

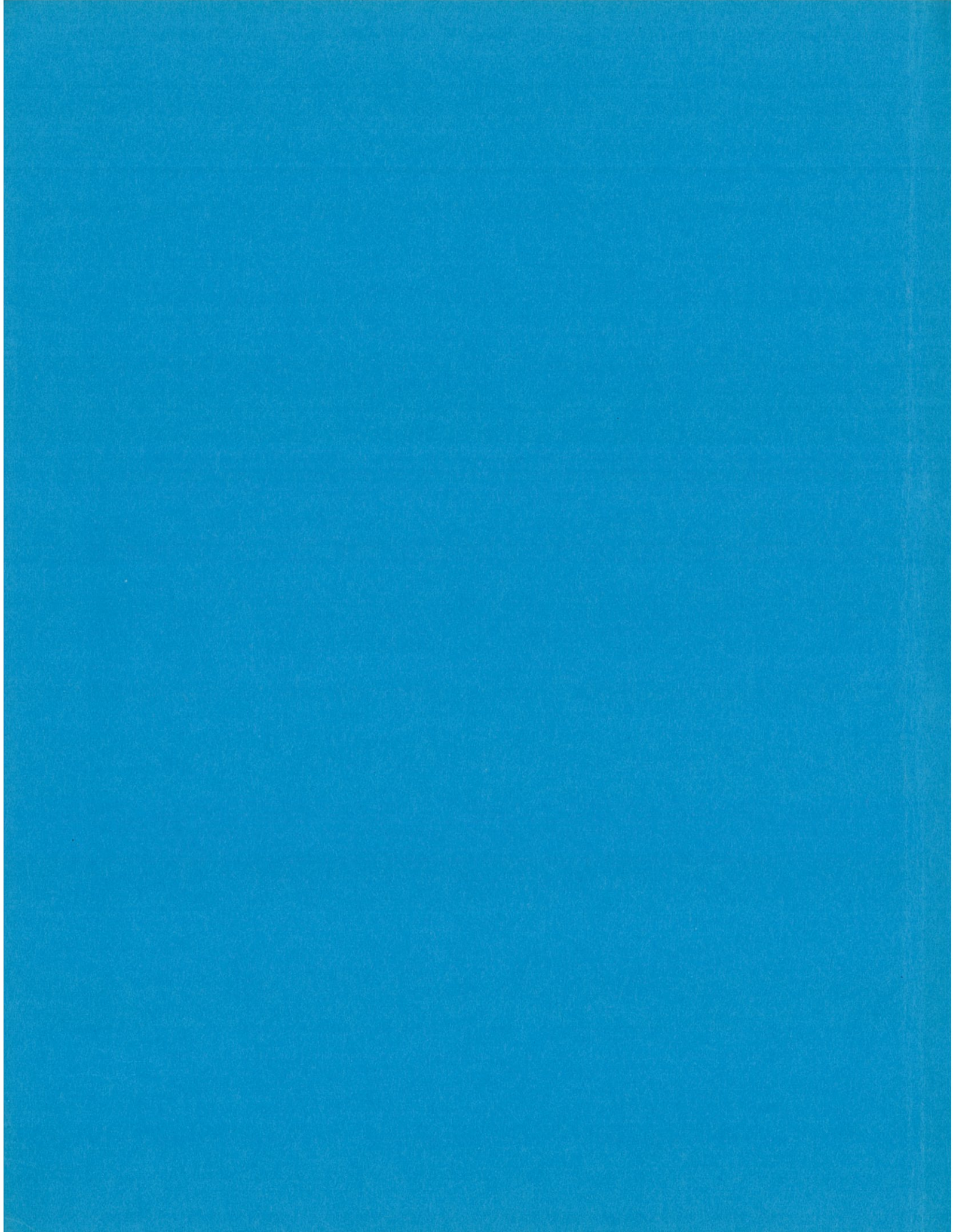
Patricia Beck

COM/*

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

_____	)	FILED
Order Instituting Rulemaking on the	)	PUBLIC UTILITIES COMMISSION
Commission's Proposed Policies	)	APRIL 20, 1994
Governing Restructuring California's	)	SAN FRANCISCO OFFICE
Electric Services Industry and	)	R.94-04-031
Reforming Regulation)	
_____)	
Order Instituting Investigation on)	
the Commission's Proposed Policies)	
Governing Restructuring California's)	
Electric Services Industry and	)	I.94-04-032
Reforming Regulation)	
_____)	

**ORDER INSTITUTING RULEMAKING AND
ORDER INSTITUTING INVESTIGATION**



COM/*

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

_____)	
Order Instituting Rulemaking on the	)	FILED
Commission's Proposed Policies	)	PUBLIC UTILITIES COMMISSION
Governing Restructuring California's	)	APRIL 20, 1994
Electric Services Industry and	)	SAN FRANCISCO OFFICE
Reforming Regulation	)	R.94-04-031
_____)	
)	
Order Instituting Investigation on)	
the Commission's Proposed Policies)	
Governing Restructuring California's)	
Electric Services Industry and	)	I.94-04-032
Reforming Regulation)	
_____)	

**ORDER INSTITUTING RULEMAKING AND
ORDER INSTITUTING INVESTIGATION**

TABLE OF CONTENTS

SUMMARY 1

BACKGROUND 3

 Origins of the Commission’s Proposed Policy 3

 Consensus for Reform 5

 The Goals of Our Policy Making Process 7

 The Proposed Policies and Implementation Strategy 9

A VISION FOR THE FUTURE OF CALIFORNIA’S ELECTRIC SERVICES INDUSTRY 12

 The Fundamentals of Our Vision 12

 The Events and Observations Guiding Our Vision 14

 The Link Between Wholesale Electric Markets and Direct Access 15

 Fundamental Changes in Energy Policy Sever the Link Between Ownership and Use 17

 The Need for a More Consumer-oriented Vision 20

 The Convergence of Telecommunications with Electric Services Promotes Direct Access 21

