



Comments of Jerry Jordan
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Before the
Milton Marks "Little Hoover" Commission
On
California State Government Organization and Economy

On The

Energy Agency Reorganization Plan
May 25, 2005

Thank you for the opportunity to submit the views of the California Municipal Utilities Association (CMUA) on the Governor's plan to reorganize the state's energy agencies.

CMUA is a statewide association of publicly owned electric water and gas utilities. Included in our membership are 35 of the State's 36 publicly owned electric distribution systems and three large joint powers agencies which own and operate power plants and major transmission lines. Many of our member agencies have been providing electricity in California for more than 100 years. We have worked with the California Energy Commission (CEC) since its creation in 1974, and lately have been working a lot more with the California Public Utilities Commission (CPUC) than we would prefer since we are not subject to their jurisdiction. CMUA was actively involved in the creation of a regional transmission planning organization the Western Regional Transmission Association (WRTA), as well as negotiations that lead to the state's ill fated electricity reorganization legislation, AB 1890. CMUA, and its member agencies, actively participated in the Western Energy Power Exchange (WEPEC) Technical Advisory Committee which eventually led to the creation of the California Power Exchange (PX) and the California Independent System Operator (ISO). We supported the legislation creating the California Power Authority (CPA) because at the time it was not clear that the Investor Owned Utilities (IOUs) were going to be healthy enough to build sufficient generation resources. CMUA has actively participated in all of the proceedings of the Federal Energy Regulatory Commission (FERC) dealing with the California market issues and the ISO.

When AB 1890 was passed the Legislature recognized the value of local control and left decisions on resource portfolios and competitive structures to local elected officials who regulate publicly owned utilities. They all decided to remain vertically integrated utilities, providing generation, transmission, and distribution services necessary to serve their customer/owners. As a result, although publicly owned utilities were not immune to the impacts of the western market, they weathered the energy crisis in much better shape than did the state regulated IOUs. CMUA members never embraced the "market will provide" philosophy. They recognized early on that the market structures put in place by AB 1890 and encouraged by the Federal Energy Regulatory Commission were failing to build either power plants or transmission lines needed to serve California business, industry and residences. Publicly owned utilities, however, have continued to build electricity infrastructure to meet their customer's needs.

The Commission has asked us to address the following three questions:

- What are the State's greatest challenges in developing a cohesive energy policy? How does the State's organization structure impede or enable the resolution of those challenges?
- Does the Governor's proposed reorganization plan solve these structural deficiencies? Does the plan create any new challenges for developing and implementing a cohesive energy policy?

- What impact might the new organization structure have on the price and reliability of energy in the state? How will the structure affect the ability of municipal utilities to provide reliable and efficient energy?

CMUA supports the goals of the plan to eliminate overlaps and conflicts among state agencies; the proposal may help streamline some decision making. As CMUA responds to the enumerated questions, it will be clear in many instances that while we support the reorganization plan, we believe that other important issues must be addressed in order to restore order to the electricity industry in California.

What are the State's greatest challenges in developing a cohesive energy policy? How does the State's organization structure impede or enable the resolution of those challenges?

The State's greatest challenges on energy policy are developing a clearly stated plan that has political backing from all relevant areas of government, including the Legislature and the Executive. The lack of agreement on state energy priorities and direction means conflicting signals to the electric industry and the investment community about policy direction, and creates policy vacuums that are quickly filled. Right now, the vacuum is being filled in part by a not-for-profit corporation, the California Independent System Operator (ISO), thrust into a policy development role in the absence of checks and balances provided by a functional state policy apparatus. These are issues that, for some reason, have been difficult ones on which to initiate a constructive discussion, let alone solve. Yet, without an active policy debate, the Plan will not reach its full potential of setting California on a sound and constant course toward its energy future.

