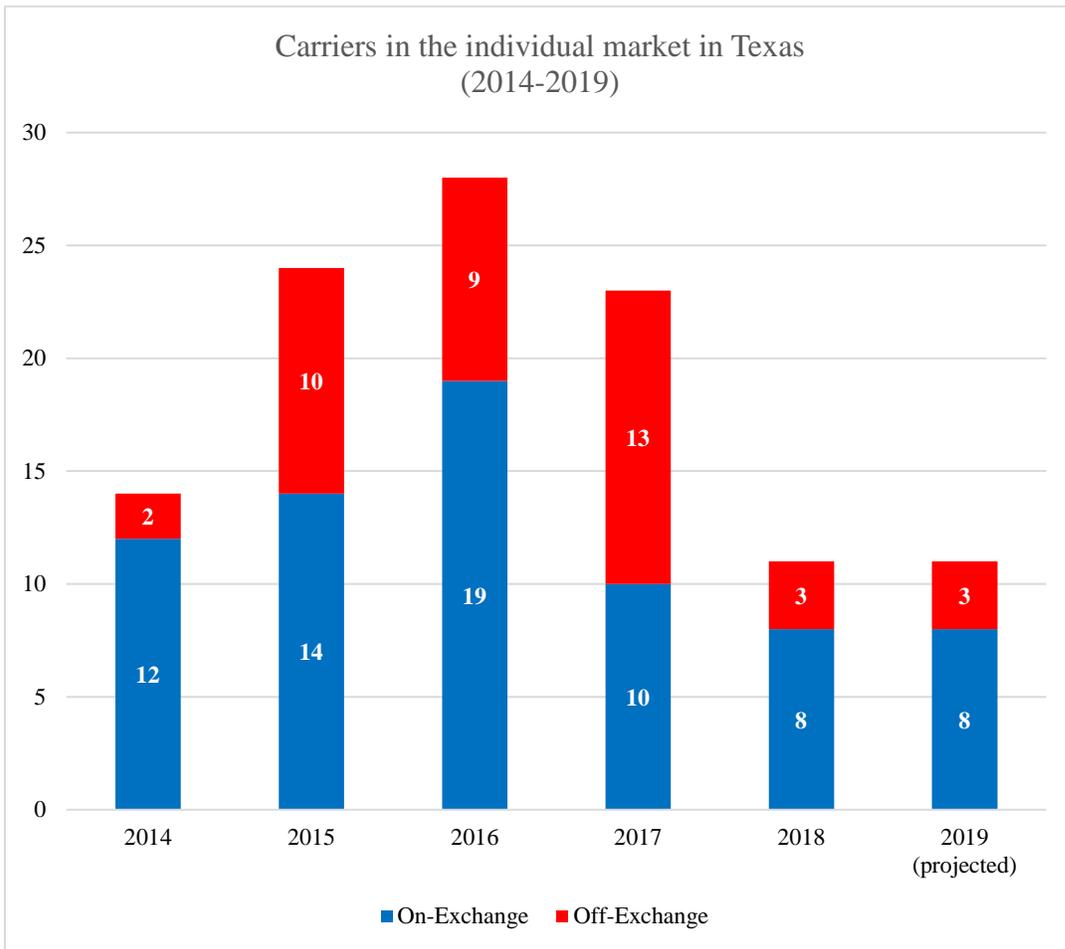
Enrollment - Texas ACA FFM effectuated enrollment declined for the first time in 2017 since implementation of the ACA, and then increased again in 2018.



* On-exchange enrollment for 2014 is based on initial enrollment and may include individuals who did not pay their first premium. Figures for 2015-2018 are based on effectuated enrollment (individuals who paid their first month's premium).

Note: Individual market enrollment (in blue) is taken from the Supplemental Healthcare Exhibits. Individual market enrollment also includes off-exchange enrollment and non-ACA (transitional and grandfathered) enrollment.

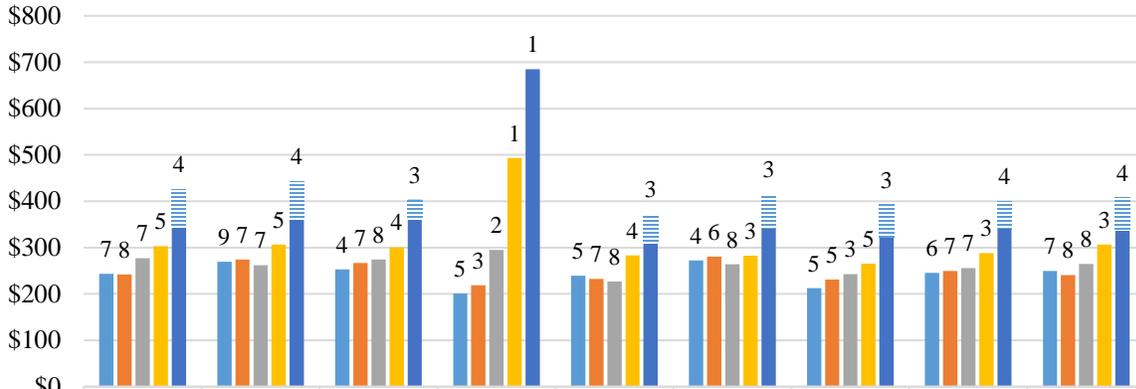
Competition - The number of carriers offering plans on the exchange has dropped from a high of 19 in 2016 to 8 in 2018.



Premiums - The chart below illustrates the rising costs of silver plans in Texas and other states. Second-lowest cost silver plans are the basis for determining APTCs.

On-exchange Second Lowest Cost Silver Plan Premiums - Individual Age 40 2014-2018

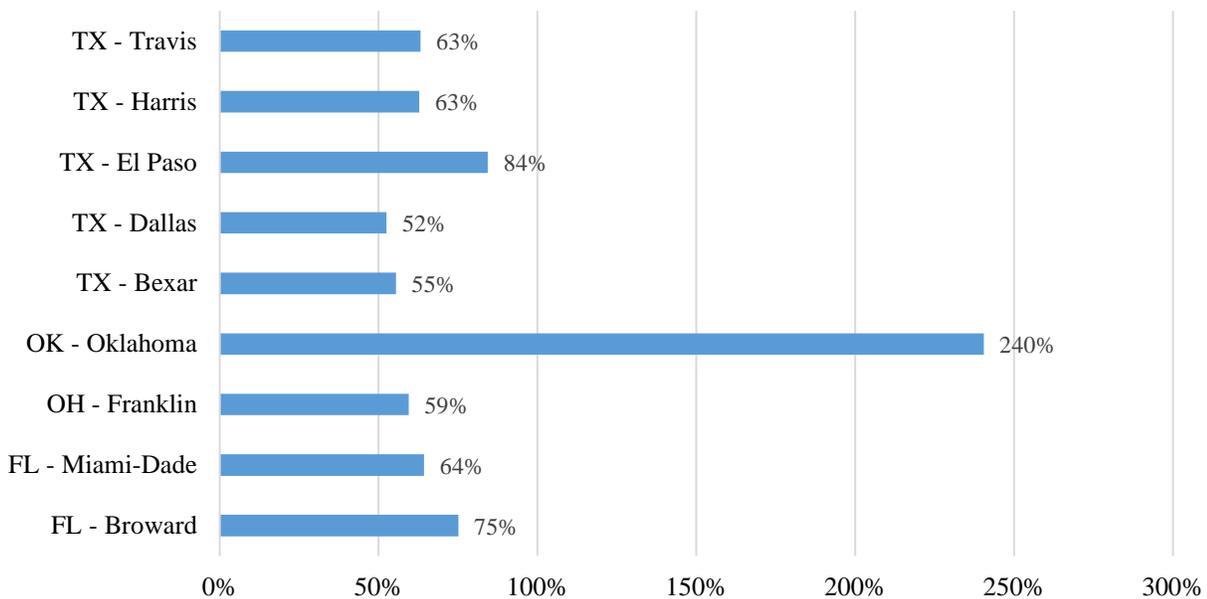
(The number of on-exchange issuers in the county are shown on top of the respective bars)



	FL - Broward	FL - Miami-Dade	OH - Franklin	OK - Oklahoma	TX - Bexar	TX - Dallas	TX - El Paso	TX - Harris	TX - Travis
■ 2014	\$243	\$269	\$253	\$201	\$239	\$272	\$212	\$245	\$250
■ 2015	\$242	\$274	\$266	\$219	\$233	\$280	\$231	\$250	\$241
■ 2016	\$277	\$262	\$274	\$295	\$227	\$264	\$243	\$256	\$264
■ 2017	\$303	\$306	\$301	\$493	\$283	\$283	\$265	\$288	\$307
■ 2018	\$426	\$442	\$403	\$685	\$372	\$415	\$391	\$399	\$407

▨ Represents the portion of premium attributable to the loss of CSR funding.
Note: The Oklahoma issuer adjusted for loss of CSR funding in 2017.

Second Lowest Cost Silver Plan On-exchange Rate Change 2014-2018

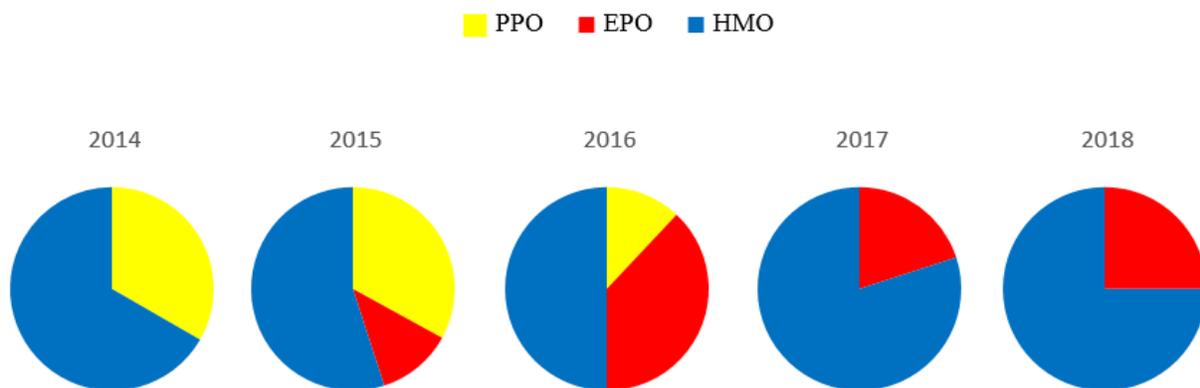


Subsidies:

- The APTC has increased from \$233 per month in 2014 to \$475 per month in 2018.
- 90 percent of Texas enrollees on the exchange received APTC subsidies in 2018.
- 59 percent of enrollees received CSR assistance.

Changes in Product Types:

Distribution of Carriers by Product Type on the Exchange



Impact of the ACA:

- Narrower networks and less choice of providers
 - There has been a significant shift from PPOs to HMOs and EPOs in the individual market.
 - There were no carriers offering PPOs on the exchange after 2016.
- Increasing premiums for unsubsidized individuals.
- Increased cost-sharing for individuals ineligible for CSR subsidies.
- The uninsured rate declined from 22 percent in 2013 (prior to the ACA) to 17 percent in 2017.
- Stable premiums for individuals receiving APTC subsidies.
- Coverage is more comprehensive than pre-ACA:
 - Essential Health Benefits (EHBs) must be covered (including maternity care, mental health and substance use treatment, and prescription drugs).
 - Preventive care with no cost-sharing.
 - No annual or lifetime limits.
- Coverage is more accessible:
 - No pre-existing condition exclusions.
 - No premiums based on gender or health status.

Potential Waiver Opportunities

Several potential waiver options are presented below. Common goals are of waiver options are:

- affordability – lowering the premiums and total out of pocket costs to enrollees;
- stability – stabilizing the market by encouraging healthy individuals to enroll and reducing adverse selection;
- competition and choice – increase carrier participation in the market; and
- accessibility – reducing the uninsured rate.

Creation of a High-risk Reinsurance Pool

Background:

A high-risk reinsurance pool may address three issues facing the individual insurance market: defensive pricing and market competition, premium increases for unsubsidized individuals, and coverage for individuals with high-cost preexisting conditions. A brief explanation of these issues follows. High-risk pools were the default used by states as the last resort coverage option when people could not get private insurance due to their medical histories. Texas had a high-risk pool (the Texas Health Insurance Pool). However, coverage through the pool terminated in March 2014, as medical history was no longer an obstacle to obtaining health insurance in the private market under the ACA.¹⁸⁸

Defensive pricing and market competition:

Very high-cost, low-frequency, claims are difficult to predict. Without reinsurance, issuers may adopt defensive pricing strategies to protect against worst-case scenarios and thereby contribute to market instability. Reinsurance makes claims costs more predictable and may also encourage smaller carriers to enter or remain in the individual market.

Premium increases for unsubsidized individuals:

The current structure of federal ACA subsidies puts a disproportionate burden on unsubsidized individuals (those earning over 400 percent of the federal poverty level). The premiums for persons eligible for APTCs are capped at a percentage of income. Once this cap is reached, further increases in premiums have no impact on the net cost of the second-lowest cost silver plan and less expensive plans for APTC eligible individuals.

Unsubsidized enrollees bear the entire cost of premium increases and are more likely to exit the market as premiums increase. Healthier individuals, who receive less economic benefit from insurance, may be the most likely to drop coverage and this can increase the average morbidity of the remaining risk pool. A state reinsurance program may provide a method of using federal subsidies to reduce the cost of insurance for unsubsidized individuals. This is accomplished by using reinsurance funds to cover a portion of claims costs, lowering the overall premiums, and funding a portion of the reinsurance via federal pass-through funding available due to the lower subsidy amounts needed for people receiving APTCs.

¹⁸⁸ Louise Norris, Texas Health Insurance, Healthinsurance.org (Sep. 10, 2018), <https://www.healthinsurance.org/texas/>.

Because the number of subsidized individuals is less than the number of total enrollees, in the absence of dramatic morbidity improvement, the pass-through funding will always be less than the total cost of the reinsurance program. Outside funding sources are needed to make up the difference.

Individuals with high-cost preexisting conditions:

For a risk to be “insurable” it must be random in nature, having an element of chance. Preexisting high cost conditions are not “insurable risks” in the traditional sense but the community rating and guaranteed issue provisions of the ACA require individual market issuers to cover these costs. Placing the burden of these costs on the small segment of society that purchases plans in the individual market, even with subsidies, may lead to adverse selection with healthier individuals leaving the market due to disproportionately high premiums, resulting in a sicker remaining risk pool and a further exodus of healthy enrollees. Reinsuring the claims of high-cost individuals may insulate the individual market from the effects of uninsurable risks resulting in lower premiums, reduced adverse selection, and market stability.

Potential goals:

- Lower premiums
- Increase competition
- Stabilize the market by:
 - subsidizing a portion of premiums for high-risk individuals (invisible risk pool); or
 - reinsuring a portion of the claims cost for high-cost individuals.

Waiver required: Waiver of single risk pool requirements under section 1312(c)(1) of the ACA (Subtitle D, Part I).

Considerations:

- A reinsurance plan is compatible with the FFM, so Texas would not have to manage exchange functions.
- May result in lower premiums for currently unsubsidized individuals.
- May encourage healthier individuals to enroll, stabilizing the market.
- May result in more carriers entering the market, as risks are mitigated, increasing choice and competition.
- Pass-through funding levels are based on complex estimates of enrollment behavior, so actual pass-through funding may be more or less than anticipated.
- May remove incentives for issuers to control the cost of reinsured claims.
- Changes in federal laws may impact the availability of continued federal funds.

Barriers to Implementation:

- Deficit neutrality guardrail may be difficult to justify and achieve.
- Time constraints.
- Costs may exceed appropriated amounts.

Funding and Impact:

The impact of a high-risk reinsurance program on premiums and enrollment depends on several variables in addition to overall funding levels. Major factors include: the sensitivity of enrollment numbers to changes in premium; the health of new enrollees and their need for financial assistance; and, the degree to which reinsurance payments to issuers are passed on as premium reductions to enrollees. A detailed actuarial analysis will be necessary for a more accurate estimate; however, preliminary internal estimates, assuming the current market requirements, indicate the state's share of the costs would be hundreds of millions of dollars.

The premium impact and funding estimates expected in other states using a waiver to establish a reinsurance program are summarized below.

Comparison of State Reinsurance Plan Premium Impact and Funding							
		2018		2019		2020	
State	Premium Reduction	Total Funding	State Funding	Total Funding	State Funding	Total Funding	State Funding
AK	4%*	\$60M	\$11M	\$64M	\$12M	\$69M	\$13M
MN	20%	\$271M	\$133M	\$298M	\$147M	\$328M	\$163M
OR	7.50%	\$90M	\$57M	\$95M	\$63M	\$100M	\$69M
OK	30%	\$325M	\$16M	\$325M	\$63M	\$325M	\$51M

*Alaska implemented a state reinsurance program in 2017 which resulted in a premium increase of 7.3 percent compared with pre-reinsurance estimates of 42 percent.

Waiver of QHP Standards

Background:

A Qualified Health Plan (QHP) is a plan certified to meet certain benefit (including EHB), cost-sharing, actuarial value, accreditation of issuer, and other standards. QHPs are certified by CMS for the federally facilitated marketplace, and by the states (using federal standards) for the state-based exchanges. QHPs are the only plans that may be offered on an exchange and are the only plans eligible for APTCs and CSRs. A QHP also qualifies as minimum essential coverage under the ACA individual shared responsibility provision.

QHP standards are set at the federal level but a state may request a section 1332 waiver to establish its own standards for QHP certification. Current CMS guidance does not allow state-specific modifications to the federal exchange platform therefore most waivers of QHP standards would require a state to assume plan management and exchange operation functions. As with all 1332 waivers, any proposed waiver of QHP standards must comply with the federal guardrails.

Waivers of QHP standards could be used to expand choice and competition in the marketplace, but increased plan variation may lead to adverse selection. Conversely, plan variation could be limited to reduce adverse selection. EHBs could be redefined under a waiver program, but the coverage would have to be at least as comprehensive as the ACA benefits under the current guardrails.

Potential Goals:

- Stabilize the market by reducing adverse selection.
- Increase flexibility in plan design and choices.
- Improve market competition.
- Better align benefits with Texas specific needs.

Waiver examples:

- Waive the requirement for carriers to offer at least one gold and one silver plan on-exchange.
- Redefine essential health benefits (EHBs) that must be provided by QHPs.
- Change or eliminate metal level and/or actuarial value requirements.
- Expand eligibility for catastrophic plans.

Waiver required: Waiver of qualified health plan requirements under Subtitle D, Part I of the Affordable Care Act.

Considerations:

- Greater flexibility in plan design and choices may lead to more participation and choices on the exchange.
- Reduced administrative costs related to maintaining actuarial values within a narrow range may improve affordability.
- Limitation of plan choice may reduce adverse selection and stabilize the market.
- Essential health benefits may be better aligned with Texas’s needs.
- Eliminating metal levels makes comparison between plans more difficult or choices could lead to further adverse selection.

Barriers to Implementation:

- Texas would have to assume plan management functions and establish its own exchange.
- Reduction of EHBs may not conform to the guardrail requiring plans be at least as comprehensive as the ACA EHBs.
- Expansion of EHBs may not be compatible with the deficit neutrality guardrail.
- Costs may exceed appropriated funds.

Waiver of Exchange Standards

Background:

In addition to the QHP standards outlined in the previous section, the ACA also establishes exchange standards for both the federally facilitated marketplace and state-based exchanges. Exchange standards that may be waived include, but are not limited to, provisions relating to the type of plans that may be offered, the individuals eligible to purchase plans on an exchange, open and special enrollment periods, Navigator provisions, and issuer administrative requirements. Current CMS guidance does not allow

state-specific modifications to the federal exchange platform therefore waivers of exchange standards would require a state to establish a state-based exchange.

Potential Goals:

- Reduce the uninsured rate.
- Minimize adverse selection.
- Stabilize the market.

Waiver examples:

- Change open enrollment and special enrollment periods.
- Expand exchange eligibility standards; allow individuals currently ineligible to purchase exchange plans.
- Allow sales of non-QHP plans on the exchange.
- Expand eligibility for Navigator grants to agents and brokers.

Waiver required: Waiver of exchange standards under Subtitle D, Part II of the Affordable Care Act.

Considerations:

- May reduce adverse selection and improve stability.
- May increase enrollment and lower the uninsured rate in Texas.
- Potential incompatibility of expansion of enrollment eligibility with deficit neutrality may require additional state funds.

Barriers to Implementation:

- Texas would have to assume plan management functions and establish its own exchange.
- Costs may exceed appropriated funds.

Waiver of Cost-sharing Reductions and Premium Tax Credits

Background:

The ACA includes two programs to assist in affordability of premiums and the affordability of care, APTCs and CSRs. Under the APTC program enrollees earning between 100 percent and 400 percent of the FPL (inclusive) are required to pay only a percentage of income to purchase the second-lowest cost silver plan with a subsidy to make up the difference. The CSR provisions require issuers to reduce deductible and/or copayments for enrollees earning up to 250 percent of the FPL. Subsidy payments for CSRs were stopped in October 2017, pending resolution of the House v. Price lawsuit but the requirement for issuers to provide reductions in cost sharing remains. The current subsidy structure provides no APTCs for enrollees below 100 percent of the FPL (the “coverage gap”) and none for those above 400 percent of the FPL (the “cliff”).

Through Section 1332 waivers, states, via the pass-through funding provision, could use the subsidy funds to restructure the subsidy program. For example, through waivers, subsidies could be extended to enrollees below 100 percent and above 400 percent of the FPL, changed from income to age-based eligibility, or converted to a flat payment system. Total APTC funding to Texas residents for 2017 is estimated at \$3,315,000,000. Current IRS guidance does not permit the IRS to operate different subsidy programs for different states and would require Texas to manage and disburse pass-through funds under a state-run program.

Potential Goals:

- Decrease the uninsured rate.
- Improve affordability.
- Stabilize the individual market.

Waiver examples:

- Replace the current CSR program with state-funded HSA-type accounts.
- Allow subsidies for off-exchange plans and other metal levels in addition to silver.
- Eliminate the “coverage gap” by providing subsidies to enrollees earning below 100 percent of the FPL.
- Change the premium subsidy structure from the current income and plan cost basis.

Waiver required: Waiver of section 1402 of the ACA and section 36B of the IRS Code.

Considerations:

- May provide incentives for younger and healthier individuals to enroll in coverage, reducing the uninsured rate and stabilizing the risk pool.
- May make plans more affordable for older enrollees and those earning below 100 percent of the FPL.
- May reduce the rate of increase of health care costs by returning control of funds to enrollees via HSA-type accounts.
- State administrative costs may be substantial.
- Expansion of enrollment eligibility may not be compatible with the deficit neutrality guardrail.
- Expansion of subsidies to additional plans and individuals may impact deficit neutrality.
- Pass-through funding may not continue at expected levels if federal rules and laws change.

Barriers to Implementation:

- Texas would have to assume plan management functions and establish its own exchange.

Texas would have to waive the entire IRS-based system of subsidies and administer subsidies at the state level, funded by pass-through funding and other sources.