 Getting From Here to There 26

ACHIEVING THE VISION: AN EVOLVING REGULATORY COMPACT AND A TWO-TRACK STRATEGY FOR CHANGE 28

 Strategy Summary 28

 California’s Regulatory Compact Must Evolve 33

 A Two-Track Strategy For Reform 34

 The First Track: In the Absence of Competition, Replace Traditional Cost-of-Service Regulation with Alternatives Better Focussed on Performance 35

 The Second Track: Where Competition Exists, or the Potential for Competition Exists, Replace Economic Regulation with the Discipline of Market Forces .. 37

 Direct Access Requires Ratemaking Reform 40

 Direct Access, Integrated Resource Planning and Efficient Infrastructure Investment 47

 Environmental Quality, Fuel Diversity and Energy Efficiency 52

 Safe and Reliable Electric Service 55

 The Pursuit of Broader Social Objectives 56

 Conclusion 57

PROPOSED IMPLEMENTATION 59

 Proposed Schedule and Road Map 59

COM/*

**STATE OF CALIFORNIA
PUBLIC UTILITIES COMMISSION**

**PROPOSED POLICY STATEMENT ON RESTRUCTURING CALIFORNIA'S
ELECTRIC SERVICES INDUSTRY AND REFORMING REGULATORY POLICY**

SUMMARY

By this order, we open a rulemaking proceeding to consider a restructuring of California's electric services industry. The program we propose for comment would permit some consumers to choose direct access to the competitive market for generation services by January 1, 1996. Choice among competing generation service providers through direct access would be opened to all consumers by January 1, 2002. Simultaneous with our proposal to establish direct access for the state's consumers, we would replace traditional cost-of-service regulation with performance based regulation.

While our minds are open to modifications of our proposal, or even the substitution of what we could come to be convinced is a superior suggestion, we are single-minded in its objective--to lower the cost of electric service to California's residential and business consumers without sacrificing the utility's financial integrity. As we engage the state's stakeholders in a discussion over the next several months, our principal interest shall be to determine, with the assistance of parties, whether our proposal meets that objective.

The respondent utilities to this rulemaking will, and interested parties may, file comments on these proposed rules within 30 days. The respondent utilities will, and parties may, file reply comments 15 days thereafter. Subsequent to those filings, we intend to hold

COM/*

one, or several, full panel hearings to allow parties to address the full Commission with respect to the proposal we set forth and any comments submitted. Our final decision in this matter will rely heavily on the comments we receive and the participation of the state's many stakeholders.

We also open today a companion investigation to this rulemaking, naming the same utility respondents. This investigation will serve as the forum for taking evidence should we determine that, based on the comments filed on this rulemaking, evidentiary hearings are necessary to resolve any particular issues. It will also serve as the forum to address issues of service unbundling and the potential for uneconomic utility generating assets as discussed further below.

Respondents to the two proceedings initiated today are Pacific Gas & Electric Company (PG&E), Southern California Edison Company (Edison), San Diego Gas & Electric Company (SDG&E), Southern California Gas Company (SoCalGas), Sierra Pacific Power Company (Sierra), and Pacific Power and Light Company (PP&L).

Since R.94-04-031 and I.94-04-032 involve related issues of law and fact, it is appropriate to consolidate these two dockets pursuant to Rule 55 of the Commission's Rules of Practice and Procedure. Consolidation provides the Commission with maximum decision-making flexibility in addressing the issues before it in these proceedings. For administrative convenience, the rulemaking will be the lead docket, and all filings shall be made in that docket unless otherwise specified.

BACKGROUND

Origins of the Commission's Proposed Policy

In February 1993, with the release of our Division of Strategic Planning's report entitled *California's Electric Services Industry: Perspectives on the Past, Strategies for the Future*, this Commission embarked on a comprehensive reexamination of the structure of California's electric services industry and the regulatory policies governing it. With the issuance of this proposed policy statement, the Commission requests comment on the proposed vision it sets forth for California's electric services industry, and the proposed strategy offered to achieve that vision. To the extent parties choose to offer alternatives to our proposal, those alternatives should be comprehensive, addressing both industry structure and California's regulatory framework.

The release of the Division's report followed closely on the heels of the passage of the Energy Policy Act of 1992 (EPAct).¹ EPAct sets forth a long term, comprehensive vision for the nation's electric services industry. EPAct embraces increased competition and a greater reliance on market mechanisms as the preferred means to develop, deliver and market energy services in the United States. Many believe, as do we, that EPAct promises to bring significant change to the industry. We discuss the potential for such change more fully below.

In order to achieve the vision articulated in EPAct, Congress significantly reformed federal laws. Some of these laws, the Federal Power Act and the Public Utility Holding Company Act in particular, were originally enacted as far back as the 1930s. In other cases, EPAct broadened and more clearly defined federal regulatory jurisdiction. For the most part, however, Congress refrained from imposing a single, prescriptive approach on the nation. Appropriately, Congress chose instead to grant states and regions broad latitude to

¹ Public Law 102-486, 106 Stat. 2776 (1992).

COM/*

develop the specific policies and programs required to make EPA's vision a reality. Faced with the most sweeping federal energy legislation in almost two decades, and increasingly concerned with the adequacy of California's own regulatory framework, we directed our Division of Strategic Planning to prepare its report.

