

Natural Gas Consumers

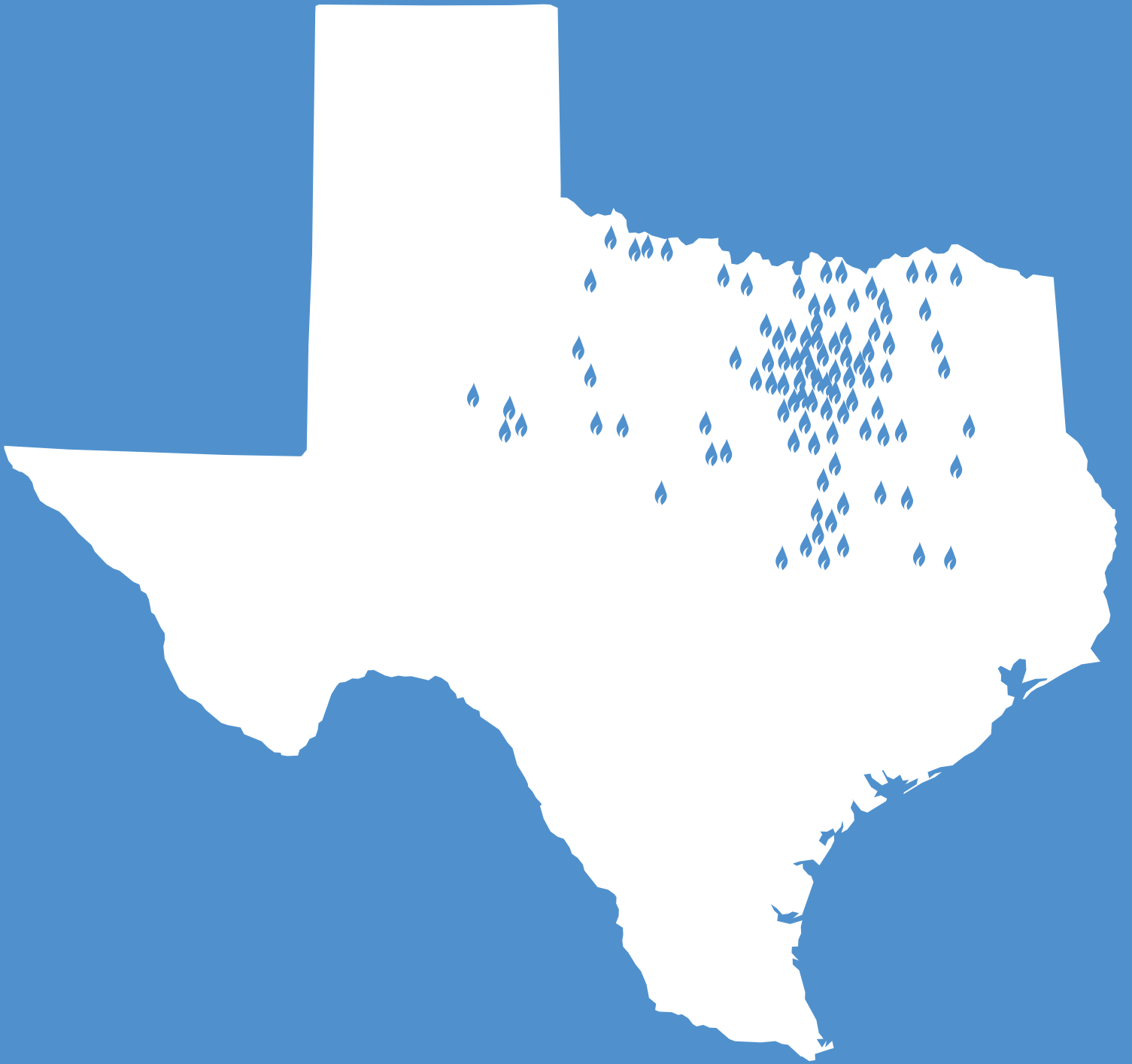
& THE TEXAS RAILROAD COMMISSION

Pocketbook & Policy Issues



DECEMBER 2010

A SPECIAL RESEARCH PROJECT *by the*
Atmos Cities Steering Committee



About the Atmos Cities Steering Committee



Cities have been standing up for the rights of natural gas consumers for generations - especially at the Railroad Commission of Texas. In fact, concerns raised by municipalities contributed to the Texas Legislature's decision in 1920 to assign gas utility matters to the Commission. The experience of cities handling gas ratemaking issues on behalf of consumers is unparalleled.

One of the most important municipal coalitions currently active in gas ratemaking is the Atmos Cities Steering Committee, an organization of over 150 cities in north and central Texas with nearly 1.2 million residential customers. Membership in this standing committee is determined by passage of a resolution by each governing body. The Steering Committee undertakes activities on behalf of its city members and their citizens such as participation in rate cases, rulemakings and legislative efforts that impact natural gas rates.

ATMOS STEERING COMMITTEE CITIES INCLUDE:

Abilene	Colorado City	Grapevine	McKinney	Royce City
Addison	Comanche	Haltom City	Melissa	Sachse
Allen	Coolidge	Harker Heights	Mesquite	Saginaw
Alvarado	Coppell	Haskell	Midlothian	Seagoville
Angus	Corinth	Haslet	Murphy	Sherman
Anna	Corral City	Hewitt	Nocona	Snyder
Argyle	Crandall	Highland Park	North Richland Hills	Southlake
Arlington	Crowley	Highland Village	Northlake	Springtown
Bedford	Dalworthington Gardens	Honey Grove	Oak Leaf	Stamford
Bellmead	Denison	Hurst	Ovilla	Stephenville
Benbrook	DeSoto	Iowa Park	Palestine	Sulphur Springs
Beverly Hills	Duncanville	Irving	Pantego	Sweetwater
Blossom	Eastland	Justin	Paris	Temple
Blue Ridge	Edgecliff Village	Kaufman	Parker	Terrell
Bowie	Emory	Keene	Pecan Hill	The Colony
Boyd	Ennis	Keller	Plano	Tyler
Bridgeport	Euless	Kemp	Ponder	University Park
Brownwood	Everman	Kennedale	Pottsboro	Venus
Buffalo	Fairview	Kerrville	Prosper	Vernon
Burkburnett	Farmers Branch	Killeen	Quitman	Waco
Burleson	Farmersville	Krum	Red Oak	Watauga
Caddo Mills	Fate	Lakeside	Reno (Parker County)	Waxahachie
Carrollton	Flower Mound	Lake Worth	Richardson	Westlake
Cedar Hill	Forest Hill	Lancaster	Richland	Whitesboro
Celeste	Fort Worth	Lewisville	Richland Hills	White Settlement
Celina	Frisco	Lincoln Park	River Oaks	Wichita Falls
Cisco	Frost	Little Elm	Roanoke	Woodway
Cleburne	Gainesville	Lorena	Robinson	Wylie
Clyde	Garland	Madisonville	Rockwall	
College Station	Garrett	Malakoff	Roscoe	
Colleyville	Grand Prairie	Mansfield	Rowlett	



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Introduction

THE TEXAS RAILROAD COMMISSION

oversees energy production in Texas - everything from oil wells to uranium mining. It promotes the use of liquefied petroleum gas and provides rebates for the use of propane appliances. It is an agency of great interest to oil and natural gas producers, as it regulates both industries.

But the Railroad Commission has another important duty: it determines how much Texans pay for natural gas service. Nearly 4 million consumers in more than 1,000 Texas cities receive natural gas service through distribution networks regulated by the Railroad Commission.¹ The agency's commissioners have the power to approve, reject or alter rate requests from monopoly utilities. The Commission's decisions in this regard directly impact the public welfare and the state economy.

And yet the Railroad Commission has relegated this vitally important responsibility to an inferior position among its other duties. An examination of the agency's website, its mission statement - even in the history of its ratemaking decisions - reveals that rather than positioning itself as a ratepayer watchdog, the Commission increasingly positions itself as a champion of industry. Many Texans are unaware of the agency's vitally important role in their daily lives, also contributing to a lack of accountability.

Are gas customers well served by the Commission's continued oversight of gas utility rates and service, or should those responsibilities be shifted elsewhere? Is gas service simply too expensive in Texas?

This report, prepared by the Atmos Cities Steering Committee ("ACSC"), will consider these questions and more as part of a general examination of natural gas ratemaking at the agency. This report also examines the important ratemaking role of cities, which by default have become advocates for consumers before the Commission. The report will analyze discrete Railroad Commission decisions and programs, including the impact of the Gas Reliability Infrastructure Program ("GRIP") adopted by the Texas Legislature in 2003.

Included are "spotlight" examinations of four major policy areas, sections on findings and recommendations for reform, a short history of the agency and an appendix that includes a Railroad Commission timeline.