The California ISO: The ISO policies have tremendous impact on California consumers, yet it is not-for-profit private corporation with little oversight by the Legislature. Without direction by the Legislature, the ISO, which operates transmission serving about 70% of California, has the ability to embark on expensive market designs with no real policy direction. While it is true that the ISO board is now appointed by the Governor and confirmed by the Senate, in fact the ISO remains a staff run organization because it is involved in highly technical issues that any part-time Board would find difficult to master. When the Board and Managers are fully informed and engaged, things may work well. However, sound organizational structures with checks and balances need to be in place to assure that policy survives the vagaries of human institutions. Even if any given market decision turns out to be right, the process of letting a relatively unaccountable private corporation impact the electric consumers to such a degree is not good public policy.

The Commission will not find the ISO in the state's energy organizational structure in any official capacity. That is a problem that the Reorganization Plan should tackle.

Market Structure: California now appears to be somewhere between encouraging retail competition and returning the IOUs to an obligation to serve; the Legislature has not

made either decision. As a result of this policy indecision, the CPUC is trying to implement the previous direction of the Legislature to procure sufficient resources to serve the load, sometimes supporting a return to direct access, and trying to encourage further investment through the independent energy production industry. This mishmash of policy direction serves no one well, and is actually hampering the development of needed infrastructure. In the meantime, the ISO is irretrievably committing tens of millions of dollars to take the state into a market design advocated by FERC that has a questionable track record and has yet to produce sustained consumer benefit anywhere it has been implemented.

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Transmission: Nearly everyone in California recognizes the need for additional high voltage transmission. While the Governor’s Plan streamlines the jurisdictional issue for IOUs and may result in improvement in the siting of jurisdictional transmission lines, the real problem is not addressed by the Plan. Because the ISO sets the rules for access to the relevant transmission facilities, transmission investment signals will not be correct unless the rules of the ISO are correct. This inescapable link between federal transmission pricing policy and state energy policy cannot be ignored if California hopes to right the electric industry ship. CMUA is concerned that the ISO’s rules emphasize short term objectives at the expense of long term price certainty, and will not create the stable environment necessary to justify the 30 year or greater outlay of capital necessary to investment in transmission.

Generation: Publicly owned utilities continue to build generation to meet the needs of their customer/owners. Based on state agency forecasts, it appears that the current indecision on market structure and procurement issues has thwarted the investment in generation necessary to serve IOU or energy service provider customers.

Does the Governor’s proposed reorganization plan solve these structural deficiencies? Does the plan create any new challenges for developing and implementing a cohesive energy policy?

As stated above, CMUA supports the Governor’s Plan to refocus the efforts of energy agencies in the state of California. The Plan is a first step that may provide the policy making framework to solve the hard issues facing California’s energy industries. CMUA is concerned that the Plan does not go far enough and fails to deal with important reforms necessary to return health to the state’s electric utility industry. The Plan, however, does have potential for dealing with some of the policy and regulatory conflicts which have developed over many decades.

The Plan is a good first step in rebuilding the California electricity industry. CMUA’s specific comments on the Plan are as follows:

- **Electricity Regulation (Transmission):** While ratemaking authority is not changed, the most significant restructuring which is included in this proposal is

transferring the authority to site major transmission lines from the PUC to the CEC. The CPUC record on transmission has not been impressive. The lack of new transmission is not the result of a lack of planning, but a failure of the regulatory and market structures in California. CMUA does not believe that changing the jurisdiction alone will create new transmission. Unfortunately, the current market does not provide adequate incentives to build transmission. Specifically, we do not believe that the move by the California Independent System Operator (ISO) to a market structure that is built around short term markets and development of complex systems to allocate the current scarcity is likely to result in necessary transmission investment.