We requested comments on the report and received submittals from a wide variety of interests, including consumer groups, the state's municipal and investor-owned electric and gas utilities, environmental organizations, nonutility service providers, federal, state and regional government entities, legislators, academics and industry consultants.² With the benefit of those comments, we held three full panel policy hearings, at which industry experts and stakeholders from California, the nation, and abroad offered insights for our consideration. In this way, we gauged the need to reformulate California's energy and regulatory policy and respond to the changing structure of the electric services industry.³ At the hearings we discussed the problems facing California and the reasons why restructuring and reform might be necessary. Participants were asked to offer a vision and suggest the means necessary to achieve it. At our third policy hearing, each of the state's investor-owned utilities presented to Commissioners and the hearing's other participants its proposed vision and implementation strategy.

After our policy hearings, we asked specific questions of interested participants and observers; those questions were intended to further explore certain issues surrounding restructuring and reform raised in written comments on the Division's report and at the hearings. Many diverse stakeholders responded to our inquiry.⁴

² A list of those who responded to the Division's report is attached as Appendix B.

³ The agendas and lists of participants from the policy hearings are attached as Appendix C.

⁴ Both the questions issued and the list of respondents are included as Appendix D.

COM/*

A Consensus for Reform

The views, opinions and suggestions offered by the stakeholders during the course of our process were as varied and diverse as the interests they represent. As striking as the diversity of opinion, however, was the clear consensus which emerged during our policy deliberations. Despite their many differences, stakeholders overwhelmingly agreed on one thing--*the Commission must fundamentally reform California's regulatory policy governing investor-owned electric utilities*. There was considerably less agreement, however, on whether *industry restructuring* ought to accompany regulatory policy reform. The Commission continues to enunciate its belief that California needs regulatory reform. Our proposed policies address the need to reform California's energy regulation, as well as the need to restructure the industry.

We believe that recent events, and the circumstances facing California, demand that the Commission move decisively to enact fundamental reform. The following specific reasons persuade us that this is the case:

- *Command-and-control and cost-of-service regulation, and government central planning are fundamentally at odds with, and ill-suited to, the increasingly competitive electric services industry confronting California and its utilities. The federal government has already recognized the need for significant reform and showed considerable leadership and foresight with the passage of EPAct.⁵*
- *California's investor-owned utilities currently charge some of the highest prices in the country. This distressing fact prompts us to explore reasonable alternatives to the current framework. Our express objective is to establish a new framework that does a considerably better job of exerting downward pressure on the prices California's*

⁵ We recognize that between the end of the Second World War and the oil embargo of 1973, the traditional cost-of-service regulatory model governing vertically integrated, natural monopolies appeared to many to work remarkably well. We note, however, that, as described in our Division of Strategic Planning's recent report, the conditions under which that success occurred have faded. (See Division of Strategic Planning, *op. cit.*, pp 27-56.)

COM/*

*residential and business consumers must pay for investor-owned electric services.*⁶

- *This Commission has actively promoted when appropriate policies designed to harness market forces and establish market-based regulatory solutions in each of the industries it oversees, including the electric services industry. With respect to the electric services industry, the Commission's aggressive promotion of competition in electric generation pursuant to the Public Utility Regulatory Policies Act of 1978, and our more recent efforts to bring competition to utility energy efficiency programs as called for in P.U. Code 747, stand out in particular.*

If we ignore the rapid change already upon us, we place California's investor-owned utilities and the state's economy at considerable risk. Revenues of the state's investor-owned electric utilities exceeded \$18 billion in 1993, representing approximately two percent of California's gross state product. The majority of California businesses, which make up the remaining ninety-eight percent of California's almost \$800 billion economy, depend heavily on reliable, safe and competitively-priced electric service.

California's electric strategy must therefore look beyond simply preventing businesses from falling victim to challenging economic times or leaving the state altogether for lower cost destinations. California must shy away from proposals which simply *maintain* the current level of economic activity, and we must opt instead for a strategy which fosters economic *growth*, enhancing the state's competitiveness, and increasing business opportunities. By ensuring the development and delivery of high quality, low cost electric service, this Commission, the state's investor-owned utilities, and the electric services industry generally, can contribute significantly to the revitalization and sustained growth of

⁶ The utilities, and Edison in particular, have offered very useful information detailing some of the reasons for which the cost of providing electric service in California tends to be higher relative to other locations. The principal reasons cited by Edison include California's temperate climate; California's energy usage patterns; California's customer mix relative to other states, particularly its greater number of residential compared to industrial consumers; and the portfolio of utility resources available to deliver electric service. (Edison comments to the Division of Strategic Planning's report, pp 3-10.) While we concur that these factors may indeed contribute to higher prices for electricity in California compared to other states, we are not convinced these factors fully explain why California energy prices in some cases approach twice the national average.

COM/*

California's economy. In addition, California's residential consumers can look forward to relief from some of the highest electricity prices in the country, without compromising either safety or reliability of service. With this in mind, our proposed vision and implementation strategy build upon existing competition in the electric services industry to foster a truly competitive market for California.

This Commission must respond promptly to remedy the ills which currently plague California's electric service industry. In addition to the state's high rates, these ills include a regulatory structure that 1) is out of step and often in conflict with a changing, more competitive industry; 2) offers the utility at best weak incentives to operate and invest efficiently; 3) is composed of numerous, costly, and administratively burdensome proceedings; and, 4) creates unnecessary barriers to, and therefore threatens the quality of, public participation. We are equally compelled to respond expeditiously to the sweeping changes enacted at the federal level and underway across the nation. This being said, we recognize that the Legislature can assist in the timely implementation of our proposal. With the proposal issued for comment today, we look forward to working with the Legislature, and offering any assistance necessary, to take the important first steps toward revitalizing California energy policy.

