
STATE OF CALIFORNIA



**A Vision for
California's
Energy
Future**

DEPARTMENT OF ENERGY

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I. SUMMARY

Energy is fundamentally important to the welfare of California through its impacts on jobs, industry, consumers and the environment. That importance has grown over time. The State plays a central role in encouraging energy supply, transmission, and efficiency investments by: protecting the environment; responding to the challenges of increased U.S. and world-wide oil and natural gas prices; managing State natural gas and electricity purchase contracts; developing and supporting new energy technologies; aggressively representing state interests at the Federal level; coordinating regional energy policy with nearby states; providing energy information to Californians; and managing energy price and availability risks.

During this past year, the Administration has taken several steps to unify California's energy policy and foster competitive wholesale and retail electricity markets. The Administration has urged the California Public Utilities Commission (CPUC) to expeditiously and consistently implement the State's electricity procurement rules. The Administration has called upon on state regulators to accelerate resource adequacy requirements and work closely with the California Independent System Operator (CAISO) to implement reliability standards. The Administration has urged the CPUC to adopt the recommendations of the Energy Action Plan to require utilities to institute a loading order when planning for power needs.

However, there is still more that must be done. California needs a more comprehensive approach for energy policy development to reduce the level of regulatory uncertainty in the marketplace and attract the necessary investment in new resources and energy infrastructure required to meet future demand. Recognizing that the State's energy infrastructure does not stop at its borders, California must coordinate with neighboring states to ensure that there is adequate electricity, natural gas and transportation fuels to meet the region's needs.

The issue of consolidating energy regulatory and policy functions has been discussed since the creation of the Energy Resources Conservation Development Commission (Energy Commission) in 1974. The California Legislature in a 1989 Senate Concurrent Resolution stated that the existing regulatory system has "resulted in significant fragmentation, duplication, overlap and confusion in the formulation and execution of state energy related functions."¹

In recent years, several efforts to consolidate various state energy agencies have been advanced. In 1995, Governor Wilson sought to consolidate the Energy Commission with elements of the Department of Conservation into a Department of Energy. In recommending that the plan be implemented, the Little Hoover Commission declared the proposal to be "an important opportunity to align similar functions so that increased efficiency, effectiveness and accountability are achieved."²

¹ SCR 7, 1989

² *Review of Governor's Reorganization Plan No 1*, Little Hoover Commission, March 1995. Available at <http://www.lhc.ca.gov/lhcdir/131rp.html>

The Public Policy Institute of California observed in 2003 that the restructuring of the electricity sector, followed by an energy crisis, has led to an ad hoc and confusing mix of state agencies and departments. The Institute stated that the fractured and overlapping set of agencies leads to inefficiencies and conflicts, and concluded that state energy policy has lost its coherence because elements of devising energy policy are addressed in many separate forums. In a field where optimal coordination is absolutely essential, opportunities for accountability and synergy have been missed along the way.

Energy agency consolidation will permit the State to set strategic direction for California's future energy needs, sharpen policy development and program implementation, and eliminate duplication of effort.

II. THE CASE FOR REORGANIZATION

The Energy Resources Conservation Development Commission (Energy Commission) was created in 1974 to “ensure that a reliable supply of electrical energy is maintained at a level consistent with the need for such energy for protection of public health and safety, for promotion of the general welfare, and for environmental quality protection.” Among other things, the Energy Commission was given jurisdiction for reviewing and approving thermal power plants that generate electricity of 50 megawatts or more.

In 1996, California restructured its energy regulatory apparatus, transitioning the State from highly regulated, local monopolies that provided their customers with a total package of all electric services toward a market in which competitive companies provide the electricity while utilities continue to provide transmission or distribution services. Since that time, many states have moved toward oversight of an increasingly deregulated industry in which prices are determined by competitive markets.