TESTIMONY

The Committee met on January 23, 2018 to discuss issues relating to this charge. Importantly, the final rules for the October 2017 executive order on association health plans and short term plans were not released yet. Additionally, the legal challenges had not materialized. Much of the testimony focuses on potential of 1332 innovation waivers and the potential creation of a reinsurance pool.

The invited testimony on this charge consisted of two panels. The first witness was Jan Graeber, the Director and Chief Actuary of the Life and Health Actuarial Office at the Texas Department of Insurance. The second panel consisted of stakeholders, research centers and industry members.

Ms. Graeber testified that Texas's individual health insurance market has fared better than other states. The challenges in the individual market are the rates are increasing, enrollment is falling and plans are leaving the market. She explained that other states have addressed some of these same concerns by applying for federal 1332 State Innovation Waiver.

Texas is one of four states that opted not to operate their own exchange, and that is important to keep in mind because most of the 1332 waiver options available would require Texas to operate its own exchange. Additionally, Ms. Graeber explained that Texas needs enabling legislation allowing for the specific waiver. Texas is one of four states that are not enforcing the ACA, and have not entered a collaborative arrangement. Instead, Centers for Medicaid and Medicare Services is responsible for ACA enforcement in TX, as well as Missouri, Oklahoma, and Wyoming.

The two major consideration when deciding whether to apply for a 1332 Waiver, Graeber noted, are time and cost. Based on federal requirements, the process for applying and receiving approval of a 1332 Waiver is extensive and likely to take 18 months. TDI's initial analysis of the cost would be hundred of millions of dollars. The amount of federal funding available today for a reinsurance pool would not offset the total cost of the program, so the state would have to commit to providing additional funding through assessments or another funding mechanism.

Graeber also testified on selling health insurance across state lines. Currently, health plans are allowed to sell insurance in Texas as long as they are licensed in Texas and meet certain regulatory requirements. Statutory changes would be needed to allow an unlicensed carrier to sell insurance in Texas. In addition to licensing and solvency requirements would need to consider, if any, which requirements to impose on the plans. For example, there are requirements for network adequacy and credentialing, complaint and enforcement processes to protect consumers, guarantee fund requirements, and prompt payment to providers.

Jason Baxter testified on behalf of the Texas Association of Health Plans. The problem of risk, he explained, is still a problem today and this problem existed before the passage of the ACA. This risk problem occurs when a large group with chronic conditions or serious illnesses enroll in the ACA while not enough healthy people have coverage. The health plan greatly underestimated the cost associated with the large enrollment of people who are now covered and have medical needs, which has caused the prices of the exchange plans to increase rapidly.

Additionally, Baxter explained that the uncertainty created by activity at the federal level with efforts to repeal the ACA, repeal the individual mandate and the non-payment of cost sharing reduction payment exacerbate the already challenging marketplace. TAHP explained that they support a waiver for a reinsurance program that 15 states are pursuing or have already been approved to implement. Baxter gave the example of Oklahoma that submitted a waiver, which was withdrawn, that would have reduced health insurance premium costs by 34 percent. TAHP believes that a 1332 waiver would allow Texas to take back control of the individual commercial insurance market.

Mr. Russell Withers with the Texas Conservative Coalition Research Institute testified on TCCRI's support for purchasing insurance across state lines, right to shop legislation and TCCRI's approach to reinsurance. Selling and purchasing insurance across state lines has been a long held conservative policy goal that Mr. Withers believes should be pursued in Texas. He believes that statutory changes could designate states that have licensing schemes that conform with Texas law.

Right to shop policies are also supported by TCCRI. Mr. Withers explained that these measures work when a medical service, such as MRI, is recommended for a consumer. Then, the consumer accesses a website or phone database where they are presented with different options of where they can get the procedure and how much it would cost. Any cost saving that result from that process, the consumer splits with the health plan.

Lastly, Mr. Withers explained that TCCRI supports that a reinsurance pool not be used as an argument against repeal of the ACA. If the ACA is repealed and Texas created a reinsurance pool, Texas should be prepared to get rid of a reinsurance pool and go back to a high risk pool similar to what Texas previously had before the ACA.

Stacey Pogue, Senior Policy Analyst with the Center for Public Policy Priorities, testified that six percent of Texans get health insurance through the ACA, and those who are not eligible for insurance through other coverage options. Her testimony included that six states have already enacted laws to encourage the sales of insurance across state lines, however no health plan has taken up this option. She also mentioned that the ACA also allows insurers to sell across state lines if there is an agreement between two states, however, no states can formed an agreement.

Ray Callas representing the Texas Medical Association testified that TMA supports that if insurance is sold across state lines, the insurance needs to be regulated by the State of Texas in order to ensure the insurance has an adequate network of providers, that it meets the prompt payment requirements and that it meets the minimum financial solvency requirements for insurance companies.

Garrin Raymond representing the Texas Association of Health Underwriters, that represents independent health insurance agents. Mr Garrin focused on the 1332 waiver regarding metallic plans. He testified that the ACA created plans using Bronze, Silver, Gold and Platinum levels based on an actuarial value for consumers to understand which level of coverage they were getting. However, because of volatility in the market, 70 percent of the plans were not in compliance with the requirements for each metallic level. TAHU is supportive of a waiver to allow for five percent variance between the actuarial values on the

metallic plans. This would decrease the confusion the agents, health plans, consumers and employers are having to grapple with as the plans have to revamp the plan offerings.

CONCLUSIONS

There are many factors contributing to the unpredictable Texas health insurance market. Between the new federal rules on association health plans and short term plans as well as the many waiver options, Texas has options to shape what is best to implement in order to stabilize the health insurance market. Other proposals such as right to shop and selling insurance across state lines may be viable options if stakeholders can agree on the best parameters to make these proposals workable for Texans.

Texas has fared better with the ACA exchange plans offered in our state. However, the large increases in premiums over time that have now plateaued a bit more, along with dwindling enrollment coupled with the growing number of HMOs, show that the ACA is not working like it was intended to do.

Many 1332 waiver options require the state to run its own exchange, and Texas is one of four states that has completely rejected running its exchange at the state level. The Texas Department of Insurance's testimony that implementing a reinsurance pool through a 1332 waiver will cost hundreds of millions of dollars makes the process cost prohibitive without adequate federal funding. Given the high cost and amount of time to implement, it is unlikely that there is support for applying for waivers. Moreover, many waivers require Texas to run their exchange, which Texas has opted not to do.

Texas could still use federal fund from "repeal and replace" legislation for a high risk reinsurance pool, but nothing will happen under S.B.2087 if federal funding doesn't become available. So for the time being, the legislation is dormant and is set to expire in August 2019. There is not a need for a high risk reinsurance pool as long as the ACA remains intact and private health insurance plans must comply with the requirement that coverage be guaranteed issue, regardless of a consumer's medical histories.

Association health plans and short term limited duration plans, if implemented thoughtfully, and with a consumer protection and disclosure focus, could be a more affordable health insurance options for individuals and small employers if one of those plans better fits their health needs.

RECOMMENDATIONS

During the 86th Regular Legislative Session, the Committee recommends continuing to monitor efforts at the federal level on efforts to "repeal and replace" the Affordable Care Act. Texas would need to adequately adjust its health insurance measures at the state level should federal legislation pass and take steps to potentially establish a high risk reinsurance pool if federal funding is provided.

Additionally, the Committee recognizes the need to work with the Texas Department of Insurance and monitor the implementation of the recently released federal rules for association health insurance and short term plans.

Texans would benefit from finding ways to increase transparency in both healthcare services and insurance products to ensure that consumers are protected and know what healthcare services and insurance they receive and/or purchase.

The Committee sees the potential consumer benefits in "right to shop" proposals and should work to determine if forming compacts with similarly regulated states would encourage health plans to offer health insurance products across state lines.

7. Review licensing requirements and fees imposed on entities within the committee's jurisdiction. Make recommendations for state licenses and fees that should be reduced, repealed or transitioned to private-sector enforcement.

BACKGROUND

The State of Texas has over 500 occupational license certifications for specific trades and professions that are administered and overseen by various boards and agencies within state government. Each licensure requirement has been established by the Texas Legislature, and each requirement can only be eliminated if the Legislature decides it is appropriate to do so. The opportunity for the Legislature to address existing licensure programs surfaces through the biennial appropriations process and through periodic Texas Sunset Advisory Commission (Sunset) reviews that examine the continued need for most state agencies.¹⁸⁹

Traditionally, Sunset has reported and made recommendations on whether an agency should be abolished, and if not, how it might operate more efficiently. With passage of HB 86 (Rep. Callegari - 83R) in 2013, statute now requires Sunset to consider whether a licensure program serves a meaningful, defined public interest and provides the least restrictive form of regulation to adequately protect the public. Sunset must also consider whether the regulatory objective of the program can be achieved by other means; the extent to which licensing criteria ensure applicants have skills or competencies that correlate with a public interest; the impact of those criteria on applicants, particularly those with low or moderate incomes; and the extent to which the program stimulates or restricts competition and affects consumer choice and the cost of services.

The agency responsible for administering the most licensing programs within the state is the Texas Department of Licensing and Regulation (TDLR), which oversees 39 licensing programs that include 214 individual and business occupational license types. The core purpose of the agency is to protect the health and safety of Texans and ensure they are served by qualified professionals and that registered equipment is routinely inspected for safety. As of September 1, 2018, TDLR had issued:

- 700,051 licenses to individuals and businesses in occupations ranging from barbers and cosmetologists to podiatrists and speech-language pathologists; and
- 123,736 licenses for continuing education courses, equipment such as elevators and boilers, permits for the Weather Modification program, and project registrations for the Elimination of Architectural Barriers program.¹⁹⁰

Since 2005, the Sunset Commission has recommended consolidating many smaller licensing boards and divisions under the overall regulatory umbrella of TDLR, resulting in 21 program and more than 377,172 licensee transfers by the Legislature during that time. In 2015, the Legislature passed SB 202, a Sunset Recommendation to consolidate thirteen health-related licensure programs previously overseen by the

¹⁸⁹ Written testimony submitted by Brian Francis, Executive Director, Texas Department of Licensing & Regulation to the Texas Senate Committee Business & Commerce, August 28, 2018

¹⁹⁰ Ibid

Department of State Health Services (DSHS) and move them under TDLR. That same year, the Legislature passed HB 1786, which moved the Parent Taught Driver Education Program from the Department of Public Safety (DPS) and the Driver and Traffic Safety Education Program from the Texas Education Agency (TEA), both to TDLR. In 2017, the Legislature passed HB 3078 to abolish the independent Texas State Board of Podiatric Examiners and transfer the Podiatry program to TDLR.

Because the Legislature has continued to insist on more efficient government regulation of businesses and trades, the policy trend since 1999 has been toward the consolidation of licensure responsibilities under as few agencies as possible, while maintaining the overall mission of protecting the public’s health and safety. During this 19-year period, TDLR’s responsibilities have increased from regulating 17 programs in 1999 to the 39 programs previously mentioned and 214 individual occupational license types. During that same period, TDLR’s licensee population has increased from 122,837 to 823,787.¹⁹¹

TDLR Scope of Responsibilities as of September 1, 2018*:

<p style="text-align: center;">Business and Occupations (11)</p> <ul style="list-style-type: none"> Combative Sports Driver Education and Safety For-Profit Legal Services Licensed Breeders Polygraph Examiners Professional Employer Organizations Service Contract Providers Towing Companies Transportation Network Companies Used Automotive Parts Recyclers Vehicle Storage Facilities 	<p style="text-align: center;">Medical and Health Professions (11)</p> <ul style="list-style-type: none"> Athletic Trainers Behavior Analysts Dietitians Dyslexia Therapy Hearing Instrument Fitters and Dispensers Massage Therapy Midwives Podiatric Medicine Orthotists and Prosthetists Sanitarians Speech-Language Pathologists and Audiologists
<p style="text-align: center;">Building and Mechanical (8)</p> <ul style="list-style-type: none"> Air Conditioning and Refrigeration Architectural Barriers Boiler Safety Code Enforcement Officers Electrical Safety Elevators, Escalators, and Related Equipment Industrialized Housing and Buildings Mold Assessors and Remediators 	<p style="text-align: center;">Professionals (7)</p> <ul style="list-style-type: none"> Auctioneers Barbering Cosmetology Laser Hair Removal Offender Education Providers Property Tax Consultants Property Tax Professionals
	<p style="text-align: center;">Natural Resources (2)</p> <ul style="list-style-type: none"> Water Well Drillers and Pump Installers Weather Modification

*Note: For-Profit Legal Services will be deregulated on September 1, 2019.¹⁹²

As a regulator, TDLR’s primary mandate is to determine licensure requirements that protect the health and safety of Texans. It is also charged with ensuring they are served by qualified individuals in each of

¹⁹¹ Written testimony submitted by Brian Francis, Executive Director, Texas Department of Licensing & Regulation to the Texas Senate Committee Business & Commerce, August 28, 2018

¹⁹² Ibid

the regulated programs. This in turn necessitates that the agency evaluates whether licensing requirements are still appropriate or needed. TDLR does this through formulation of the biennial Strategic Plan or “Strat Plan.”¹⁹³

Since the “Strat Plan” encompasses a five-year period of review, TDLR asks individuals in regulated programs to give guidance on their forward outlook of how they see their professions changing to indicate whether continued regulation would be needed to fulfill the agency’s core mission. This is manpower-intensive but provides a mechanism for the state’s continual review over a large segment of the state’s occupational licensure programs.

TDLR’s 2016 Strat Plan Overview included consideration of the following actions when assessing both the need for and effectiveness of existing licensure programs and license types:

- Deregulation of Programs
- Elimination of Licenses
- Transfer of Programs
- Elimination of License Impediments
- Elimination of Redundancies
- Elimination of Government Interference with Business Practices
- Removal of Inflexible, Rigid, and Excessive Requirements
- Removal of Criminal and Civil Penalties for Administrative Violations¹⁹⁴

As a result of the Strat Plan process, TDLR presented the Legislature with its recommendations for the repeal and deregulation of four programs and seven license types in its 2016 Strategic Plan. During the 85th Legislative Session, 15,318 occupational licensees under 14 Texas Department of Licensing & Regulation (TDLR) license types were successfully deregulated, making this one of the largest deregulation efforts in Texas history, enacting all of TDLR deregulatory recommendations.¹⁹⁵

¹⁹³ Written testimony submitted by Brian Francis, Executive Director, Texas Department of Licensing & Regulation to the Texas Senate Committee Business & Commerce, August 28, 2018

¹⁹⁴ Texas Department of Licensing & Regulation, 2017-2021 Strategic Plan
<https://www.tdlr.texas.gov/StratPlan/2017/TDLR%202017-2021%20Strategic%20Plan.pdf>

¹⁹⁵ Written testimony submitted by Brian Francis, Executive Director, Texas Department of Licensing & Regulation to the Texas Senate Committee Business & Commerce, August 28, 2018

Program	Recommended Statutory Change	Benefit of Change
1 Temporary Common Worker Employers	Programs have zero to little enforcement activity, and minimal risk of consumer harm. Repeal statewide licensing requirement; preserve municipal authority and retain consumer protection provisions.	Individuals and companies will no longer be required to submit initial license or renewal applications, pay the initial fees and renewal fees, and be subjected to potential disciplinary action in the form of administrative penalties and sanctions.
2 For-Profit Legal Service Contracts		
3 Vehicle Protection Product Warrantors		
4 Vehicle Towing and Booting, Sections relating to Booting	Repeal statewide requirement for booting company and operator licenses. Preserve the authority of municipalities, political subdivisions, and institutions of higher education to regulate these activities.	
5 Threading (Barbers and Cosmetologists) (See House Bill 4069, 84R – 2015)	Repeal statewide licensing requirement for an individual engaging in threading to hold an operator license, esthetician license, Class A barber license, or a barber technician in the barbering and cosmetology statutes.	
6 Shampoo Apprentice Permit (Barbers and Cosmetologists) (See House Bill 2720, 84R – 2015)	Repeal the requirement that an individual must hold a cosmetology or barber student permit to shampoo.	Salons and barber shops will no longer be required to employ a licensed person to shampoo.

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As a result of TDLR’s 2018 Strat Plan process, the agency has identified and recommended a number of statutory changes to deregulate or transfer a program, eliminate licenses, and remove redundancies and impediments, including:

- Deregulate or transfer the Mold program back to the Department of State Health Services’ Environmental and Sanitation Licensing Division;
- Eliminate voluntary orthotic and prosthetic technician licenses;
- Remove the business impediment requiring driver education schools to have a brick-and-mortar establishment before being allowed to offer courses exclusively online;
- Simplify license renewal and lower costs by extending license terms from one to two years;
- Streamline examination requirements by allowing approved schools to administer the practical portion of barber and cosmetology exams; and
- Decrease costs for business owners that operate under separate cosmetology and massage therapy licenses by allowing dual licenses.¹⁹⁷

After several years of failed occupational licensing reforms at the federal level, this summer the *New Hope and Opportunity through the Power of Employment (New HOPE) Act* authored by Senator John Cornyn of Texas passed Congress with overwhelming support. The *New HOPE Act* is a bipartisan occupational licensing reform bill that will provide tools to help states decide if they want to eliminate or reduce burdensome licensing requirements that are serving as an impediment to job creation. Representative Henry Cuellar of Texas introduced the bill in the U.S. House of Representatives.¹⁹⁸

The bill provides additional authority to state governors receiving an existing, bipartisan appropriation of discretionary funds for career and technical education, giving them the discretion to use this money for

¹⁹⁶ Written testimony submitted by Brian Francis, Executive Director, Texas Department of Licensing & Regulation to the Texas Senate Committee Business & Commerce, August 28, 2018

¹⁹⁷ Ibid

¹⁹⁸ Washington Examiner, "Congress quietly seeks to help states fix occupational licensing headaches", August 4, 2018 <https://www.washingtonexaminer.com/opinion/congress-quietly-seeks-to-help-states-fix-occupational-licensing-headaches>

the identification, consolidation, or elimination of licenses or certifications which provide limited consumer protection and pose an unnecessary barrier to entry for aspiring career and technical education workers.¹⁹⁹

Senator Cornyn released the following statement after President Trump signed the New HOPE Act into law in late July of 2018:

“Texans pursuing a career with higher wages and more gratifying work shouldn’t be penalized by onerous and duplicative licensing requirements,” said Sen. Cornyn. “This law will give states the tools to revise these burdensome practices and reduce barriers to certain professions for Texas job-seekers.”²⁰⁰

TESTIMONY

Matt Mitchell, Director and Senior Research Fellow, Project for the Study of American Capitalism, Mercatus Center at George Mason University began his testimony by noting that economists of all political persuasions agree that occupational licensure is counterproductive and harmful to consumers, stating that it is a barrier to entry.²⁰¹

Mitchell noted that in 2015 one in four Texans worked in an occupation that required licensure. Expounding on the effects of licensure in Texas, Mitchell continued, "Among 37 low to moderate income occupations licensed by Texas, the average requires 241 days in training, \$253 in fees. This does not count either the cost of the education, which can be in the thousands, or the income that people forego when they spend months in often unnecessary training, which can be in the tens of thousands. Licensure is often arbitrary. Compared with emergency medical technicians, aspiring barbers in Texas must undergo 10 times as many months of training. Security alarm installers, who by the way are unlicensed in 36 states, must complete more than 20 times as much training. And athletic trainers must complete more than 40 times as much training as EMTs."²⁰²

It was noted that about three quarters of Texas Occupational Licensing Boards are, by law, dominated by a majority members of the professions they oversee. Mitchell express the legal concern that in light of the US Supreme Court's 2015 decision in *North Carolina State Board of Dental Examiners v. Federal Trade Commission*, 574 U.S. (2015), which held that states may be liable for antitrust violations, when boards are dominated by members of the professions they oversee and when elected officials fail to actively supervise them. "The practical concern, that the boards will tend to act as industry cartels, controlling entry of new members rather than ensuring public safety." Mitchell testified.²⁰³

¹⁹⁹Senator John Cornyn, "Cornyn Bill to Ease Burdensome Occupational Licensing Requirements Signed Into Law", July 7, 2018 <https://www.cornyn.senate.gov/content/news/cornyn-bill-ease-burdensome-occupational-licensing-requirements-signed-law>

²⁰⁰ Ibid

²⁰¹ Direct testimony from Matt Mitchell, Director and Senior Research Fellow, Mercatus Center to the Texas Senate Committee Business & Commerce, August 28, 2018

²⁰² Ibid

²⁰³ Direct testimony from Matt Mitchell, Director and Senior Research Fellow, Mercatus Center to the Texas Senate Committee Business & Commerce, August 28, 2018

Mitchell continued by noting that licensure requirements disproportionately affect certain groups like military spouses, ethnic minorities, and people with a criminal record. Mitchell highlighted one particular example for the Committee, "For example, there's a recent story, I read not too long ago, in Texas where the state spent a lot of money to rehabilitate a offender, trained her in a new profession. She got out of jail and then wasn't allowed to practice the profession that the state had paid for her to train, because she couldn't pass the licensing with the criminal record. 80% of the studies we reviewed find that licensure has a disparate impact on ethnic minorities."²⁰⁴

Mitchell again stressed that the available evidence suggests that licensure does not increase the quality of goods and services, "Well, we looked at 19 studies, all peer reviewed academic studies. 16% of them did find that licensure seems to increase quality, but more than that, 21% found a negative affect on quality. And the vast majority, 63%, found mixed, unclear, neutral effects on licensure and quality. So, to me, the balance of the evidence suggests that it's really hard to say that licensure increases quality. If anything, it may decrease it, and most likely, it probably has no affect." Mitchell testified.²⁰⁵

Mitchell discussed approaches to licensure that have been adopted in Nebraska and Arizona. In Nebraska, Mitchell explained, established an independent commission comprised of experts familiar with the economic literature on licensure and with no financial stake charged with identifying, and eliminating burdensome and anti-competitive licensing laws. Nebraska now requires their legislative committees to review all licenses under their jurisdiction every five years and are required to use the least restrictive means necessary to protect consumers from undue risk. The Nebraska legislation actually establishes a hierarchy of these needs from least restrictive, like market competition and consumer ratings, all the way to more restrictive means, such as inspections or the most restrictive, which is licensure.

Arizona has taken a different approach by attempting to reverse the burden of proof: existing Arizona law had already declared that there was a "fundamental civil right" to pursue a chosen profession, free from arbitrary or excessive government interference. But now, the new Right to Learn a Living Act permits any person to file an action in a court of general jurisdiction to challenge an occupational license. The law creates a presumption against the state's regulatory authority unless the regulation is "demonstrated to be necessary to specifically fulfill a public health, safety, or welfare concern." The law clarifies, I might add, that health, safety, or welfare does not include the protection of existing businesses from competition. Mitchell testified, "So what this does is not only does it empower individuals to police the licensing regime itself. But it also encourages regulators who might be worried about undue interference in the right to earn a living to also police themselves. So none of these approaches are mutually exclusive. Indeed I believe that they all reinforce one another. And for policymakers who value consumer protection, lower prices and greater opportunities for employment, especially among the most vulnerable populations. I think they would do well to consider these reforms."²⁰⁶

When asked by the Committee which occupations he has determined should remain licensed, Mitchell discussed nurse practitioners as an example, stating that health and safety should be a priority when considering licensure requirements.