The Goals of Our Policy Making Process

We designed our reexamination of California's energy regulatory policy and industry structure with two key goals in mind: 1) Exploit alternatives to litigation as much as possible, and 2) focus on a comprehensive, long term solution to the challenges confronting California.

First, we intend to rely significantly on alternatives to traditional procedures for establishing broad policies for the restructuring of the electric services industry and the regulations governing it. We recognize that the litigious, adversarial environment of the

COM/*

hearing room is ill-suited to policy development. We further recognize that programs succeed when their development is guided by clear, unambiguous policy direction. We have therefore refrained from litigation in this matter thus far. Beyond our efforts to ensure that this Commission clearly delineates between policy *development* and the *implementation* of policy, we continue our concerted efforts to substitute when appropriate alternatives to formal litigation. We intend to turn to formal litigation of disputes *only after* the Commission is assured that we have afforded parties the opportunity to exhaust the considerable array of alternatives.

Second, we have taken a comprehensive, long term view in our policy deliberations in this matter, and we continue this approach for each of the industries we oversee. All too often, regulatory and industry reforms arrive piecemeal, with portions of the overarching regulatory framework, or industry structure, addressed in isolation from the whole. While a single reform may appear to offer potential benefits when viewed in isolation, it may also impose costs on other areas of the regulatory framework. Those costs may ultimately outweigh the benefits of reform, and bring into question the desirability of enacting it at all.

For example, the severe dislocations of the US electric industry stemming from the fuel supply disruptions of the 1970s required speedy and decisive action by this Commission.⁷ The variety of reforms enacted in response to those challenging times served a well-intentioned purpose and contributed significantly to overcoming very difficult times. But the reforms occurred piecemeal, making it difficult to assess the effect one single reform might have on the others, or the linkage to the existing regulatory framework. Equally important, as described in the Division of Strategic Planning's report, the reforms responded to conditions which no longer persist. Thus, California has paid a price. Our state finds itself with a fragmented, outdated, arcane, and unjustifiably complex set of regulatory

⁷ See *California's Electric Services Industry: Perspectives on the Past, Strategies for the Future*, Division of Strategic Planning, pp 27-79.

COM/*

policies. In many cases duplicative and conflicting programs and incentives further frustrate and confuse market signals.

The Proposed Policies and Implementation Strategy

With this proposal, we intend to take the important first steps necessary to remedy the regulatory inadequacies plaguing California's electric services industry. Our comprehensive review has convinced us that change is necessary. We resist the tendency to drape outmoded regulatory approaches onto new and dynamic circumstances. Instead, we propose a comprehensive framework designed to harness and responsibly manage change for the benefit of California's consumers, its businesses, and the state's economy.

We recognize that attempts to predict, plan or mandate a single electric future for California means more of the same--central planning and micro-management. For this reason, the vision and strategy we propose for comment take a different tack. We attempt to achieve a clearly articulated set of goals--goals designed to bring benefits to California's consumers of electric services, large and small alike. We look principally, though not blindly, to markets and the private sector, rather than to command-and-control regulation, as the preferred means to achieve the goals established and benefits identified. Where competition, or the potential for competition, exists, our proposal attempts to exploit rather than ignore it. Our proposed vision and strategy attempts to guide rather than dictate. We intend to provide for all stakeholders the flexibility and signals required to make mid-course corrections and respond nimbly to changing circumstances.

Evidence of changes in the way energy products and services are developed, delivered and consumed is already apparent in California and across the nation. From our experience with increased competition and emerging market forces in the telecommunications and natural gas industries, we learned we cannot fully immunize the suppliers and consumers of energy services from the effects of those changes. Our experience with restructuring in the nation's

COM/*

natural gas industry demonstrates that, unless properly managed, some consumers may ultimately bear a disproportionate share of the cost burden that accompanies such transitions. We intend to continue to ensure a fair distribution of the costs of California's electric services infrastructure. This includes costs attributable to current and future changes. Specifically, as California confronts the challenges and changes ahead, we will not tolerate cost-shifting among customer classes. We will be particularly vigilant in our efforts to prevent costs from being shifted to residential consumers. With few exceptions, we intend to guard the fundamental principles derived from the Commission's cost allocation policies, and the result fostered by the application of those principles. Both the policies and the proposed modifications are described in more detail below.

In developing these proposed policies, we sought a broad scope of participation. We have profited from that participation. We better understand the effect particular policy and/or regulatory changes might impose on the various stakeholders as a result. In particular, we recognize the potential effects such changes might bring to the individuals and businesses that depend on electric services in California. We recognize that specific stakeholder representatives may assert that the change our proposal seeks is at odds with that group's particular interests as reflected in the *status quo* industry and regulatory arrangements. We have consciously attempted to craft a proposal which balances competing interests and, most important, which best serves Californians as a whole. We are hopeful that parties responding to our proposal will take a similar approach.

The Division of Strategic Planning's report launching our policy review, the suggestions, proposals and recommendations offered at our policy hearings, and the written comments submitted by California's energy services community have each contributed significantly to the policy statement we propose today. In our previous deliberations, and in comments submitted, considerable time and resources have been devoted to exploring what long term goals--what "vision"--ought to guide California's electric services industry, and the

COM/*

specific steps required to achieve those goals. Now is the time to advance the dialogue. This proposal marks the beginning of the Commission's formal examination of the electric services industry. We intend to continue our practice of convening full panel hearings to discuss with the state's varied interest groups matters as vital as those included in today's proposal. We intend to hold those hearings during the month of June.