In 2000-2001, California experienced a significant electricity crisis. In the years leading up to the crisis, investment in new power generation capacity did not keep pace with increasing demand for electricity. California's generation capability decreased two percent from 1990 through 1999, while retail sales increased by 11 percent. Reduced hydroelectric power generation caused by a drought in the Pacific Northwest resulted in a reduction of power imports to California. Path 15, the high voltage transmission line connecting Southern California to Northern California, became congested at times, reducing the flow of surplus electricity in the South to meet shortages in the North. The wholesale electric market rules established under the restructuring plan contributed to the increase of wholesale prices. Under the rules, the major utilities were required to buy all of their power on the spot market. They were effectively prohibited from entering into forward long-term contracts for energy. Natural gas price increases significantly contributed to the increase in wholesale electricity prices. Shortages in generating capacity increased the bargaining strength of merchant power generators and energy traders and led to market manipulation by certain generators. The Public Policy Institute of California called this confluence of events and factors leading to the crisis a “perfect storm.”³

California's electricity crisis brought to light regulatory policy fragmentation, called into question earlier assumptions about adequacy of electrical generation resources, and resulted in significant and sometimes contradictory policy initiatives.

There has been considerable debate concerning the exact causes of the crisis, but most observers agree that several factors unrelated to the restructuring of the market contributed to the crisis.⁴ It is also clear that California's energy policy structure has been in disarray for decades. In February 1984, the Little Hoover Commission found among other things that the California Energy Commission lacks effective mechanisms to put its policy recommendations into effect,

³ *What Can Be Learned from California's Electricity Crisis?* Research Brief, Public Policy Institute of California, Issue 66, January 2003.

⁴ See, e.g., *California Electricity Situation*, Energy Information Administration, US Dept. of Energy, available at <http://www.eia.doe.gov/cneaf/electricity/>; *The California Electricity Crisis: Causes and Policy Options*, Public Policy Institute of California, 2003

and that there is overlap and duplication between the Energy Commission and the California Public Utilities Commission. The Little Hoover Commission called for increased coordination between the two entities and wrote that the “development of state energy policy only has purpose and meaning if the policy is meaningful and there exists a mechanism for its implementation.”⁵

A major finding of the Little Hoover Commission in its 1995 review of the Governor’s Reorganization Plan for Energy declares that the “creation of a department with a single point of accountability for energy and conservation issues and functions will enhance policy focus...”⁶

Criticism of energy policy inconsistency continued after the state’s electricity crisis. For example, in recommending that reorganization of the State’s various energy agencies be considered, the Legislative Analyst’s Office observed that existing energy agencies sometimes advocate different policies.⁷

In 2002, the Bay Area Economic Forum studied the California power market, reporting that it is “broken and in urgent need of reform.” The researchers stated,

*“Despite the wake-up call delivered by the energy crisis of 2000-2001, the state still does not have a clear and well-integrated power policy in place. Instead, the state has a complex patchwork of different agencies – each making critical decisions regarding the power industry – without a common vision or philosophy. The state’s energy infrastructure is critical to its economy and the well-being of Californians, yet the current low level of investment in generation and transmission facilities – caused at least partly by the lack of a coherent, long-term strategy for managing the power system and lack of retail demand responsiveness – could lead to another power crisis.”*⁸

The energy policy inconsistencies outlined in these various studies and reports demonstrate the need for the state law and energy policies to clearly define the strategic directions and the rules under which electric power generation and siting of facilities will occur in California as it moves away from the energy crisis.

⁵ *A Study of the Organization and Coordination of Electric Energy Planning and Electric utility Regulation in California*, Little Hoover Commission, February 1984.

⁶ *Review of Governor’s Reorganization Plan No 1*, Little Hoover Commission, March 1995. Available at <http://www.lhc.ca.gov/lhcdir/131rp.html>

⁷ *Reorganizing California’s Energy-Related Activities*, Legislative Analyst’s Office, 2002-2003 Budget Bill: Perspectives and Issues

⁸ *California’s Energy Future: A Framework for an Integrated Power Policy*, Bay Area Economic Forum, November 2002

III. STRATEGIES FOR ENERGY REFORM

As the sixth largest economy in the world, California is directly connected to the national and global economy for products and ideas, as well as, energy supply. The State's energy policies must ensure vigorous, transparent, and competitive energy markets and procurement processes that provide adequate investment opportunities. These policies must be supplemented with prudent, effective regulation for consumer protection.