²⁰⁴ Direct testimony from Matt Mitchell, Director and Senior Research Fellow, Mercatus Center to the Texas Senate Committee Business & Commerce, August 28, 2018

²⁰⁵ Ibid

²⁰⁶ Direct testimony from Arif Panju, Managing Attorney, Institute for Justice to the Texas Senate Committee Business & Commerce, August 28, 2018

When asked by the Committee how consumers would have recourse against faulty work or fraudulent professionals without licensure boards, Mitchell testified that unlicensed professionals can obtain insurance or bond postings to cover the consequences of mistakes or bad work and that the court system already protects consumers from faulty work and fraud.

Arif Panju, Managing Attorney, Institute for Justice, testified that no state has more licensing boards than Texas. The Committee asked Panju to discuss the positives of occupational licensing, to which he argued that licensing can function as a market signal that indicates competency in that occupation. Expounding on the theme, Panju testified that while licensure boards also provide recourse for injured consumers, they often try to suppress future competition, adding that recourse for consumers can be achieved through the legal system and legislation like trade practices acts. Ultimately, Panju reasoned that there certainly are benefits to licensure but that those benefits can be achieved through other mechanisms, like registration/certification.

Dr. Vance Ginn, Senior Economist and Director of the Center for Economic Prosperity at the Texas Public Policy Foundation, testified that Texas has a high rating for economic freedom because of its low tax burden, but that the state has extensive licensure laws and requirements that prevent people from going into business. Dr. Ginn continued by noting that in Texas, from 1999 to 2015, the number of licensees increased by 460% to 650,000 which the population over that period increased by 37.5%. This accounts for an increase by tenfold over that 16 year period, compared with just the population increase.²⁰⁷

Turning to the effects of occupational licensing on the criminal justice system, Dr. Ginn testified, "When you think about those who have a record, and I know Matt mentioned this, but then you can't even join into that occupation. And so that could end up putting them in this downward spiral where they can't find a job. So they turn back to a life of crime and end up back in the criminal justice system. And so this will be a way to help to help to overcome some of those issues, by looking at rolling back some of the occupations and reducing the burden of entering into these occupations."²⁰⁸

Russell Withers, General Counsel and Senior Policy Analyst, Texas Conservative Coalition Research Institute, testified that many licenses are not essential, "[a]nd whenever you're talking about repealing licenses or whether to adopt new licenses, the conversation always goes back to health and safety. And there are a lot of professions that turn directly on health and safety. But the problem is, every profession will tell you that they are justified for a license under health and safety. And I've seen this from florists all the way up to anesthesiologist's assistants. Which Members of the Committee I'm sure are aware of, because that is a fight that you have to deal with every single session." Withers mentioned painters, handymen, and general contractors, stating that they are not licensed but do dangerous work and enter people's homes in trust. Withers testified that there is no way to address every bad actor and said that consumers should always be diligent in choosing with whom to do business, regardless of whether a professional is licensed.²⁰⁹

²⁰⁷ Written testimony submitted by Dr. Vance Ginn, Senior Economist, Texas Public Policy Foundation to the Texas Senate Committee Business & Commerce, August 28, 2018

²⁰⁸ Direct testimony from Dr. Vance Ginn, Senior Economist, Texas Public Policy Foundation to the Texas Senate Committee Business & Commerce, August 28, 2018

²⁰⁹ Direct testimony from Russell Withers, General Counsel, Texas Conservative Coalition Research Institute to the Texas Senate Committee Business & Commerce, August 28, 2018

Withers discussed voluntary registration for interior designers, adding that most designers in Texas are now operating without a license. Withers recommended a full deregulating of interior design.

The discussion turned to voluntary registration and waivers by which a customer can acknowledge that a professional is unlicensed and still hire them to do work. It was noted by the Committee that if an unlicensed professional is allowed to build something under such a waiver, the risk to the public remains, despite the customer's acknowledgement.

Jared Meyer, Senior Fellow, Foundation for Government Accountability, testified that Texas licensing boards can deny a license to someone who has a criminal history that they deem related to the occupation indefinitely. There's no time limit for how long a related occupation can be denied. For an unrelated conviction, it's up to five years. For certain violent and sexual crimes, licensure can be denied indefinitely as well.²¹⁰

Texas has over 130 automatic restrictions for people with felonies trying to enter licensed occupations. This is the highest total in the nation out of every state. Meyer continued, "And if you look at the population right now, it's estimated that about a third of Texas residents have a criminal record. And what's surprising is that after the 70,000 people a year leave incarceration just in Texas alone, 60% are unemployed a year after they leave. And if you look even years after they leave, the unemployment rate for people who've been incarcerated is 27%. It's more than six times the Texas overall unemployment rate, which is great. So, while the economy's been good to a lot of Americans, for those with criminal records, they're still struggling. And I think it's because a lot of it has to do with all of these restrictions stopping people for criminal records from going into a licensed occupation."²¹¹

Meyer said that licensure boards should list criminal convictions that will cause a denial of licensure so that potential future applicants can be made aware and recommended changing the look-back period. He stated that employers should feel safe hiring applicants who have avoided related crimes for five years. "So right now, as a reminder, it's indefinite look back period for related crimes, five years for unrelated. I would suggest moving, even for related crimes, five years of being crime-free. Because if someone's been crime-free for three to four years, numerous studies have shown they are no more likely to commit a crime than you or me." Meyer testified.²¹²

RECOMMENDATIONS

Occupational licensing has rightly been recognized as one of the predominant labor policy issues in America and Texas is no different. Overly burdensome and unnecessary state licensing mandates require individuals to pay excessive fees, complete lengthy education and training programs, and often pass exams before they can enter some of the very professions most suitable to giving them a chance at meaningful work. When implemented properly, occupational licensing can help protect the health and safety of consumers by requiring practitioners to undergo a designated amount of training and education in their

²¹⁰ Written testimony submitted by Jared Meyer, Senior Fellow, Foundation for Government Accountability to the Texas Senate Committee Business & Commerce, August 28, 2018

²¹¹ Direct testimony from Jared Meyer, Senior Fellow, Foundation for Government Accountability to the Texas Senate Committee Business & Commerce, August 28, 2018

²¹² Ibid

field. While there is certainly a need for professional licensure in certain critical areas and that the state's mission to preserve the health and safety of Texans through the regulation of trades is warranted, many of these licenses have little grounding in protecting public safety and serve as barriers to entry for the same Texans seeking a better life. The Texas Legislature should continue to review these occupational licensing regulations to ensure they are promoting opportunity and fostering a regulatory climate that encourages entrepreneurship and job creation.

The Committee recommends the following:

- Utilizing federal funds made available through passage of the New HOPE Act as well as the Comptroller's forthcoming comprehensive report on study on state-regulated occupational licensure, every license must undergo a Sunrise Review by the Sunset Commission.
- The Legislature reexamine and, if found prudent, introduce legislation to eliminate, the stipulation in Texas law which revokes/refuses licensure to individuals in default of federal student loans.
- The Legislature recommission the forthcoming Comptroller study on state-regulated occupational licensure on a bi-annual basis due November 1st of every even numbered year ahead of the legislative session. The study will assess: the current number of state-regulated occupational licenses, the total number of Texas licensees, the percentage of Texans who work under a state-regulated occupational license, highlight the ten year trend of state-regulated occupational licensure in Texas, and compare these findings with current employment and population numbers from the Bureau of Labor Statistics.

8. Social Media Access: Study access issues regarding digital assets of decedents. Study social media privacy laws and whether job applicants and students' privacy is jeopardized under current law.

BACKGROUND: Access Issues Regarding Digital Assets of Decedents

Estate planning and probate law provides that once someone dies or loses capacity to manage affairs, a fiduciary is allowed legal authority to manage or distribute the person's property. Most everyone now has a variety of digital assets, including photographs, documents, social media accounts, web sites, and more, some of which present special privacy concerns. Before the Texas Revised Uniform Fiduciary Access to Digital Assets Act, Senate Bill 1193 by Senator Van Taylor, Texas did not have an established law to handle digital (online) assets of a deceased person (the decedent).

In Texas and nationwide there were few appellate court cases that prompted the need for a model law. However, there were a variety of well-publicized media stories describing the difficulties of accessing a deceased's online assets. One story that received a lot of coverage was one involving Yahoo!. Initially Yahoo! refused to give a family's request to gain access to their son, Lance Cpl. Justin Ellsworth's, emails after he was killed in Afghanistan serving with the United States Marine Corps in 2004. The family ended up receiving a data CD of their son's emails from Yahoo! but were disappointed that it only contained emails that he had received and none that he had written or sent.²¹³

Other cases involving access to decedents' other online accounts are also becoming more commonplace. One Wisconsin couple fought against Google and Facebook to help them understand their son's suicide.²¹⁴ Two leading appellate cases also deal with access to digital assets and propelled the model law into motion. One case in the federal district court in California where the personal representative of the decedent attempted to compel Facebook to provide the content of the decedent's Facebook account because they believed it would provide evidence that the deceased did not commit suicide and was instead murdered.²¹⁵ In that case, the court noted that the federal Stored Communications Act (SCA), lawful consent to disclosure may permit a custodian such as Facebook to turn over electronic communications but it does not *require* disclosure. Therefore, Facebook could not be forced to turn over contents of the online account.²¹⁶

In response to these cases and society's need to address the digital evolution, the Uniform Law Commission drafted this legislation for states to serve as an update to state fiduciary law for the Internet age.²¹⁷ There was an original version of the legislation and a revised version, and the intent of both

²¹³ Yahoo Gives Dead Marine's Family E-mail Info., NBC News (April 21, 2005 5:47AM ET),

http://www.nbcnews.com/id/7581686/ns/world_news-mideast_n_africa/t/yahoo-gives-dead-marines-family-e-mail-info/.

²¹⁴ See Jessica Hopper, *Digital Afterlife: What Happens to Your Online Accounts When You Die?*, Rock Center, June 1, 2012.

²¹⁵ See *In re Facebook, Inc.*, 923 F. Supp. 2d 1204 (N.D. Cal. 2012).

²¹⁶ *Ibid.*

²¹⁷ A Few Facts about The Revised Uniform Fiduciary Access to Digital Assets Act, The Uniform Law Commission (2015). The ULC is a nonprofit formed in 1892 to create nonpartisan state legislation. Over 350 volunteer commissioners—lawyers, judges, law professors, legislative staff, and others—work together to draft laws ranging from the Uniform Commercial Code to acts on property, trusts and estates, family law, criminal law and other areas where uniformity of state law is desirable. *Id.*

addresses the legal authority for a fiduciary to manage digital assets in accordance with the user's estate plan, while ensuring that a user's private electronic communications remain private unless the user consented to disclosure.²¹⁸

In 2015, the Texas Legislature considered enactment of the original Uniform Act, House Bill 2183 by Representative Jeff Leach. In the original version of the bill, a personal representative would have automatic access to the digital assets of a decedent. A decedent would have to proactively take steps to restrict access.²¹⁹ This version of legislation had support from the estate planning attorneys. However, the providers ("the industry") and the privacy groups opposed the original version. The industry opposed it because they believed that it violated the federal Stored Communications Act (SCA). If the industry revealed the contents of digital assets, then it would violate the restrictions of the SCA, and if they did not reveal the contents of the digital assets, then it violated the original Uniform Act, or state law.²²⁰ The privacy groups such as the ACLU and the Center for Democracy and Technology asserted that allowing access of the content of the e-mail messages and texts invaded the privacy interests of both the recipient and sender of the information. The privacy groups argued that unless someone printed their communication, then the person has an expectation that the contents of their electronic communications will remain private. Allowing access to content of communications without consent could cause unintended damage to both the sender and the receiver of the communication. Messages could contain information the decedent never intended to share.

As association of internet companies then released a third version of the legislation called Privacy Expectation Afterlife and Choices Act ("PEAC") in response to the original Uniform Act. This bill went out of favor as well primarily because it only addressed personal representatives of estates and did not address other fiduciaries. Additionally, it was impracticable for fiduciaries because it required personal representatives to seek a court order to access communications.²²¹

In 2015, response to the failure of multiple attempts to make this type of legislation work, the National Conference of Commissioners on Uniform States Laws (NCCUSL) came up with a compromise that now all stakeholders have endorsed. The compromise is the Revised Uniform Fiduciary Access to Digital Assets (RUFADAA) Act in July 2015. Unlike the original version of the legislation, the revised version places emphasis on if the decedent user expressly consented to content disclosure of the digital assets. The express consent could be through an online tool or in the decedent's estate planning documents or power of attorney. By ensuring there is "lawful consent", RUFADAA does not violate the SCA.²²²

As of August 2018, forty-one states and the U.S. Virgin Islands have enacted RUFADAA. This legislation is pending in the District of Columbia and four states: New Hampshire, Oklahoma, Pennsylvania, and Rhode Island.²²³

²¹⁸ A Few Facts about The Revised Uniform Fiduciary Access to Digital Assets Act, The Uniform Law Commission (2015).

²¹⁹ Memo, Governor Preston E. Wmth Regents Professor of Law, Geyer W. Beyer (Aug. 2018).

²²⁰ Ibid.

²²¹ Ibid.

²²² Michael D. Walker, *The New Uniform Digital Assets Law: Estate Planning and Administration in the Information Age*, REAL PROP., TR. & EST. L.J., Spring 2017, at 59.

²²³ Legislation Enacted, Uniform Law Commission, The National Conference of Commissioners on Uniform State Laws (Sep. 6 2018).

TESTIMONY

Lindsay Beaver with the Uniform Law Commission confirmed that Texas and 42 other states have adopted RUFADAA. Ms. Beaver gave a summary of what RUFADAA provides. She also explained that digital assets refer to all sorts of electronic documents such as photos, email, social media and accounts that can be accessed online that have real value--both monetary and sentimental value. She also explained that this helps fiduciaries. Fiduciaries are those who are appointed to manage someone else's property. Fiduciaries cannot do their jobs without accessing digital assets.

Ms. Beaver testified that before RUFADAA, fiduciaries were encountering an emerging problem. They were being prevented from being able to access the digital assets due to password protections and restrictions on the terms of service. RUFADAA provides a balanced solution to allow privacy for the decedent and also a way for the fiduciary to perform their task of managing the digital property.

Ms. Beaver provided the background of RUFADAA, explaining that it had been revised since its first draft written in 2014. Ultimately all stakeholders came together and drafted what has been passed by the Texas Legislature.

Ms. Beaver outlined the three main ways the revised version changed from the original version. First, default privacy for electronic mail was implemented. One of the first acts of a fiduciary is to forward the decedent's paper mail to the fiduciary. This is much different than a fiduciary having complete access to a decedent's electronic email due to email's archiving function that would give a fiduciary access to much more than incoming mail. Opponents were concerned that this violated the Electronic Communications Privacy Act. (ECPA). Now a fiduciary may get a catalogue of the emails but they cannot get the content of the emails, which allows the fiduciary to complete most tasks.

Second, the revised version has a three-tier hierarchy for user directions. In the original version of RUFADAA, any terms of services that prevented a fiduciary from gaining access to digital assets were considered void unless the user had separately agreed to this aside from the general terms of service. The idea was that terms of service are not read by people, and therefore, they should not be bound by them. Opponents argued that contractual terms should not be overturned easily, so this would create a bad precedent.

Under the newly revised Act, there is a three-tier system of priorities. Users such as Facebook or Google can use an online tool to control direction. If there is a will or record held by a fiduciary, then that will trump any general terms of service. Lastly, if there are no directions or records such as a will, then the terms of service will prevail.

Finally, there will be greater user involvement. Users had to grant access to anyone claiming to be a fiduciary. The users argued that they may not know if the person is a true fiduciary. They were concerned with identity fraud. So, under the revised version, the users can require more information to confirm the identity of the fiduciary and the users can deny access unless there is a court order.

Senator Zaffirini asked for clarification on if the act includes guardians of a person. Ms. Beaver said that she would check and get back to the Senator.

Terri Helge, a professor of law from Texas A&M University, testified that Senate Bill 1193 helped to create order in a previously chaotic landscape in the rights of access to digital assets. Ms. Helge focused

her testimony on the role of the user (or custodian) of online accounts. She explained that before RUFADDA, users were routinely requiring court orders from fiduciaries to show the access to digital assets was necessary. The Stored Communications Act did not require users to provide fiduciaries with access but only that the user *may* allow access. These issues obstructed the fiduciary's ability to protect the identify of the decedent because they were not able to close down online accounts in a timely manner, and then were unable to complete their duties to distribute property to beneficiaries and pay outstanding bills.

Harry Wolff, an estates and probate attorney, testified that the passage of Senate Bill 1193 was very important to his law practice because it will help fiduciaries carry out their duties in a world where assets are not stored in a safety deposit box but rather a cloud. Because the law is so new, there is not a lot of case law or war stories to show how the law is working. Mr. Wolff testified that the biggest challenge right now is educating their clients on the new law. Also, he testified that many practitioners have wills, powers of attorney and trust agreements that were written before the passage of this law, and as a result, anyone operating with those documents will be solely relying on the new law.

Mr. Wolff explained that he sees two areas that are likely to create conflict and could lead to litigation. First, the user's discretion to provide access to the digital assets. Second, new claims of breaches of fiduciary duty. Mr. Wolff testified that Google and Facebook seem to require court orders as their default to avoid liability of wrongfully permitting access, but this will put a strain on the probate courts. The other issue is that there are not standardized guidelines on what is needed to satisfy a court order or properly work through this new statute, so what may be good enough for one judge may not satisfy another. That will frustrate our clients abilities to do their jobs moving forward.

The duty of care, duty of confidentiality and the duty of loyalty are codified in the statute. However, Mr. Wolff thinks that the legal community will grapple with if there is a distinction in the duties if something is sentimental or has a monetary value as a digital asset.

Senator Nichols explained that he updated his will after the enactment of RUFADDA, and nothing about this new law was mentioned to him. He wondered whether his fiduciary would have access to his digital assets. Mr. Wolff explained that in that case the law would govern, and his fiduciary would have access.

Senator Zaffirini asked if Mr. Wolff's section of the bar has addressed this legislation yet. Mr. Wolff did not think that it had.

Senator Hancock asked the witnesses to discuss how this bill impacts digital currency such as bitcoin. Ms. Beaver explained that the term digital asset included digital currency, whereas funds in an online account are not included because although the funds are in an account that is accessible online, the funds are not digital. Digital currency is, however, a digital asset that is governed by this legislation.

RECOMMENDATIONS

Given the recent enactment of the Texas Revised Uniform Fiduciary Access to Digital Assets Act by passage of Senate Bill 1193 in the 85 Regular Session, the Legislature can continue to monitor this issue.

The estate planning community as well as technology industry stakeholders and privacy advocacy groups all approve of the version of this model act that most other states have also enacted. In the coming years

as this law will be tested by attorneys, other professional advisors, and the courts. The Texas Legislature should continue monitor how this law is interpreted as well as how digital assets evolve to determine if RUFADAA requires any refinement in the future.

BACKGROUND: Social Media Privacy Laws

Texas currently does not have any established law that governs social media privacy of job applicants and employees. Social media is ubiquitous across the nation as a way for people to stay connect, gather information and express themselves both on and off the job and at school. Employees, job applicants and students reported concerns because employers or educational institutions began requesting or requiring access to usernames or passwords for personal social media accounts. Employees feel this is the invasion of employees' privacy comparable to reading a diary or requiring a visit to their home.²²⁴

Some employers contend that access to an employees social media accounts is necessary as a mode to protect the employer's proprietary information or trade secrets. Additionally, they contend it helps employers to comply with certain federal financial regulations or to prevent the employer from subjected to legal liabilities.

State lawmakers began introducing legislation beginning in 2012 to prevent employers from requesting passwords to personal Internet accounts to get or keep a job. Similar legislation prohibits colleges and universities from requiring access to students' social media accounts.

Social media privacy laws applicable to employers seek to protect the personal social media account information of employees and job applicants, and social media privacy laws applicable to educational institutions seek to protect the personal social media account information of students and prospective students applying to the institution. Social media privacy laws applicable to educational institutions generally apply only to postsecondary educational institutions, though there are some states with laws that also apply to elementary and secondary schools, including Illinois, Louisiana, Michigan, and Wisconsin.

The National Conference of States Legislatures show that twenty-six states have enacted social media privacy laws that apply to employers. Sixteen states have law that apply to educational institutions, and one state, Wisconsin, applies to landlords. In addition, Maine and Vermont authorized studies on this policy issue.

Texas Social Media Privacy Legislation

No legislation has passed in Texas governing social media privacy of employees, job applicants or students; although, there have been bills filed and considered. There was a bill filed during the 85th Regular Session, House Bill 2087, by Representative Gary Van Deaver titled the Student Privacy Act that was passed and signed into law. The act protects student data or the data that a student's parents provide to a website or some other online application for education purposes.²²⁵ Texas does not, however, have law governing the privacy of a student's social media that is not used for educational purposes.

²²⁴ National Conference of State Legislatures, State Social Media Privacy Laws, Jan. 2, 2018 <http://www.ncsl.org/research/telecommunications-and-information-technology/state-laws-prohibiting-access-to-social-media-usernames-and-passwords.aspx> .

²²⁵ House Bill 2087 by Representative Gary Van Deaver, 85th Regular Session (2015).

According to the Texas Legislative Council, since the 83rd Regular Legislative Session, there have been five bills relating to the social media privacy of employees, job applicants, students. Most recently, House Bill 1777, relating to prohibiting an employer from accessing the personal online accounts of employees and job applicants through electronic communication devices was reported out of the House Business & Industry Committee but failed to pass to engrossment. In 2013, the following bills were filed in the 83rd Legislature:

H.B. 318, relating to employer access to the personal accounts of certain employees and job applicants through electronic communication devices;

S.B. 118, relating to prohibiting an employer from requiring or requesting access to the personal accounts of employees and job applicants through electronic communication devices;

H.B. 451, relating to restrictions on access to certain personal online accounts through electronic communication devices by employers or public or private institutions of higher education; and

S.B. 416, relating to restrictions on access to certain personal online accounts through electronic communication devices by employers or public or private institutions of higher education.

None of the identified bills introduced in the 83rd Legislature were enrolled, but H.B. 318 was passed by the house.

