



Testimony before the Little Hoover Commission
Topic: Governor Schwarzenegger Energy Reorganization Plan
From: California Independent System Operator
Submitted by: Robin Smutny-Jones, Director of State Affairs
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INTRODUCTION

Thank you for providing the California Independent System Operator (CAISO) with the opportunity to submit testimony to the Little Hoover Commission relative to the Governor's Energy Reorganization Plan (GERP). The CAISO is a nonprofit, public benefit corporation charged primarily with maintaining the reliability of approximately 2/3 of the state's transmission grid.

The views of the CAISO contained herein are those of ISO Management and the Governing Board. Our intention in providing these comments is to focus on those areas in the plan that affect or are of particular interest to the CAISO and its operations. Overall, the CAISO supports the direction of the GERP as it relates to increasing coordination of the state's energy policy. Following are CAISO's views on the issues raised by the Commission, as well as certain matters we feel need further consideration or modification.

CHALLENGES FACING STATE GOVERNMENT IN DEVELOPING ENERGY POLICY

The Commission has asked for direction on what are the state's greatest challenges in forming energy policy as well as whether the proposed GERP aids or hinders development of energy policy.

First and foremost, the biggest challenge facing the state is the deficiency of the existing infrastructure in meeting the growth in demand for electricity. Our collective goal is to realize affordable energy, reliably delivered and environmentally responsible. The supporting cast for these objectives is adequate infrastructure. This includes generation, transmission and infrastructure designed to support demand side, energy efficiency and renewable energy policies. It is common knowledge that margins are thin with respect to both generation and transmission adequacy. The cost of transmission congestion management has been escalating annually, nearing \$1 billion in the past year in the form of reliability must run contracts and other, largely inefficient, measures to run generators as a work around to transmission problems. Every

year since the crisis, the ISO has sailed close to the wind as it has endeavored to ensure sufficient reserve margins during peak energy usage.

Related to this challenge is the achievement of proper alignment of policies and regulatory functions of the agencies and entities involved in energy. In the aftermath of the energy crisis, duties and responsibilities were fragmented between several different agencies and entities and, thus, accountability was lacking. It would behoove the state to have a clear understanding of roles and responsibilities and a direct line of accountability for all aspects of energy policy. We believe that great strides are being made to bring about needed energy facility infrastructure through resource adequacy and energy procurement proceedings underway at the CPUC, integrated resource planning efforts underway at the CEC, as well as market redesign activities underway at the CAISO. The nature of the activities taking place at the CPUC, the CEC and the CAISO necessitate extremely close coordination. For example, the CAISO works very closely with the CEC on energy resource and load forecasting activities, and the CPUC resource adequacy rules must be harmonized with the wholesale market redesign changes being developed at the CAISO.

We note that the GERP places both the President of the CPUC and the President/CEO of the CAISO as non-voting, ex-officio members of the CEC within the Department of Energy. We believe this is a positive development that would serve to formalize and enhance coordination between the state's energy entities involved with development and implementation of energy policy and make it easier to achieve the infrastructure adequacy objectives outlined above.

The CAISO is a unique entity, in that we are regulated by the Federal Energy Regulatory Commission (FERC), and also governed by state statute with the board members appointed by the Governor and confirmed by the Senate. To be sure, there was seriously uncomfortable tension between the State of California and FERC during the 2000-2001 energy crisis, with CAISO in the middle trying to work with both sides. We believe the time has come to move forward on energy policy development on a consensus basis whenever possible. Wholesale markets will continue to exist and be regulated by the federal government, while retail activities are within the state's jurisdiction. Wholesale and retail activities are inextricably linked given the interstate commerce nature of electricity transactions, so it is critical that the state finds ways to work toward harmonizing state and federal energy policies. Formally engaging the CAISO with the state through a relationship with the Department of Energy provides the opportunity for state and federal policies to coalesce in an efficient manner to the benefit of all consumers.