Findings

GAS RATEMAKING AT THE TEXAS RAILROAD COMMISSION

- In all or nearly all major rate cases in recent years, the Commission has amended the recommendations of its own hearing examiners in such a way as to favor the utility's interests to the detriment of residential ratepayers.
- The agency and its leaders place little emphasis on its rate-setting and consumer protection responsibilities. Only once in the last dozen years has it required a natural gas utility in a major case to lower its rates.
- Insufficient resources have been devoted to the protection of consumers in ratemaking proceedings.
- The examiners who currently adjudicate gas utility rate requests are employed by the Railroad Commission. Rate requests for virtually all other regulated industries are heard by independent judges at the State Office of Administrative Hearings ("SOAH"). As such, it is inevitable that examiners who hear gas rate matters will not be as removed from the political and policy sentiments of the Railroad Commissioners as SOAH judges are removed from politics at the Public Utility Commission of Texas and other agencies where SOAH judges hear cases.
- Outside the context of a general rate case, no formal process exists in Texas whereby the prudence of natural gas acquisition by utilities comes under regulatory review.
- In no other state are responsibilities for gas and electricity rate regulation divided between two agencies.

THE GAS RELIABILITY INFRASTRUCTURE PROGRAM

- Under the auspices of the Gas Reliability Infrastructure Program, the Commission has allowed gas utilities to repeatedly increase rates without meaningful review. Atmos Pipeline Texas, for instance, has instituted seven increases in six years on rates charged at its city gate meters. That amounts to a total increase for city gate meter charges of 2,200 percent without any substantive review of the reasonableness of the increase.
- For many years prior to the implementation of the Gas Reliability Infrastructure Program statute – a statute ironically intended to streamline regulation at the agency – major rate cases were rarely adjudicated at the Commission.

PUBLIC CONFUSION

- Many members of the public are unaware of the Commission's ratemaking authority. This has enhanced the influence of industry insiders at the agency and makes it less accountable to the public.
- The agency's incongruous name has added to the public confusion. The Commission no longer has authority over railroads, and yet it continues to be known as the Railroad Commission. The Commission has not done enough to clear up this confusion.

SAFETY

- The agency waited more than a decade after receiving the appropriate authority to assess its first fine for a safety violation relating to a pipeline accident. Subsequent fines were comparatively small.
- The number of pipeline inspections has decreased during recent years. Less is spent in Texas on a per-mile basis for pipeline safety than is spent in other states.
- The Commission has initiated only a limited number of enforcement actions against oil and gas producers that have been found to have been out of compliance with state regulations. Records appear to be inadequate.
- The Commission does not post online its enforcement data in a manner that is easily accessible to the public.



Recommendations

A single agency should handle all utility rate-setting responsibilities

Currently the Texas Railroad Commission has responsibility for regulatory issues relating to gas utilities and the Public Utility Commission has responsibility for regulatory issues relating to electric utilities. Texas is the only state to use separate agencies to regulate gas and electric utilities. Consolidating regulatory responsibilities within a single agency – whether the Railroad Commission or the PUC – would make Texas government and regulatory practice more efficient.

State Office of Administrative Hearings should adjudicate gas utility cases

To ensure more independence in the adjudication of gas utility rate requests, the practice of assigning those cases to hearing examiners employed by the Texas Railroad Commission should be abandoned. Instead, adjudication of such cases should be assigned to SOAH judges. This reform should be implemented, regardless of whether or not the Legislature consolidates the agency's ratemaking authority with the PUC.

Change Commission's name

The Texas Legislature should change the agency's name in such a way as to remove the misleading word "railroad" from the title. If gas utility ratemaking authority remains vested with the Commission, the new name should reflect the agency's responsibilities to gas utility consumers.

Refocus agency's mission

If gas utility ratemaking authority remains vested with the Commission, the statutory mission of the Texas Railroad Commission, as enumerated in the Gas Utility Regulatory Act, should be altered in such a way as to heighten the agency's focus on gas utility consumers.

Improve safety guidelines

The Commission should establish a system whereby rules violations are classified based upon the severity of the potential threat to the public safety or the environment, and based upon whether the violator is a repeat offender. These rules should provide staff specific guidance on which sorts of violations should be forwarded to the central office for enforcement action.

More transparency in pricing data

If ratemaking authority remains with the Texas Railroad Commission, the agency should collect and post data in an easy-to-read format on its website regarding natural gas base rates and fuel charges paid by the home consumer, by region and utility. The Commission should also provide historical pricing data as well as additional complaint and enforcement data.



“In 1919 the League of Texas Municipalities called for the establishment of a public utility commission to regulate not just rates for gas monopolies, but also those for telephone, telegraph and electric monopolies. That is, cities proposed that a single entity oversee all public utilities. This is a regulatory model common in other states.”

GAS RATES & THE TEXAS RAILROAD COMMISSION:

A Brief History

Populist Roots at the Texas Railroad Commission

Cities have been standing up for the rights of natural gas consumers for generations — especially at the Railroad Commission. It was in response to concerns raised by cities that the Texas Legislature in 1920 first assigned gas utility regulation to the agency. At the time, smaller municipalities without home-rule status were complaining about the lack of control over gas rates inside their communities. City councils of larger home-rule municipalities had relatively more control over rates and services, but still no authority over systems extending beyond their boundaries.

Gas utilities had already established a strong foothold in the state. Houston Gas Light Company (later Houston Gas and Fuel, and eventually CenterPoint Energy) had started 50 years earlier processing coal gas for distribution to local customers.² In West Texas, the brothers Frank and J.C. Storm had founded the Amarillo Gas Company. By 1920, the company was distributing locally produced gas.³ There was also Lone Star Gas, which through a series of mergers and acquisitions had emerged as the state's largest gas utility. It served the area around Dallas and Fort Worth.⁴

But services and rates were inconsistent — much to the chagrin of the cities, which were deeply dependent upon gas service. After a series of gas shortages during the winters of 1919 and 1920 — and in the wake of demands from Lone Star Gas for higher rates⁵ — an exasperated Dallas Mayor Frank Wozencraft⁶ declared that no

other issue was more important to the welfare of his community than gas utility rate regulation. Proposed hikes by the Houston Gas Fuel Company also fueled public outcry.⁷

In 1919 the League of Texas Municipalities called for the establishment of a public utility commission to regulate not just rates for gas monopolies, but also those for telephone, telegraph and electric monopolies.⁸ That is, cities proposed that a single entity oversee all public utilities. This is a regulatory model common in other states.⁹ But under stiff opposition from Lone Star Gas, that effort failed.¹⁰ Cities also sought relief from the Texas Railroad Commission, but Commissioner Clarence Gilmore said the agency then lacked jurisdiction.¹¹ Litigation and negotiations with utilities also failed.

In response to the growing discontent, Gov. W. P. Hobby called a special session devoted exclusively to the passage of regulatory legislation. The result was the “Cox Gas Bill,” named for Abilene Democrat Ben L. Cox, which conferred upon cities the right to regulate gas utilities that operate within their jurisdictions. But the legislation also gave utilities the right to appeal decisions to the Texas Railroad Commission.¹² This bifurcated system — that is, the system whereby regulatory power is divided between cities and the state — remains in place today. The Legislature adopted the Cox Act on June 12, 1920 and it became effective three months later.

The Early Years of the Texas Railroad Commission



The Texas Railroad Commission must have seemed like the logical choice to regulate the state's ever more powerful gas utilities. As the oldest regulatory agency in the state,¹³ it already had extensive experience with public service regulation. However, a 1914 U.S. Supreme Court decision transferred much of its authority for the railroad industry over to the federal government.¹⁴ This meant that the agency was free to consider other regulatory issues — such as gas utility rate regulation. But the task would be a daunting one. During the first eight years of the agency's Gas Service Division, the number of cities with gas service increased by an estimated 921 percent.¹⁵ Early appropriations were small.¹⁶

It would be several years before the Railroad Commission would have the appropriate rules in place to begin its utility oversight duties. Responding in June 1922 to an inquiry from the U.S. government, the director of the newly created Gas Utilities Division noted that even if the agency could quickly adopt the necessary rules, it would still lack the authority and resources to enforce them. Such concerns led the Texas Legislature in 1931 to increase appropriations for the Gas Utilities Division by more than 300 percent.¹⁷ This gave the division sufficient funds to audit the books of utilities, an essential task for the regulatory process. During this period, the Railroad Commission also consulted with the Oklahoma Corporation Commission, which had more experience in gas utility matters. In addition, the Commission gathered information from the National Association of Regulatory Utility Commissioners (“NARUC”).¹⁸

Under the then-emerging regulatory system, cities maintained responsibility for the regulation over the patchwork of pipes that carried gas to the homes and busi-

nesses within city limits. The Commission, meanwhile, would consider utility appeals of city decisions. It also would make rate decisions for unincorporated areas. But the agency by this time had already moved away from its populist roots. Ohio State University professor William R. Childs, an expert on the Commission's history, writes that its management culture by the 1930s had shifted from one based on progressive beliefs to “one based more on the ability of the commissioners to respond to as many interest groups as possible.” Childs also noted that “the pressure to get reelected ... prompted the Commissioners to hire political favorites” and that its “management approach became more and more associated with (industry) capture.”¹⁹ Political scientist David F. Prindle, writing in a separate history of the agency, noted that it should “be thought of not as a discrete governmental body outside the industry, but as an integral part of that industry.”²⁰