A VISION FOR THE FUTURE OF CALIFORNIA'S ELECTRIC SERVICES INDUSTRY

The Fundamentals of Our Vision

We propose to revitalize California's vision for the electric services industry, and offer a long term, comprehensive package of policies and programs necessary to make that vision a reality. Our proposed package addresses both industry restructuring and regulatory reform.

We foresee a California in which:

1. *California's consumers gradually enjoy direct access to generation suppliers, marketers, brokers and other service providers in the competitive marketplace for energy services.*
2. *All of California's consumers have a reasonable and fair opportunity to enjoy the benefits of an increasingly competitive electric services industry.*
3. *California's consumers enjoy direct access to the most efficient, environmentally sound electric services infrastructure available.*
4. *Competitive electric services make a significant contribution to growth, productivity, competitiveness, and job creation throughout the state's economy.*
5. *All Californians enjoy universal access to a basic and affordable package of electric services which reflects and keeps pace with innovation taking place in the broader, competitive market for electric services.*

Specifically, we envision an electric services industry in which consumers choose freely whether to:

- 1) remain subject to the tenets of the traditional regulatory compact and retain the regulated utility as the consumer's sole "portfolio manager" for energy

COM/*

services;⁸ *or*,

- 2) leave the traditional regulatory compact and contract directly with generation and other service providers to tailor a portfolio of energy services, thus foregoing the utility's portfolio management services; *or*,
- 3) leave the traditional regulatory compact to contract with energy service brokers, marketers, or other service providers, who, on behalf of the consumer, act as an independent portfolio manager.⁹

Clearly, the vision we propose and the strategy to achieve it mark the end of one era and the beginning of another. In this new era, consumers will no longer be automatically subject to a monopoly franchise and thus dependent upon the utility as the sole provider of retail electric services.¹⁰ Furthermore, we believe that a managed and responsible shift to consumer choice through direct access promises to steer the utilities and other nonutility service providers away from the hearing room, and to more productive, consumer-oriented strategies focussed on delivering a diverse array of competitively priced, high-value products and services. As in other product and service markets, choice will appropriately decentralize decision-making and give consumers *direct* influence over the development, delivery,

⁸Those tenets are outlined below in the section discussing our proposed implementation strategy.

⁹The rights and responsibilities comprising the "new compact" which we propose to apply to consumers opting to leave the traditional compact are also detailed in our proposed implementation strategy. We use broker and marketer in the traditional sense: "broker" refers to service providers who take no title to the service or product; "marketer" refers to providers who purchase for resale. Recently, the Federal Energy Regulatory Commission (FERC) disclaimed jurisdiction over Enron Power Marketing Inc.'s brokering activities, and will allow its marketing activities to go forward based on market-based rates.

¹⁰We recognize that all consumers have some level of access to energy services which to varying degrees escapes both the state's energy regulatory apparatus and the utility's monopoly franchise. For large consumers, these alternatives include self-generation and flight from California to reestablish business in another state. In addition, all consumers can purchase energy efficiency services from private, unregulated firms, commonly referred to as energy service companies, or ESCOs. But as we discuss further below, these options are not necessarily optimal in every case from a societal perspective; from the state's perspective, the option of moving to another state can be particularly harmful to remaining consumers, the utilities' financial position and the state's economy. In addition, California's current regulatory framework governing the industry tends in many cases to raise significant barriers for consumers to adopt economic alternatives, and in other cases, offers consumers perverse incentives when choosing among alternatives. Our goal is to expand the number of low cost, valuable options and to facilitate their use by consumers.

COM/*

consumption and price of energy services. We believe this shift will benefit both large and small electric consumers, providers of electric services, including the utilities we oversee, California businesses, and the state's economy.

In the policies we propose for California, *consumer choice through direct access--* "retail wheeling" in the jargon of the industry--represents the cornerstone of our vision for the electric services industry. We believe that the proposed strategy accompanying our vision promises to 1) achieve that vision efficiently, fairly, and as predictably as can be expected in the face of rapid change, and 2) maintain California's enduring goals for the industry--electric service that is safe, reliable, reasonably priced and responsive to environmental concerns.

The Events and Observations Guiding Our Vision

Several key observations guide and support our vision:

- 1) A wholesale market for electric services, and the attendant institutional, financial and contractual arrangements necessary to facilitate a more vibrant market, currently exist and continue to develop. A direct access policy for California, and the transmission provisions of EPAct, promise to expand the market and enhance efficiency;
- 2) California and federal energy policy began some time ago to shift away from vertically integrated, natural monopolies and command-and-control regulation as the basis for organizing the electric services industry. State and federal energy policy look increasingly to markets and competition as the new organizing principles to bring the benefits of electric services to consumers;
- 3) Wholesale power markets have increased benefits for consumers and producers, and brought those benefits to more consumers than would be the case without these markets. Injecting additional competition in power markets will continue that trend;
- 4) Wholesale power markets have not compromised safety or system reliability within a specific utility's service territory, or within the infrastructure as a whole in the West;

COM/*

indeed, those markets have tended to enhance reliability;¹¹ and,

- 5) The convergence of telecommunications technologies and electric services will greatly facilitate competition, thereby benefitting consumers; this meshing of industries will further benefit consumers as new market arrangements, products and services emerge, and information and transactions costs fall.

Each of these observations is discussed in greater detail below.

The Link Between Wholesale Electric Markets and Direct Access

Many of the institutional and contractual arrangements, financial instruments, and information systems necessary to support direct access and retail competition in the electric services industry already exist, and continue to develop, just as they have in the natural gas and telecommunications industries.