The Uniform Law Commission's Employee and Student Online Privacy Protection Act

The Uniform Law Commission has drafted model legislation on the subject of social media privacy, entitled the Employee and Student Online Privacy Protection Act (ESOPPA), but it has not yet been enacted by any state. The Uniform Law Commission's goal with the model act is to provide a way for employees and students to control who, when and how someone else has access to their personal online accounts. The act "prohibits employers and public and private post-secondary educational institutions from requiring, coercing, or requesting that employees or students provide them with access to the login information for, or non-public content of, these accounts."²²⁶ It further prohibits these same entities from "requiring or coercing an employee or student to add them to the list of those given access to the account (to "friend" them, in common parlance), though it does not prohibit them from *requesting* to be added."²²⁷

TESTIMONY

On August 28, 2018 the Business and Commerce Committee heard testimony on social media privacy access issues related to job applicants, employees and students. The focus of this topic's testimony was on employers, job applicants and employees given the Committee's jurisdiction. The Committee heard from a panel of four witnesses on this topic. The witnesses included Lindsey Beaver from the Uniform

²²⁶ Uniform Law Commission, Enactment Kit, Employee and Student Online Privacy Protection Act Summary, (September 10, 2018).

²²⁷ Ibid.

Law Commission, employment law professor Jarod Gonzalez from Texas Tech University School of Law, and two practicing employment law attorneys, Phil Durst and Michael Golden.

Lindsey Beaver, legislative counsel with the Uniform Law Commission testified about that exactly ESOPPA does. She explains that the law does four main things to prohibit coercion from education institutions and employers: First, the act prohibits an employer (or educational institution) from taking certain actions that would compromise the privacy of an employee's (or student's) protected personal online account. Ms. Beaver explained that the actions are those such as forcing the employee to hand over login information or forcing the employee to allow the employers to "shoulder surf" while the employee is on their computer showing information the employer wants. Second, the legislation also contains exceptions if there is a legitimate need, such as if there is a court order for information. Third, if there is an exception, there are limits on what the information can be used for. Fourth, the act provides guidance if the employer or educational institution "sweeps up" login information. It authorizes the attorney general to press a civil action if there is a violation and allows for a private right of action.

Chairman Hancock asked Ms. Beaver how many states have enacted this legislation. Ms. Beaver responded that none have enacted the legislation but that currently 2 states are considering the act.

Professor Jarod Gonzalez from Tech Texas School of Law provided context and posed questions for the Committee to complement when deciding how to address this policy issue. Mr. Gonzalez reminded the Committee that Texas is an "at will" state where employers and employees value the ability to work through workplace policies on their own. There is a reasonable desire from employees wanting privacy, so he posed if Texas decides to regulate, then how and what is the basis of that regulation. Other states have passed laws, and with exceptions. This model act also includes independent contractors. How would far would Texas go and how would it define employer? Would Texas want to include "mom and pop businesses" or would there need to be an employee limit? Some states have passed laws but the laws have a prohibition of accessing personal social media accounts without a remedy. There is no private right of action in some of those laws. Would Texas want to get an governmental agency involved as some other states have or provide for a private right of action with damages available? Mr. Gonzalez testified that there is not a lot of case law on this topic. Employers are still working through how to handle information that they are given from social media accounts even if the employer is not actively seeking it.

Michael Golden testified as a practicing employment law attorney representing the perspective of the employer and how employers are currently counseled in Texas on handling social media privacy of employees and job applicants.

Mr. Golden said that the first and the fourth part of the model act go together to prohibit unauthorized access to private social media accounts. Mr. Golden explained that there is already the federal Stored Communications Act (SCA) that prohibits this and there is plenty of case law that supports that this law applies to accounts such as Facebook, My Space, Twitter, Gmail and Yahoo. Mr. Golden then describes that the second and third part of the model act limit what sort of areas where an employer may access social media information from an employee and what they can do with the information once they have it. Mr Golden believes that the model act's language would create a situation where the employer cannot even ask for information, even if an employer believes that they fall within the exceptions of the law, and therefore, creates an incentive for the courts to sort it out.

Mr. Golden argued that under Texas law's at-will employment doctrine, if we limit employers in the way the model act does, then we limit employers' ability to conduct investigations to protect customers, co-workers and their others employees. Right now Texas' law allows employer to terminate someone's employment for any reason or for no reason at all. When a states creates a law where exceptions must to met to satisfy the law, then courts end up litigating the issue of whether the exceptions have been met and not whether or not the employer should have asked for the information it needed to decide whether or not to fire the employee. Mr. Golden illustrated his point by explaining the Texas Supreme Court case of *Texas Farm Bureau Mutual Insurance Company v. Sears*. In that case, a contractor with Texas Farm Bureau, Mr. Sears, gets his contract terminated by Texas Farm Bureau because the company believes that Sears was involved in a kickback scheme. There was an investigation by the company, and Sears sued claiming that the investigation was negligent. The Court reasons that Texas' at-will employment doctrine is harmed by including the negligent standard for the investigation. Mr. Golden believes that law such as the model act will incentive companies not to investigate employment matters even when it is reasonable to do so.

Philip Durst testified from the perspective of an employment law attorney representing the employee perspective. Mr. Durst suggested two bills that could be a more targeted default approach than the model act. He prefaces that employees are tracked by key catchers, by video surveillance and by their social media accounts. Because this type of monitoring occurs, he suggests that employers disclose that methods they are using to track their employees. The disclosure could be part of the handbook, on a form or on a website. Mr. Durst believes that because the free market works, employees would have notice and could decide if they want to work for an employer with full knowledge of their monitoring techniques. Another bill could describe a "default setting" of the employer so that employee is given a presumption that their personal space is private unless the employer discloses in what way they do want to monitor the employee.

Chairman Hancock asked for the panelists for recommendations. Mr. Golden replied that right now the federal Stored Communications Act and the general common law in Texas is that there is a presumption that employers need to be disclosing if they are monitoring their employees. Chairman Hancock asked what happens in the scenario where an employee uses Facebook at work on the business' server. Mr. Golden explained that the information from the Facebook account may go through the business server, but it is stored on a Google or some of type of server, in which case federal law governs. Senator Nichols commented that as an employer, he was sued more for things he put into writing then for what he did not put it in writing.

There was discussion about a possible scenario of a human resources manager who was "friends" on Facebook with an employee where the HR manager learns from that platform that the employee went to a Ranger's game instead of being sick as they calling into claiming earlier that day. The witnesses all agreed that the HR manager can use that information without violating the model act or federal law because the information was disclosed on a public platform, and the employee was not forced to provide it.

RECOMMENDATIONS

Texas is an at-will employment state and, in order to preserve that doctrine, there is no need to adopt the Uniform Law Commission's Employee and Student Online Privacy Protection Act or any other social media privacy statute at this time. Employers are developing best practices such as disclosing to

employees how they are being monitored and the free market is incentivizing employers to monitor employees in a reasonable manner. The federal Stored Communication Act already governs social media privacy in a reasonable manner. Adding more regulation in this area of law will incentivize businesses not to investigate or monitor matters that need attention and can hinder employers from protecting their other employees and consumers.

9. Grid Reliability: Examine the 2018 electric reliability forecasts announced by ERCOT and review how expected diminished reserve markets will impact the rates of residential and business consumers. Monitor current mechanisms available to ERCOT to ensure grid reliability, identify trends in the wholesale electric market, and make recommendations to maintain grid reliability moving forward.

BACKGROUND

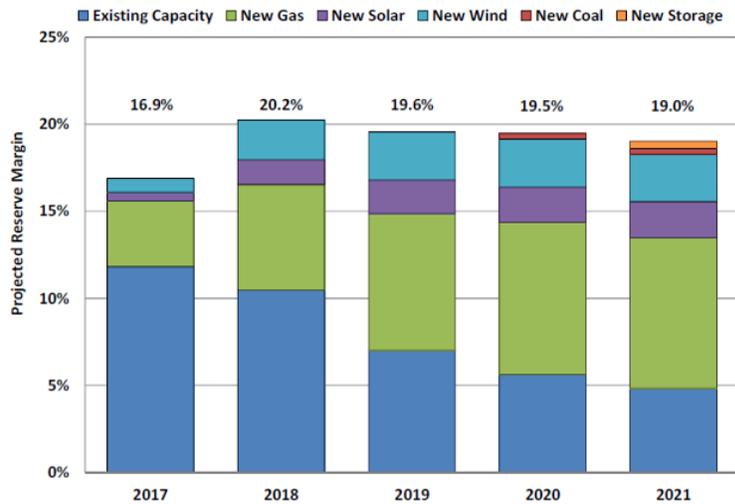
The Electric Reliability Council of Texas (ERCOT) operates an “energy-only” competitive wholesale market, which means that the market relies solely on high wholesale prices during scarcity events to incentivize resource development. Absent those scarcity pricing events, investors will not receive the appropriate signals our market relies upon to support continued operation and encourage new projects. The combination of persistent, historically low natural gas prices and the regulatory distortions introduced into our market by the Federal Production Tax Credit (PTC) for wind and the Investment Tax Credit (ITC) for solar have resulted in historically low wholesale prices in Texas. The resulting impact of suppressed energy prices has recently led to the retirement of and delayed investments in "dispatchable" generation resources.

Pressure on the economic viability of baseload dispatchable generators has been discussed for years within forums hosted by the Public Utility Commission of Texas and ERCOT. Finally, in 2017 the owners of approximately 7,000 megawatts of coal and natural gas fired electric plants announced that they would be retiring their facilities as a result of low wholesale power prices. Many industry observers have asserted that ERCOT was oversupplied with generation capacity, and that the retirement announcements made in 2017 have been a part of a natural rebalancing of the state's energy portfolio.

Such a drastic reduction in overall generation capacity was notable in that total electricity reserves available to ERCOT were cut almost in half, and a significant tightness in available reserves for ERCOT is anticipated over the next 5 years as a result of the announcements. The following two charts demonstrate the effect this had for the purposes of ERCOT's forecasts demonstrated in its biannual Capacity Demand and Reserves Report (CDR), projecting power supplies out through the winter of 2022. The first chart demonstrates the forecast used in the 2016 CDR that showed ample reserves above 20% in some years, while the second chart demonstrates the revision used in December of 2017 when reserves dropped to an average of 11% for the foreseeable future.

Projections based on the December 2016 CDR:

Figure 85: Projected Planning Reserve Margins



Source: ERCOT Capacity, Demand and Reserves Report - December 2016

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Projections based on the December 2017 CDR:



Source: ERCOT Capacity, Demand and Reserves Report - December 2017

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The Texas Senate Committee on Business & Commerce sought to understand the challenges facing the ERCOT wholesale electricity market through this study, by identifying disruptive forces that are currently impacting price formation and reliability, or could in the near future. Additionally, the Committee

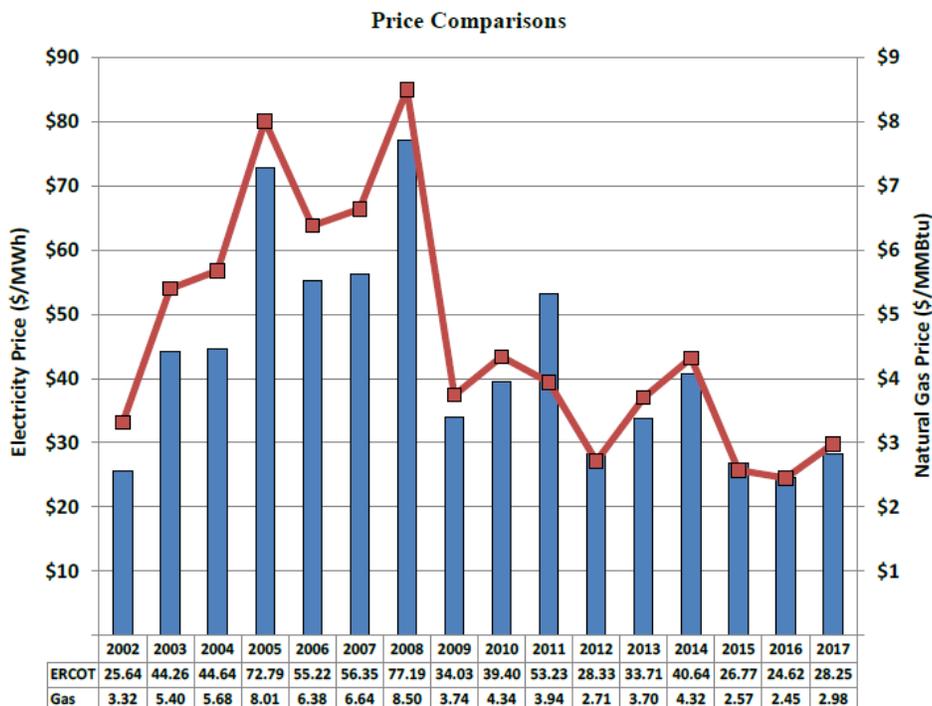
²²⁸ Page xviii, Potomac Economics, Independent Market Monitor for ERCOT, "2016 State of the Market Report for the ERCOT Electricity Markets", <https://www.potomaceconomics.com/wp-content/uploads/2017/06/2016-ERCOT-State-of-the-Market-Report.pdf>

²²⁹ Page xx, Potomac Economics, Independent Market Monitor for ERCOT, "2017 State of the Market Report for the ERCOT Electricity Markets", <https://www.potomaceconomics.com/wp-content/uploads/2018/05/2017-State-of-the-Market-Report.pdf>

reviewed tools available to the Public Utility Commission of Texas (PUC) and to ERCOT to understand how the state may best ensure that the people of Texas have reliable sources of power, and at what cost.

Contributing Factors Pressuring Base Load

Low Natural Gas Prices: ERCOT all-in prices on average have hovered between \$20 and \$40 per megawatt hour for the last six years. The all-in price as well as the real time price are tied to the price of natural gas. Since natural gas is the most abundant fuel source in the ERCOT system it helps establish the "marginal production cost" for most producers previously described in Charge 5 of this report.

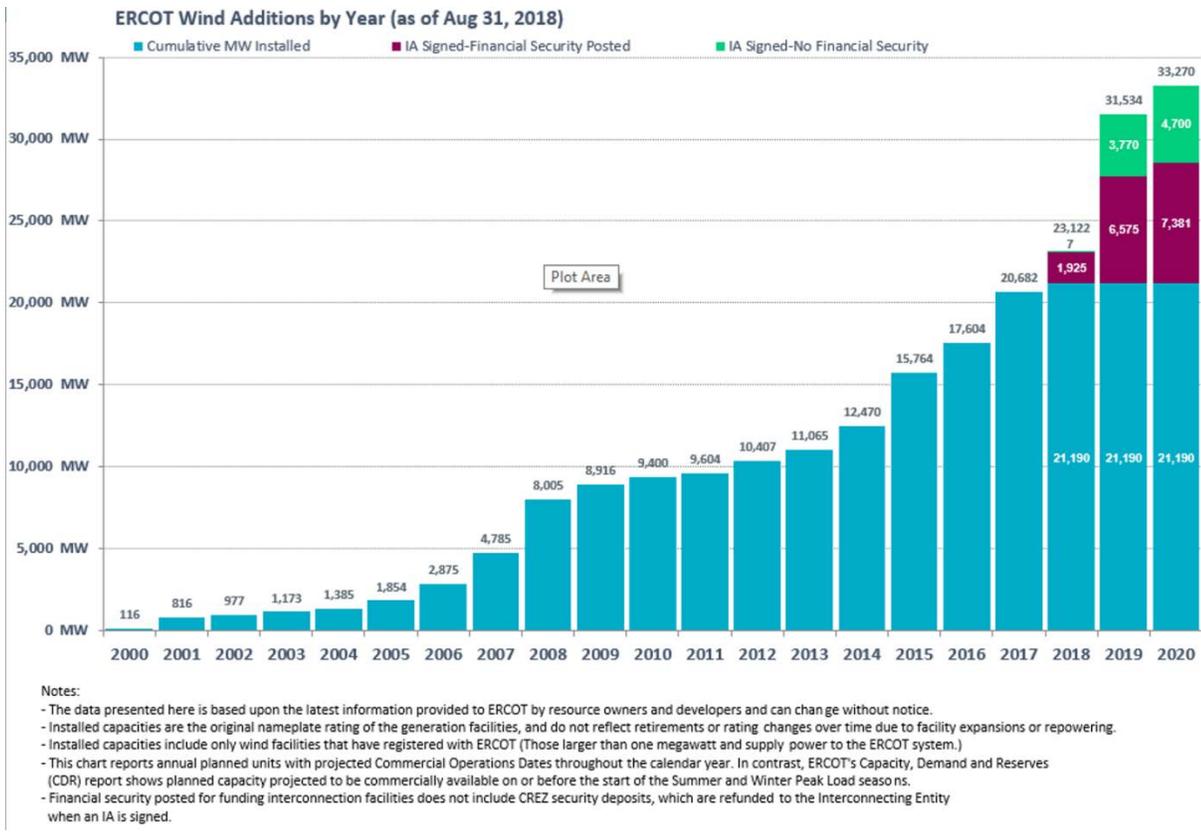


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Pressure from Renewables: As natural gas prices have declined renewable penetration into the ERCOT market has proceeded at a remarkable pace. Renewables as a rule generally have lower production costs since they do not pay for fuel. According to ERCOT, wind is on track to comprise over 30% of the total generating capacity within the system by 2020. As noted by Bloomberg, the combination of wind and solar have "helped push the average on-peak price set by ERCOT - down 55 percent the past five years to \$25.34 per megawatt hour, according to data compiled by Genscape Inc."²³¹ Still, wind commitments to build within the ERCOT system continue to grow unabated as the following chart demonstrates.

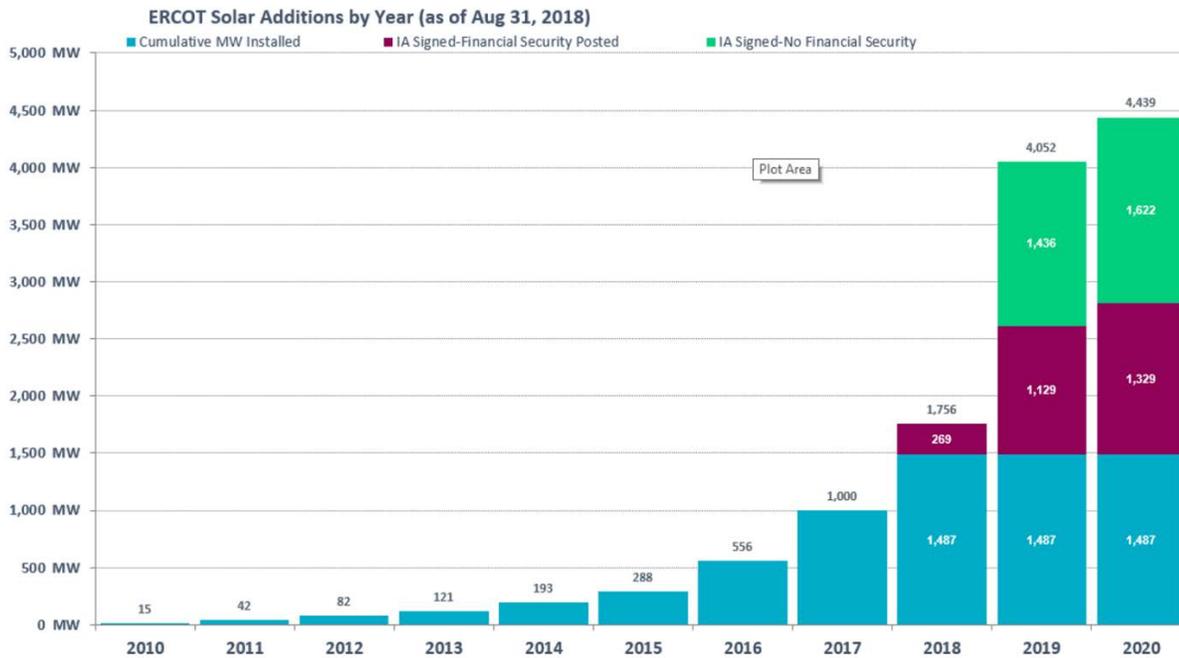
²³⁰ Written testimony submitted by Beth Garza, Potomac Economics, Independent Market Monitor for ERCOT, to the Senate Committee on Business & Commerce, May 1, 2018.

²³¹ Bloomberg: "Texas Is Too Windy and Sunny for Old Energy Companies to Make Money", by Ryan Collins, <https://www.bloomberg.com/news/features/2017-06-20/texas-is-too-windy-and-sunny-for-old-energy-companies-to-make-money>, June 20, 2017



Some observers have pointed to the lucrative Production Tax Credit as having boosted wind's ability to build when economic signals may tell it there is no need. Solar for its part is a growing force in the overall energy mix, only not at the dynamic rate of wind. The amount of solar energy produced in Texas has almost doubled each year for the last three years while commitments for future megawatts forecast that solar may comprise up to 5% of the total generating capacity of ERCOT by 2020, up from less than 2% today.

²³² ERCOT Capacity Changes by Fuel Type Charts, August 2018
http://www.ercot.com/content/wcm/lists/162615/Capacity_Changes_by_Fuel_Type_Charts_August_2018.xlsx



Notes:
 - The data presented here is based upon the latest information provided to ERCOT by resource owners and developers and can change without notice.
 - Installed capacities are the original nameplate rating of the generation facilities, and do not reflect retirements or rating changes over time due to facility expansions or repowering.
 - Installed capacities include only solar facilities that have registered with ERCOT (Those larger than one megawatt and supply power to the ERCOT system.)
 - This chart reports annual planned units with projected Commercial Operations Dates throughout the calendar year. In contrast, ERCOT's Capacity, Demand and Reserves (CDR) report shows planned capacity projected to be commercially available on or before the start of the Summer and Winter Peak Load seasons

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Why Build When Prices Are Low: Direct and indirect subsidies for different forms of energy generation help explain why continued buildout occurs bucking a trend of negative price signals. The University of Texas Energy Institute captured the scale of subsidies associated with different generation resources in its 2017 paper "The Full Cost of Electricity (FCe-)".