During the early years, the Texas Railroad Commission considered a number of gas utility rate cases involving quality of service issues. It also considered cases in which it was necessary to determine an appropriate rate of return for the utilities.²¹ But it devoted relatively little attention to issues associated with natural gas production. This is because natural gas was then considered relatively valueless. Billions of cubic feet of natural gas came out of the ground each day as a byproduct of oil production. This gas was routinely burned off as a waste product. The Commission prohibited the practice in 1947, and instead required gas to be returned to the ground in order to preserve the natural resource and to help support well pressure and therefore oil production.²²



The Post War Years

During the 1950s, with the post World War II expansion of the economy, the industry began promoting the use of natural gas appliances in suburban homes. As part of those promotional efforts, the industry assured the public of the safety and reliability of gas appliances.²³ During the 1960s the industry prompted the “Blue Star” seal program — a “little metal seal with a blue star on a white circle” — which alerted homeowners that a gas appliance could be counted upon for years of safe use.²⁴

One of the most important gas issues to confront Texas regulators during the 1970s related to the Lo-Vaca Gathering Company, a subsidiary of the Coastal States Gas Corp. By this time, natural gas was no longer considered a valueless commodity. Lo-Vaca, which had contracts to supply natural gas to cities and industrial customers, found itself in the winter of 1972 unable to meet its obligations. Gas curtailments followed, prompting Austin, San Antonio and other cities to turn to expensive fuel oil to

meet their needs. Accusations arose that Lo-Vaca had welched on its long-term contracts because gas prices were on the rise.²⁵ The Railroad Commission grappled with the problem for years²⁶ and went so far as to authorize prices beyond the limits specified in the contracts. In December 1977, the Commission ordered that Coastal refund \$1.6 billion in overcharges to Lo-Vaca’s customers.²⁷

It was also during the 70s, but later in the decade, that some utility lobbyists began urging lawmakers to transfer all rate-making authority away from cities, and instead to grant exclusive jurisdiction over gas rates to the Railroad Commission. At the time, Lone Star gas was pushing for \$7 million in rate hikes and had grown weary of resistance from cities. According to one publication: “The company hasn’t liked the assertion of local independence one bit, so now wants to terminate any hometown authority over rates.”²⁸



Rate Cases in the Modern Era

There were few major rate cases at the Commission during the 1980s and 1990s. The gas utility industry had entered a period of declining costs — that is, the per-customer cost of service was declining. Cities and utilities also managed to settle cases without Commission involvement. This period of relative inactivity began to change during the late 1990s, especially after the establishment of the Gas Reliability Infrastructure Program, or GRIP for short. The product of legislation in 2003 and 2005, GRIP was meant to save consumers money by making the regulatory process more efficient. But an analysis of the program shows that the opposite has occurred.

“If it were not for the cities and their accountants, we would never know about these things. If it weren’t for the cities, there would be virtually no voice for the average consumer in these cases. The Railroad Commission has generally failed in its duty to take aggressive action to police the industry it’s supposed to regulate.”

- TOM “SMITTY” SMITH,
DIRECTOR OF PUBLIC CITIZEN-TEXAS²⁹

COMMISSION DUTIES

The Commission approves base rates for unincorporated areas of the state. City governments that choose to exercise original jurisdiction have responsibility for approving rates for citizens living inside city limits. The Commission becomes involved in setting rates within cities only when the utility timely appeals a municipal rate ordinance. To determine a reasonable rate, the Commission examines a utility's expenses and revenues to make sure the company can adequately serve its customers. By law, a utility must have rates that give it the opportunity to earn a reasonable return on invested capital after all reasonable and necessary expenses are covered. The actual commodity costs of natural gas are passed through to consumers.

The Commission's Safety Division enforces safety rules and regulations governing the transmission and distribution of natural gas. It received this authority in 1970. Personnel based in field offices inspect natural gas and hazardous liquid facilities to evaluate design and pipe integrity. The emergency procedures of pipeline companies are also reviewed. The section began its hazardous liquids safety program in October 1985.

By the Numbers:³⁰

\$80,000,000

*Texas Railroad Commission budget
(includes state and federal dollars and industry fees)*

722.6

*Number of Railroad Commission employees,
as measured in full-time equivalents*

200

Number of investor-owned gas utilities in Texas

84

Number of municipally-owned gas utilities in Texas

179,567

Miles of gas pipeline overseen by Railroad Commission

\$20

*Approximate per-mile expenditures by
Railroad Commission on pipeline safety*

Cities Play a Historic Role in Protecting Utility Customers

Natural monopolies, when left unchecked, can charge unreasonably high prices because of the inherent lack of competition. This is especially true when the monopoly sells an essential service, such as gas or electricity. Moreover, without oversight, nothing prevents monopolies from providing inconsistent service. Regulation is a necessary substitute for competition. Cities have always played a role in the regulation of gas and electric utilities because it is their citizens who are the captive customers of utilities, and because utilities largely depend upon city rights of way for their distribution system. High utility bills for city facilities can also impact city budgets, which translates into less money for essential city services.

DID YOU KNOW?

Recommendations to place all ratemaking authority with a single entity are nothing new. Citing uncertain rate levels and poor-quality service, the League of Texas Municipalities began calling in 1919 for the creation of a single, stand-alone agency to regulate natural gas, telephone, telegraph and electricity service.³¹ They noted that with the exception of Iowa and Delaware, no state other than Texas was without a commission to regulate public utilities. Assigning responsibilities to a single entity also made sense because ratemaking issues for those industries were strikingly similar.

The Texas Legislature rejected those suggestions, and instead adopted the Cox Act in June 1920 that assigned jurisdiction over gas rates to cities and the Texas Railroad Commission.³² The Texas Legislature ultimately created the Public Utility Commission in 1975 to provide comprehensive statewide regulation of telephone and electricity utilities. Texas became the last state in the country to do so.³³ However, Texas remains the only state in the nation without a single agency to manage both electric and gas regulation.³⁴

WHAT'S IN A GAS BILL?

When Texans pay home gas bills, some of the money is used by the utility to defray its cost to purchase gas, and some is used to defray the separate costs of operating the utility.

The first part — the gas cost component — simply reflects the market price of natural gas. It is set by the commodity market. That is, the utility negotiates a free-market price for gas with a supplier and then passes along the expense to its customers. Under Texas law, the utility is not allowed to profit when it passes through this cost to consumers. The Texas Railroad Commission may review gas procurement practices and specific expenditures to ensure the utility did not make them imprudently. However, the Commission has done so only on rare occasions.ⁱ

The second part of the bill relates to the expense of operating a utility. Unlike the gas cost component, a utility's operations and infrastructure investments are subject to regulatory scrutiny in the context of setting rates. Because gas utilities operate as natural monopolies, no competitive forces exist that would prevent it from overcharging its customers for the use of its pipelines and distribution system. An unregulated monopoly, especially a monopoly that sells a service like gas service that is absolutely essential to the public's welfare, has the power to charge almost any price it wants. It is this fact that led to the establishment of gas rate regulation in Texas.

The utility's operations and infrastructure costs are covered in its **base rate**. The base rates are further divided into two parts: the **customer charge** and the **consumption charge**. The customer charge is a fixed monthly amount, while the consumption charge is a per unit charge that varies with the amount of gas consumed.

The base rate is expected to cover the company's **revenue requirement**, which is the amount it needs to cover its annual operating expenses, its infrastructure costs and to collect a reasonable profit. If the Railroad Commission authorizes a revenue requirement that is greater than the annual revenues the utility already collects, then the result is a base rate increase. However, overall bills can still go down under such a scenario if there is a decline in the gas cost component — that is, the commodity price of natural gas has gone down.

The Railroad Commission also oversees the allocation of rates between different classes of consumers. For instance, the Commission, on occasion, has shifted some of the relative responsibility for paying the revenue requirement from industrial consumers to residential consumers. This can result in a rate increase for residential customers, even if the overall revenue requirement has gone down.

ⁱ Outside the context of a general rate case that only occasionally comes before the Railroad Commission, no formal process exists in Texas whereby the reasonableness of natural gas costs that are automatically passed onto customers on a monthly basis comes under regulatory review. Cities have no jurisdiction to question the reasonableness of the cost of gas delivered to municipal limits. Rather, jurisdiction over the cost of gas rests with the Railroad Commission, which unfortunately has seldom evaluated the prudence of gas acquisition practices or the reasonableness of specific gas contracts. In fact, the only regular review of a utility's gas costs — those of Atmos Energy Mid Tex — was terminated by the Commission in GUD 9696.



