

STATE OF CALIFORNIA  
**ELECTRICITY OVERSIGHT BOARD**



Arnold Schwarzenegger, Governor

Before the  
Little Hoover Commission

Testimony of  
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The Electricity Oversight Board is pleased to assist the Little Hoover Commission in its consideration of energy reorganization and I am pleased to appear before the Commission for that purpose.

The Electricity Oversight Board (EOB) was created in 1996, at the same time the state was enacting major changes in how its electric energy industries would operate and also at the same time the federal government was in the midst of implementing major changes in how it would regulate the wholesale energy industry and electric transmission. Within weeks of its creation, the EOB became a party in a number of cases before the Federal Energy Regulatory Commission (FERC), which regulates electric and natural gas transmission and wholesale sales of electricity and natural gas, as well as some other energy matters. The EOB incorporated the Independent System Operator (ISO) and the Power Exchange and was lead in getting operating tariffs approved for them during 1997. Since its creation, the EOB has appeared and advocated on behalf of California consumers at the FERC in a broad variety of electric proceedings and a smaller number of natural gas proceedings.

The EOB is often asked whether or how its role has changed over time and so I believe it is appropriate to speak to this question briefly. The EOB was created to protect the interests of California consumers with respect to FERC-regulated electricity markets and the FERC-regulated ISO and Power Exchange. The EOB has been an active advocate and litigant before the FERC since immediately after its creation. It has performed market monitoring and investigation roles since 1998 (when the California markets actually commenced operation). The EOB originally appointed the boards of directors of the ISO and Power Exchange. In 2001, the task of appointing the ISO governing board was given directly to the Governor.

In 1996, the FERC initially claimed that several functions of the EOB were precluded because they were preempted by federal jurisdiction. These included monitoring and investigating wholesale energy markets, overseeing the ISO and serving as an appeal venue for decisions made by the ISO board of directors. The EOB litigated this jurisdictional dispute with the FERC and eventually settled it, with the FERC conceding to the EOB's authority to monitor and investigate markets and also recognizing a continuing authority to hear ISO appeals in eight subject areas that are identified in Section 339 of the Public Utilities Code.

While the EOB's core functions, except for appointing the ISO board, have not changed over time, the wholesale markets themselves have changed significantly. The Power Exchange has ceased to operate as a forward market, causing most forward electricity trades to occur through direct transactions between buyers and sellers. The ISO has opened forward markets and has altered its other market structures. A number of longer-term contracts have been entered into and greater reliance on forward contracting is contemplated in the future. As a consequence of these changes, the focus and methods used by the EOB for market monitoring have changed substantially. The agency now must seek information from many more sources than was originally the case and must analyze the information using different tools than was the case when the markets first opened.

As with market oversight, there is sometimes confusion over whether the EOB role in FERC is one of its original functions. The agency was created in late September of 1996 and submitted its first important FERC filing in November of that year. The EOB was lead agency in representing the state's statutory and executive policies thereafter. The EOB first brought a complaint for market misbehavior in the summer of 1998, less than three months after the wholesale markets opened. The EOB was the only agency to bring a complaint seeking wholesale market refunds during in 2000 and was designated co-lead by the Governor's office in setting up a coalition of parties to work toward getting such refunds; work that continues today. The EOB is presently a party in over three hundred dockets before the FERC.

The other agency that has historically been active before the FERC is the Public Utilities Commission (CPUC). The EOB and CPUC have used various mechanisms to coordinate their activities in the federal regulatory forum. In 1998, the Legislature directed the CPUC and EOB to enter into a formal memorandum of understanding regarding the two agencies' responsibilities in FERC matters. The most relevant language from that document that reflects the agreed subject areas at the time is set forth as follows:

*In representations before the FERC, the following division of lead agency responsibilities shall apply: The EOB shall have principal authority and shall be considered lead agency on matters concerning the ISO and the PX and policies, rules and proceedings affecting these and similar entities, the operation or reliability of the interconnected transmission system, transmission system adequacy and planning, and the generation and bulk energy markets. The CPUC shall have principal authority and shall be considered lead agency on electricity matters concerning retail distribution service, reliability of the distribution system, regulation of retail providers, the administration of investor-owned utility contracts with qualifying facilities, and retail elements of direct access, but not including FERC approved costs that may be passed through to consumers. The CPUC shall have lead responsibility for representing the State in investor-owned utility merger cases.*

*Two categories of proceedings before the FERC in which each agency is recognized to have subjects of lead agency responsibility are IOU transmission rate cases and Reliability-Must-Run (RMR) contract rate cases. In these proceedings the following lead responsibilities are recognized: The CPUC shall be lead agency with respect to determinations of the applicant's costs of providing service and cost-based return on equity, the internal structure of cost-based rates to account for costs and attribute them to specific rate components, and auditing of costs. The EOB shall be lead agency concerning transmission system operation and reliability, ratesetting policy and rate methodology, operational aspects of RMR services, and the impact of issues in these proceedings on bulk-energy and generation markets. In addition to the provisions of this paragraph, each agency shall have lead authority concerning the subjects for which it is designated lead in the preceding paragraphs to the extent that they arise in investor-owned utility transmission rate cases and RMR contract rate cases. Where both agencies have lead responsibility for one or more subjects in the same proceeding, the agencies shall coordinate their representation to avoid conflicts and each agency shall conduct its representation so as not to conflict with the other agency on matters for which the other agency has lead authority.*

More recently, there are also a number of FERC matters in which the EOB and CPUC have proceeded jointly, sometimes submitting joint filings. These include both the California refund cases and the cases to modify the long-term energy contracts entered into by the Department of Water Resources.