IMPACT OF THE GERP ON ISO

The Commission asked us to comment on what impact the new structure might have on the price and reliability of energy in the state. To the extent that institutionalized coordination between and among state agencies and the ISO

leads to consensus energy policy and better harmonization of rules and procedures, CAISO expects an overall positive impact. While it is more difficult to predict impact of the GERP on the price of energy, if the agencies work in a more efficient fashion to develop the rules needed to bring on needed infrastructure in a timely manner, this should translate into greater reliability of the grid.

There are two areas that are of particular interest to the CAISO contained within the GERP. One relates to the newly created Office of Energy Market Oversight. The other relates to the consolidation of energy facility siting functions.

OFFICE OF ENERGY MARKET OVERSIGHT: For the most part, the Office of Energy Market Oversight subsumes the responsibilities of the Electricity Oversight Board, which generally results in status quo relative to former EOB duties. We would like to comment on a couple of features of the Plan in particular.

First, we view the consolidation of state participation in proceedings before FERC as a generally positive change to the extent that mixed or inconsistent messages are avoided. However, there may be times when it would be in the interest of consumers for more than one state agency to submit information or opinions to FERC. It appears that the GERP allows for this. We encourage any final version to allow for this flexibility.

Second, we appreciate the proposed authority of the Office of Energy Market Oversight to develop rules that protect the confidentiality of market sensitive information. Often in the past it has been the CAISO that has been called upon to provide EOB with market sensitive information, and it has been a cumbersome and inefficient process due to current rules. Generally, we have only been able to provide the EOB information via subpoena and only with sufficient guarantees of confidentiality to satisfy the ISO's federal tariff obligations. It will serve the interests of the state to streamline this process and provide for explicit pre-determined protections so that the market oversight office can get the information it needs in a timely fashion and protect it to the extent it is in the interest of consumers to do so.

We note that the function of the EOB serving as an appeal body for members of the ISO Board regarding certain ISO board decisions is transferred to the Office of Energy Market Oversight. To set context, this is a function that was instituted during a time when stakeholders governed the ISO board and the Electricity Oversight Board was fully constituted and met on a regular basis. The GERP proposal is a significant structural change whereby the appeal function appears to be transferred to the Office of Energy Market Oversight, effectively placing an appeal before staff to the Department of Energy. Irrespective of the GERP, we recommend that the state re-evaluate the usefulness of this function given that the ISO board itself is now appointed by the Governor and confirmed by the Senate. We also believe that there is limited utility from having one state-

appointed body (and perhaps even the staff of that body) placed in a position where it could overrule the decisions of another state-appointed body. Furthermore, the appeal function was never actually used in practice.

We further note that under current law, the EOB must approve any amendment to the bylaws of the ISO following adoption of the amendment by the ISO Board. Again, this requirement was crafted for the previous regime when stakeholders governed the ISO Board. We do not believe that it serves an important state interest to require that one state-appointed body (the EOB or OEMO) approves the changes made to the bylaws of another state-appointed body (the ISO Board). At this time, as an example, the lack of a quorum of EOB voting members has held up the final adoption of ISO bylaw amendments intended to comply with a state statute that became effective in January 2002. It would be our recommendation that this function (approval of bylaws) be repealed either through modification of the GERP or accompanying statutory change.

INTEGRATION OF RESOURCE PLANNING AND SITING

The GERP consolidates siting of energy facility infrastructure into the Department of Energy, transferring some of these functions from the CPUC. We view the proposed change to have the potential to help integrate the process of generation and transmission planning and siting. While several billion dollars worth of transmission and generation have been planned and sited in recent years, it has not kept pace with demand. Consolidation of siting processes may lead to greater efficiencies and timely infrastructure development. Having said this, streamlining the siting process will not, in itself, solve all of the problems. Part and parcel to the siting process is ensuring that generation and transmission are planned in an efficient manner. For example, the state agencies, whether consolidated or not, need to develop a process to weigh alternatives to transmission when it is proposed. While the market can provide some signals to developers of both generation and transmission, one of the severe lessons learned during the crisis is that the market alone will not provide timely and efficient outcomes. To protect consumers and achieve policy objectives associated with adequate infrastructure, energy efficiency and the environment, competition needs to be complemented with an integrated planning process managed by the state.