BASE RATE CASES IN 6 STEPS

1. *Utility files notice with a municipality of its intent to hike its base rates.*
2. *The city council determines whether to accept, modify or reject the increase.*
3. *If the city rejects the increase, or awards less than the company requested, the utility may file an appeal with the Texas Railroad Commission.*
4. *The Commission holds a hearing on the rate request, and then must reach a decision on whether and how much rate relief is merited within 185 days.*
5. *All parties may request rehearing from the Commission.*
6. *Parties may also appeal final Railroad Commission decisions to a state district court in Austin.*



Policy Spotlight I

THE RATE ANALYSIS

Ten Years of Increases at the Railroad Commission

FINDINGS

- *The Railroad Commission consistently sides with utilities over consumers when setting rates*
- *The Railroad Commission has elected to increase rates in every major rate case that it has adjudicated over the last ten years. On two occasions recommendations for rate decreases from the Commission's own hearing examiners were overturned and instead became rate increases. Texans are paying millions more each year for gas service as a result.*
- *In some cases, the Commission has shifted the burden for paying rates from industrial consumers onto residential consumers.*
- *The Railroad Commission is adjudicating significantly more rate requests in recent years.*
- *Consumers went without any independent legal representation during a 2005 rate case.*



The Texas Railroad Commission has consistently sided with gas utilities over residential consumers when setting rates in major cases, according to an analysis of more than ten years of rate decisions.

The analysis shows that the agency's commissioners have overturned the recommendations of their own hearing examiners to the detriment of residential consumers in nearly every major rate case since 1997. In two instances, commissioners converted a recommended rate decrease into a rate hike. In others, the commissioners accepted the examiners' recommendations for a rate hike – but then increased its size. The commissioners in some cases also shifted the rate burden away from big industrial customers and onto residential users. Such rate shifts have the effect of unfairly increasing residential rates.

The Analysis

Under Texas law, monopoly gas utilities must first seek approval from city councils that retain original jurisdiction before they can hike base rates within incorporated areas. Only if the cities and the utilities fail to reach an agreement does the Texas Railroad Commission step in.ⁱⁱ Once a city rate decision has been appealed, the Commission's hearing examiners consider evidence, listen to expert testimony and then render a recommended judgment. The company typically argues for more revenues and higher rates. Cities, representing the interests of consumers, argue for more restraint. The hearing examiners act as impartial judges.

For purposes of this analysis, the Atmos Cities Steering Committee considered recommendations issued by hearing examiners in major base rate cases, and then compared those recommendations to the final orders adopted by the Commissioners themselves. Only decisions in fully-litigated cases associated with a major city, with the unincorporated areas surrounding a major city, or that impact a major utility's customers on a system-wide basis were considered for this analysis. In addition, only cases that included both a "Final Order" from the Railroad Commission and a recommendation from the Commission's hearing examiners were included in this analysis. Ten cases between 1997 and 2010 were identified that met the criteria. Earlier cases were not considered because there were relatively few that met the criteria for a long stretch prior to 1997.

The rate cases identified for this analysis include a 1997 case for Lone Star Gas,³⁵ a 1998 case for Southern Union Gas,³⁶ a 2000 case for TXU Gas Distribu-

tion,³⁷ a 2003 case for Texas Gas Service,³⁸ a 2004 case for TXU Gas,³⁹ a 2005 case for CenterPoint Energy Entex,⁴⁰ a 2010 case for CenterPoint Energy⁴¹ and 2007, 2008 and 2010 cases for Atmos Energy.⁴² Hearing examiners in each case considered a number of accounting and financial issues. The hearing examiners in each case also calculated the utility's overall "revenue requirement," that is — the appropriate amount of revenue that a utility needs to collect each year to cover its operations and infrastructure costs and earn an appropriate profit.

The hearing examiners are charged with making impartial recommendations after considering testimony and evidence from parties that both oppose and support the utility rate increase request. Typically, a hearing examiner's decision falls somewhere between that espoused by the utility and that espoused by its opponents. These recommendations are then forwarded to the three-member Railroad Commission for final action.

Given that the hearing examiners consider testimony and evidence from both sides of the case and then typically issue recommendations that fall somewhere in the middle, one might expect that over time the decisions of an impartial Railroad Commission would parallel those recommendations. One would not expect an impartial Commission to consistently overturn the recommendations of its own hearing examiners to the consistent benefit of the utility.

Unfortunately, this analysis shows that the Railroad Commission consistently overrules their own examiners, and in almost every case, the effect is to favor the utility's interests over those of consumers.

ⁱⁱ Besides having jurisdiction over utility appeals of city rate decisions, the Texas Railroad Commission also has jurisdiction over base rates charged in cities that have surrendered original jurisdiction and base rates charged in unincorporated areas of Texas.

The Cases

Utilities were awarded higher rates in each of the examined cases since 2000. That is, in no major case during the current decade were rates lowered for consumers, according to the analysis. In all but one of the contested cases,⁴³ the Commission rejected the overall revenue requirement proposed by their hearing examiners in favor of a revenue requirement granting the company more money. In one case, consumers had no legal counsel or testifying experts. The utility received 100 percent of its adjusted rate request in that instance. On two separate occasions, the Commission overturned recommendations for a rate decrease in favor of a rate increase for the company.

As a consequence, Texans have paid at least \$156 million more for gas service than they otherwise would have paid had the Commission adopted the recommendations of their own hearing examiners. The specifics of a few of the cases merit closer examination:

- In the 2004 TXU case, the examiners recommended that the North Texas gas utility receive a \$19.7 million rate decrease.⁴⁴ However, the commissioners overturned that recommendation and instead awarded the utility a \$11.7⁴⁵ million increase. The Commission also shifted some of the burden for gas rates from the utility's industrial customers onto its residential customers.⁴⁶ As a result, residential bills went up 4-5 percent, while commercial customers received an 8.4 percent rate cut and industrial customers rates were cut by 27 percent.⁴⁷
- In the Atmos Energy case from 2007, a \$21.5 million residential rate decrease recommended by hearing examiners became instead a \$10.1 million rate increase under the Commission Order.⁴⁸ There was also a similar shifting of the rate burden from industrial customers to residential customers. The Commission staff, which is tasked with representing the public interest, cross-examined only one of the company's witnesses during the course of a multi-week hearing.
- The Railroad Commission, in a 1997 Lone Star Gas case, whittled down an \$89 million rate decrease recommended by its hearing examiners, and instead decreased rates by only \$5 million.⁴⁹ This is a difference of \$84 million — to the detriment of consumers. Nonetheless, the \$5 million cut was the last rate decrease that North Texas gas utility customers would see.



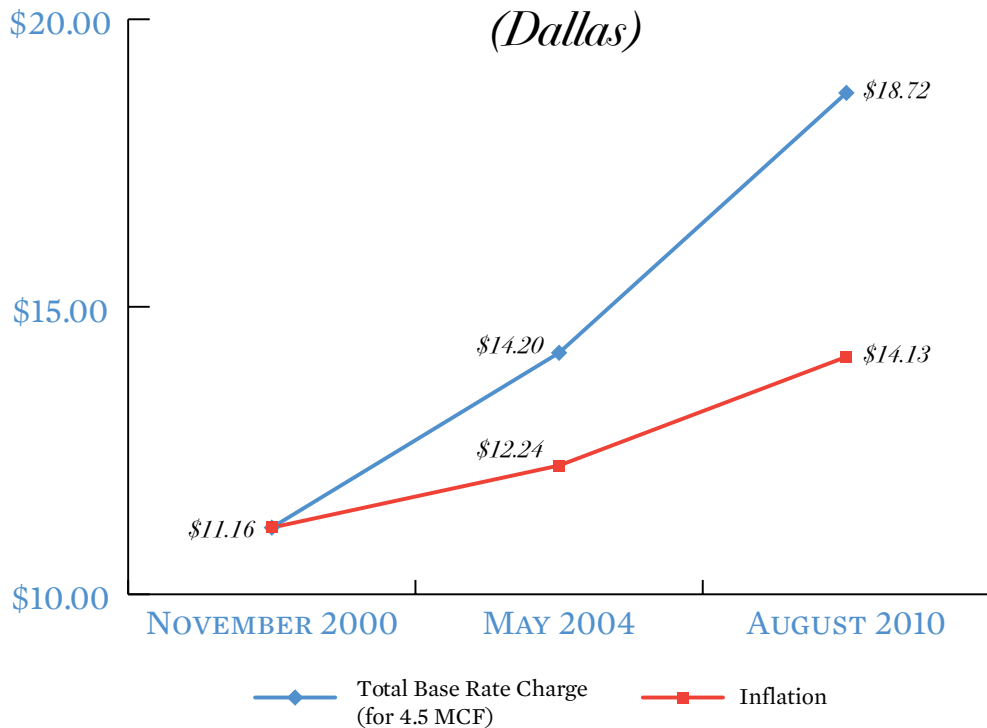
“Texans have paid at least \$156 million more for gas service than they otherwise would have paid had the Commission adopted the recommendations of their own hearing examiners.”

There are two relatively minor exceptions to this trend that merit examination. This is because consumers still fared poorly in both cases:

- In 2010, hearing examiners recommended a \$5.7 million increase for the Houston-area customers of CenterPoint Energy. The Commission adopted an increase of only \$5.1 million – or a rate increase that is about \$600,000 smaller than that recommended by the hearing examiners.⁵⁰ However, the Commission also excluded businesses from any responsibility for paying the increase. Instead, the Commission decreased rates for commercial customers by \$14.3 million. As a result, residential customers were left not with a \$5.1 million increase, or even one for \$5.7 – but an increase of \$19.4 million.⁵¹
- In a case from 2005 involving CenterPoint Energy/Entex, the examiners’ recommendations were adopted by the Commission without any change whatsoever. But unlike other cases examined in this analysis, consumers had no independent representation – not even from the Railroad Commission staff. The only party in this case was the utility itself. The hearing examiners called for a slight alteration to the company’s requested rate hike, and then the Commission adopted that recommendation without additional change. (See the separate Rate Case Spotlight on page 23.)