For example, with respect to institutional arrangements, it has been decades since California's utilities relied exclusively on their own infrastructure to provide retail service. Throughout the country, the predominately voluntary development of interconnected transmission networks have enhanced beneficial wholesale energy transactions, and facilitated the development of sophisticated contractual arrangements and financial instruments. In the West, these arrangements arose primarily from the Western System Coordinating Council (WSCC). Though the WSCC was initially created to enhance reliability among utilities, grid interconnection and advanced telecommunications currently allow members to engage in an increasing number of trades which benefit WSCC members and their retail consumers. Advanced telecommunications have played a significant role in dramatically lowering the costs of collecting and analyzing trading data, and the costs of performing trades. By reducing these costs, the industry-led WSCC increased the ability of members to engage in a growing number of beneficial wholesale trades.

¹¹The infrastructure's impressive performance after the Northridge earthquake in Southern California is testimony to the high degree of control and coordination which can and must exist in a highly decentralized network of generating resources and loads.

COM/*

Approved by FERC in 1991, the Western Systems Power Pool (the Pool) is now a permanent institution in the West and represents another industry-led institution facilitating trades within the industry. The Pool significantly improves upon the arrangements WSCC members have developed and benefited from for some time. The Pool contains approximately 60 members and serves twenty-two states, a Canadian province and sixty million people.¹² The Pool is centrally managed by a single computer hub located in Phoenix, Arizona; it relies on sophisticated telecommunications technology to provide a forum in which to engage in short-term trades for electric energy, capacity, exchanges and transmission services. Through the Pool, members engage in mutually beneficial transactions and make more efficient use of the West's generation and transmission infrastructure.

The Pool's success exhibits the importance of severing the link between *ownership* of the electric services infrastructure and the *use* of the infrastructure. Severing this link is integral to the achievement of our vision. It is precisely the severing of this link, under terms and conditions agreed to by Pool members and approved by FERC, which allows considerable benefits to flow widely from more than one thousand monthly offers. Moreover, this separation of ownership and use has not compromised the high degree of central *control and coordination* necessary for the efficient, safe and reliable operation of an infrastructure as dynamic, complex and far-reaching as that necessary to deliver electric services in California and the West. Indeed, the *current* institutional arrangements governing electric power in the region are so stable and robust that the New York Mercantile Exchange has announced it has chosen the West as the site of its first futures contract for electricity. The futures contract can provide a significant and useful instrument for buyers and sellers in the West to manage risk. It can further enhance wholesale transactions and foster continued development of financial instruments designed to manage risk.

Yet despite the success of the Pool, and other industry-led pools throughout the

¹²Appendix E lists the Pool's current members.

COM/*

country, government and a variety of stakeholders have expressed concern that impediments persist within these quasi "markets" and continue to hamper the development of a robust electric services market. A frequent concern is the relationship between ownership and use of the electric transmission infrastructure.

First, while the current arrangements governing transactions function quite smoothly, not all power providers operating in the broader industry enjoy pool membership. As such, for suppliers who are *not* pool members, the information and transaction costs associated with selling power outside the Pool can pose significant barriers to access and efficient use of the infrastructure. Non-members also suggest that these barriers frustrate the efficient expansion of the transmission system. Finally, those wishing to benefit from wholesale markets by *buying* from the pool may face similar barriers to the extent that they, too, neither enjoy membership in the pool, nor own transmission assets.

Fundamental Changes in Energy Policy Sever the Link Between Ownership and Use

With EAct, Congress effectively severed the link between ownership and use of the nation's electric transmission infrastructure. In so doing, Congress took the first important and necessary steps toward achieving the goal of eliminating barriers to increased efficiency in wholesale power markets. EAct severs the link by amending Title VII of The Federal Power Act to place with FERC authority to require transmission owners to provide wholesale transmission service.

The debate over, and subsequent passage of, EAct prompted development of yet another industry led institution--the "regional transmission group" (RTG)--with the hope that RTGs can provide an effective forum in which to provide access to the grid. We believe that, ultimately, RTGs are likely to merge with industry-led pools and reliability councils to form an integrated market for transmission, or set of markets, in the West, further increasing

COM/*

the system's efficiency, benefits and beneficiaries.¹³

We applaud the rich history of cooperation that has allowed industry-led institutions like the WSCC and the Pool to flourish. These institutional arrangements have brought significant economic benefits to consumers and enhanced system reliability. We support the development of industry-led transmission groups and we welcome FERC's authority under EPAct to foster competitive wholesale power markets. We note, however, that Congress expressly retained a vital and considerable role for the states with respect to the use and expansion of the electric transmission system. Specifically, Congress left the states' jurisdiction over retail rates intact, and clarified that the prohibition on FERC-ordered retail wheeling did not affect state "...authority...concerning the transmission of electric energy directly to an ultimate consumer."¹⁴ We believe that preserving the states' role in both areas is appropriate. Yet we recognize that EPAct did not clarify all the boundaries of federal and state jurisdiction--ambiguities which have created some conflicts in the past. In addition to the jurisdictional gaps which persist between state and federal authority, we recognize as well the current dearth of institutional arrangements designed to guide the operations of international electric services markets in North America.

We are nonetheless confident that the policies and strategies we propose today for California build upon and generally support the policies and goals set forth in EPAct, as well as those established by FERC. We do not, therefore, anticipate conflict. Indeed, we intend to work closely and cooperatively with FERC to ensure a smooth transition to the new

¹³The WSCC recently broadened its membership to include independent power producers. These same power producers are active participants in the development of the Western Regional Transmission Association (WRTA), initiated and sponsored by WSCC members. As proposed, WRTA would include industry participants in the Western states, Canada and Mexico. FERC recently ordered the WSPP to open membership and participation to qualifying facilities seeking to participate in the Pool. The order does not require QFs gaining member status to waive any rights granted them under PURPA (See Western Systems Power Pool, 66 FERC ¶61, 201, 1994).