The EOB remains committed to diligently monitoring energy markets for circumstances that may harm the public's interests and to effectively advocating the public interest and the state's energy policies in federal regulatory matters and believes these are important interests to ensure in a new energy agency structure. With that background, the staff of the Commission asked me to respond to several specific questions. Those questions appear below.

***What were the considerations for establishing the Electricity Oversight Board separate from existing energy-related agencies? How have those considerations changed since the board was established?***

When the EOB was created, it was the third agency with significant energy responsibilities. The existing agencies were the CPUC and the Energy Commission. Each was considered in relation to the EOB functions and a choice was eventually made to set up a new organization around these functions. Several factors were publicly discussed in the legislative deliberations at the time.

In consideration of the CPUC, it was noted that the wholesale markets were intended to operate for all of California's consumers; those served by investor-owned utilities as well as those served by municipal utilities and competitive providers. Several Legislative members wanted an oversight agency that was clearly mandated to protect all consumers equally and not regard those of regulated utilities differently from those of public entities. A closely related concern was a desire to have a market oversight entity that would scrutinize the activities of investor owned utilities in the wholesale markets under the same standards that were applied to any other entity in wholesale markets. There was an apparent concern that it would be difficult for the CPUC to regard the utilities it regulates at the retail level in the same way as market participants that it does not regulate. Another consideration related to the role of the Governor in setting state energy policy and a desire to have a structure that allowed close communication with the Governor's office on policy matters without creating problems under the rules regarding proceedings that are underway or are expected to be filed at the CPUC.

In relation to the Energy Commission (CEC), there was concern that some programs at the CEC created conflicts with the concept of an unbiased market monitor. Most clearly mentioned were programs to promote specific technologies and the role the CEC had played in advocating for several sectors of the industry in this regard. Also discussed was a concern very similar to that with the CPUC of whether the CEC would have difficulty treating all market participants equally with respect to market oversight. Some market participant companies contribute funding to programs at the CEC. At any given time,

several companies also have proposals for new facilities pending before the CEC. There was some discussion of whether these activities would create conflicts for the CEC.

Finally, one last consideration is perhaps delicate to mention but important to an honest discussion of the thinking at the time. Both the CPUC and the CEC had some important policy differences with the Governor and the Legislature (and each other) as to how the restructured industry should look. There was open concern expressed in the Legislature that either of these agencies might go into the FERC and advocate for the reversal of policy choices made in California Law. The committee that eventually fashioned the EOB structure expressed a belief that this structure was more certain to conform its filings to the policies established by the Legislature and the Governor

***What organizational factors should be considered in assigning the functions now performed by the Electricity Oversight Board and how are those considerations reflected in the proposed organizational structure?***

In any revised structure, it is important to ensure that besides combining compatible functions, conflicting ones be kept separate. This doesn't necessarily mean apart in wholly separate agencies but there may need to be a clear structural separation. In the case of the EOB functions, they should be kept separate from areas in which the state is a market participant. The EOB has access to confidential data from many market entities and it must be clear that this is not used in situations such as where the state is buying power or gas or directing specific purchases of these things.

Beyond this, the EOB functions should be structured to allow close consultation with the Governor's office and any communications required to conduct investigations and where appropriate settlement discussions, without creating any ex-parte problems for any regulatory function of the state.

The organizational structure proposed by the reorganization plan places the EOB functions within the Department of Energy but does so by placing them in a discretely-defined statutory office. Provisions are set forth to maintain a separation from any incompatible functions. The office that would house these functions is accountable to the Governor's office on matters where energy policy is set by the Governor. In these

respects, the proposal does appear to create a workable structure in which to house these functions.

***How might the Oversight Board's functions need to change once the state establishes a direction for its electricity policy? How might those choices influence how the Board's functions should be structured or governed?***

The state does have established energy policies in a number of areas but also does need to finalize its direction in some others. There are some key aspects of longer-term procurement policy, retail customer provider choice, infrastructure planning, and market structure that need to be worked out. None of these choices fundamentally change the functions of the EOB nor diminish the need for them. At the same time, each of these choices will somehow modify how the EOB market monitoring role needs to be focused. Obviously, these choices will also modify the objectives of the EOB or its successor in federal proceedings needed to approve any such market structure. The primary issues related to a sensible structure for the EOB do not appear to depend on how these choices are made as much as will the way the EOB functions must be conducted after the policies are set.