Residential Gas Rate Increases vs. Inflation

(Dallas)



This chart examines residential base rates set by the Texas Railroad Commission for the City of Dallas. As shown, residential gas base rates (for typical usage of 4.5 thousand cubic feet of gas) have increased 67 percent over the last ten years. The average annual increase in the Dallas base rate is 5.25 percent, as compared to the average annual rate of inflation of 2.45 percent. This means that residential base rates in Dallas, as adopted by the Texas Railroad Commission, have increased at more than twice the rate of inflation. The figures exclude natural gas costs and taxes.

Source: Texas Railroad Commission Gas Utility Dockets 9145-48, 9400, 9869 and 9961.

THE RAILROAD COMMISSION CONSISTENTLY OVERTURNS RECOMMENDATIONS FROM ITS OWN HEARING EXAMINERS TO THE DETRIMENT OF CONSUMERS.

YEAR	UTILITY	EXAMINER RECOMMENDATION	COMMISSION ACTION	CONSUMER IMPACT ⁱⁱⁱ
2010	Atmos	\$14,500,000 rate increase	\$14,800,000 rate increase	(-\$300,000)
2010	Centerpoint Gas	\$5,700,000 rate increase	\$5,100,000 rate increase	\$600,000 ^{iv}
2008	Atmos	\$12,700,000 rate increase	\$19,700,000 rate increase	(-\$7,000,000)
2007 ^v	Atmos	\$21,500,000 rate decrease	\$10,100,000 rate increase	(-\$31,600,000)
2005	Centerpoint Energy Entex	\$12,400,000 rate increase	\$12,400,000 rate increase	\$0 ^{vi}
2004	TXU Gas	\$19,700,000 rate decrease	\$11,700,000 rate increase	(-\$31,400,000)
2003	Texas Gas Service	\$708,851 rate increase	\$887,295 rate increase	(-\$178,444)
2000	TXU Gas	\$1,300,000 rate increase	\$2,600,000 rate increase	(-\$1,300,000)
1998	Southern Union Gas	\$2,000,000 rate decrease	\$98,692 rate decrease	(-\$1,901,308)
1997	Lone Star Gas	\$89,000,000 rate decrease	\$5,000,000 rate decrease	(-\$84,000,000)

ⁱⁱⁱ Comparison of examiners' recommended utility revenue requirement with Commission's final order. In eight of nine contested cases, commissioners awarded the utility a larger revenue requirement than had been recommended by hearing examiners.

^{iv} The Commission's decision places the entire burden for this increase on residential consumers. Specifically, the Commission increased rates for the residential class by \$19.4 million, but reduced rates for the small commercial class by \$6.3 million and reduced rates for the large commercial class by \$8.0 million.

^v 2007 Atmos rate figures reflect those for residential class.

^{vi} Consumers had no independent representation in this case. The hearing examiners recommended the exact increase that was requested by the utility, after the utility made changes to the request in response to questions from the hearing examiners. That recommendation was then adopted by the Commission without change.

RATE CASE SPOTLIGHT:

Utility Maximized Rate Hike by Sidestepping Consumer Scrutiny

In 2005, CenterPoint Energy/Entex pushed through a \$12.4 million rate hike without scrutiny from independent consumer representatives. The company made a slight alteration to its requested rate hike, and then the Railroad Commissioners adopted it without further change. Consumers who must shoulder the burden of those higher rates had no input whatsoever in the unorthodox proceeding.

How did the company manage to sidestep independent consumer scrutiny of their rate hike that is usually provided by cities and other potentially adversely affected parties? Recall that the Cox Act of 1920 established a three-pronged regulatory scheme that: 1) gives cities original jurisdiction over rates charged within their communities, 2) gives utilities the right to appeal city decisions to the Railroad Commission, and 3) gives the Railroad Commission original jurisdiction over rates collected outside city limits. The company obtained its rate hike by gaming this three-pronged system.

Historically, in distribution rate cases, the company files first in each of the cities it serves that have retained original jurisdiction. If the utility and the cities reach agreement, rates within cities are increased via city ordinance. The utility will then prepare a filing at the Railroad Commission to request implementation within environs (unincorporated areas) of the new rates approved by the cities. If the utility is dissatisfied with the rates set by the municipalities it serves, it may appeal to the Railroad Commission and simultaneously initiate a request for implementation of the same higher rates with environs.

This becomes a *system-wide* case. City experts represent consumers in such consolidated appeals. The hearing examiners hear evidence and the Railroad Commission renders a decision. In this manner, all consumers affected by the rate hike — even consumers living in unincorporated areas — benefit from consumer representation.

But the 2005 case was different. Instead of beginning at the city level, CenterPoint went first to the Railroad Commission to hike its rates only within unincorporated areas. As a consequence, cities were effectively blocked from the proceeding. Imagine a court case in which only one side has legal representation. This was the practical effect for consumers in the 2005 rate case. Because it was not an appeal of a city decision, cities did not participate and there was no consumer representation.

The Railroad Commission agreed to the entirety of the company's rate request after only a slight adjustment by the hearing examiners. CenterPoint then sought to institute the same uncontested hike at the city level. The company attempted to convince local officials that opposing the hike would be pointless because it had already been approved by the Railroad Commission. Most cities agreed, fearing the expense involved in contesting the hike. But several cities balked, and in a settlement with them the utility agreed to forego such regulatory maneuvering in the future.

Major Distribution Gas Utilities Operating in Texas



The largest natural-gas-only distributor in the United States, Atmos Energy operates in 11 states other than Texas. It acquired TXU Gas in 2004. Atmos Mid-Tex, its largest division, serves about 1.5 million customers in the North Texas area, largely around Dallas and Fort Worth. Atmos West Texas serves approximately 80 communities in West Texas, including the Amarillo, Lubbock and Midland areas.⁵²

CenterPoint Energy operates both in the state's electricity and natural gas markets. Its natural gas division serves customers in various cities, including Houston.⁵³

With 603,000 customers in 97 communities, Texas Gas Service is the third largest natural gas distribution company in Texas. It serves customers in Austin, El Paso, the Rio Grande Valley, Galveston, Port Arthur, Weatherford and several communities in the Permian Basin and the Texas Panhandle. Texas Gas Service is a division of Tulsa-based ONEOK, Inc.⁵⁴



Policy Spotlight II

HIKING RATES WITHOUT REVIEW The Failed Gas Reliability Infrastructure Program

FINDINGS

- *The Gas Reliability Infrastructure Program has led to increases in natural gas rates without appropriate review. It has not served the function for which it was created.*
- *The Commission has not exercised sufficient authority over rates charged by natural gas pipeline companies. In one instance, unexamined gas charges increased by 2,200 percent in six years.*

Imagine if state lawmakers hiked taxes every time a single state agency reported extra expenses. Without considering offsetting savings elsewhere in the state budget, without considering the possibility of existing revenue surpluses — without even considering whether the extra expenditures were warranted — lawmakers simply hiked taxes.

The public wouldn't stand for it. Texans elect their leaders to scrub the entire budget, from top to bottom, and not to spend more public money every time a new highway or a new prison gets built. And yet a similar fiscally questionable dynamic can be found within a controversial program at the Texas Railroad Commission. In the Commission's case, however, it's gas rates going up, not taxes.

The Gas Reliability Infrastructure Program, or GRIP, allows monopoly utilities to hike rates even if the company's overall expenditures are on the decline, or even if its revenues are increasing. Under GRIP rules, a utility need only claim extra investment associated with one part of its business — capital costs associated with infrastructure — and then it can obtain a rate hike. The agency's elected commissioners grant these allegedly interim hikes as a ministerial act without consideration of the utility's overall revenues, without consideration of offsetting savings in other areas of the utility's business — without even consideration as to whether the infrastructure investments are prudent. Unlike a more traditional rate case, there is no avenue in a GRIP case to prevent a utility from charging ratepayers for unwarranted utility expenditures.

GRIP, which was created in 2003 by the Texas Legislature, allows gas utili-

ties to hike rates in this fashion once a year, for up to six years. At the end of that period, the utility is required to submit to a comprehensive rate case. What does this mean for ratepayers? Consider that in the case of Atmos Pipeline, the North Texas gas provider, city gate meter charges associated with its transmission system have gone up nearly 2,200 percent because of GRIP rules. That's from \$200 in 2003 to \$4,370 in 2010. Hundreds of these meters are spread throughout the North Texas Atmos system. The costs are ultimately borne by the company's roughly 1.5 million customers of Atmos Mid-Tex in the North Texas region around Dallas and Fort Worth.

How do gas utilities justify these GRIP rules? First, they claim that such quick rate hikes allow utilities to more efficiently manage their infrastructure investments, which they count as a benefit to consumers. More specifically, the utilities claim the GRIP program reduces so-called "regulatory lag," which is that period of time between when a utility makes infrastructure investments and when it would receive reimbursement for them through rate hikes.