Single Point of Accountability

This reorganization will consolidate the State's authority for energy policy and all related functions into one department. It maintains critical, public involvement through a Commission structure for generation and transmission siting, and for establishing appliance and building efficiency standards.

To implement this strategy, the reorganization vests authority for a unified, integrated state energy policy with a Cabinet-level Secretary of Energy. The Secretary will also serve as the Chairperson of the Energy Commission, with the remaining Commission members serving the public through staggered four-year terms. The Department's operations will be organized in a manner consistent with its functions and mission.

The Department of Energy will assume responsibility for several energy programmatic functions now performed by staff of the Energy Commission. Among these are developing public interest energy research on renewable energy technology, petroleum fuels supply and demand analysis, natural gas supply and electricity demand forecasting, the renewable energy portfolio standards program, appliance standards, and energy efficient building standards. In addition, the proposal transfers the process for siting transmission lines from the CPUC to the Department under the Commission structure, as well as related natural gas pipeline and storage infrastructure approvals.

This proposal eliminates the California Power Authority (CPA) and transfers its functions to the Department of Energy. The electricity market monitoring and CAISO oversight functions that are now performed by the Electricity Oversight Board (EOB), will be performed by the Office of Market Oversight within the Department.

The reorganization also consolidates minor energy functions now located in other entities of state government and moves them to the Department, specifically those functions performed by: the California Energy Extension Service Office of the Office of Planning and Research; the Energy Services Programs in the Office of the State Architect; and the Energy Assessment Program in the Department of General Services.

California Energy Commission

The proposal establishes a newly configured California Energy Commission with modified responsibilities and functions. The Energy Commission will remain within the Department of Energy. The program and technical responsibilities along with the staff of the existing Energy Commission will be transferred to the Department of Energy. The Energy Commission will continue its current licensing and regulatory responsibilities with support from the department

staff. The membership of the Energy Commission will be comprised of four public members, and will be chaired by the Secretary of Energy. The public members shall have backgrounds in the professional disciplines of engineering or physical science, law, environmental protection or economics, which will enhance public input and participation in the Commission's regulatory process. The public members will be appointed by the Governor as full-time commissioners for staggered 4-year terms, and will be subject to Senate confirmation.

In addition, the President of the Public Utilities Commission, and the President/CEO of the CAISO, will sit as non-voting *ex officio* members of the Commission.

The Commission will be responsible for licensing generation facilities, and transmission and natural gas infrastructure. Transmission and generation are inextricably linked, and consolidating these activities into a single jurisdictional venue will result in better coordination and planning. The Commission will also approve building and appliance energy efficiency standards, as well as other regulations.

The licensing process provides a forum for the consideration of the views and the expertise of the CAISO in the planning of transmission lines for California. As a FERC-regulated electric transmission operator, the CAISO is responsible for carrying out federal regulations requiring open access to electric transmission lines and planning for wholesale transmission facilities.⁹ It is critical that the CAISO be involved and work closely with other planning entities in charting the state's energy needs for the short and long term.

Transmission Line Planning and Siting

California continues to face serious challenges as it attempts to ensure a reliable electric grid and adequate sources of electric power to meet the growing electricity needs of the state's businesses and consumers. The state has made significant progress in constructing new plants and upgrading older inefficient power plants since the electricity crisis, but has struggled to meet present and future needs in siting new or upgraded electric transmission lines. Panelists at a recent forum entitled, "Keeping the Lights on in California," said that no one has the clear responsibility to see that new power plants and transmission lines get built.¹⁰

Environmental analyses of transmission projects are inconsistent, and the regional and statewide benefits of transmission lines are not adequately considered. As a result, existing permitting processes create duplication between local, State, and federal agencies, as well as delays in approvals, and denial of needed projects.