¹⁴See Section 722 of EPAct, which amends Section 212 of the Federal Power Act.

COM/*

competitive framework and industry structure we advance today.

Though bold and ambitious, our proposed vision represents the next logical and desirable step in an evolution begun in earnest with the passage of the Public Utility Regulatory Policies Act of 1978 (PURPA), and advanced in 1992 by passage of EAct. Our proposal takes an incremental step toward a destination envisioned some time ago. It is constructed using the basic principles clearly present in the *current* institutional arrangements governing power markets and pools. These principles include efficiency and fairness; respect for adequate system control, coordination and reliability; sophisticated bilateral and multilateral contractual, financial and technical arrangements; and the use of advanced telecommunications products and services to facilitate transactions.

Our proposal is designed to launch us from the end of one era--that of PURPA-- to the beginning of a new era articulated by EAct.¹⁵ It will, if implemented, result in a more competitive, consumer-driven electric services industry. By focussing on competition, our vision of consumer choice through direct access simply follows where EAct leads. Through its passage of EAct, Congress has affirmed what already exists--or soon will--in both the US and abroad.¹⁶

¹⁵We find considerable merit in the recent statements of one utility chief executive officer: "Is there a difference between wholesale and retail wheeling? Are the principles we apply to wholesale wheeling issues equally applicable to some retail wheeling issues? I believe they are, and suggest that we should talk simply about wheeling, and drop the separate wholesale and retail labels." See John E. Hayes, Jr., chairman of the board, president, and CEO, Western Resources Inc., *Fortnightly*, February 1, 1994, pp 17-19. We find the recent comments of TransAlta Utility Corp.'s chairman equally informative. He urges utilities to "...consider shaping the industry's future by addressing issues such as transmission access and retail wheeling." See Harry Schaefer, "Are Electrics Headed for a Fall?", *Fortnightly*, March 15, 1994, pp 15-16.

¹⁶ We note that the Michigan Public Service Commission initiated a five-year, experimental retail wheeling program on April 11, 1994. We note as well that the State of Connecticut's Department of Public Utility Control recently opened an investigation into retail electric transmission service (Docket No. 93-09-29). In addition, the direction we propose to take California's electric services industry is akin, though distinct in many respects, to that taken by, or under consideration in, the countries of Europe, Scandinavia, Central and South America and others. A growing number of stakeholders in the US are examining these models. More recently, the Province of British Columbia's Ministry of Energy, Mines and Petroleum Resource announced in September

COM/*

The Need for a More Consumer-oriented Vision

The response we received from consumers during our reexamination of the electric services industry and California's regulation significantly shaped our proposed policy. For example, many of California's large consumers expressed frustration and confusion over the fact that while they can, *if they so choose*, forego bundled utility natural gas service and go directly to the competitive natural gas market to arrange service, they are prohibited from enjoying the benefits of competition in the electric power industry. These consumers point to the vast array of new products and services that have emerged in the natural gas industry as a result of increased competition and consumer choice, including financial instruments designed to manage risk. Consumers argue that the disaggregation and development of new natural gas products and services allow consumers to tailor services to meet their particular needs, and compete more effectively in an increasingly global marketplace as a result. They point to the fact that prior to the changes in federal and state gas policies promoting increased competition, direct access and consumer choice, the majority of these new products and services did not exist, nor did most foresee their emergence. Instead, they assert, prior to the enactment of those policies, consumers were forced to accept a single, bundled service from the utility, or select from a comparatively limited array of service options if the utility felt a "real" threat of bypass existed. Finally, they point to significant reductions nationally in the price of natural gas and natural gas services since change first took hold in the natural

1993 its approval of a "Power Exchange Operation" (PEO) sponsored by B.C. Hydro and its wholly-owned marketing subsidiary, POWEREX. According to POWEREX, "The objective of the PEO is to provide both electricity suppliers and consumers with greater access to an active, short-term electricity market." The PEO establishes a short term (less than one year) electricity market. Products and services offered by the PEO include buying and selling short-term firm and interruptible energy and capacity, storing and lending energy, and providing wholesale and retail wheeling services. PEO transactions are not regulated and are made through negotiations and/or prices offered on the PEO's computer bulletin board. Participation is voluntary; eligible members include utilities, large consumers who purchase power at the 60 kV transmission level and above, independent power producers and cogenerators. See, the Ministry's press release of September 17, 1993, In the Matter of the Utilities Commission Act S.B.C., 1980, C.60; and In the Matter of an Application by POWEREX and B.C. Hydro for an Energy Project Certificate and an Energy Operation Certificate for a Power Exchange Operation; and POWEREX, "Briefing Session - Fall 1993: Power Exchange Operation." Though a number of differences exist between our direct access proposal and the Province of British Columbia's, an intolerance for cost-shifting among consumers represents one among several notable similarities.

COM/*

gas industry.

Faced with the successful results of changes in the natural gas and telecommunications industries; average prices for electric service in California which in some cases approach *twice* the national average and exceed that of our neighboring states by a significant amount; a vibrant and competitive electric supply industry; and the necessary technical capability, consumers increasingly support change and reform.¹⁷ We find considerable merit in consumer calls for direct access to electricity services. We intend to ensure that all consumers, large and small alike, benefit from our proposal. Our policy introducing direct access through consumer choice to the electric industry responds affirmatively and directly to the problems identified by California's policy makers and the industry's stakeholders; it advances national and state policies. Most important, our policy responds to consumers.