But note that no actual *consumer* group makes such arguments. Utilities already have a duty and incentive to make investments in the system — no further regulatory incentive should be required. Moreover, consumers know that rather than encouraging efficiency, rapid GRIP reimbursements instead encourage bloated spending. Leading economists also note that far from being a bad thing, regulatory lag actually encourages utility efficiency. This is because utilities always will seek to check their expenditures during the lag

“Prior to the adoption of the GRIP statute in 2003, the Texas Railroad Commission ordered only one rate increase in 20 years for the customers served by Atmos or its predecessors. In the seven years since, there have been 18 rate increases. Some were through the GRIP process, some through a separate but related process, and some through major rate cases.”

period. “Freezing rates for the period of the lag imposes penalties for inefficiencies ... and offers rewards for (the) opposite,” writes Dr. Alfred Kahn, author of *The Economics of Regulation*.⁵⁵ But such efficiencies disappear if utilities know they can rapidly hike rates every time they increase their infrastructure spending.

Utilities also claim that the GRIP statute reduces the necessity of more full-scale rate cases. But this is a misreading of history. Prior to GRIP, municipalities and the gas utilities commonly reached settlements without the expense or necessity of going forward with complete rate cases. But with the establishment of GRIP, rate cases are mandated at roughly six-year intervals and can come even more frequently because municipalities have no other way to obligate the Railroad Commission to review major utility expenditures than to initiate “show cause” rate cases.

The experience of Atmos and its predecessor utilities in North Texas is a good case in point. Prior to the adoption of the GRIP statute in 2003, the Texas Railroad Commission ordered only one rate increase in 20 years for the customers served by Atmos or its predecessors. In the seven years since, there have been 18 rate increases. Some were through the GRIP process, some through a separate but related process, and some through major rate cases.

The gas utilities also claim that consumers who end up getting overcharged under GRIP will get reimbursed later, after the utility submits to a full-blown rate case. The problem here is that gas utilities can go for years without a thorough review. In the meantime, consumers get stuck paying inflated rates, and the utilities rake in millions in excess profits. Inherent inefficiencies with GRIP, such as those associated with the regulatory lag issue, also make it unlikely that consumers ever will be made whole. Another problem relates to the long time gap created by the process between the moment when a utility incurs an expense and when that expense comes under regulatory review. Because of this long gap created by the GRIP process, determining whether the expense has been incurred prudently can be extremely difficult.

Neither do the GRIP rules include any parallel mechanism that would allow consumers to demand rate cuts should a utility’s infrastructure expenditures suddenly decline. For these and other reasons, consumer groups have uniformly opposed these ratemaking schemes. They have argued that, like the state budget, it’s important for policymakers to consider the totality of expenses before reaching into the public’s pocket. Consumer groups understand that GRIP can only increase bills and hurt business.

THE GAS RELIABILITY INFRASTRUCTURE PROGRAM: By the Numbers

18

The number of rate increases received by Atmos Mid-Tex since the implementation of the GRIP statute (includes increases through distribution and pipeline system GRIP cases, Rate Review Mechanism cases and general rate cases).^{vii}

1

The number of system-wide base rate increases received by the North Texas gas utility (previously known as Lone Star Gas, which was acquired by Texas Utilities and then Atmos) authorized by the Texas Railroad Commission in the 20 years prior to the implementation of the GRIP statute.^{viii}

7

The number of consecutive rate increases for Atmos Pipeline under the GRIP statute prior to the filing of a general rate case, where the seven increases could finally be evaluated for reasonableness.

2,200%

The amount Atmos pipeline meter charges increased without meaningful review from the Texas Railroad Commission under the GRIP statute.

11

The number of GRIP cases from Atmos Energy affiliates considered by the Texas Railroad Commission since 2003.



^{vii} Calculation includes 13 GRIP filings for the Atmos pipeline system and/or the Atmos Mid-Texas distribution system between 2003 and 2010 (Gas Utility Docket Numbers: 9560, 9615, 9658, 9734, 9802, 9961, 9964, 9726, 9788, 9855, 9950) and the following major rate cases: GUD: 9400, 9670, 9762 and 9869.

^{viii} References consolidated case 9145-9148 from 2000, and case 8664 from 1997, in which the utility was ordered to lower rates by \$5 million annually.

A Short History of the GRIP



State lawmakers authorized the GRIP statute in 2003 in the hope that it would encourage gas utilities to make infrastructure investment for safety and reliability purposes. GRIP was intended to encourage utility investment by allowing the companies to immediately receive a return on their investment without having to file a general rate case. In theory, the interests of ratepayers would be protected by requiring utilities to report their earnings on an annual basis and by requiring utilities to submit to a general rate case in approximately five-year intervals. The Legislature amended the GRIP statute in 2005.

GRIP has led to successive, un-reviewed rate increases and windfall utility profits. It has encouraged bloated and wasteful spending of ratepayer money. Utilities have attempted to use GRIP to accelerate the recovery of expenses not related to system reliability or safety — including expenses relating to furniture, food, travel for company executives, office supplies and art work.⁵⁶ By availing itself of GRIP, one utility increased meter charges by 2,200 percent in the course of just six years. The Railroad Commission failed to conduct any meaningful review of these increases. Courts have interpreted the GRIP statute to mean that the Legislature intended for the Commission to rubber stamp a GRIP rate request.

Also, because the courts and the Railroad Commission have determined that no meaningful review of GRIP filings can occur without a general rate case, the GRIP statute has led to more — not fewer — cases. Consider that there were only two major rate cases for the principal gas utility in North Texas in the two decades prior to the implementation of GRIP. One of these rate cases resulted in a \$5 million a year rate cut for consumers. But in the years since, there have been three major rate cases and no fewer than 11 GRIP cases. The Texas Railroad Commission rubber stamped the rate increases in each of the GRIP cases.

In 2007, the Atmos Cities Steering Committee negotiated an alternative procedure in lieu of GRIP called the Rate Review Mechanism, or RRM for short. Participating cities judged RRM necessary on a trial basis in order to end the piecemeal approach to ratemaking inherent to GRIP. Cities agreed to the annual expedited rate review the utility desired, but expanded the review to include revenues and expenses in addition to capital investments. But the RRM offers cities only limited protection against hikes associated with gas distribution systems within city limits and absolutely no protection for hikes associated with gas pipeline systems located outside city limits, which still file GRIP cases. The RRM has mitigated some of the most frustrating aspects of the GRIP statute, but still leaves consumers vulnerable to annual rate increases. It is an imperfect solution, at best.



Policy Spotlight III

THE NAME GAME

Public Confusion Over the Texas Railroad Commission

FINDINGS

- *The Texas Railroad Commission is one of the most misunderstood agencies in Texas government. Many Texans are unaware that the agency does not actually regulate railroads, but does control natural gas rates.*
- *The Commission has done a poor job of clearing up this confusion. There is insufficient mention of its lack of jurisdiction over railroads on the Commission website, and insufficient references to its authority over home natural gas rates.*
- *This confusion benefits the industry because it allows the Commission to act outside most public scrutiny.*
- *The press and public interest groups have historically paid relatively little attention to the Railroad Commission, instead devoting most attention to the separate Texas Commission on Environmental Quality and the Public Utility Commission of Texas.*

“There are several reasons for the public’s confusion about the Railroad Commission, not the least of which is its misleading name. The Texas Railroad Commission does not regulate railroads. It was created in 1891 with authority over the rates and service of rail operators, but that authority has gradually been eliminated.”



One of the principal roles served by the Texas Railroad Commission — and one that seems to have escaped the attention of much of the public — is that of rate regulator. The Commission is charged with reviewing filings by regulated natural gas utilities and approving rates. It is an important role, and yet the public’s confusion over the Railroad Commission has allowed the agency to carry out this function with relatively little public scrutiny. Even candidates for commission seats have expressed confusion about this important function. In 2008 one candidate erroneously told a newspaper reporter: “When you think about it, they don’t control rates in the cities.”⁵⁷

There are several reasons for the public’s confusion about the Railroad Commission, not the least of which is its misleading name. The Texas Railroad Commission does not regulate railroads. It was created in 1891 with authority over the rates and service of rail operators, but that authority has gradually been eliminated. It surrendered its last bit of that authority to the Texas Department of Transportation in October 2005.⁵⁸

But the Railroad Commission has not done enough to dispel this confusion. For example: there is nothing on the homepage of the agency’s website that clearly indicates that it has no authority over railroads.⁵⁹ Moreover, a “Frequently Asked Question” page on the website includes an entry devoted entirely to activities the Commission DOES NOT regulate. But nowhere in this entry is there a reference to its lack of regulatory authority over railroads. Instead, roads, traffic,

noise, odors and royalty payments are listed under the heading “What does the Railroad Commission NOT have jurisdiction over?”⁶⁰

Citing such ongoing confusion, then-Rep. John Whitmire proposed legislation in 1979 to change the name to the Texas Energy and Transportation Commission.⁶¹ In more recent years, lawmakers have proposed changing it to the “Texas Energy Commission.”⁶² In each instance this common-sense legislation has failed, largely the result of behind-the-scenes industry pressure. The fact that the industry has opposed such legislation constitutes *prima facie* evidence that the industry benefits from the confusion. This cannot be good news for consumers.