The 2003 Integrated Energy Policy Report (IEPR) recommends that the state should "consolidate the permitting process for all new bulk electricity transmission lines ... using the Energy Commission's power plant siting process as the model." This reorganization implements this recommendation, vesting with the Department exclusive responsibility for transmission siting approvals.

⁹ The CAISO is a non-profit public benefit corporation, but is also a creature of state law in many respects, among them the fact that its directors are appointed by the Governor and confirmed by the Senate.

¹⁰ *Worries Surface Over Energy*, Contra Costa Times, Rick Jurgens, January 29, 2005.

Representation before FERC

Several agencies represent the State on energy-related issues before FERC. Since restructuring of California's electricity industry, the state has significantly increased its representation before FERC.¹¹ Several state agencies represent or have represented various state perspectives on state energy-related issues before FERC.

The Electricity Oversight Board (EOB) has represented the State's interests before FERC on various energy-related issues. It oversees the California Independent System Operator (CAISO), a FERC-regulated entity that provides a variety of electricity transmission services in the State and operates wholesale electricity markets. The EOB is the designated state oversight authority of the CAISO under its federal tariff structure, and represents the interests of the State's ratepayers before FERC. The CPUC also represents the State before FERC on matters affecting ratepayer interests.

The *Supplemental Report of the 2002 Budget Act* directed various state agencies to submit to the Legislature reports on the perspectives they represent before FERC. In its review of the reports, the Legislative Analyst's Office (LAO) concluded that several agencies are involved in representing some of the same state energy-related issues before FERC and noted that this is especially the case with regard to the EOB and CPUC, both of which are involved in representing most of the state's major energy-related issues before FERC. The LAO stated, "specifically, EOB and CPUC have each been involved in FERC proceedings related to state requests for refunds from generators, charges of market manipulation, and proposed changes in market design."¹²

The California Attorney General also noted that, "while the CPUC, the EOB, and the California Energy Commission each play a role in oversight of the energy markets in this state, the enforcement capabilities of these entities needs to be expanded, and where appropriate, combined."¹³

This reorganization proposal would abolish the EOB, and transfer its functions to the Office of Energy Market Oversight within the Department of Energy. This office will, among other things, exclusively represent ratepayer interests before FERC.

The EOB oversees the CAISO, monitors grid operations and investigates matters in wholesale energy markets insofar as the public interests of ratepayers may be concerned. Public Utilities Code § 335(d) provides that EOB shall "investigate any matter related to the wholesale market for electricity to ensure that the interests of California's citizens and consumers are served, protected, and represented in relation to the availability of electric transmission and generation and related costs, during periods of peak demand."

¹¹ The FERC is an entity within the United States Department of Energy that regulates the transmission and sale of wholesale electricity and natural gas and the transmission of oil by pipeline.

¹² *Coordinating State Agency Representation Before the Federal Energy Regulatory Commission*, Analysis of the 2003-04 Budget Bill, Legislative Analyst's Office.

¹³ "Attorney general's energy white paper: A law enforcement perspective on the California energy crisis, etc. Attorney General Bill Lockyer, April, 2004.

Checks and Balances

The reorganization establishes a system of checks and balances within government to manage and resolve the normal tension between preserving and protecting the environment and developing the energy resources necessary for economic growth.