According to the research:

- "Total federal financial support for the electricity-generating technologies ranged between \$10 and \$18 billion in the 2010s. Support was highest in 2013 due to one-time American Recovery and Reinvestment Act (ARRA) related funding. Excluding this temporary source of funding, electricity support totaled approximately \$7 billion in 2010 and could rise to \$14 billion in 2019 according to some estimates. The growth in perennial spending is attributable to renewables, especially wind. The total value of all federal financial support for the fossil fuel industry (not shown in Figure 17) is comparable to that spent on renewables. When considering only the portion of fossil fuel subsidy that relates to electric power, however, renewables receive a greater share."²³⁴

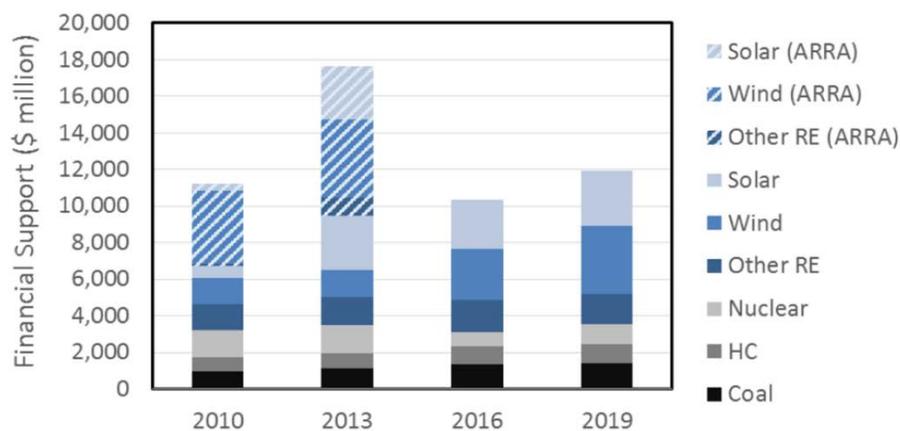
²³³ ERCOT Capacity Changes by Fuel Type Charts, August 2018
http://www.ercot.com/content/wcm/lists/162615/Capacity_Changes_by_Fuel_Type_Charts_August_2018.xlsx

²³⁴ Written testimony submitted by Dr. Joshua Rhodes, University of Texas Energy Institute, "The Full Cost of Electricity (FCe-)", to the Senate Committee on Business & Commerce, May 1, 2018. <https://energy.utexas.edu/policy/fce>

- "When considering total electricity-related support on a \$/MWh basis, renewable technologies received 5x to 100x more support than conventional technologies. Generation from fossil fuels receive a large amount of support, but their per-MWh cost is modest due to the very large installed base and the high quantity of generation. Renewables by contrast, receive somewhat more money but generate less electricity. Depending on the year, fossil fuels and nuclear receive \$0.5-2/MWh. Wind received \$57/Mwh in 2010 (falling to \$15/MWh in 2019) and solar received \$875/MWh in 2010 (falling to \$70/MWh in 2019). Overall, electricity technologies receive financial support worth \$3-5/MWh. As generation from renewables grows, the \$/MWh differential between renewable and conventional technologies is forecast to decline."²³⁵
- "Renewable generation is supported by direct subsidies while generation from fossil fuel power plants are supported via indirect subsidies. That is, the government encourages the production of fossil fuels generally, but not their burning for electric power specifically. Renewables receive funding for R&D, as well as direct support for electricity production and capacity additions. There are no subsidies that directly encourage the burning of hydrocarbons for electricity production. Most financial support for coal targets externalities, either by adding pollution controls or conducting R&D on clean coal and carbon sequestration. Coal also receives approximately 3% of its support through electricity production tax credits. Nuclear power receives diversified support in the form of R&D funding, tax credits on electricity sales, and programs aimed at plant costs (decommissioning, insurance)."²³⁶

FIGURE 17

Federal financial support for Electricity by Fuel and Year (\$ million, nominal). Solid shading represents perennial support; hashed shading represents one-time support via ARRA.



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All Subsidies Are Not Created Equal: The federal Production Tax Credit (PTC), is the crown jewel of energy subsidies. According to the Department of Energy: "the tax credit is an inflation-adjusted per-kilowatt-hour tax credit for electricity generated by qualified energy resources and sold by the taxpayer to an unrelated person during the taxable year. The duration of the credit is 10 years after the date the facility

²³⁵ Written testimony submitted by Dr. Joshua Rhodes, University of Texas Energy Institute, "The Full Cost of Electricity (FCe-)", to the Senate Committee on Business & Commerce, May 1, 2018. <https://energy.utexas.edu/policy/fce>

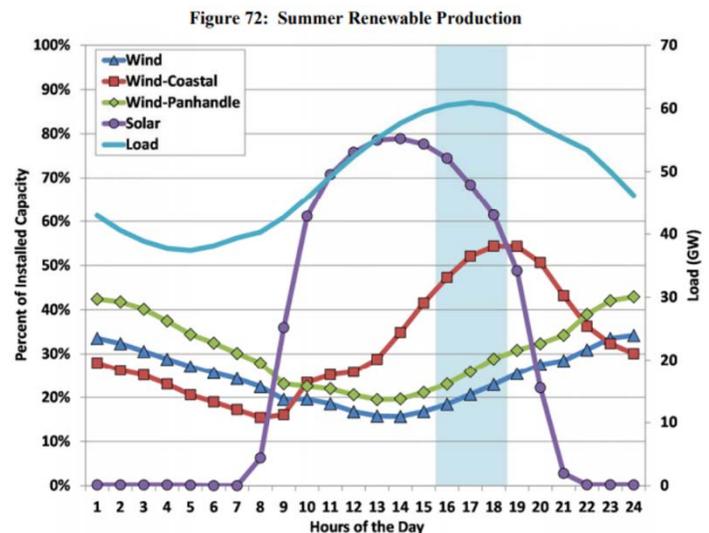
²³⁶ Ibid.

²³⁷ Ibid.

is placed in service." The PTC was originally enacted in 1992, and is currently set to expire on December 31, 2019. The value of the credit depends on the date of a qualifying wind, geothermal, biomass, or non-ITC solar project's construction. For example, if a wind farm began its construction in 2017 the tax credits associated with these facilities would be worth \$0.19/kWh, while projects beginning in 2018 the PTC value will be 40% less than the previous year's inflation adjusted value.²³⁸ In contrast, the federal Investment Tax Credit (ITC), primarily utilized by solar resources, is a 30% corporate tax credit based on the upfront investment costs associated with a project.²³⁹

Unintended Consequences: Since the PTC value is tied to the production of power, qualifying resources then have an incentive to produce energy, even when market signals might determine there would be no value for that energy. In markets all across the world who have employed similar incentive programs to attain carbon neutral energy goals this has resulted in a distorting phenomena known as "negative prices". Sub zero prices, or negative prices, occur when there is more supply than demand, typically in periods of the day when demand for power is low, known as "off peak hours". Wind as an energy resource in Texas most often blows during periods of the day when demand is low. The following chart from ERCOT assesses when our renewable resources most often participate in the market.

The ERCOT IMM noted that "this figure shows that while the total installed capacity of solar generation is much smaller than that of wind generation, its production as a percentage of installed capacity is the highest in the early afternoon, approaching 70%, and producing almost 70% of its installed capacity during peak load hours. The contrast between coastal wind and all other wind is also clearly displayed in Figure 72. Coastal wind produced over 50% of its installed capacity during summer peak hours. Output from Panhandle wind and all other wind (primarily West zone) was less than 30% during summer peak hours."²⁴⁰



As wind produces more power during off peak hours, incentivized by its ability to profit off of production tax credits, the phenomena of negative prices seems to be rising over time. Bloomberg reported that between 2017 and mid July of 2018 negative prices had increased exponentially in Texas, California, New

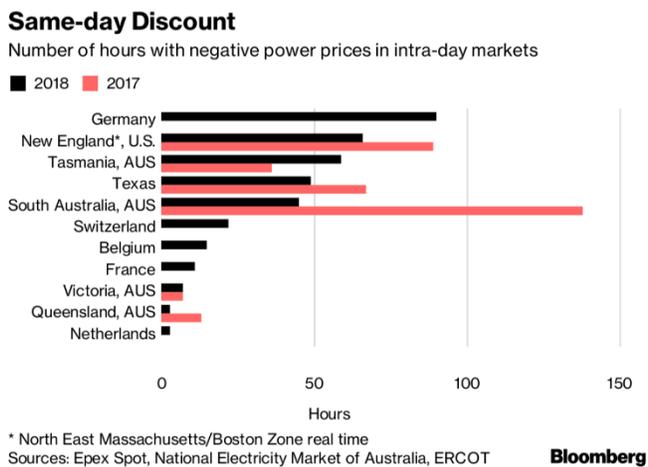
²³⁸ Renewable Electricity Production Tax Credit (PTC), Energy.Gov, <https://www.energy.gov/savings/renewable-electricity-production-tax-credit-ptc>

²³⁹ Business Energy Investment Tax Credit (ITC), Energy.Gov, <https://www.energy.gov/savings/business-energy-investment-tax-credit-itc>

²⁴⁰ Page 88, Potomac Economics, Independent Market Monitor for ERCOT, "2017 State of the Market Report for the ERCOT Electricity Markets", <https://www.potomaceconomics.com/wp-content/uploads/2018/05/2017-State-of-the-Market-Report.pdf>

England, and other areas that had been heavy adopters of renewable friendly policies as the following chart indicates.²⁴¹

Why Are Negative Prices A Bad Thing: In an "energy only" market such as it exists within the ERCOT system, prices determine the dispatch of power. Put another way, the lowest offered price for a unit of power determines who, among the Texas electric generators, get to sell their power onto the market. As the Bloomberg article indicates, "a negative price is essentially a market signal telling utilities to shut down certain power plants. It doesn't result in anyone getting a refund on bills - or in electric meters running backward. Instead, it often prompts owners of traditional coal and gas plants to shut down production for a period even though many of the facilities aren't designed to switch on and off quickly."²⁴²



Minimum Grid Reliability Management Requirements

ERCOT’s main goal of “keeping the lights on” is achieved through a number of benchmarks. ERCOT is charged with constantly matching the supply of electricity and demand of the more than 25 million electric customers in the region in real time. Bulk electricity systems in the United States, including ERCOT, are required by NERC to maintain a standard frequency within a very narrow range of 60 Hz. When there is excess generation relative to demand, frequency will rise above 60 Hz and ERCOT must call on generators to reduce output; when there is less generation relative to demand, frequency will fall below 60 Hz and ERCOT must call on generators to increase output or curtail loads to reduce consumption. While minor and very short frequency excursions can be managed, frequency deviating too far from 60 Hz can result in impairment or even damage of electrical equipment, so system operators such as ERCOT must be prepared to either restore frequency or shed load to protect customers and resource equipment from harm.

According to the most recent Capacity, Demand and Reserves (CDR) report, the region has over 76,000 MW of generation capacity available to produce power during periods of peak demand, with just over 6% of that coming from renewable resources.²⁴³ These renewable resources provide an additional level of complexity to ERCOT as they are utilizing the wind and sun as fuel, which are dependent on the weather. In addition to forecasting the electrical needs of Texans, ERCOT must also forecast the wind, sun and cloud cover across the state. In January 2017, ERCOT added a Reliability Risk Desk to its operations to monitor and respond to errors with these forecasts, net load ramps, system inertia levels, and ancillary service needs.

²⁴¹ Bloomberg, "Power Worth Less Than Zero Spreads as Green Energy Floods Grid", by Jesper Starn, August 5, 2018, <https://www.bloomberg.com/news/articles/2018-08-06/negative-prices-in-power-market-as-wind-solar-cut-electricity>

²⁴² Ibid.

²⁴³ ERCOT Capacity Demand and Reserve Report, December 2017, <http://www.ercot.com/content/wcm/lists/143977/CapacityDemandandReserveReport-Dec2017.pdf>

Ancillary Services

ERCOT procures capacity from dispatchable load and generation resources to manage both the normal and continuous changes in supply and demand and to recover from more unexpected disruptions. ERCOT consumers, through their REPs (or municipal utility or electric co-operative), must buy these services either directly from providers or through ERCOT's auction process.

This capacity, called "Ancillary Services", consists predominately of three major types:

1. Regulation Service - Regulation is used to correct for small changes in supply and demand.
2. Non-Spinning Reserve Service - Non-Spin can be used for multiple reasons including replacing a loss of generating capacity, compensate for forecast uncertainty, and to compensate for periods when load is increasing but wind decreases²⁴⁴.
3. Responsive Reserve Service which is designed to overcome sudden interruptions in supply.

While Ancillary Service quantities are a relatively small part of the overall market, the costs were projected to be significant and increasing. As previously discussed, one primary reason for these increases is the growing penetration of inverter technologies associated with renewables driven by federal subsidies. These changes in the generation mix have incited traditional dispatchable generation to run less often, and in some cases exit the market. The reduced availability of dispatchable generation has increased costs to consumers, according to ERCOT's Independent Market Monitor²⁴⁵. The Brattle Group in 2015 performed a study on behalf of ERCOT which estimated over \$500 Million in annual ancillary service costs are expected to increase due to additional wind and solar technology²⁴⁶.

Ancillary Services procurement needs are also changing and are affected by the changing resource mix. Regulation quantities are evaluated at least annually and an increase in wind capacity can increase the amount procured²⁴⁷. In addition, the changes are leading to a previously unheard-of problem in ERCOT – the lack of system inertia^{248,249}. ERCOT has identified a need for a new Ancillary Service to address

²⁴⁴ Page 3, ERCOT "Methodologies for Determining Minimum Ancillary Service Requirements", http://www.ercot.com/content/wcm/key_documents_lists/89135/ERCOT_Methodologies_for_Determining_Minimum_Ancillary_Service_Requirements.zip

²⁴⁵ Page 39, Potomac Economics, Independent Market Monitor for ERCOT, "2017 State of the Market Report for the ERCOT Electricity Markets", <https://www.potomaceconomics.com/wp-content/uploads/2018/05/2017-State-of-the-Market-Report.pdf>

²⁴⁶ Page 1, Brattle Group for ERCOT, "Cost-Benefit Analysis of ERCOT's Future Ancillary Services (FAS) Proposal", http://www.ercot.com/content/wcm/key_documents_lists/30517/667NPRR_12a_Cost_Benefit_Analysis_122115.pdf

²⁴⁷ Page 3, ERCOT "Methodologies for Determining Minimum Ancillary Service Requirements", http://www.ercot.com/content/wcm/key_documents_lists/89135/ERCOT_Methodologies_for_Determining_Minimum_Ancillary_Service_Requirements.zip

²⁴⁸ Page 1, Brattle Group for ERCOT, "Cost-Benefit Analysis of ERCOT's Future Ancillary Services (FAS) Proposal", http://www.ercot.com/content/wcm/key_documents_lists/30517/667NPRR_12a_Cost_Benefit_Analysis_122115.pdf

²⁴⁹ Page 3, ERCOT, "Inertia: Basic Concepts and Impacts on the ERCOT Grid", http://www.ercot.com/content/wcm/key_documents_lists/141324/Inertia_Basic_Concepts_Impacts_On_ERCOT_v0.pdf

this problem caused by the displacement of traditional dispatchable resources and has suggested that ERCOT consumers bear the costs, similar to the other Ancillary Services²⁵⁰.

Considerations for Grid Planning

Storage

Batteries are often primarily associated with the emergence of hybrid and electric vehicles over the past several years, but have also attracted significant interest in electricity markets. Battery costs remain relatively high and low energy prices have limited their market penetration to date, but projected reductions in battery costs open several potential applications such as price arbitrage and reliability services. While these same applications of energy storage have been technically feasible for years through other technologies such as compressed air, flywheels, pumped hydro, and thermal, batteries have the added benefit of being comparatively compact, modular and free of geographical or geological placement constraints. These flexible battery characteristics offer additional use cases beyond other energy storage technologies that also compete with distributed generation (such as backup power), demand response, and deferral of transmission and distribution investments.

The multiple use cases have also raised policy questions regarding the appropriate classification of storage technologies. In Texas, Chapter 35, Subchapter E of the Utilities Code was adopted in 2011 to address this question and applies to electric energy storage equipment or facilities that are intended to provide energy or ancillary services at wholesale and deems those assets to be generation assets subject to registration as a power generation company with the PUCT.

Distributed Generation

Distributed generation resources, which typically refer to small scale fossil or renewable facilities but can also include energy storage installations, have experienced tremendous growth in Texas recently and that growth is expected to continue. Based on annual reports filed at the PUCT by Transmission & Distribution Service Providers located in the competitive choice areas, there are nearly 1,300 Megawatts (MW) of distributed generation resources.²⁵¹ ERCOT estimates there are over 200 MWs in the Non-Opt In Entity (NOIE) or non-competitive territories. It should be noted that NOIEs do not have a requirement to report distributed generation to the PUCT. In a report published by ERCOT in 2017, ERCOT determined that the current amount of installed capacity of distributed generation resources “does not pose an immediate reliability concern.”²⁵² However, ERCOT identifies operational and reliability concerns if the amount of distributed generation continues to grow. ERCOT states that at higher penetration levels, distributed generation “has the potential to affect grid operations in multiple ways”. The main impacts are increased error in load forecasting and inaccurate modeling of the ERCOT grid.

Transmission

²⁵⁰ Proposal for Synchronous Inertial Response Service Market

http://www.ercot.com/content/wcm/key_documents_lists/73817/Proposal_for_Synchronous_Inertial_Response_Service_Market_March112015.docx

²⁵¹ Based on submissions in PUCT Project NO. 47928.

²⁵² ERCOT, "Distributed Energy Resources (DERs) Reliability Impacts and Recommended Changes, March 22, 2017, http://www.ercot.com/content/wcm/lists/121384/DERs_Reliability_Impacts_FINAL.pdf

As directed by PURA, ERCOT is responsible for system-wide transmission planning and ensuring the reliability and adequacy of the regional electric network in accordance with ERCOT and NERC Reliability Standards. Therefore, ERCOT supervises and exercises comprehensive independent authority over the planning of transmission projects for the ERCOT transmission grid.²⁵³ The PUCT Substantive Rules further indicate that ERCOT shall evaluate and make a recommendation to the PUCT as to the need for any transmission facility for which it has authority. ERCOT examines the need for proposed transmission projects based on ERCOT planning criteria and rules established by ERCOT stakeholders.

Transmission in the ERCOT market must meet minimum need requirements to be included in the ratebase for all consumers to pay. To demonstrate need, there are three options:

1. Reliability Need - ERCOT determines a reliability need for the transmission element. Projects over \$10 million in value requires ERCOT Board Endorsement.²⁵⁴
2. Economic Need - ERCOT determines that the annual production cost savings of the transmission element is estimated to cover the cost of the new transmission element over 6 years. Projects over \$10 million in value requires ERCOT Board Endorsement.²⁵⁵
3. Competitive Renewable Energy Zone (CREZ) – Once the PUCT determines the goal capacity for the CREZ, ERCOT determines what transmission elements are required to cost effectively deliver those MW to load. Importantly, the PUCT did not need to find a Reliability or Economic Need for the transmission element if it is part of the CREZ.²⁵⁶ PUCT has since modified its rules to require all future transmission projects in a CREZ to meet the Reliability or Economic Need requirements.²⁵⁷

For the years 2007 through 2017, over \$15 billion of transmission projects were approved through the ERCOT planning process.²⁵⁸ Approximately \$7 billion were related to CREZ projects.²⁵⁹ For the years 2018 through 2024, ERCOT reports an additional \$7 billion of transmission projects are proposed.²⁶⁰ Consumers pay for the costs to upgrade, maintain, and operate the transmission system. The annual Transmission Cost of Service (TCOS) requirement for 2018 is \$3.5 billion. The annual TCOS requirement in 2008 was less than \$1.5 billion. Part of this increase is a result of CREZ.

4CP

²⁵³ ERCOT, "Report on Existing and Potential Electric System Constraints and Needs", December 2017 http://www.ercot.com/content/wcm/lists/114740/2017_Constraints_and_Needs_Report.pdf

²⁵⁴ Texas Utilities Code § 37.056(c), and PUC §25.101, <http://www.puc.texas.gov/agency/rulesnlaws/subrules/electric/25.101/45124adt.pdf>

²⁵⁵ Ibid.

²⁵⁶ Texas Utilities Code § 39.904(h)

²⁵⁷ PUC §25.174 (e)(2), <http://www.puc.texas.gov/agency/rulesnlaws/subrules/electric/25.101/45124adt.pdf>

²⁵⁸ Ibid.

²⁵⁹ Texas Tribune, " \$7 Billion Wind Power Project Nears Finish", by Jim Malewitz, October 14, 2013, <https://www.texastribune.org/2013/10/14/7-billion-crez-project-nears-finish-aiding-wind-po/>

²⁶⁰ ERCOT, "Transmission Project and Information Tracking Report", February 2018, http://www.ercot.com/content/wcm/key_documents_lists/89026/ERCOT_February_TPIT_No_Cost_020118.xlsx

The ERCOT Independent Market Monitor (IMM) noted that, “Load curtailment to avoid transmission charges may be resulting in price distortion during peak demand periods because the response is targeting peak demand rather than responding to wholesale prices.”²⁶¹

Transmission costs in ERCOT are allocated on the basis of load contribution during the highest 15-minute system demand in June, July, August and September. This allocation mechanism is routinely referred to as four coincident peaks, or 4CP. Since 2012 annual ERCOT transmission costs have increased from \$1.7 Billion to \$3.5 Billion which has amplified the signal to curtail load not in during peak periods and near peak periods. These load curtailments are not in response to energy prices but instead in response to transmission cost assignments. The IMM Notes, “This was readily apparent in 2016 as there were significant load curtailments corresponding to peak load days in June, July and September when real-time prices on those days were in the range of \$25 to \$40 per MWh. This trend continued in 2017, with significant load curtailments on peak load days in June, August and September when real-time prices were less than \$100 per MWh.”²⁶²

What is ERCOT & How Does It Make Decisions

Responsibilities: ERCOT manages the flow of electric power to 25 million Texas customers representing about 90 percent of the state’s electric load. As the independent system operator (ISO) for the region, ERCOT schedules power on an electric grid that connects more than 46,500 miles of transmission lines and approximately 610 generation units. It also performs financial settlement for the competitive wholesale bulk-power market and administers retail switching for 7 million premises in competitive choice areas. ERCOT is a membership-based 501(c)(4) nonprofit corporation, governed by a board of directors and subject to oversight by the PUCT and the Texas Legislature. Its members include consumers, cooperatives, generators, power marketers, REPs, investor-owned transmission and distribution electric utilities, and municipally-owned electric utilities.²⁶³

²⁶¹ Page xxvi, Potomac Economics, Independent Market Monitor for ERCOT, "2017 State of the Market Report for the ERCOT Electricity Markets", <https://www.potomaceconomics.com/wp-content/uploads/2018/05/2017-State-of-the-Market-Report.pdf>

²⁶² Page xxvi, Potomac Economics, Independent Market Monitor for ERCOT, "2017 State of the Market Report for the ERCOT Electricity Markets", <https://www.potomaceconomics.com/wp-content/uploads/2018/05/2017-State-of-the-Market-Report.pdf>

²⁶³ ERCOT, "About", <http://www.ercot.com/about>

ERCOT Governance

The PUCT has jurisdiction over activities conducted by ERCOT. ERCOT is governed by a board of directors made up of independent members, consumers and representatives from each of ERCOT's electric market segments. The Technical Advisory Committee (TAC) makes policy recommendations to the board of directors. The TAC is assisted by four standing subcommittees as well as numerous workgroups and task forces comprised of stakeholder representatives. The board of directors appoints ERCOT's officers to direct and manage ERCOT's day-to-day operations, accompanied by a team of executives and managers responsible for critical components of ERCOT's operations areas.²⁶⁴

Board composition is as follows:

- Consumers
 - Residential - Office of Public Utility Council (OPUC) for example
 - Small Commercial (Cities of Belton, Eastland, Frisco, and Hutto; towns of Prosper and Trophy Club; organizations such as Public Citizen, EDF, Sierra Club, etc.)
 - Large Commercial (Cities of Dallas, Houston, Waco, and Corpus Christi; Wal-Mart, etc.)
 - Industrial (Oxy, Dow, Valero, Exxon, Chevron, Air Liquide, etc.)
- Cooperatives (LCRA, Golden Spread, Pedernales, South Texas Electric Coop, etc.)
- Independent Generators (Avangrid Renewables, Buffalo Gap Wind Farm, Calpine, E.ON North America, Exelon, First Solar, Luminant, Recurrent, Solar Prime, etc.)
- Independent Power Marketers (Citigroup, Morgan Stanley, Merrill Lynch, Shell Energy, Tenaska etc.)
- Independent Retail Electric Providers (Direct Energy, EnerNOC, Enerwise Global Technologies, Just Energy, Priority Power Management, Reliant, Source Power & Gas, Viridity Energy Solutions, etc.)
- Investor-Owned Utilities (AEP, CenterPoint, Oncor, Sharyland Utilities, Texas-New Mexico Power, Wind Energy Transmission of Texas, etc.)
- Municipals (Austin Energy, CPS Energy, Denton Municipal Electric, Garland Power & Light, etc.)²⁶⁵