- **Energy Efficiency Programs:** Placing administration of energy efficiency, building standards and appliance efficiency setting standards in the policy making DOE makes sense.
- **Forecasting :** Electricity forecasting is currently a CEC function which would be transferred to the new DOE's Division of Energy Analysis. As mentioned elsewhere, we believe that the siting function of the current CEC should remain independent of the new DOE. Separating the agency responsible for the forecasting function from that responsible for siting decisions makes sense. We support housing forecasting at the DOE and siting at an independent Siting Board.
- **Market Oversight:** The plan would transfer market oversight and monitoring from the Electricity Oversight Board to DOE. Market oversight is not a function that can be adequately performed at the state level. The electricity market is region wide throughout the western United States. We believe it is up to Congress and FERC to develop an appropriate market monitoring mechanism.
- **CERS:** The power contract management functions of the states contracts to bail out the IOUs would be transferred to the new DOE. We support that change.
- **FERC Representation:** The state is theoretically represented by the Electricity Oversight Board on FERC issues. In actuality the CPUC, the Oversight Board and the ISO all claim to represent California. At times, the Attorney General has also participated, as has the Legislature. While the EOB functions will be transferred to the new DOE it is not yet clear that the other agency involvement will be curtailed. This may still result in conflicting state positions in front of FERC.
- **Major Plan Deficiency:** We believe it is a mistake to mix power plant siting decisions with policy development. The possible conflicts of interest between advocating policies and adjudicating power plant applications are simply too great. CMUA believes that the siting functions of the current Energy Commission should remain independent of the DOE. As we will explain below, we believe that significant reform of the current siting process is advisable and possible, which we will detail later in this document.

- **Issues Not Covered in the Plan:** While CMUA and its members support the goals of the Plan, we do not think the Plan is sufficient to improve the crippled electricity industry in California. There are issues that need to be addressed, either as elements of the plan or in trailer legislation in the very near future

- **Energy Commission Siting Reform**

California's publicly owned utilities have had several experiences with siting power plants at the CEC and worked through that process. Over the last 30 years, however, the Commission staff has been granted the status of an independent intervener in power plant siting cases. Frankly, this has resulted examples where, although plants are sited and built, delays are attendant and costs are increased. One still hears frequent examples of plant delays due to disputes over landscape design, fence paint color, or the germination rate of planted grass seed. Disputes of this type are the result of a lack of political accountability introduced into Commission processes, resulting in inadequate checks and balances on the entrenched bureaucracy. This is not good public policy and it introduces delay and expense to power plant development. CMUA believes this bureaucracy is the result of previous decisions to allow the staff to present their own alternatives in siting cases and to be granted intervener status. The plan while it is increasing efficiency of government should reform the siting process by providing that the CEC staff work at the direction of the presiding Commissioners in siting cases not as independent entities. A Public Advisor to available to assist real interveners.

- **ISO Reform: Issues of ISO accountability of symptomatic of the state's broader inability to coordinate policy implementation.**

When California passed the ill fated electric restructuring legislation in 1996, AB 1890, it created a very strange yet very powerful new institution, the ISO. Because there was a belief that markets were inherently good, there was no mechanism built into the legislation to adequately regulate the new institution that was created. The ISO is a non profit corporation which is not regulated by the state of California in any manner and is not effectively regulated by FERC. Although created by state statute, the Legislature has no oversight responsibility or ability to approve budgets or even to direct the policy decisions of the ISO. Yet the ISO operates the Control Area that delivers covers about 70% of the electric energy in California. Even FERC faces challenges to regulating the ISO. This is not a problem limited to California; FERC has established a rulemaking to wrestle with the problems it has encountered with cost containment and accountability with similar institutions in other regions of the nation. The FERC regulates utilities in much the same way as the CPUC; it disallows expenditures from the rates if they are not prudently incurred. By the time FERC examines decisions of the ISO, much of the money has been spent and any disallowance of costs would be illusory because there is no source from which to collect the costs but customers; it is the ultimate zero sum game. The result of this strange

structure is that FERC looks to the state to control the ISO, and the state looks to FERC.

This lack of effective oversight has led to a control area serving 70% of California that does not operate by the same rules and market practices as the rest of the control areas in the western United States, and has greatly escalated the cost of control area services. It is also embarking on a market design that has not been tested in the Western United States. Whether right or wrong, its market design is put forward without clearly stated policy direction from the State.