A review of newspaper articles over the last decade also suggests a general downward trend in media interest in the agency, with a high of 264 stories by the major Texas dailies in 1997 to just 88 stories in 2009.⁶³ Because of changes in the media industry, far fewer media outlets cover the agency (as compared to coverage in decades past), and those news outlets that do cover the Railroad Commission generally have fewer resources to do so. Currently, no reporter from any major news outlet in Texas covers the Texas Railroad Commission on a full-time basis.

Neither has the agency been a top priority for consumer or environmental groups, which typically have devoted more resources to the Texas Commission on Environmental Quality (previously the Texas Natural Resources Commission) and the Texas Public Utility Commission.



Policy Spotlight IV

PIPELINE SAFETY

Deadly Accidents, Spotty Response

FINDINGS

- *The agency waited more than a decade after receiving the appropriate authority to assess its first fine for a safety violation relating to a pipeline accident. Subsequent fines were comparatively small.*
- *The number of pipeline inspections has decreased during recent years. Less is spent in Texas on a per-mile basis for pipeline safety than is spent in other states.*
- *The Commission has initiated only a limited number of enforcement actions against oil and gas producers found to have been out of compliance with state regulations and records appear to be inadequate.*
- *The Commission does not post enforcement data online in a manner that is easily accessible to the public.*



On March 18, 1937 a school house exploded in New London, Texas, killing 293 students, teachers and visitors. An investigation determined that natural gas had accumulated beneath the building, the result of a leak from a faulty connection. But because natural gas was then odorless, none of the teachers or students had the slightest warning. In response to the horrific New London accident, the Texas Legislature adopted House Bill 1017 that allowed the Texas Railroad Commission to order the odorization of natural gas.

Although the New London explosion is remembered today as one of the most serious natural-gas related accidents in Texas history, it would be by no means the last. The increased use of natural gas in suburban homes following World War II brought with it more accidents — many of them fatal. Industry leaders mounted public relations campaigns to assuage consumer fears about the safety of gas appliances.

Texas has the largest pipeline infrastructure in the nation, including 97,800 miles of natural gas distribution lines and 76,487 miles of hazardous liquid and natural gas transmission lines.⁶⁴ Oversight of these two categories of pipeline falls directly to the Texas Railroad Commission. Unfortunately, the agency's record in this area has been mixed. For instance, the agency went for years without levying a single fine for a gas pipeline safety violation relating to an accident, despite having been granted the authority to do so. The acceptance by commissioners of political donations from utilities under investigation for fatal accidents also has eroded confidence in agency decisions. The Railroad Commission also has faced criticism that it has not responded quickly enough to reports of unsafe pipelines. The number of safety inspections has decreased during the past decade.

However, the Commissioners have received high marks in recent months for their efforts to force replacement of aging steel service lines in the Atmos Mid-Tex system.

The History

House Bill 1017, the legislation adopted in response to the New London explosion, marked the Texas Legislature's first important directive to the agency regarding natural gas safety issues. But while HB 1017 authorized the Commission to odorize natural gas, it did not direct the agency to assume the more extensive oversight role it possesses today. Instead, that authorization was assumed over a number of years. In 1951, for instance, the Legislature adopted a law directing the Commission to establish safety rules relating to liquefied petroleum gas.⁶⁵ The agency's pipeline safety division began enforcing safety rules during the 1970s relating to the safe transmission and distribution of natural gas.⁶⁶ It was during this period that the agency ordered the temporary shutdown of several municipally-owned gas utility systems for safety reasons — including systems in Daisetta, Huntington, Tenaha and Hemphill.⁶⁷

In 1983, the Legislature gave the agency authority to assess fines for safety violations.⁶⁸ But, here, however, the agency's record becomes mixed. It would be more than 15 years before the Railroad Commission would assess any fine in relation to a pipeline accident — even though on several occasions it appeared fines may have been warranted.⁶⁹ In 1992, for instance, a gas explosion near Brenham killed three people and injured another 21. The company that owned the gas pipeline had been cited repeatedly for violations of inspection rules, but the agency never fined the company for those violations.⁷⁰

The Commission merged its gas utility activities with its gas transportation program during the early 1980s. It charged the newly created Transporta-

tion/Gas Utilities Division with ensuring a continuous, safe and reasonably priced supply of natural gas. In 1997, the agency adopted new pipeline enforcement rules. It was only then, more than a decade after being granted such authority from the Texas Legislature, that the agency began assessing fines for safety violations that contributed to an accident. But even then, they were relatively infrequent. For instance, the agency assessed fines in as few as five percent of the reported pipeline incidents it received between 1998 and 2004. And none of the fines during that period exceeded \$225,000 — an amount that fell far short of the top fines assessed by the Railroad Commission's sister agency, the Texas Public Utility Commission.⁷¹

During the 2000s, the Texas Railroad Commission came under fire for its safety record relating to so-called "Poly 1" pipe, which had been found to be unsafe. The North Texas gas utility had begun installing Poly 1 pipe in North Texas during the 1970s, but then almost immediately learned that it was prone to cracking. The utility began efforts to remove the pipe later in the decade. But the Commission claimed it had remained completely in the dark about problems with Poly 1 until 1983, when an explosion killed a 21-year-old woman in Terrell, Texas.⁷² In response, the Commission secured an agreement with the utility to shore up the pipe with clamps. But the Commission waited another 17 years before it would order the pipe out of the ground, and then only after another fatal explosion.⁷³ The Commission also fined the company \$250,000.⁷⁴ The agency faced criticism for not acting sooner.

Another controversial case in-

volved a 2006 explosion that killed an elderly couple in Wylie. According to documents produced in a lawsuit, a top commission staffer changed the report from one of her investigators in such a way as to shift blame away from the utility’s use of a controversial pipe coupling.⁷⁵ The Commission investigator also originally recommended that the Railroad Commission should “immediately ask all Texas gas companies to develop an ‘expedited’ plan to get the old couplings out of the ground,” but that reference also was removed from the report.¹³ The investigator’s supervisor denied that her decision was based on outside influence by the company or by the agency’s elected commissioners.⁷⁶ The *Dallas Morning News* reported that regulatory agencies in other states had been quicker to take corrective action in such cases.⁷⁷

In recent years, pipeline safety inspections have decreased in Texas. According to Railroad Commission data, there were 2,639 inspections performed in 2001, versus 2,171 in 2009 — a decrease of more than 17 percent.⁷⁸ There’s also less spent in Texas for pipeline safety, on a per-mile basis, than that spent in adjoining states such as Oklahoma and Louisiana. In New Mexico more than twice as much was spent in 2008 on a per-mile basis, according to Railroad Commission data.⁷⁹

The Commission also has initiated only a limited number of enforcement actions against oil and gas producers found to have been out of compliance with state regulations. For instance, less than four percent of more than 80,000 oil and natural gas production-related violations in 2009 were forwarded to the agency’s central office for enforcement action. That’s in contrast to the Texas Commission on Environmental Quality, which referred for enforcement about 20 percent of its violations.⁸⁰ Pipeline companies found to have violated safety rules in 2008 were fined, on average, just \$18 per violation.⁸¹