Committee Structure

- ERCOT Board of Directors – statutorily defined (Section 39.151(g), Utilities Code)
 - PUCT Chairman (ex officio non-voting)
 - OPUC (ex officio voting)
 - ERCOT CEO (ex officio voting)
 - Six market participants (one from each segment; elected by market segments to one-year terms): generators, investor-owned utilities, power marketers, REPs, municipally-owned utilities, and electric cooperatives
 - One industrial consumer (elected by industrial consumer segment to one-year term)
 - One large commercial consumer (elected by large commercial consumer segment to one-year term)
 - Five unaffiliated directors (selected by the other Board members to serve three-year terms; the presiding officer must be an unaffiliated director)

²⁶⁴ ERCOT, "Governance", <http://www.ercot.com/about/governance>

²⁶⁵ ERCOT, "Membership", <http://www.ercot.com/about/governance/members>

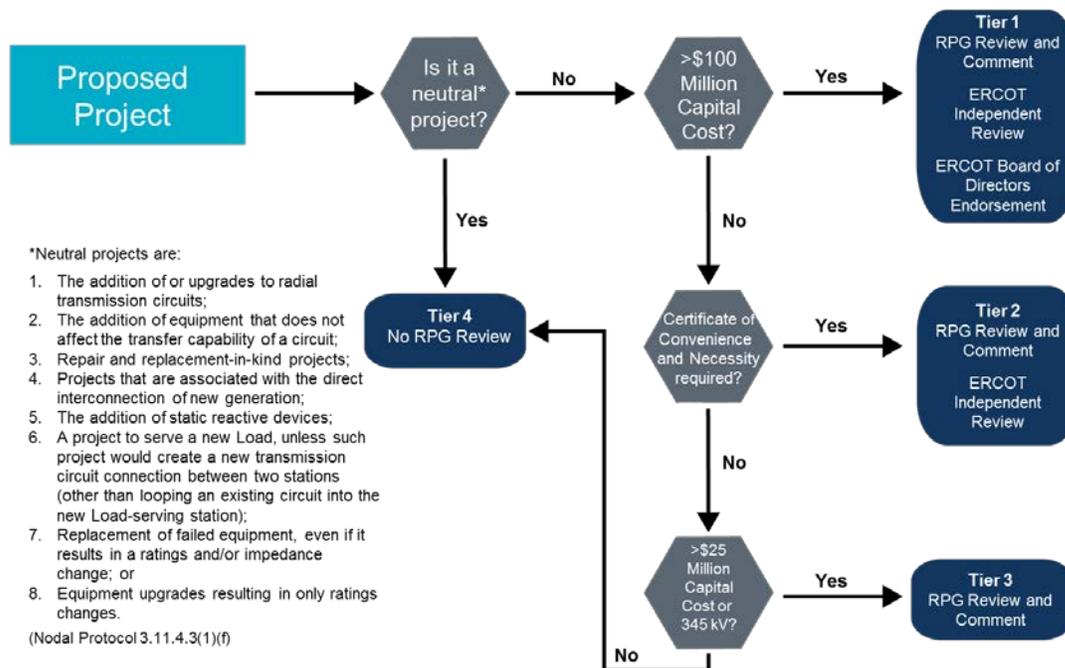
- Technical Advisory Committee (TAC) –The TAC, comprised of stakeholders, makes recommendations to the Board of Directors and is assisted by the subcommittees listed below. Consumers are represented on all subcommittees, which meet monthly. Numerous task forces and working groups reporting to these major subcommittees also meet regularly. TAC makes recommendations to the Board regarding ERCOT policies and procedures and is responsible for prioritizing projects through the Nodal Protocol Revision Request, System Change Request and various market guide and other binding document revision request processes.
- Protocol Revision Subcommittee (PRS) – The ERCOT Nodal Protocols set forth the procedures and processes used by ERCOT and market participants for the orderly functioning of the ERCOT system and market. ERCOT and market stakeholders may propose changes to the Nodal Protocols by submitting a formal Nodal Protocol Revision Request (NPRR). The PRS is responsible for reviewing and recommending action on formally submitted NPRRs.
- Retail Market Subcommittee (RMS) – The RMS is a forum for issue resolution in regard to retail market matters directly affecting ERCOT and ERCOT Protocols. The RMS is also responsible for monitoring PUCT rulings as they apply to retail markets and retail market participants and ensuring that PUCT requirements are reflected in the Retail Market Guides, Protocols and Texas Standard Electronic Transaction (Texas SET).
- Reliability and Operations Subcommittee (ROS) – the ROS develops, reviews and maintains operating guides and planning criteria. The ROS reviews ERCOT reports and procedures related to the reliable operation of the ERCOT system, including planning assessment; blackout restoration procedures; coordination of protective relay settings; operational communication facilities; operating reserve obligations; emergency operations; abnormal system conditions; transmission interconnections to generation; coordination of outage schedules; and other activities. The ROS also reviews ERCOT Protocol revisions and performs Protocol-required reviews of ancillary service provisions and commercially significant constraints.
- Wholesale Market Subcommittee (WMS) – The WMS reviews issues related to the operation of the wholesale market in the ERCOT region and makes recommendations for improvement. The WMS monitors PUCT rulings as they apply to wholesale markets and market participants. Among its many functions, the WMS provides input into the methodology for determining competitive constraints, changes to ancillary services (AS) and the evaluation of resource adequacy in the ERCOT region. The WMS also monitors the AS market operations and management of system congestion.

Other Groups of note:

- Grid Resilience Working Group (GRWG) - GRWG is responsible for assessing risks that have a low probability of occurrence but potential high consequence of impact to the ERCOT System if they were to occur. GRWG is further responsible for considering and evaluating practices that may address these risks.

- Critical Infrastructure Protection Working Group (CIPWG) – CIPWG serves as a vehicle to facilitate and enable ERCOT entities to secure their critical assets, achieve compliance with relevant security standards, and maintain their compliance. The CIPWG likewise apprises members of the ROS on matters being considered by the North American Reliability Corporation’s (NERC’s) Critical Infrastructure Protection Committee (CIPC) or Critical Infrastructure Protection (CIP) standards approved by FERC that require regional action.
- Regional Planning Group (RPG) - RPG provides a forum for discussion, input and comment on issues related to planning the ERCOT system for reliable and efficient operation.

Approval for Transmission Projects process mapped below, from the RPG charter:



As complex and sophisticated as ERCOT's decision making process is in practice, it is still predicated on a principle that the market should be managed by market participants, and decisions should be carefully balanced and consensus driven. Naturally, all stakeholders represent constituencies as outlined in the previously discussed governance structure, but each member of the Board, pledges to abide by a fiduciary duty of care when viewing proposals that come before the board.²⁶⁶ This pledge requires Board members to account for the interests of the ERCOT system before the interests of a company or entity who employs them.

TESTIMONY

²⁶⁶ ERCOT, Governance, Board Policies and Procedures, [http://www.ercot.com/content/about/governance/legal/Board_Policies_&_Procedures_\(eff_8.12.2014\).pdf](http://www.ercot.com/content/about/governance/legal/Board_Policies_&_Procedures_(eff_8.12.2014).pdf)

The Senate Committee on Business and Commerce received invited testimony from both regulators and industry experts regarding the condition of the ERCOT electricity market, what impacts they could foresee may effect the price and reliability of power in the near future, and what steps may be taken to manage those impacts. Consensus among those who testified was achieved on only one point, the "energy only" market design, as adopted by Texas through deregulation is working as intended. Price signals for the preceding years have indicated ERCOT had been oversupplied with generation, and the market responded.

At the time of the hearing on May 1, 2018, there was great anticipation on the part of all market participants that the coming summer would yield tight market conditions. The possibility of real time prices moving higher to scarcity levels had been reflected in electricity futures, and had prompted the Public Utility Commission to request that any available generation present in the market be made ready to respond to peak seasonal demand for the sake of reliability.

DeAnn Walker, Chairman of the Public Utility Commission of Texas briefed the Committee through prepared comments, that "we believe ERCOT has sufficient tools to address the reliability of the system." She elaborated that "we have seen this very cyclical thing before in 2002, or 2005, or 2006 and prices have increased and new generation was built."²⁶⁷ This hypothesis was supported during the hearing by Bill Magness, President and CEO of ERCOT, who announced that 512 megawatts of generation capacity that had previously been listed as "mothballed" units, had decided to re-enter the market for the summer on the prospect of higher prices. Overall this had the effect of raising the expected reserve margins for the summer of 2018 to 11% rather than the previously anticipated 9%.²⁶⁸

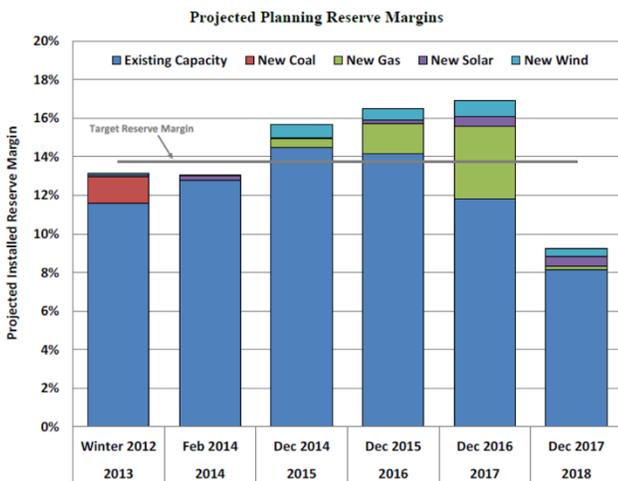
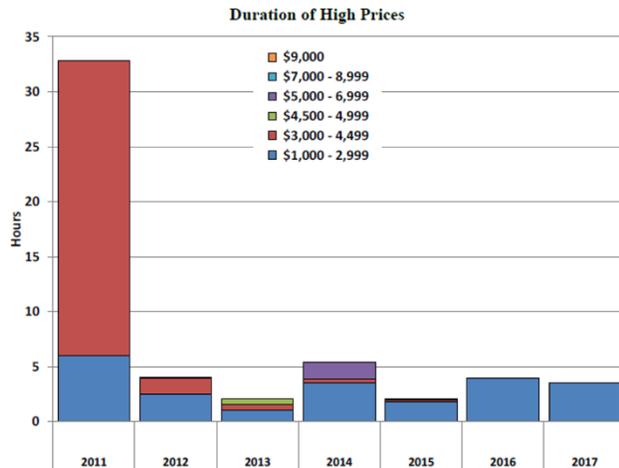
²⁶⁷ Direct testimony from DeAnn Walker, Chairman, Public Utility Commission, to the Senate Committee on Business & Commerce, May 1, 2018.

²⁶⁸ Direct testimony from Bill Magness, President and Chief Executive Officer, ERCOT, to the Senate Committee on Business & Commerce, May 1, 2018.

Effect of Prices on Resources

Beth Garza the Director for the Independent Market Monitor for ERCOT, explained to the Committee that "prices during shortage conditions, which we are talking about here, is a critical aspect for the ERCOT wholesale electricity market. Ensuring long-term supply in ERCOT depends on allowing prices to rise." In recent memory there have been instances when power supplies have fallen below the ERCOT target reserve margin of 13.75%, as in 2012 and 2013. The effect of tightening reserves prompted a regulatory response at the Public Utility Commission who increased the system wide offer cap (SWOC) for power to \$9,000 per MWh. Additionally, as per Ms. Garza, "in September 2013 the PUCT Commissioners directed ERCOT to move forward with implementing Operating Reserve Demand Curve (ORDC), a mechanism designed to ensure effective shortage pricing when operating reserve levels decrease."²⁶⁹

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As the market welcomed a more accommodative position from the PUC more generation was built in the succeeding years of 2015 and 2016 on the belief that prices would trend higher. However, even with the expanded SWOC of \$9,000 for scarcity conditions, prices have only on occasion increased to \$1,000 per MWh over the last four years, and very rarely to levels higher than \$3,000 per MWh under the most extreme circumstances. The price spikes of 2011 occurred due to anomalous weather events that forced fuel curtailments for generators. The chart on the left demonstrates the trend as noted by the IMM:²⁷¹

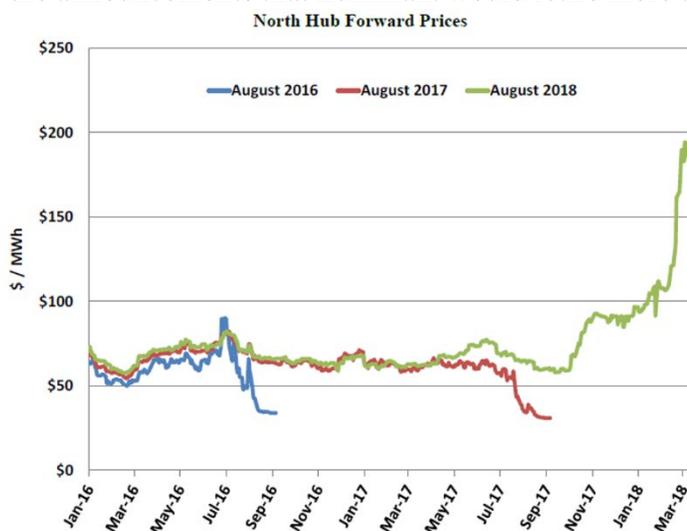
On the topic of wholesale prices the Committee had a great deal of discussion about the root causes pressuring prices in the energy only market. Senator Robert Nichols, through an exchange with the IMM expressed concerns about wind as a resource bidding into the market at negative values, thus suppressing normal price formation. As he put it, "all this works in a free market system, but not when one generator is heavily subsidized." Ms. Garza responded by saying that "even without the production tax credit, winds marginal costs are next to zero." She also noted that in 2016 the ERCOT system wide experienced almost 100 hours of negative prices in the context of 8,760 hours in a year.

²⁶⁹ Written testimony submitted by Beth Garza, Director for the Independent Market Monitor, ERCOT, to the Senate Committee on Business & Commerce, May 1, 2018.

²⁷⁰ Ibid.

²⁷¹ Ibid.

Even as lackluster prices on the wholesale market have resulted in generation mix adjustments Ms. Garza insists that price signals determining that future investment is needed are working. As she put it, "the response by market participants to the lower reserve margin projections has been evident in forward prices. Forward prices for August 2018 have risen to much higher levels, starting in the fall of 2017 when they increased to almost \$100 per MWh shortly after the announcements that Luminant would retire more than 4,000 MW of capacity. Since the beginning of 2018, on-peak prices for August steadily increased to almost \$200 per MWh. The current projection of planning reserve margin combined with expected shortage pricing during the summer of 2018 after years of higher reserve margins and lower prices demonstrates that the market is functioning properly."²⁷² The chart on the right demonstrates the North Hub forward prices as they existed on May 1, 2018 overlaid against similar forward prices experienced in 2016, and 2017.²⁷³

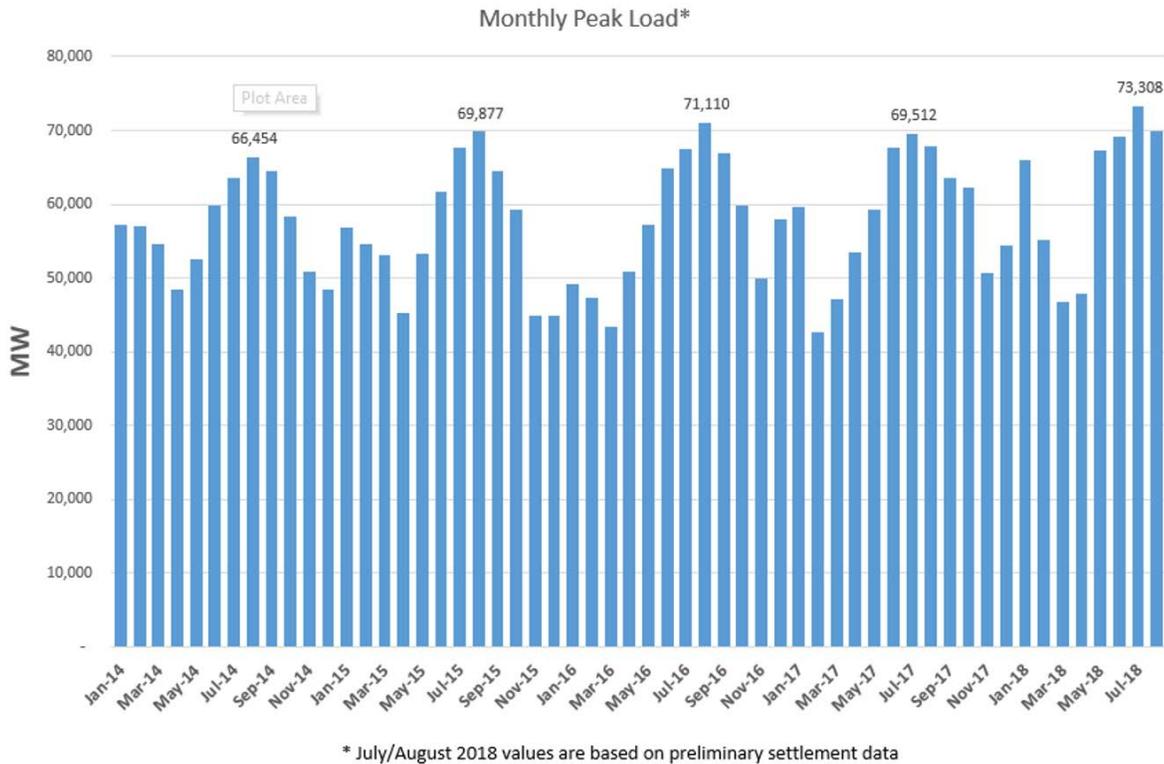


Load Growth Continues

As prices have stagnated ERCOT and the PUC both recognize that demand for electricity, also known as load, continues to grow at an accelerated pace. During 2017 the system experienced 357.4 million MWh of load, an increase of 1.9% from 2016. The summer of 2017 produced a peak of load of 69,512 MWh on July 28, 2017. To put this in the context of the summer of 2018 the new ERCOT peak load record was established at 73,308 MWh on July 19, 2018. At the time this report went to print 14 load records had been set within the ERCOT system during 2018 alone. The following chart demonstrates the growth trend since 2014.

²⁷² Written testimony submitted by Beth Garza, Director for the Independent Market Monitor, ERCOT, to the Senate Committee on Business & Commerce, May 1, 2018.

²⁷³ Ibid.



Stakeholder Identified Problems & Possible Solutions

All witnesses coming before the Committee agreed that the price of electricity in an "energy only" market design is the most essential element enabling ERCOT to function. Amanda Frazier, Vice President of Regulatory Policy for Vistra Energy, stated that "price signals are crucial to the success of this market, and supporting competitive price outcomes through all phases of the market cycle is critical."²⁷⁴ Dr. Susan Pope, of FTI Consulting and co-author of the Hogan-Pope Study, concurred calling prices the "linchpin of the ERCOT market". Dr. Pope went on to point out that for generators "prices paid to suppliers for their actual output is their only revenue for covering their full costs, both fixed and variable. It is therefore problematic when this price is suppressed by subsidies such as the PTC or other non-market factors."²⁷⁵

Dr. Pope's written testimony called into question the "locational variations" in prices experienced in the market through the nodal price system, which was implemented in 2010. As she put it:

"The price of electricity varies by location because constraints on the transmission system limit the movement of electricity produced in one location to consumers that are located elsewhere; thus, the location of the supply and the demand affect the value of electricity. New transmission infrastructure is very expensive to build, so the most efficient way to

²⁷⁴ Direct testimony from Amanda Frazier, Vice President of Regulatory Policy, Vistra Energy, to the Senate Committee on Business & Commerce, May 1, 2018.

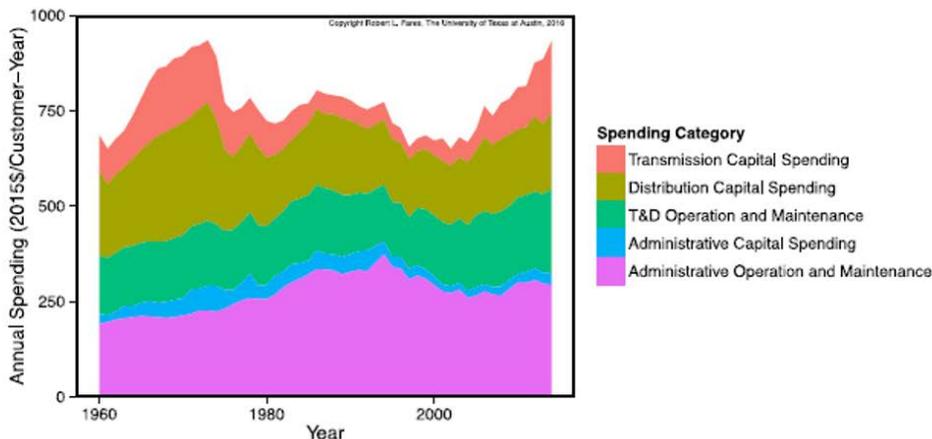
²⁷⁵ Direct testimony from Dr. Susan Pope, FTI Consulting, to the Senate Committee on Business & Commerce, May 1, 2018.

operate an electricity system is not to build transmission to eliminate all transmission constraints."²⁷⁶

Indeed transmission costs have been increasing nationally as reported by the University of Texas Energy Institute since the early 2000's as the following chart demonstrates on a per customer annualized basis.

FIGURE 4

Electricity transmission, distribution, and administration costs each consist of upfront capital investments and recurring operation and maintenance costs. Total transmission, distribution, and administration costs have been \$700–\$800 per utility customer per year for much of the past 54 years. Figure from [6].



