



# CALIFORNIA MUNICIPAL UTILITIES ASSOCIATION

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August 12, 2004

JERRY JORDAN, Executive Director

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Co-Executive Directors  
California Performance Review  
1102 Q Street, Sixth Floor  
Sacramento, California 95814

**RE: Preliminary Comments on California Performance Review;  
Energy Infrastructure**

Messrs. Hamilton and Gutierrez:

The California Municipal Utilities Association (“CMUA”)<sup>1</sup> appreciates the opportunity to provide these Preliminary Comments on the Report of the California Performance Review – Government for the People for a Change (“CPR”).

CMUA is a statewide organization of local public agencies in California that provide water, gas, and electricity service to California consumers. CMUA membership includes 34 electric distribution systems, a metropolitan water district, and three large joint powers agencies. CMUA membership also includes the City and County of San Francisco, which is not a distribution system, but provides public power pursuant to federal statute. In total, CMUA members provide electricity to approximately 25-30 percent of the population in California.

These Preliminary Comments are focused solely on the issue of electricity infrastructure and related reforms. CMUA wholeheartedly agrees that virtually

<sup>1</sup> CMUA electric utility members are the Cities of Alameda, Anaheim, Azusa, Banning, Burbank, Colton, Corona, Glendale, Healdsburg, Hercules, Industry, Lodi, Lompoc, Los Angeles, Moreno Valley, Needles, Palo Alto, Pasadena, Pittsburg, Redding, Riverside, Roseville, Santa Clara, Shasta Lake, Vernon, and Victorville as well as the Imperial, Merced, Modesto, Turlock Irrigation Districts, the Northern California Power Agency, Southern California Public Power Authority, Transmission Agency of Northern California, Lassen Municipal Utility District, Sacramento Municipal Utility District, the Trinity and Truckee Donner Public Utility Districts, the Metropolitan Water District of Southern California, and the City and County of San Francisco, Hetch Hetchy.

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An organization for the protection of municipally owned utilities.

C.M.U.A. members provide utility service to more than 70% of the people of California.

every element of the energy infrastructure in California is deficient. Undoubtedly, this is due in part to a dysfunctional regulatory environment that has not provided clear signals and incentives to build transmission, generation, natural gas transportation, and other needed infrastructure. CMUA supports efforts to reevaluate how the electricity industry is regulated. CMUA pledges that it will do its part, on behalf of the municipal electric utility community, to actively and constructively participate in the development of needed reforms in the coming months. These Preliminary Comments are designed to raise issues worthy of additional consideration within the context of the CPR.

### **1. The Structure of Energy Agencies Depends in Part on the Structure of the Electricity Market.**

Effectiveness of the CPR in the area of electricity industry regulation and oversight would be aided by some direction on electricity policy. Siting and rate procedures will be influenced by why facilities are proposed to be built, and who proposes to build them. In turn, this will depend upon the structure adopted for the electricity market. A clear example of this is the siting of generation and transmission. In a market-based structure, it is probable that financial backing for some generation and transmission projects will come from non-utility sources. These entities will be proposing projects not because they are necessary for reliability or to best meet load-serving requirements, but because the sponsors believe the projects will make money. With specific respect to transmission, under the general market structure championed by the Federal Energy Regulatory Commission (“FERC”) sometimes termed Standard Market Design, and as proposed by the California Independent System Operator Corporation (“CAISO”), transmission project sponsors will receive either guaranteed cost recovery or a stream of revenues based on financial derivatives that reflect differences in locational energy prices. While the details of this are complex, the primary point for this discussion is that these facilities may not be needed for reliability or even lower costs to consumers. They may be built solely because an investor sees a financial opportunity. This is a new approach to building electricity infrastructure, especially transmission, and regulatory reforms must take this into account.

On the other hand, generation and transmission that comprise part of a utility’s integrated resource plan may require different regulatory treatment. These facilities will have been determined to be necessary or appropriate to meet the obligations of load serving entities, or the reliability needs of the system. Already today, the CAISO attempts to differentiate transmission projects based on the rationale for building the project, i.e., reliability or economics. The CPR should consider the appropriate siting procedures for both types of investment in infrastructure, and specifically whether they should be different.

Other issues confronted by the CPR would be influenced by electricity market structure. Consumer protection functions may be housed at different agencies depending on market structure. If California consumers are going to pay for energy priced by competitive outcomes, then regulators versed in consumer protection, policing markets, and enforcing antitrust laws should be given primacy. If, on the other hand, California consumers are going to pay for energy based on a traditional cost-of-service model, rate regulation can be housed at the traditional agencies. Today's morass of different positions by different state agencies on the same issues must be avoided.

The proposed elimination of particular agencies would be also be influenced by the structure of the market. The CPR proposes to eliminate the Consumer Power and Conservation Financing Authority ("CPA"), or at least consolidate its functions into a proposed Infrastructure Department. The CPA was conceived as a backstop to the market due to the perception that the market was not responding with sufficient investment in generation. It is appropriate to examine whether or not the purpose of the CPA remains valid. The answer to that question will depend in part on whether or not California will continue to rely on market structures to ensure adequate generation investment.

The CPR should not be held up because substantive policy debates on the electricity industry continue. However, the CPR should take into account how policy choices will affect the proposed regulatory structure.

**2. California is Not an Island. Planning and Siting Require Regional Coordination to Maximize Efficiency. Regulatory Reform Should Include Specific Proposals to Assist Regional Coordination.**

Time and again, California has made energy decisions with no regard for consequences on neighboring states and the entire Western region. This includes transmission siting (Path 15 and regional impacts), natural gas transportation (Mojave Pipeline expansion), and market design (CAISO market practices). And, what goes around comes around. Decisions are being made in neighboring states that have significant impacts on California consumers. Currently, upgrades of transmission facilities in the Pacific Northwest and Desert Southwest are being considered that would allow vital energy to be imported to serve California. These projects may not get built due to the lack of a structure to consider regional costs and benefits.

The isolationist tendencies of California on energy issues must be reversed. Within the context of the CPR, the duty of coordination with neighboring states and the consideration of regional impacts of California's decisions should be expressly recognized and that responsibility assigned to a single energy agency.

**3. The Role of the CAISO Should be Discussed in the CPR.**

While not a state agency, the CAISO has more influence on energy policy than most regulators. Further, the CAISO Board of Governors is appointed by the Governor. As such, it is appropriate to include the CAISO within the CPR.

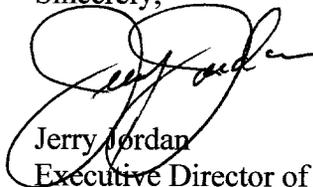
Actions of the CAISO will affect whether California has a stable operational and market environment to support investment in transmission, generation, and demand response. Issues made at or affected by the CAISO include:

- Cost Recovery for Transmission;
- Pricing of Energy and Capacity for Generation and Demand Response;
- Assessing Local Requirements for Generation Capacity;
- Allocation of Transmission Rights that Affect Price Stability of Delivered Energy;  
and
- Transmission Planning, including Initial Needs Determinations for New Facilities.

It is no secret that CMUA is concerned that the CAISO's rules inhibit long term investment in generation and transmission. CMUA does not want to debate that issue here. However, it is fair to point out that effective reform of electricity industry regulation cannot take place without consideration of the role of the CAISO.

Again, CMUA appreciates the opportunity to submit these Preliminary Comments, and looks forward to active participation as the CPR is considered.

Sincerely,



Jerry Jordan  
Executive Director of the  
California Municipal Utilities Association