We commend the authors of the Plan for recognizing the importance of the ISO to the California electricity industry by providing a place for the ISO as an Ex Officio member of the Energy Commission. Unfortunately we do not think this is an appropriate role for the ISO as it is currently constituted.

Of course, change will be controversial and resisted. Some approaches to make the ISO an integrated and accountable part of the energy apparatus in California include:

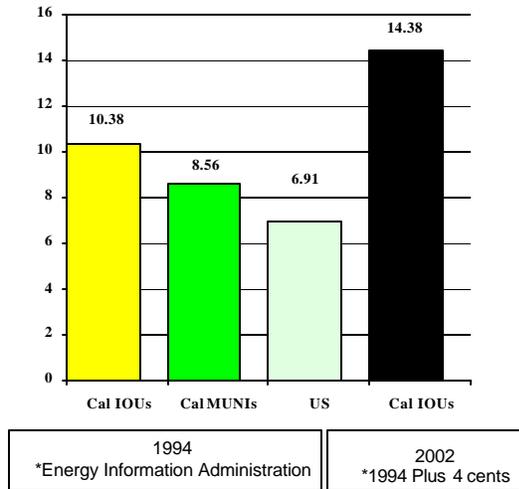
1. Transform the ISO into a public agency subject to the Brown Act, the Public Records Act and all other requirements of the Government Code. Publicly owned utility control areas have no difficulty serving the public and conforming to these laws.
2. Carefully define the roles of the ISO through statute, provide for Legislative budget review, and mandate that that Attorney General exercise its already broad powers to oversee not-for-profit corporations such as the ISO
3. An extreme, yet possible alternative is to instruct the ISO through legislation to return control of the Investor Owned Utilities (IOU) transmission to the IOUs if there is no other means of insuring accountability and State oversight.

We do not mean to suggest that the above measures are the only alternatives, but some means of providing meaningful state policy decisions and oversight to the current ISO structure must be found. While we are encouraged by the quality of the current ISO Board, accountability should not be dependent on the quality of the appointments. There must be mechanisms in place to insure that the ISO is responding to state policy, regardless of who the board members happen to be. The new Department of Energy and the Legislature need to have serious policy discussions about the direction of the ISO.

What impact might the new organization structure have on the price and reliability of energy in the state? How will the structure affect the ability of municipal utilities to provide reliable and efficient energy?

In the short term, we do not see that the proposed new structure will necessarily improve the price or reliability of the energy in the state. When California

restructured the electricity market it did so because of a perception that California's rate structure for IOUs was much higher than the national average:



Nothing in the Plan will prevent a future CPUC from making poor rate decisions or engaging in policy initiatives that go far beyond its responsibility to protect consumers. The restructuring failure grew out of a CPUC plan which it thought would lower the IOUs rates by replacing the obligation to serve with market forces. As is shown in the chart, the result was rates which were 40% higher than the rates when the CPUC adopted its infamous “Blue Book” which in turn led to the passage of AB 1890. While the plan does transfer some policy functions to the DOE, it does not prevent the CPUC from engaging in other policy initiatives similar to the one that led to the last crisis. The Plan should be accompanied by legislation directing the CPUC to stick to traditional ratemaking, not policy development.

The plan should not affect the ability of local elected officials to continue to meet their obligation to provide reliable electricity service at the lowest possible rates. The Plan has appropriately recognized that there is no need to change the current authority of publicly owned electric utility elected boards to decide resource and rate issues for their constituents. Local elected boards demonstrated their ability to effectively regulate their utilities in the interest of their customer/owners.

Conclusion

Reorganizing and consolidating the functions of the state’s energy agencies is an appropriate first step which should streamline regulatory processes. At the very least consolidation of the policy functions should prevent one energy agency from pointing the finger at another, and hopefully will result on the State being able to focus on issues as they arise in a more efficient manner.

As stated above, while CMUA is concerned that much more must be done, we recognize that the important issues may be beyond the realm of a reorganization plan. The test of the newly created Department will be when it tackles these thorny issues head on.