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They conclude that total transmission cost per customer per year for the period between 2000 and 2010 averaged between \$700 - \$800. On a per kilowatt hour basis costs have increased from .3 cents/kWh in 1994 to .9 cents/KWh in 2014 for transmission capital infrastructure, operation, and maintenance.²⁷⁸

The UT study notes that "in the ERCOT region, the generator developer pays for the spur line and point of interconnection, but the bulk system costs are recovered directly from end-use customers via an adder to retail bills." Furthermore, "in general, renewable energy sources such as utility-scale solar and wind energy require more bulk transmission system expansion because the best wind and solar resources tend to be located further away from electric load." The authors cite the CREZ project as an example of cost increases for the transmission system, which according to UT, "cost approximately \$6.9 billion in total, or \$600/kW, which is more than conventional greenfield and brownfield generation projects."²⁷⁹

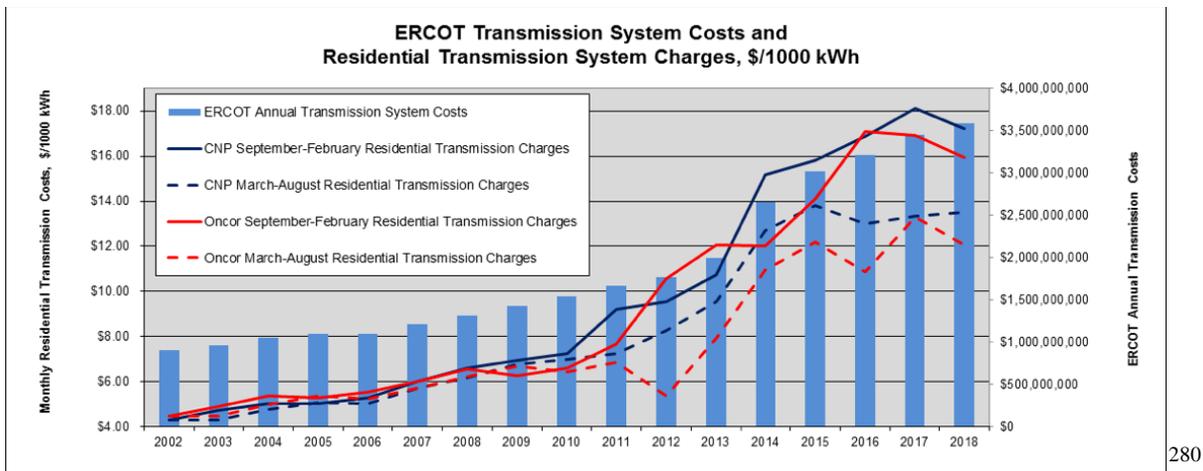
ERCOT specific transmission costs tend to bear the trend out as the following chart demonstrates. Transmission costs within the system have increased over 400% since 2002 and approximately 260% over the last decade.

²⁷⁶ Written testimony submitted by Dr. Susan Pope, FTI Consulting, to the Senate Committee on Business & Commerce, May 1, 2018.

²⁷⁷ Written testimony submitted by Dr. Joshua Rhodes, University of Texas Energy Institute, "The Full Cost of Electricity (FCe-)", to the Senate Committee on Business & Commerce, May 1, 2018.

²⁷⁸ Ibid.

²⁷⁹ Ibid.



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To counter the downward pressure on wholesale prices and upward march of transmission costs, Dr. Susan Pope proposed including transmission losses in the price of dispatched power. The concept, known as "marginal loss", is based on the physics of electricity transmission. When electricity is transmitted from one point to another, the longer the distance of travel will determine the ultimate amount in loss of energy that reaches its final destination. Dr. Pope believes in her own words, "marginal loss" should be added to ERCOT's energy market pricing and dispatch consistent with the best practice in every other competitive power market in the United States and Mexico."²⁸¹

Additionally, Dr. Pope suggested modifications in the way that ERCOT prices local capacity reserves under scarcity conditions. This would enhance scarcity prices on a regional basis so that generators within the region experiencing scarcity prices can realize higher prices for longer.²⁸² Each proposal has the effect of incentivizing the construction of generation closer to load in the long term, thus decreasing the need for more transmission infrastructure.

These proposals have divided the electric generation industry segment, pitting generators with power plants located in the highest demand areas of Texas against consumer groups and generators with assets located in between load centers. In fact Jeff Clark, President of the Wind Coalition, argued that contrary to the arguments for a marginal loss formula, the system of postage stamp transmission pricing has been responsible for expanding opportunities for new generation and lowering energy costs for consumers. Mr. Clark asserted that this system, "encourages economic development all over the state, it allows us to maximize development of a very diverse mix of resources, and finally it ensures we are also not putting generation in areas where it would contribute to emissions that would conflict with other industries."²⁸³

Retirements Effect on Consumers

²⁸⁰ Public Utility Commission of Texas, "Utility Transmission System Charge and Transmission Cost Recovery Factors", ERCOT Transmission Cost of Service, Dockets 25002, 26950, 28937, 30474, 32084, 33550, 35011, 36374, 37680, 38900, 39916, 40946, 42062, 43881, 45382, 46604 from 2002-2018, <http://www.puc.texas.gov/industry/electric/rates/TDArchive.aspx>

²⁸¹ Written testimony from Dr. Susan Pope, FTI Consulting, to the Senate Committee on Business & Commerce, May 1, 2018.

²⁸² Ibid.

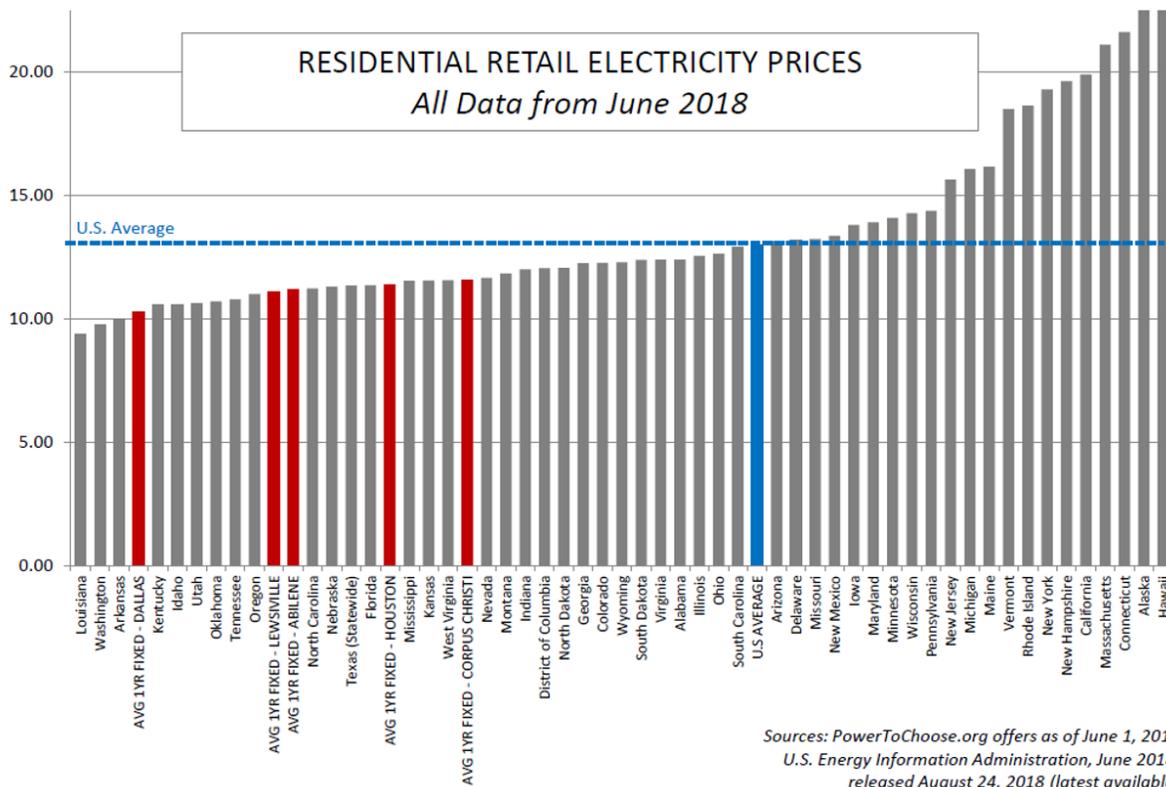
²⁸³ Direct testimony from Jeff Clark, President, Wind Coalition, to the Senate Committee on Business & Commerce, May 1, 2018.

The Committee heard from Derek Mauzy, with Reliant Energy who described the sophistication of the fully developed competitive retail market in Texas. As Mr. Mauzy put it, "if a customer wants it, we offer it," which seems to stand as a motto for retail power industry.²⁸⁴ As an industry REPs differentiate themselves by the following:

- Brand
- Service Offerings
- Digital & Mobil Capabilities
- Incentives
- Product Features
- Pricing Options

Offerings can include anything from renewable energy to demand side management. All of this is baked into a package available to consumers in competitive areas of Texas who have access to an all in price that can include hedges against energy volatility. Mr. Mauzy said that "REPs have access to numerous supply management options including the forward and real time markets to buy power for customers and lock in costs for customers."

Average 1-Year Fixed Price Offers in ERCOT Are Significantly Lower than the National Average Price



²⁸⁴ Direct testimony from Derek Mauzy, Principal, Innovation and Competitive Intelligence, Reliant Energy, to the Senate Committee on Business & Commerce, May 1, 2018.

Ultimately, consumers in ERCOT markets did see an increase in prices simply because forward prices included hedges against price volatility, but retail rates have remained some of the lowest in the country. The above chart demonstrates a state by state comparison of retail rates using June residential retail data collected by the U.S. Energy Information Administration. As of June rates would have included forward prices in the computation of a final rate, and should be representative of Summer retail samples.

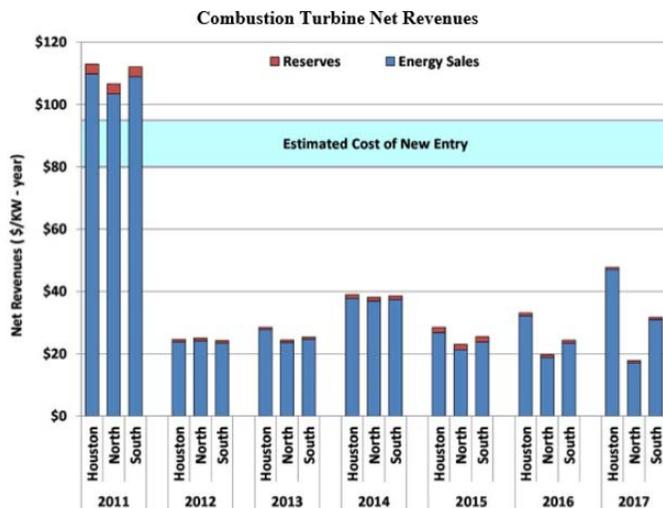
Final retail rate comparisons for the remainder of the summer months are still being reported as part of the Public Utility Commission's "summer look-back", Project # 48551, "Review of Summer 2018 ERCOT Market Performance". This PUC led review will compile the final market outcomes for 2018, but tentative data from ERCOT indicates the retail provider segment took necessary financial precautions going into the summer. Challenges to the ERCOT system seem to indicate more systemic challenges in the future.

CONCLUSIONS

Renewable energy is here and here to stay. Both wind and solar represent a clean source of power that will provide unlimited benefits to the public as long as it can be harnessed in a reliable and cost efficient way. When the Texas renewable portfolio standard was last amended in 2005 no one could have envisioned the success of renewables in the ERCOT market, but they are undeniably on course to be a major market participant if not the dominant resource in the near future.

With renewable integration the question of pairing an intermittent resource with a dispatchable source of power is important for policy makers to consider. Large utility scale batteries are still in the beta testing phase of development. Costs remain high, and deployment of the technology remains infrequent in the ERCOT market. Once batteries become economically viable they have the capacity to unlock the full potential of renewable resources and lower energy costs over the long term for Texas consumers.

Without batteries the energy only market design signals a need for investment for new generation exclusively through the price of power. For ERCOT, massive penetration of wind and potentially solar in the coming years, should mean that peaker plants would be highly desirable. Peakers are quick-start internal combustion engines (like a jet engine), that ramp up quickly to meet peak price during scarcity events. Unfortunately, prices are so low even peakers are uneconomic at these value levels. The chart on right, produced by the IMM, demonstrates the cost of new entry for a new peaker plant in ERCOT over the last 7



years. For 2017, prices were below the estimated cost of new entry by 40%.²⁸⁵

Why not try a Capacity Market?

Most other systems in the United States employ some form of a “capacity market”, where generators are paid a capacity payment to stay in operation. The payment level in these markets is the source of heavy litigation between consumer groups and generators every time a modification to a rate tariff is needed. In the end, whether the direct subsidy actually incents new generation be built is the subject of heated debate. It certainly has the effect of propping up older, more inefficient power plants and technology at a cost to consumers that become inordinately burdensome. Of note, the Committee put the question of whether a capacity market is needed to Amanda Frazier representing Vistra Energy, the largest baseload generator in the State of Texas. Ms. Frazier said that "we are committed to this market and we believe that if this market is allowed to work it will work over time."²⁸⁶

Conversely, in the energy only market ancillary services remain the primary means by which ERCOT structurally regulates system reliability, and the costs of those services are continually uplifted to load. Since the real-time price of power is the only market signal that determines when and how generation, regardless of its capabilities, should run, ERCOT is constantly trying to manage the market with ancillary service contracts and programs just to keep the lights on. All of which have costs for reliability maintenance that are always borne by the consumer, and not by the source of the reliability problem. As these ancillary service and transmission costs continue to grow to ever greater numbers this will become a concern for policy makers.

RECOMMENDATIONS

The State of Texas needs a reliable source of power. The market grows in complexity by the day with the introduction of new and innovative technologies. The industry may not be best suited to adapt our market to incorporate the numerous disruptions that they face. The Legislature needs to continue to actively monitor and engage in public dialogue about the regulations necessary to ensure our electric services are maintained and enhanced. The PUC should continue to provide a space where ideas can be debated about how to achieve the goal of providing reliable and cost effective resources for Texas consumers.

²⁸⁵ Page xviii, Potomac Economics, Independent Market Monitor for ERCOT, "2017 State of the Market Report for the ERCOT Electricity Markets", <https://www.potomaceconomics.com/wp-content/uploads/2018/05/2017-State-of-the-Market-Report.pdf>

²⁸⁶ Direct testimony from Amanda Frazier, Vice President of Regulatory Policy, Vistra Energy, to the Senate Committee on Business & Commerce, May 1, 2018.

10. Monitor the implementation of legislation addressed by the Senate Committee on Business and Commerce during the 85th Legislature, Regular Session, including:

a. the implementation of legislation to deregulate occupational licensing

BACKGROUND

During the 85th Legislative Session, 15,318 occupational licensees under 14 Texas Department of Licensing & Regulation (TDLR) license types were successfully deregulated, making this one of the largest deregulation efforts in Texas history.²⁸⁷

The following deregulated programs and license types were all effective September 1st, 2017 unless otherwise noted:

- **SB 2065 (Hancock):** Temporary Common Worker Employers Program - 59 licensees deregulated
- **SB 2065 (Hancock)/HB 2113 (Goldman):** For-Profit Legal Service Contracts - 16 licensed companies, 11,434 licensed salespersons, and one licensed administrator deregulated (*all effective 9-1-2019*)
- **SB 2065 (Hancock):** Vehicle Protection Product Warrantors - 63 licensees deregulated
- **SB 2065 (Hancock)/SB 1501 (Zaffirini):** Vehicle Booting, 93 licensed booting operators and 15 licensed booting companies deregulated (SB 1501 also deregulated the Tow Training License). Full removal of the state licensure requirement for booting operators (*all effective 9-1-2018*)
- **SB 2065 (Hancock)/SB 1503 (Zaffirini):** Shampoo Specialists - 113 licensees deregulated
- **SB 2065 (Hancock)/SB 1502 (Zaffirini):** Threading, no current licensee activity. Through SB 2065, the Legislature clarified that threading is not part of the practice of barbering or cosmetology and removed a licensure requirement for shampooing.
- **HB 2615 (Goldman):** Dual Towing/Vehicle Storage Facility (VSF) license:
 - Dual license for Incident Management/VSF employee, 3,354 licensees deregulated
 - Dual license for Private Property/VSF employee, 44 licensees deregulated

²⁸⁷ Written testimony submitted by Brian Francis, Executive Director, Texas Department of Licensing & Regulation to the Texas Senate Committee Business & Commerce, August 28, 2018

-Dual license for Consent Tow/VSF employee, 126 licensees deregulated²⁸⁸

TESTIMONY

The Senate Committee on Business & Commerce convened on August 28th, 2018 to study this charge with invited testimony from Brian Francis, Executive Director of the Texas Department of Licensing & Regulation.

Mr. Francis testified that TDLR has completed the deregulation of several occupations but not all of those that were mandated to be deregulated by legislation passed by the 85th Legislature.

When asked by the Committee about new occupational licenses and regulations now under TDLR's jurisdiction, Francis answered that 19 programs have been added since September 1, 2016, but that they were transferred from other agencies and are not new regulations. TDLR now manages three new regulatory programs for rideshare companies, behavioral analysts, and responsible pet ownership courses.

Francis testified that consumers have saved \$20 million in fees as a result of the deregulation. Francis concluded by recommending deregulating the mold program and repealing the requirement of a brick-and-mortar location for a driver education school to offer classes online.²⁸⁹

RECOMMENDATIONS

The Committee recommends the continued monitoring of occupational licensing deregulation from legislation passed in the 85th Legislative session to its completion. Building off the success of this historic effort, the Committee recommends the continued coordination of efforts with the Texas Department of Licensing & Regulation to craft legislation deregulate additional licenses and eliminate licensure redundancies ahead of the 86th Legislative session.

²⁸⁸ Written testimony submitted by Brian Francis, Executive Director, Texas Department of Licensing & Regulation to the Texas Senate Committee Business & Commerce, August 28, 2018

²⁸⁹ Ibid

10. Monitor the implementation of legislation addressed by the Senate Committee on Business and Commerce during the 85th Legislature, Regular Session, including:

- b. The settlement of out-of-network health benefit claims involving balance billing and patient's explanation of benefits statements; and make recommendations regarding any additional legislation needed to improve, enhance, and/or complete implementation.**

BACKGROUND

Balance billing for medical care has become common practice in Texas and across the country that has become synonymous with the phrase "surprise medical bills." Balance billing happens when you get a bill from a doctor, hospital, or other health care provider and that provider is not part of your health plan's network. Many times consumers did not know they were getting care from out-of-network providers.²⁹⁰

In these out-of-network instances, there is no contract between the provider and the health plan, meaning there is no negotiated rate. Therefore, the health plan will pay its out-of-network reimbursement rate to the provider. In most cases, at this point, consumers believe their bill has been paid. But, because there was no negotiated or contract rate, the provider will often send a second bill to the patient for the difference (balance) between what was covered by the health plan and the facility/provider's "billed charges;" this is the surprise "balance bill."

An example of a surprise medical billing scenario is if a patient goes to an in-network hospital for emergency care and is treated by an out-of-network ER doctor. The doctor and the hospital each bill \$1,500 for their services, and the patient's health insurance plan pays the hospital and the doctor each \$750. An in-network hospital can only bill the patient for copays, deductibles, and coinsurance amounts. However, the doctor may bill for the \$750 that the health insurance plan did not pay, as well as any copays, deductibles, and coinsurance.²⁹¹

Currently, the Texas "usual or customary charge" (set by the Texas Department of Insurance's rulemaking authority) requires payment based on the median billed charge for services in a given area in cases of emergency care or the unavailability of in-network care. Similarly, the "hold harmless" requirement applicable to exclusive provider benefit plans and HMOs in the same circumstances requires the carrier to protect the enrollee from balance billing, even if this means paying the full billed charge. Since billed charges are set by providers without any legal limitations, these charges can range much higher than payments actually accepted in the market, thereby encouraging providers to stay out-of-network and be

²⁹⁰ Texas Department of Insurance website, Explanation of "Surprise Medical Bills".

²⁹¹ Ibid.

paid substantially higher reimbursement rates.²⁹² The Center for Public Policy Priorities found that up to 56 percent of in-network Texas hospitals have an ER physician group that does not participate in at least one of the health plan networks that include their respective hospital.

In contrast, network providers agree not to bill patients more than the amount it has agreed with the health plan to accept as payment in full.

Approximately 70 percent of Texans with health insurance cannot use the mediation system because they include Texans with federally regulated self-funded (ERISA) plans. These plans are where large employers pay the claims and take on the risk. Additionally, Medicare and Medicaid recipients and those with health maintenance organization plans cannot participate; however, people with HMOs or government plans are generally protected from balance billing.²⁹³

As of June of 2017, 21 states statutes or regulations offer some protection against balance billing for care by out-of-network providers in emergency rooms or in-network hospitals.²⁹⁴ Other states rely on market forces to minimize balance billing. Some states also rely on regulators to pressure insurers or providers to mitigate its effects on consumers. Several additional states, including Tennessee and Washington, have consumer protections that are triggered in situations where provider networks are inadequate.²⁹⁵

In Texas, TDI began accepting mediation requests in 2010 and has seen a gradual increase over time as more consumers and providers become aware of the program and as eligibility for the program has expanded. Most mediation requests are settled informally prior to actual mediation. According to TDI data, mediation has saved Texas consumers over \$15 million dollars as of June 2018.

Statutes and Rules Related to Balance Billing in Preferred Provider Benefit (PPO) Plans

Section 1301.005 of the Insurance Code states that benefits for both in-network and out-of-network services be “reasonably available” to all insureds within a Preferred Provider Organization (PPO) plan’s designated service area, and if services are not available through a preferred (network) provider, the insurer must reimburse a non-network provider “at the same percentage level of reimbursement as a preferred provider would have been reimbursed had the insured been treated by a preferred provider.”

Section 1301.155 requires an insurer to reimburse emergency care at the “preferred level of benefits until the insured can reasonably be expected to transfer to a preferred provider.” Section 1301.0046 provides that an insured's coinsurance for non-network providers may not exceed 50%.

The Insurance Code does not prescribe the reimbursement amount applicable to care delivered by out of network providers. 28 Tex. Admin. Code Section 3.3708(b)(1) requires that when a preferred provider is not reasonably available to the insured (including, in the rule, emergency care), the insurer must “pay the claim, at a minimum, at the usual or customary charge for the service...” This rule amendment was adopted by the Texas Department of Insurance (TDI) in 2013.

²⁹² 28 Tex. Admin. Code 3.3708(b)(1)

²⁹³ *Blindsided*, Houston Chronicle Special Investigation into the ER Cost Crisis in TX by Jenny Deam (Nov. 17, 2017).

²⁹⁴ Balance Billing by Health Care Providers: Assessing Consumer Protections Across States, The Commonwealth Fund Issue Brief, by Kevin Lucia, Jack Hoadley and Ashley Williams (June 2017).

²⁹⁵ *Ibid.*

Balance Billing in HMOs

Section 1271.055(b) of the Insurance Code provides that if medically necessary covered services are not available through network physicians or providers, a Health Maintenance Organization (HMO), on the request of a network physician or provider and within a reasonable period, shall: (1) allow referral to a non-network physician or provider; and (2) fully reimburse the non-network physician or provider at the usual and customary rate or at an agreed rate. Section 1271.155(a) provides that an HMO shall pay for emergency care performed by non-network physicians or providers at the usual and customary rate or at an agreed rate. Adopted in 2017, 28 TAC 11.1611 formalized a longstanding TDI requirement that HMOs hold the enrollee harmless in these situations, so that the HMO may be required to pay out-of-network providers their full billed charges if the providers will not agree to a reduced rate (and providers have little incentive to reduce the rate for services already provided). The Insurance Code includes similar provisions for exclusive provider benefit (EPO) plans. (Sections 1301.0052(a); 1301.0053). TDI Rule 3.3725(a) imposes a "hold harmless" requirement on EPO plans when the enrollee cannot reasonably reach a network provider and for emergency services. The PPO usual and customary requirement and the HMO/EPO hold harmless requirement are both the subject of a pending lawsuit filed by the Texas Association of Health Plans.