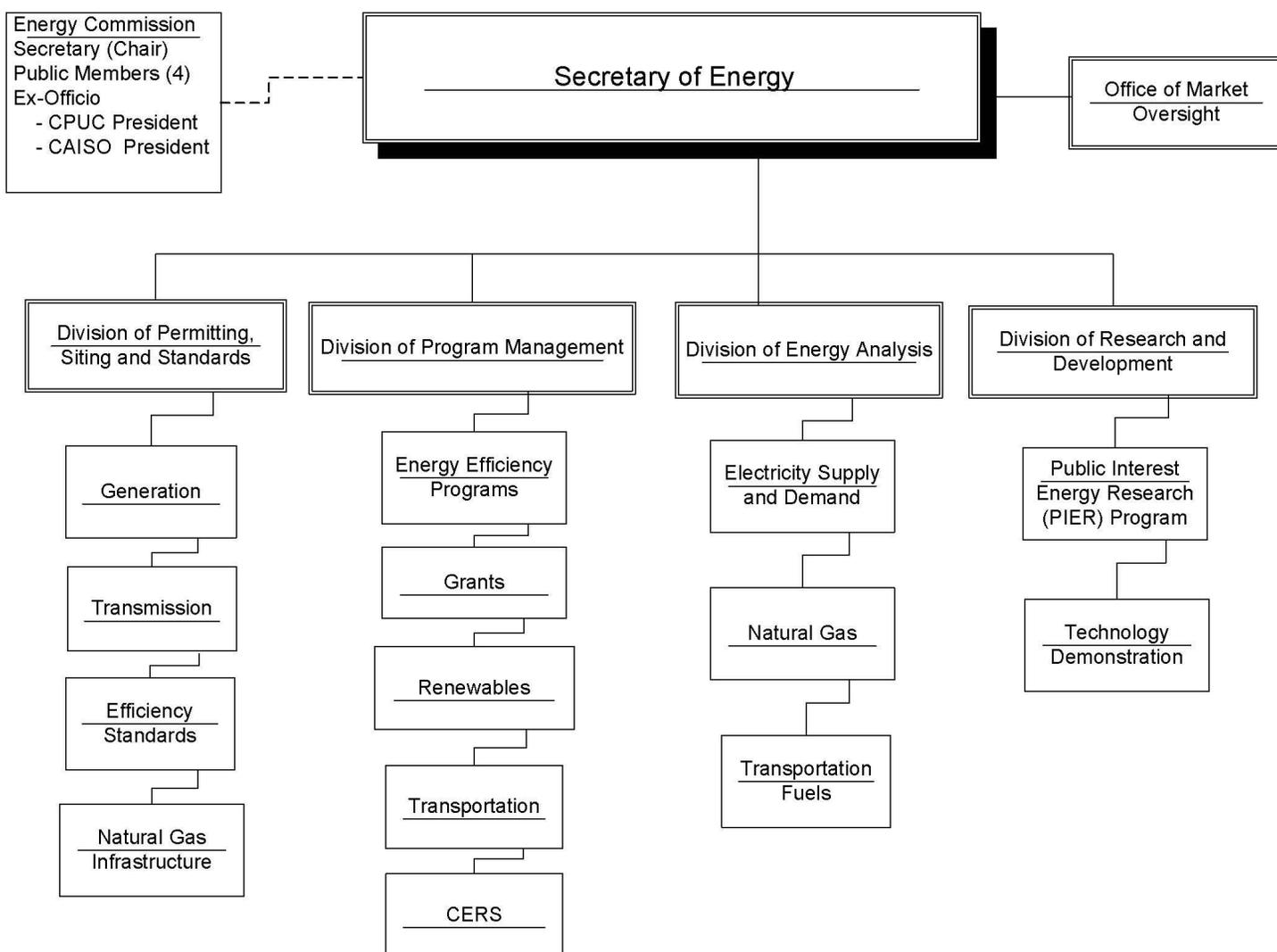
The reconfigured Energy Commission¹⁴ will be comprised of four public members, with the Secretary for Energy serving as its chairperson. The President of the CPUC and the President/CEO of the CAISO will serve as non-voting members of the reconfigured Energy Commission. The organizational structure for the new department is designed to bring the CPUC and the CAISO into the siting and permitting process, preserving well-established public and stakeholder participation.

¹⁴ The reconfigured California Energy Commission is described in Section IV, below.

IV. PROPOSED ORGANIZATIONAL STRUCTURE

Mission Statement: The Department of Energy supports the fundamental economic, environmental and risk management energy policy goals to promote adequate, reliable, affordable energy, improve the health of the economy and maintain California’s leadership position in the protection of the environment.

