

TESTIMONY OF
PATRICK MEALOY
BEFORE THE STATE OF CALIFORNIA
LITTLE HOOVER COMMISSION
APRIL 24, 2014

Hello, my name is Patrick Mealoy and I am the Managing Director of Navigant Consulting's Energy Division in Folsom, California. I have over 20 years of experience working directly in the energy industry in California. My discussion today is focused on Navigant's preliminary assessment of regulatory cost drivers in California's Energy Market, a report prepared for Californians for Affordable and Reliable Energy (CARE) in August of last year.

The report was a first step towards understanding the costs and implications of recent energy-related regulations. Navigant's objectives were three-fold:

- Inform decision makers, the business community and other stakeholders regarding the cost ramifications associated with energy policies and regulations;
- Provide a high level understanding of the issues associated with these costs; and
- Initiate a dialogue regarding the costs, issues and trends to assist California in meeting its overall policy objectives.

The assessment was **not** designed to be:

- A comprehensive analysis of all costs and/or benefits associated with recent energy-related policies and regulations; or
- A critique of the environmental objectives driving these policies.

In preparing for that report, Navigant reviewed eighteen examples of recent existing state mandates before choosing to focus on three very prominent regulations: the Renewable Portfolio Standard (RPS), Greenhouse Gas (GHG) cap and trade, and Low Carbon Fuel Standard (LCFS).

A preliminary examination of cost impacts indicated that:

- The 33 percent RPS requirement will lead to increased electricity generation cost above historical norms;
- Carbon prices will be reflected in both electricity and fuel costs; and
- There is considerable uncertainty regarding the eventual cost impacts of the LCFS and the viability of the market to provide an adequate demand for alternative fuels and the required infrastructure.

The complexity associated with simultaneously implementing several transformative policies and regulations within an already complex and increasingly costly energy landscape in California can lead to unintended consequences, such as:

- Extraneous costs and system impacts stemming from multiple regulatory programs with the same ostensible objective (i.e. GHG reductions);
- Additional strain on the electrical grid resulting in reliability concerns;
- Transformation of the business model (ratepayer cost shifts); and
- Limited utility flexibility to address future uncertainties.

As a result of these and other factors, energy costs in California are expected to increase sharply over the next several years. All Californians, including local communities will absorb these increased costs. The forecast, according to the California Energy Commission, is for electric rates to increase between 20 and 35 percent by 2020. This represents a pace that exceeds and is potentially double the expected Consumer Price Index increase for California. It is important to note that over the past 20 years, California's electric utilities have increased electricity rates at a pace that was below CPI.

Electricity providers face new generation, transmission and distribution infrastructure needs, aggressive renewable energy and emissions goals, and increasingly complex policies and regulations, all while striving to maintain reliable and affordable service. Transportation fuel providers also must meet stringent carbon intensity limits.

Over the past 18 years, California's total electricity demand has increased by an average annual amount of 0.8 percent. Navigant studied available data from the California Energy Commission (CEC), which indicated that of the four energy sectors that include residential, commercial, industrial and other (remaining load attributable to agricultural and other water pumping load, mining, construction and streetlights), the residential and commercial classes saw steady load growth. However, industrial load peaked in 2000 and has declined by 0.8 percent over the remaining years. Cumulative growth in residential (31.7 percent) and commercial (35.1 percent) loads over the past 18 years were similarly offset by reductions in industrial (-17.1 percent) and "other" (-1.4 percent) loads.

Changes in the composition of California's load – primarily the shift in industrial load that previously comprised over 20 percent of total load in 1993 to less than 15 percent in 2011– can place additional costs and operations requirements on California's utilities.

This changing load dynamic can be the result of several factors but one fact that cannot be disputed is that the retail price of electricity in California of 13.05 cents per kilowatt hour is one of the highest in the nation. In fact, it is approximately 32 percent above the national average.

Likewise California's average retail rate is above national averages for three sectors (26.1% higher for residential, 27.6% higher for commercial, and 48.2% higher for industrial), and notably higher than comparable prices in the neighboring western states of Arizona, Nevada, Oregon and Washington.¹ In comparison with Nevada, California's electric prices are 45 percent higher across all sectors (e.g. 27% higher for residential, 44% higher for commercial, and 52% higher for industrial).

The costs associated with California energy policies and regulations will likely continue to widen the disparity in energy costs between California and neighboring states. This is expected to occur as California electricity providers begin to implement the costs of recent agreements associated with qualified renewable generation along with associated integration costs. It is important to note that it is not only the costs of recent regulations and policies that are leading to increases in the costs of energy in California. Routine and deferred maintenance and capital projects are also significant cost drivers. However, the culmination of these 'business as usual' expenses and the costs associated with recent California policies are what is expected to lead to significant rate increases for the remainder of this decade.

Navigant is also conducting a preliminary and general review of energy plans for 39 other states. The intent of our review is to identify "best energy planning practices" being implemented in other states that may be of value and interest. Many of the plans share California's goals associated with clean energy: renewables development, energy efficiency and demand response, and the reduction of greenhouse gas emissions. Certain states also emphasize active promotion and economic development of their respective energy industries as very important and continuing drivers of their states' economies. Maintaining a competitive energy economy is a very important concern for some states. Certain state plans also call for action items to improve energy governance within their respective states, including:

- Centralizing coordination for all state energy agency activities (Connecticut);
- Creating an *Executive Office for Energy Policy* that would provide for coordinated development and implementation of state energy policy (Delaware);
- Creating an *Interagency Council on Energy* to coordinate the ongoing development and implementation of the state's Strategic Energy Plan (Indiana);
- Creating an energy office by consolidating exiting energy functions currently fragmented through state government (Utah); and
- Aligning the state's agencies to better meet and facilitate responsible energy development (Utah).

¹ Sources: U.S. Department of Energy-Energy Information Administration *2011 Average Retail Electricity Price for Bundled and Unbundled Customers*; and American Automobile Association *AAA Gauge Fuel Report, National Average Prices*, August 2013.

Only a handful of states have developed detailed metrics for tracking the implementation of their respective plans. Many plans from other states emphasize that it is important that the recommendations in their energy plan be subject to an organized review on a regular, scheduled basis to ensure that they continue to reflect the best interests of its citizens and businesses.

I am hopeful that a comprehensive review of other state's efforts, along with an understanding of the challenges and unique opportunities available to California can be helpful in enhancing and developing a robust energy plan for California.

I would therefore respectfully encourage that the Little Hoover Commission consider the following thoughts as having potential merit in the development of ongoing California energy policy and regulations:

- Formally recognize at the appropriate policy levels that California's energy costs continue to rise at potentially increasing rates, especially when compared to other states;
- Improve the data, analysis, and information regarding the current and forecasted energy costs of *existing* regulations across all California regions, business sectors, and ratepayers that can serve as a credible, peer-reviewed basis for adequately monitoring energy costs and the cumulative potential cost impacts of future regulations;
- Strive for better balance and transparency during the development of regulations to minimize resulting "unintended" cost impacts that can also potentially impact supply and reliability;
- Examine and look for 'best practices' from other states' that are aggressively pursuing clean energy goals while actively promoting the importance of their entire energy industries and fuel source mixes as important economic drivers for improving their states' economies, developing and sustaining in-state production and workforce strength, and providing affordable energy for businesses and citizens;
- Examine energy governance structures being explored in other states as options for future consideration by the Commission and California.

I would be happy to address Commission's questions and thank you for your time.

Enclosed:

"Preliminary Assessment of Regulatory Cost Drivers in California's Energy Market"

Prepared for: Californians for Affordable and Reliable Energy

August 2013