Transparency Requirements related to Balance Billing

Chapter 1456 of the Texas Insurance Code requires health plans to inform consumers about the network status of providers to provide consumers with estimates of payments including any deductibles, copays, co-insurance, or other costs. Health plans' provider directories and web sites must clearly identify network hospitals in which facility-based physicians are not in the network. Plans must also provide notice to consumers regarding the potential for balance billing. Chapter 324 of the Texas Health & Safety Code requires facilities to provide an estimate of charges (for non-emergencies) upon request. They must also provide notices regarding the network status of providers practicing at the facility and the potential for balance billing. The primary disclosure requirement for physicians, which applies only to non-network services, requires that an estimate of charges be provided upon request, along with a notice for the potential of balance billing. (Texas Occupations Code Section 101.351). Chapter 1456 of the Insurance Code requires non-network facility-based physicians to provide notices about network status and the potential for balance billing.

Balance Billing Mediation Legislative Timeline

From 2007 to 2018, a series of legislation has developed balance billing mediation to serve more consumers today.

In 2007, HB 2256 established a new mediation process for consumers who were balance billed more than \$1000 by a non-network facility-based physician. Mediation is available to consumers who are covered through a fully-insured PPO or EPO plan, or are covered by the State Employee Retirement System (ERS) plan. Prior to the passage of HB 2256 in 2007 there was no remedy for unexpected balance bills other than the patient attempting to set up a payment plan with the facility-based physician. HB 2256 established a

new mediation process for consumers that are balance billed. Physicians are no longer allowed to collect a balance bill from consumers once they have received notice that mediation has been requested.²⁹⁶

In 2015, SB 481 by Senator Hancock during the 84th Regular Session, expanded options for mediation by reducing the claim threshold from \$1000 to \$500 and adding assistant surgeons to the list of providers subject to mediation and required to notify consumers about the option of mediation. The bill also strengthened the required notifications to consumers that mediation is an available option to resolve a balance-billing dispute. SB 481 had health plans and providers responsible for informing consumers of the potential of balance billing by hospitals and non-network facility-based physicians on the explanation of benefits (EOB) form. This legislation required that providers notify consumers that mediation is a protection available to them on the balance bill.²⁹⁷

In 2017 during the 85th Regular session, SB 507 passed, which further expanded mediation to address outstanding concerns of consumers. SB 507 allows mediation of balance bills from all types of out-of-network providers treating patients at in-network hospitals and other facilities, including freestanding emergency departments.²⁹⁸ Previously the law only applied to the six listed types of facility-based physicians: radiologists, anesthesiologists, pathologists, ER physicians, neonatologists and assistant surgeons. Now mediation applies to balance bills for emergency care from any provider or facility of emergency care services, including freestanding emergency departments, regardless of whether the facility is in-network or out-of-network. Mediation does not apply to emergency transport by air or ground ambulance. The legislation retained the current \$500 minimum balance billing amount (per claim, not including co-pays, coinsurance or deductibles) for claims eligible for mediation.

Furthermore, it expanded disclosure requirements regarding network status and balance billing by insurers, facilities and other health care providers including the requirement that the following statement be included on balance bills: "You may be able to reduce some of your out-of-pocket costs for an out-of-network medical or health care claim that is eligible for mediation by contacting the Texas Department of Insurance at (website) and (phone number)." Health plans will include similar disclosure requirements in explanation of benefits (EOBs) sent to consumers. Currently this EOB requirement is included in TDI rules. SB 507 included this requirement in statute. Mediation protections are also now available to 250,000 Texans enrolled in the Teacher Retirement System (TRS-Care) and 430,000 enrolled in the self-funded TRS-ActiveCare program.

TESTIMONY

Implementation of Senate Bill 507 by the Texas Department of Insurance

The Texas Department of Insurance (TDI) testified that the agency has been acting to implement SB 507, which was effective for medical services received beginning January 1, 2018. TDI has updated its website and mediation documents to reflect the law's expansion. Additionally, TDI has filed formal rules to conform to the new statutory changes and is currently going through the rulemaking process. Third, TDI

²⁹⁶ Written testimony provided by Doug Danzeiser, Director, Life, Health, Accident and Health Regulatory Initiatives, Texas Department of Insurance, to Texas Senate Business & Commerce Committee, May 4, 2016.

²⁹⁷ Ibid.

²⁹⁸ Senate Bill 507, 85th Regular Session, Texas Legislature Online (2017).

is meeting informally with state agencies impacted by the legislation. The informal meeting included the State Office of Administrative Hearings, the Texas Medical Board, the Texas Nursing Board, and the Health and Human Services Commission. Finally, TDI trained its staff that handles the mediation requests so they are able to accept mediation requests that include the newest types of mediation requests allowable under Senate Bill 507.²⁹⁹

In fiscal year 2017 there was over seven million dollars billed by providers that went to mediation. An additional million dollars was paid by the health insurance carriers once the mediation process commenced, and the providers agreed not to collect six million.³⁰⁰

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BALANCE BILLING MEDIATION SUMMARY as of July 3, 2018 (chart provided by TDI)

	FY 2013	FY 2014	FY 2015	FY2016	FY 2017	FY 2018 YTD
Total Number Received	43	686	977	1,504	2,063	2,198
Mediation Billed Amount*			\$242,234.35	\$4,228,521.02	\$7,287,460.83	\$5,681,453.04
Mediation Paid Amount**			\$49,324.50	\$713,952.43	\$1,131,538.20	\$770,705.64
Total Settled via Teleconference	42	597	879	1,396	1,938	1,265
Requests pending outcome of Teleconference***						785
Total Referred to SOAH	1	89	98	108	125	148
Number Received - \$1,000 and over				1,150	1,501	1,437
Number Received - \$500-\$999****				268	319	398
Number Received - \$499 amount or below				27	17	19
Number Received - Did not qualify*****				59	226	344
Total Number Received				1,504	2,063	2,198

*The amount entered on the Mediation Request form submitted to TDI.
 **The amount paid by the carrier to the provider as a result of the informal settlement telephone conference.
 ***Mediation requests are in a pending status while TDI awaits confirmation the teleconference was completed.
 ****The mediation request threshold changed to \$500 on 9/1/2015.
 *****These mediation requests did not qualify because 1) they involved a self-funded or other type of health plan that is not eligible for this program or 2) the requester did not provide sufficient information.

²⁹⁹ Testimony provided by Doug Danzeiser, Director, Life, Health, Accident and Health Regulatory Initiatives, Texas Department of Insurance to Texas Senate Business & Commerce Committee, January 23, 2018.

³⁰⁰ Ibid.

Medical Billing Data Collected by the Department of State Health Services

During the 85th Regular Legislative Session there was discussion amongst stakeholders to include freestanding emergency rooms in the data the Center for Health Statistics was able to collect to better understand the billing practices of freestanding ERs and to provide educate consumers. The Committee requested that the Center explain what data is currently collected to better understand how this may be useful and feasible data to collect in the future.

Lisa Wyman from the Department of State Health Services Center for Health Statistics testified that currently the department collects medical claims billing information from a variety of healthcare facilities and mainly focuses of hospitals and ambulatory surgical centers, which is authorized in Chapter 98 and 108 of the Health and Safety Code.³⁰¹ Specifically, the Department is able to collect major data element related to medical claims from facilities such as disease diagnoses, healthcare charges, length of stay and basic demographics. There is no data collected from what physicians bill, only facilities, and they only collect what is billed for the health services but not what is actually collected.³⁰²

Wyman also explained that if they were asked to expand the data that is collected to include freestanding emergency rooms, then they would need additional funds for data expansion.

Licensure of Freestanding Emergency Rooms

Senate Bill 507 included emergency services, including freestanding ERs in balance billing mediation so the Business & Commerce Committee invited David Kostrum, the Deputy Executive Commissioner for Regulatory Services at the Health and Human Services Commission, to testify on the regulatory role over freestanding emergency medical care facilities and some of the requirements associated with them.

In 2009, Texas began requiring freestanding ERs to be licensed if they are separate and distinct from a hospital. These facilities are required to submit an application and fee as well as attend a pre-survey conference at a regional office to ensure that the facility is aware of all of the regulations. The facilities must get approval of all of their documents and approval of the facility itself.³⁰³ Each year they also must get a fire inspection.

In 2016, there were 209 licensed freestanding emergency rooms in Texas. As of January 2017, there were 215. It should also be noted that in 2016 there were 58 license closures and in 2017 there were 45 license closures. Of the 58 technical closures in 2016, 51 of those became hospital owned or operated, which are no required to be licensed under the statute as *freestanding* emergency rooms.³⁰⁴ However, the bulk of the closures were actual closures rather than the facilities becoming owned by hospitals.

³⁰¹ Testimony provided by Lisa Wyman, Center for Health Statistics, Department of State Health Services to Texas Senate Business & Commerce Committee, January 23, 2018.

³⁰² Ibid.

³⁰³ Testimony provided by David Kostrum, Deputy Executive Commissioner for Regulatory Services at the Health and Human Services Commission to Texas Senate Business & Commerce Committee, January 23, 2018

³⁰⁴ Ibid.

Statutory Notices by Freestanding Emergency Rooms

Kostrum also testified in the statutory posting requirements from Senate Bill 425 from the 84th Regular for the freestanding emergency rooms. A facility shall post notice that:

- The facility is a freestanding emergency medical care facility;
- The facility charges rates comparable to a hospital emergency room and may charge a facility fee;
- A facility or a physician providing medical care at the facility may not be a participating provider in the patient's health benefit plan provider network; and
- A physician providing medical care at the facility may bill separately from the facility for the medical care provided to a patient; and

Notice of a facility's fees must be in legible print on an 8.5 inches by 11 inches document. It also must be located:

- At the facility's primary entrance;
- In each patient's treatment room;
- At the patient's check-out station; and
- On the facility's website.

House Bill 3276 added some additional posting requirements for freestanding emergency rooms. A facility shall post notice that either:

- Lists the health benefit plans in which the facility is a participating provider in the health benefit plan's provider network; or
- States the facility is not a participating provider in any health benefit plan provider network.

If a facility is a participating provider in one or more health benefit plan provider networks the facility must:

- Provide notice on the facility's website listing the health benefit plans in which the facility is a participating provider in the health benefit plan's provider network; and
- Provide to a patient written confirmation of whether the facility is a participating provider in the patient's health benefit plan's provider network.

Blake Hutson from AARP testified that he believes that Senate Bill 507 is an improvement, is serving more Texans, but that there is still more that can be done. He testified that more can be done to educate patients and consumers that mediation is available to them. He also brought up that Texas Department of Insurance rule that insurers have to pay the median billed charge for emergency care physicians. However, even after the insurer is paid, the physician may still balance bill the patient above the paid amount.³⁰⁵

³⁰⁵ Direct testimony provided by Blake Hutson, Associate State Director, AARP, to the Texas Senate Business & Commerce Committee, January 23, 2018.

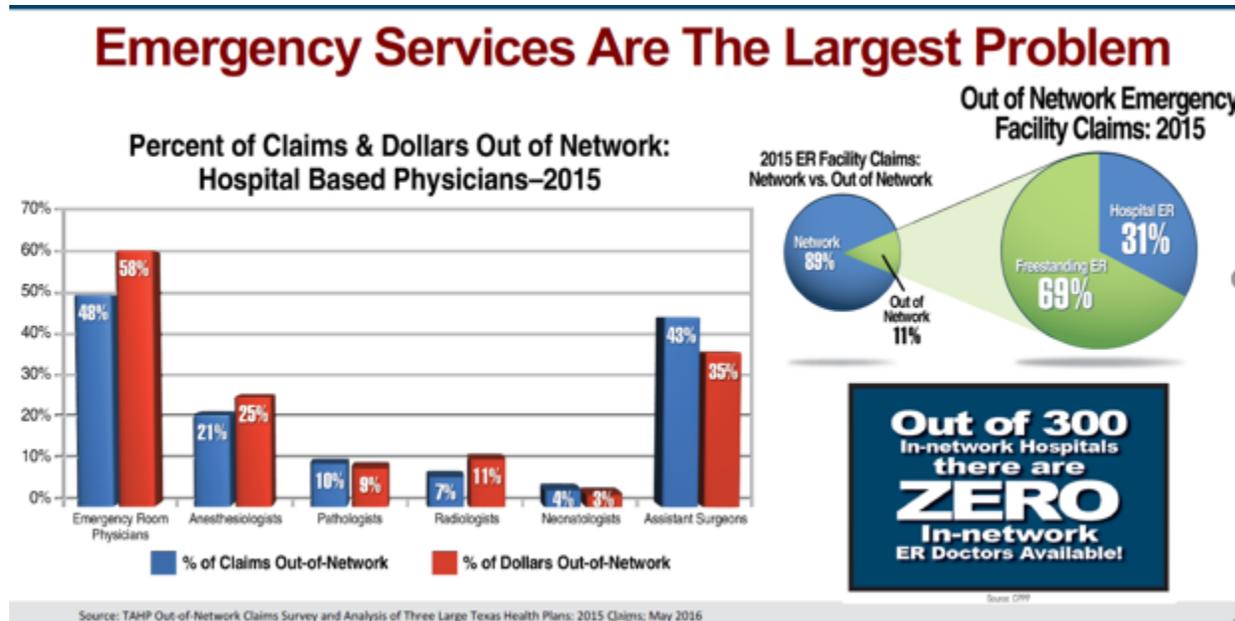
Dr. Ray Callas, an anesthesiologist with the Texas Medical Association, testified that mediation is working and that TMA supported numerous pieces of legislation last session that would provide more information and education to patients. This legislation included bills requiring better education of health insurance terminology by agents and stronger, more accurate physician directories. He also testified that TMA's biennial survey found that 89 percent of physicians who took the survey are contracted with at least one major health plan.³⁰⁶ Furthermore, 67 percent of physicians without a contract with a health plan reported that when they attempted to join a network they either received no response or a "take-it-or-leave-it attitude" from the insurer.³⁰⁷ TMA's biennial physician survey showed that 60 percent of physicians were not listed when they were participating, and 56 percent were listed as in network but they were not in the insurer's network.

Dr. Callas also testified that TMA believes that stronger network adequacy rules would aid in addressing surprise billing, because patients would go to a doctor who is in their insurance network, and therefore, would avoid balance bills.

Senator Campbell agreed that there should be greater network adequacy oversight.

Jason Baxter with the Texas Association of Health Plans testified that the health plans believe that mediation is working for Texans. Texas consumers have challenged 12.6 million dollars in surprise bills, saving 10.8 million dollars through the mediation process.

Mr. Baxter also noted that surprise out-of-network billing is primarily an emergency care problem in Texas. Almost half of the emergency of the Texas ER physician claims are out-of-network, and most out-of-network emergency facility claims in Texas, 69 percent occur at freestanding ERs.



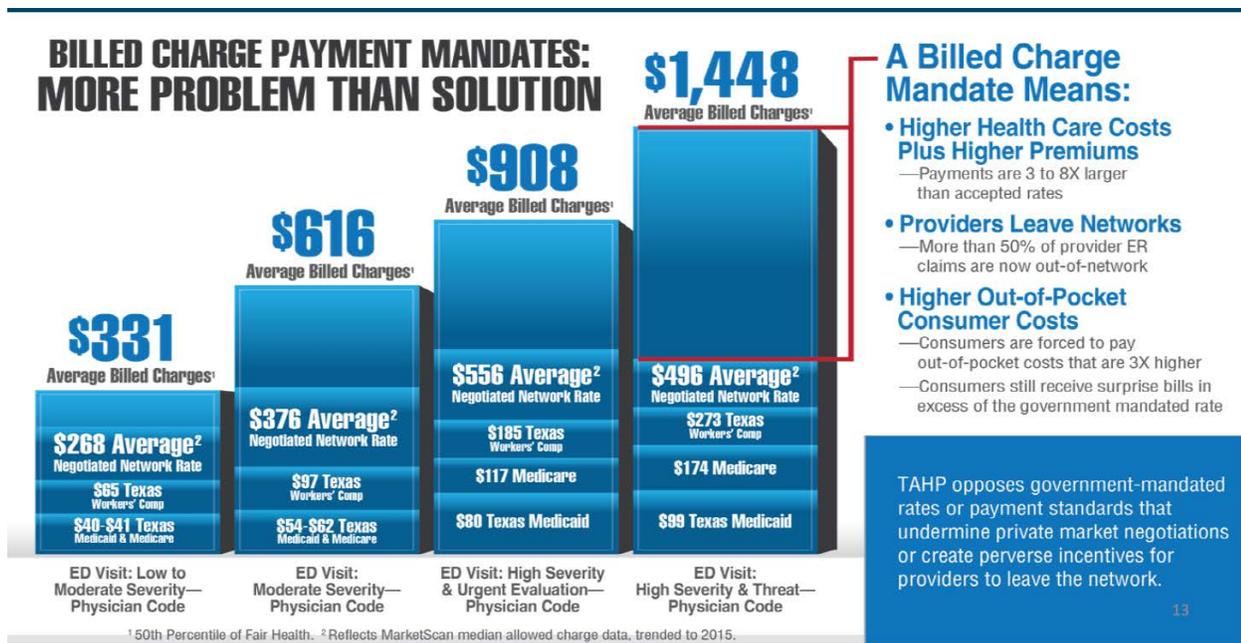
³⁰⁶ Direct testimony provided by Dr. Ray Callas, Board of Trustees Member, Texas Medical Association, to the Texas Senate Business & Commerce Committee, January 23, 2018.

³⁰⁷ Ibid.

A recent Yale study looked at the impact of hospitals contracting with EmCare, a large physician staffing company for emergency rooms.³⁰⁸ The study found that the rate of out-of-network emergency physician billing skyrocketed when the firm took over a hospital's emergency department management, increasing over 70 percent in the first year and an additional 25 percent in the second year.

Mr. Baxter believes that the decision to stay out of network is a rational business decision on the part of the ER providers. TDI has mandated the PPO plan payments for all out-of-network emergency care be based on usual and customary charges, which are based on median bill charges. Bill charges or prices in Texas are more than two to three times higher than what is generally accepted in the market and often more than five to 6 times what Medicare pays.

Mr. Baxter says that a recent study found that the prices for ER fees rose by 89 percent between 2009 and 2015, which is twice as fast as the price of outpatient care and four times as fast as overall healthcare spending.



The Texas Association of Health Plans shared their recommendations on how to further address surprise medical billing. They believe patients should be protected from out of network billing, provide fair and reasonable payments to out-of-network providers, and provide for a dispute resolution process when providers feel they are not accurately or adequately paid. TAPH also recommends studying facility and observation fees. They also support legislation to give the Attorney General the ability to go after providers who charge consumers unconscionable prices and legislation that would prohibit misleading freestanding ER advertising, including the use of health insurers' logos if it is not in-network.

Rhonda Sandel, an emergency trained nurse representing the Texas Association of Freestanding ERs, TAFEC. Ms. Sandel testified that insurers are denying claims based on the final diagnosis instead of and with total disregard for the Prudent Layperson standard and law which is mandated in Texas. The Prudent Layperson standard is supposed to allow a person to seek emergency care if they believe that they are

³⁰⁸ The Price of Medical Emergencies: Study Examines Out-of-Network Billing, YaleNews (July 24, 2017). <https://news.yale.edu/2017/07/24/price-medical-emergencies-study-examines-out-network-billing> (Sep. 11, 2018 at 1:48PM).

experiencing an emergency. Next, Ms. Sandel explained that there is a new effort by insurers to down-code emergency medical claims based on the insurer's won criteria. She also said that another insurer is denying all level 5 claims from freestanding ERs.

Senator Campbell asked for clarification about how the insurers are reimbursing providers. Senator Hancock, after dialogue between Ms. Sandel and Senator Campbell, asked Mr. Danzeiser from TDI to explain the reimbursement standards. Danzeiser explained that the Prudent Layperson standard is that if someone is experiencing an emergency, then the insurer should pay at the in-network coinsurance level, which is the higher level of payment. They should also pay it as if it was an emergency, so at the usual and customary rate to an out-of-network provider.

Mr. Danzeiser said that TDI has not received any complaints on this. That usually the provider and facilities are advised to use the appeals process of the insurer and then submit a complaint with TDI once that has been exhausted, but a complaint can also be submitted before that process is completed. TDI also said that TDI does not have regulatory guidance on how the carriers can apply their coding systems, so he was not sure how TDI could help on that issue. Senator Creighton asked for clarification on the issue of allowable amount and mandatory reimbursement because both terms are being used. Mr. Danzeiser explained that the allowable amount is the amount of the billed charge that the insurer will allow. Then, sometimes statutes or regulations gives guidance on the allowable amount the insurer needs to reimburse. So for instance, in an emergency situation when it's an out-of-network provider. they're allowable amount of reimbursement needs to be at least the usual and customary billed charge amount level. Therefore, the allowed amount being at the usual and customary billed charge amount is mandatory for emergency situations.

Senator Nichols asked why the freestanding ERs have not sued on this reimbursement issue or have filed a complaint on it yet? Ms. Sandel said that they are working through the complaint process now that they have seen a pattern and they are continuing to work with TDI.

RECOMMENDATIONS

The Committee understands that mediation is working for consumers, provider and insurers. According to TDI data, mediation has saved Texas consumers over \$15 million dollars as of June 2018.

As national attention around surprise medical billing or balance billing builds, so has the focus on the loophole in state laws that provide consumers with protections against balance billing.³⁰⁹ The loophole is that state laws do not apply to self-funded plans regulated under ERISA, the Employee Retirement Income Security Act. "Self-funded" health plans are plans that a company funds itself and pays claims out of those funds. Those claims may be administered by a major insurer.

In Texas, ERISA regulated plans make up about 40 percent of the commercial insurance market. Although ERISA plans are federally regulated, at the state level Texas healthcare consumers, providers and insurers

³⁰⁹ Chad Terhune, *A Jolt to the Jugular! You're Insured But Still Owe \$109K For Your Heart Attack*, Kaiser Health News, Aug. 31, 2018, <https://khn.org/news/the-109k-heart-attack-bill-is-down-to-332-what-about-other-surprise-bills/>.

would benefit from allowing self-funded plans to opt into the our mediation process.³¹⁰ There has been no action at the federal level on this issue, so Texas can act to further protect its consumers and help create a model that other states can adopt.

³¹⁰ A New Jersey law recently enacted allows self-funded plans to opt into a balance billing dispute resolution process. *See* Callie Richmond, *The Remedy For Surprise Medical Bills May Lie In Stitching Up Federal Law*, KUT.org, Sep. 10, 2018 at 4:11PM, <https://khn.org/news/the-remedy-for-surprise-medical-bills-may-lie-in-stitching-up-federal-law/>.