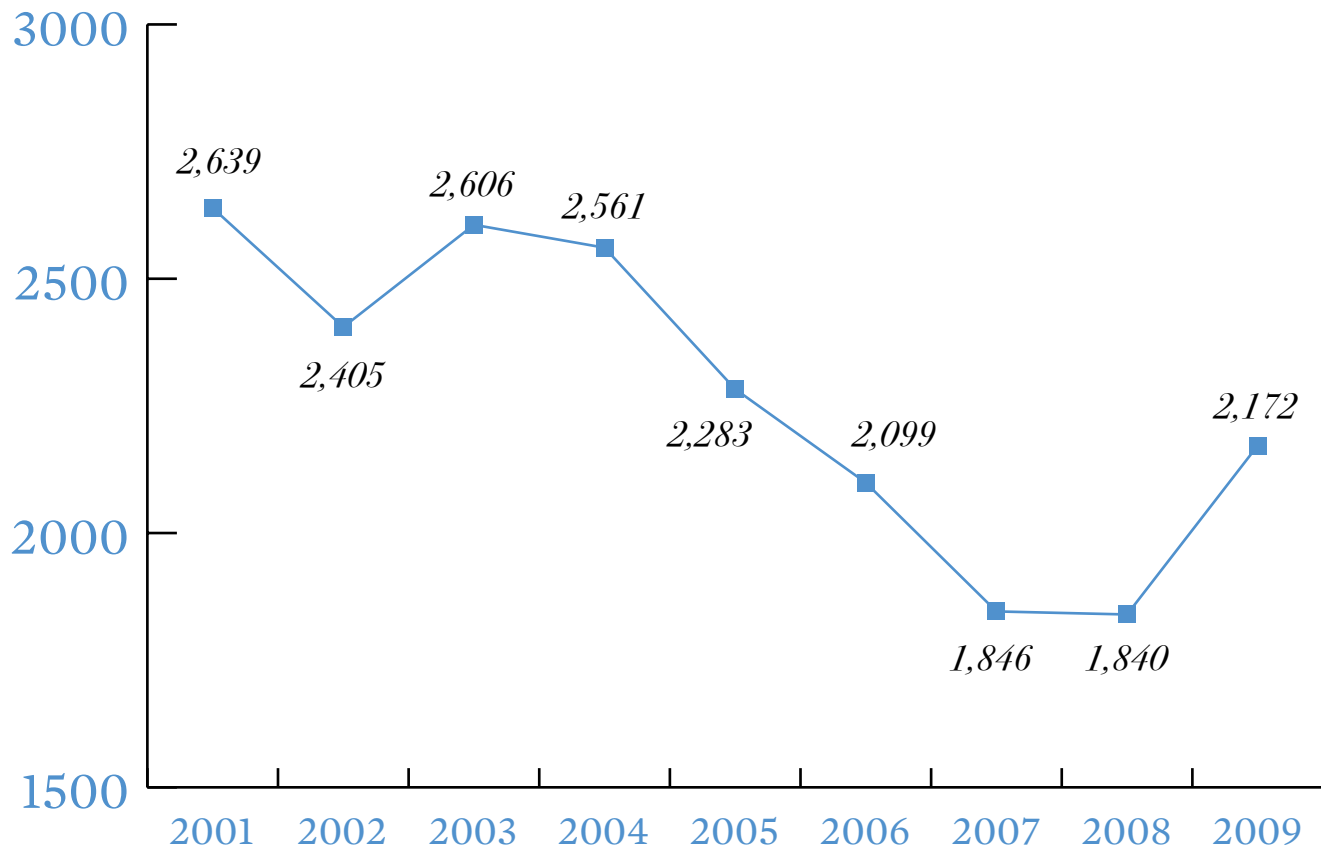
Records also appear to be inadequate. Although staff is expected to document all violations, the Commission in most cases does not specifically track those entities responsible for repeat violations. An independent report also has found that the agency does not track rules violations in a way that allows it to gauge the effectiveness of its enforcement actions.⁸² “A lack of consistent enforcement can contribute to a public perception that the Commission is not willing to take strong enforcement action,” noted a November 2010 report by staff for the Sunset Advisory Commission, a legislative panel. “In addition, the Commission does not post its enforcement data in a manner that is easily accessible to the public, making it difficult for the public to find information on the Commission’s enforcement actions.”⁸³

Pipeline Safety State Comparison

STATE	2008 PIPELINE SAFETY EXPENDITURES	PIPELINE MILEAGE	COST PER PIPELINE MILE
Oklahoma	\$1,178,097	36,989	\$31.85
Louisiana	\$1,614,761	45,803	\$35.25
New Mexico	\$864,228	17,998	\$48.02
Texas	\$3,634,600	179,567	\$20.24

Source: Strategic Plan for the Fiscal Years 2011-2015, Texas Railroad Commission, June 18, 2010

Number of Pipeline Safety Inspections Performed



Source: Strategic Plan for the Fiscal Years 2011-2015, Texas Railroad Commission, June 18, 2010

The Texas Legislature has granted the Commission regulatory authority over damage prevention laws relating to earth excavation near pipelines. However, that authority extends only to pipelines that begin and end within Texas, and no similar state or federal program exists for the oversight of roughly 80,000 miles of interstate pipelines in Texas.⁸⁴ The Commission reports that about three-fourths of pipeline incidents in Texas can be attributed to third-party damage, such as that from excavations.⁸⁵ Some media reports also have questioned whether the Commission is overly tolerant of errors in routing maps submitted by pipeline operators — especially given that the agency rates maps as “good” if they are within 301 to 501 feet of being accurate.⁸⁶ Agency spokeswoman Ramona Nye has responded by noting that “maps are not intended nor should they be used as a resource to find a pipeline before digging, as the law requires a call to 8-1-1 to notify the One Call System of excavation plans.” The agency also has launched a program to levy fines for mismarking pipelines and for not calling 8-1-1.⁸⁷

Most recently the Commission has confronted issues relating to steel service lines that connect to North Texas homes. The steel service lines went into service in North Texas beginning in the 1950s and have been linked to a 2009 blast in Mesquite as well as other explosions. In 2010 cities negotiated an agreement with the utility to implement an orderly process for removing the pipe from the north Texas system.

APPENDIX I:

A Timeline of Natural Gas Regulation in Texas

- **1891** – Founding of Texas Railroad Commission. It begins as an appointed panel.
- **1893** – Voters adopt constitutional amendment calling for election of railroad commissioners.
- **1909** – Through a process of mergers and acquisitions that begins this year, Lone Star Gas emerges from several separate entities into the largest natural gas utility in the state.⁸⁸
- **1917** – The Railroad Commission gains authority over pipelines with the passage of the Pipeline Petroleum Law (Senate Bill 68, 35th Legislature, Regular Session). This was the first act designating the Railroad Commission as the agency to administer conservation laws relating to oil and gas.⁸⁹
- **JUNE 18, 1919** – Legislature adopts the Oil and gas Conservation law (Senate Bill 350 of the 35th Legislature, Regular Session) giving the Commission jurisdiction over the production of oil and gas.⁹⁰
- **JUNE 1920** – Railroad Commission receives authority over natural gas rate regulation. The Gas Utilities Act of 1920 (House Bill 11, 36th Legislature, 3rd Called Session) gave the Commission regulatory and rate authority over individuals and businesses producing, transporting, or distributing natural gas in Texas.⁹¹
- **MARCH 18, 1937** – Disastrous accident involving natural gas occurs in New London, Texas. In response, the 45th Legislature enacts House Bill 1017 that grants the Railroad Commission the authority to adopt rules and regulations pertaining to the odorization of natural gas or liquefied petroleum gases.⁹²
- **1940s** – Amarillo Gas and West Texas Gas fuel new army camps, air force bases and defense plants during World War II.⁹³
- **1950s** – Economic expansion and increased consumer spending during the post-World War II years leads the gas industry to promote the use of natural gas appliances in homes.
- **LATE 1970** – The Gas Utilities Division’s pipeline safety section gains responsibility for enforcing safety rules and regulations governing the transmission and distribution of natural gas throughout the state. Personnel based in field offices evaluate the design, construction, operation, and maintenance of natural gas and hazardous liquid facilities. The emergency procedures of pipeline companies are also reviewed.⁹⁴
- **DECEMBER 1977** – The Commission orders \$1.6 billion in refunds to municipal and industry customers of LoVaca Gathering Company, which had found itself unable to meet the terms of its long-term gas supply contracts.⁹⁵
- **1983** – The Texas Legislature grants the agency authority to assess fines for safety violations relating to natural gas pipe.⁹⁶

- **OCTOBER 1985** – The Pipeline Safety section begins its hazardous liquids safety program.⁹⁷
- **LATE 1980S** – the Commission’s gas utility activities and transportation programs are brought together as the Transportation/Gas Utilities Division. The job of the new division is to ensure a continuous, safe supply of natural gas at just and reasonable prices.⁹⁸
- **1997** – The Railroad Commission creates new enforcement guidelines for pipeline safety. This occurs 16 years after receiving authority to do so from the Texas Legislature.⁹⁹
- **MAY 1997** – The Railroad Commission approves a \$5 million rate decrease for the North Texas gas utility. The agency’s own hearing examiners had recommended an \$89 million cut. This is the last rate reduction that the Commission will ever authorize for the north Texas utility.¹⁰⁰
- **DEC. 15, 1998** – Railroad Commission assesses first fine ever for a pipeline safety violation, a \$7,500 penalty against Entex. This is 17 years after being granted the authority to do so. The agency receives reports of 40 to 80 pipeline incidents each year, according to the Commission.¹⁰¹
- **2003** – Under heavy industry pressure, the Texas Legislature adopts legislation that creates the so-called Gas Reliability Infrastructure Program. The law opens the door to repeated, unchecked price hikes by the utility companies.
- **2004** – Gas rates are consolidated across an entire utility system for the first time. Previously, rates were set in a more granular fashion among separate cities.¹⁰²
- **2005** – The Texas Legislature updates the Gas Reliability Infrastructure Program. The Texas Railroad Commission surrenders its last bit of authority over railroads to the Texas Department of Transportation.
- **2007** – The Railroad Commission’s hearing examiners recommend a \$23 million rate decrease for Atmos Energy. The Railroad Commission instead adopts an \$11 million rate increase.¹⁰³
- **2008** – The Railroad Commission’s hearing examiners recommend a \$13 million rate increase for Atmos Energy. The Commission instead adopts an increase that is \$7 million greater.¹⁰⁴
- **MAY 2010** – Railroad Commissioner Michael Williams proposes the replacement of about 2.2 million steel service lines that provide gas service.
- **2011** – The Texas Railroad Commission faces legislative review by the Sunset Advisory Commission.

CITATIONS

- ¹ Railroad Commission website: <http://www.rrc.state.tx.us/about/faqs/gasratesfaqs.php>.
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