DEPARTMENT OF ENERGY DIVISION STRUCTURE



California Energy Commission

Strategic Intent:

The reconfigured California Energy Commission will hold as its primary responsibility the licensing of power plant and transmission facilities. In addition, the Commission will be responsible for licensing of natural gas storage facilities and infrastructure, approving energy efficiency standards for buildings and appliances and other regulatory processes. The Commission will be comprised of the Secretary of the Department of Energy, who sits as chairperson, and four public members with expertise in law, economics, engineering or physical sciences or environmental protection. The President of the Public Utilities Commission and the President/CEO of the CAISO will sit as *ex officio* non-voting members of the Commission.

Commission members will be appointed by the Governor, to staggered four-year terms, subject to confirmation by the Senate.

Transferred Functions:

The reconfigured Commission will succeed to the power plant and related transmission line permitting functions now performed by the current Energy Commission. In addition, the Commission will succeed to the permitting functions of the Public Utilities Commission for transmission lines connected to the interconnected transmission system, as well as for permit functions for natural gas storage and infrastructure.

The Office of the Secretary

Strategic Intent:

The Secretary will report directly to the Governor and serve as the primary point of accountability for the management of all energy policy and programs. The Office of the Secretary will consolidate functions that cut across program areas to create a unified, enterprise-wide approach to policy and operations. Support functions such as legal services, legislative and public affairs, and information technology will be included.

The Secretary is a cabinet-level position, appointed by the Governor and subject to confirmation by the Senate.

Transferred Functions:

The Secretary will fulfill all functions related to energy carried out by the Secretary of the Resources Agency. In addition, the Secretary will advise and assist in the implementation of major policy and program matters and be the principal communication link between the Governor and the constituent units of the Department of Energy.

In addition, administrative functions will be consolidated in the Office of the Secretary.

Office of Market Oversight

Strategic Intent:

The Office will focus on electric grid reliability issues, including transmission rules and planning standards, interconnection issues, congestion management, and local electricity reliability contracts. It will also continue to monitor the function of both organized and bilateral energy markets that serve the state. Direct participation in some proceedings before FERC is necessary to carry out market monitoring functions because that is the only venue in which one can obtain access to some categories of data.

Transferred Functions:

The market oversight and monitoring functions currently performed by the Electricity Oversight Board will be transferred to the Office to independently represent consumers on matters pertaining to the electric transmission grid and wholesale energy markets.

Division of Permitting, Siting, and Standards

Strategic Intent:

The Division will strive to ensure reliable, affordable electricity generation, and supervise the upgrading and expansion of electricity transmission and distribution infrastructure, as well as reducing the need for new generation through energy efficiency standards. The Division will review applications for energy facility projects, including power plants, transmission lines, natural gas storage facilities and related infrastructure. The staff of the Division will review energy facility applications, develop the evidentiary record and otherwise support the decision-making process at the Commission as it is newly configured.

Transferred Functions:

The staff of the Division will succeed to the power plant and related transmission line permitting functions now performed by the staff at the Energy Commission. In addition, the staff of the Division will succeed to the permitting functions of CPUC staff for transmission lines connected to the interconnected transmission system, as well as the permitting functions for natural gas storage and infrastructure.

The staff of the Division will also succeed to additional functions and duties performed by Energy Commission staff under the Warren-Alquist Act, including development of new building efficiency standards and appliance efficiency standards.

Division of Program Management

Strategic Intent:

The goal of this Division will be to improve efficiency of energy use as an important component of a reliable energy service system in the state. The program seeks to improve new construction efficiency, public sector building efficiency, reduce peak electricity demand, and improve efficiency in agriculture, transportation, wastewater treatment and industrial processes. The Division will oversee the energy efficiency, transportation and renewable energy programs. The Division will also be responsible for gas management planning, procurement, and administration of short-term and long-term power contracts.

Transferred Functions:

The staff of the Division will succeed to the functions outlined above that are now performed by the staff of the Energy Commission pursuant to the Warren-Alquist Act. The staff of the Division will assume responsibility for the functions of: the California Energy Extension Service of the Office of Planning and Research; the California Consumer Power and Conservation Financing Authority, the California Energy Resource Scheduling (CERS) Division of the Department of Water Resources; and the Office of the State Architect's Energy Services Programs and the Energy Assessment Program within the Department of General Services.

Division of Energy Analysis

Strategic Intent:

This Division will focus on supply and demand forecasts, thus ensuring an integrated view of the state's needs. The Division will collect and maintain information on California's energy systems; prepare analyses and reports to reflect current information; and, recommend actions based on supply and demand projections. The Division staff will prepare short-term and long-term supply, demand and price forecasts and assessments for the Secretary, the Governor and the Legislature.

The Division will collect and maintain information on California's transportation fuels, electricity and natural gas systems and prepare analyses and reports to reflect current information and recommend actions based on supply and demand projections. Division staff will prepare short-term and long-term supply, demand and price forecasts and assessments for the Secretary, the Governor and the Legislature.

The Division's responsibilities will also include analysis of the transportation energy system, develop energy shortage contingency plans, conduct petroleum industry reporting, and related activities.

Transferred Functions:

The Division will succeed to the energy market analysis functions currently performed by the staff of the Energy Commission.

Division of Research and Development

Strategic Intent:

The Division will conduct public interest energy research. This includes the full range of research, development and demonstration activities that will advance science or technology in support of the State's energy policies.

Transferred Functions:

The Division will succeed the duties and responsibilities of the Public Interest Energy Research program (PIER) and the climate change inventory and information program that are now performed by the Energy Commission.

V. CONCLUSION

As the complexity of the energy system expands to meet growing demand with new and existing resources, it is imperative that the State have an energy organization that is responsive and accountable to the Governor, the Legislature and the public. The current structure results in a fragmented approach to energy policy development creating inefficiencies, program overlap and duplication. Moreover, no one agency or department is completely accountable for energy policy development and implementation. This proposed consolidation enables the State to establish, in a single entity, the responsibility for developing and implementing a strategic direction for California's future energy.

By aligning the work within the divisions with the strategic directions of the new department, the State gains efficiency and can assign resources to critical areas of need. Moreover, it places the State's technical energy expertise in one department creating a synergistic effect for analysis and problem solving.

It is time to empower the State to respond to the energy challenges that are facing us. The State needs an overall energy structure that ensures full and open communication, cohesive planning and coordinated policy development and execution. The Department of Energy would develop fundamental economic, environmental and risk management energy policies to promote the financial well-being of Californians, improve the health of our economy and maintain California's leadership position in the protection of the environment.

By vesting in a single agency the obligation to plan and implement state energy policy, California sends a clear message to the public, the business community, energy industries, and the financial markets that a coherent energy policy direction is not only important, it is imperative.

While there are many advantages and benefits to creating a Department of Energy, the most important is increasing the cohesiveness and accountability California's energy policy development and implementation to ensure economic and environmental benefits for all Californians.

Together with the energy policies advanced by the Administration, the proposed reorganization will help guarantee affordable, reliable, environmentally sensitive energy supplies that will enhance California's economic growth while preserving the environment.

VI. GENERAL PROVISIONS

Transfer of Employees

Pursuant to Government Code Sections 12080.3 and 19370, all employees serving in the State Civil Service, other than temporary employees, who are engaged in the performance of functions transferred to the Department of Energy or engaged in the administration of a law, the administration of which is transferred to the Department of Energy by this Reorganization Plan, are transferred to the Department of Energy. The status, positions, and rights of such persons shall not be affected by their transfer and shall continue to be retained by them pursuant to the State Civil Service Act, except as to positions the duties of which are vested in a position exempt from civil service. The personnel records of all transferred employees shall be transferred to the Department of Energy.

Transfer of Property

The property of any agency or department, related to functions transferred as part of this reorganization, is transferred to the Department of Energy. If any doubt arises as to where such property is transferred, the Department of General Services shall determine where the property is transferred.

Transfer of Funds

All unexpended balances of appropriations and other funds available for use in connection with any function or the administration of any law transferred by this Reorganization Plan shall be transferred to the Department of Energy for use for the purpose for which the appropriation was originally made or the funds were originally available. If there is any doubt as to where such balances and funds are transferred, the Department of Finance shall determine where such balances and funds are transferred.