The Convergence of Telecommunications with Electric Services Promotes Direct Access

We expect telecommunications advances to accelerate the pace at which competition and market forces erode the monopoly franchise and alter industry structure. Advanced telecommunications continue to dramatically lower the cost of information and the cost of transacting business across most industries. The evidence is perhaps most striking in financial markets, where telecommunications technology has helped create a global financial system. And though financial markets have led the trend, the convergence of telecommunications with other forms of commerce, including the electric services industry, is accelerating rapidly.

¹⁷It is important to note that, contrary to some assertions, large, mostly industrial consumers, are not the only consumers advocating choice and direct access. At least one representative of residential consumers, while urging the Commission to exercise extreme caution and diligence, nonetheless supported changes which would allow residential consumers to choose a service provider other than the utility. (See remarks of Michael Shames, Utility Consumer Action Network, Reporter's Transcript, Full Panel Hearing on Crafting a Vision for California's Electric Services Industry, May 25, 1993, pp 98-101.) We understand that there may not currently exist among all consumer groups a consensus on the issue of whether the state should, as a matter of policy, grant consumers the ability to choose among service providers through direct access.

COM/*

With respect to the electric services and natural gas industries, telecommunications will continue increasingly to 1) lower the cost of integrating information and data, 2) enhance system coordination and control, and 3) facilitate and expand the operation of markets that already exist. Telecommunications promises to further advance direct access and retail competition by shifting greater influence to the consumer over the development, delivery and consumption of products and services. For example, fiber optics and other telecommunications technologies connected to television and personal computer technologies *currently* allow information to flow instantaneously in both directions between the utility and the consumer.¹⁸ The technology allows the utility to charge prices which vary to reflect the fact that the cost of providing service changes throughout the day, and provides the consumer with information to manage energy use directly and more effectively.¹⁹ Consumers can track price changes throughout the day and, based on that information, operate appliances or industrial equipment when it is most economic to do so. In short, *currently available* technology effectively connects the retail consumer to the power plant. Following on the heels of other US utilities, PG&E announced it will offer telecommunications-based energy management services to a select market segment through an alliance with Microsoft and TeleCommunications, Inc. (TCI).

These changes in the way the utility can deliver and price products and services, and in the way consumers can directly determine which services to select and when, promise to greatly increase efficiency in two fundamental respects. First, since consumers face price signals which more accurately reflect the cost of providing service, their choices governing energy use, including whether to invest in energy efficient devices, are apt to lead to more efficient use of resources generally. Second, better price signals, and the change in

¹⁸The convergence of telecommunications and electric services may occur more rapidly than most expect as some electric utilities look to ease their entrance into the telecommunications industry through legislation currently pending before Congress.

¹⁹This sort of price differentiation is commonly referred to as "time of use," or "real time" pricing. Californian's IOUs currently offer time of use pricing and the customized devices required to allow it.

COM/*

consumption patterns they are likely to engender, will enhance efficiency in the use of generation and transmission resources. Continued advances in metering and billing technologies--frequently cited as key stumbling blocks to decentralization, direct access and consumer choice--will further lower information and transaction costs and help disseminate these technologies and services to consumers more broadly and rapidly.²⁰

An Industry Poised for Change

A growing number of utility managers has already responded to the prospect for change and increased competition in the industry. We appreciate the joint efforts of San Diego Gas & Electric and the Commission's Division of Ratepayer Advocates to reform regulation in California. These incentive, or "performance based," regulatory proposals promise to ease the utilities' and the state's transition toward a more competitive industry structure. We have already adopted portions of the incentive proposal submitted by DRA and SDG&E.²¹ We are encouraged that Edison and PG&E have followed SDG&E's lead and filed regulatory reform initiatives of their own²²

California's utilities, with Commission support and guidance, have responded well to change in the past. We expect that trend to continue. But the significant reform proposals offered by the utilities and the Division of Ratepayer Advocates represent only the first steps in a transition toward consumer choice and direct access that will require additional reforms, and in some cases, fundamental change. The reform proposals represent important first

²⁰In the United Kingdom, where consumers currently enjoy direct access, metering technology and customized billing arrangements have advanced considerably. Similar advances have occurred, and continue to develop, in the US natural gas and telecommunications industries.

²¹See D.93-06-092.

²²See A.93-12-029 and A.94-03-008.

COM/*

steps, which neither conflict with nor impede our proposal.²³ We propose to adopt as Commission policy the conscious shift from our traditional cost-of-service framework toward performance-based regulation, which we find more compatible with competitive markets in electricity.

Other utility managers have taken more aggressive positions than California's utilities in response to emerging competitive conditions. One company, LG&E Energy Corp. has announced it intends to "de-integrate" its business, creating a new power generation, marketing and brokering unit which will operate independently from the company's retail utility distribution business. In addition, new power marketing and brokering firms have formed, similar to those operating in natural gas markets. At least one firm has received exemption from FERC jurisdiction over its brokering activities, while securing for its marketing unit FERC approval to sell at market-based prices. Finally, a sizable majority of the major rating agencies and investment firms have announced they intend to fundamentally redefine their methods of evaluating utility debt and investment quality. These new methods will focus predominately on the utility's perceived ability to compete.²⁴

Taken together, these observations support our belief that the institutional, contractual and financial arrangements, and the technical capabilities required to bring to consumers the benefits of increased choice through direct access already exist and continue to develop. We foresee arrangements in the electric services industry similar, but not necessarily identical, to those currently operating and/or under development in competitive natural gas and telecommunications markets. In particular, we foresee an industry in which:

²³Notably, PG&E's proposal, while failing to grant consumers direct access to alternative providers, is similar in key respects to the proposal we offer for comment today.

²⁴See, for example, Merrill Lynch's Bi-Monthly Review of the Utility Industry (August 23, 1993, November-December, 1993, and January-February 1994); and Morgan Stanley, "Of Elephants and Blind Men: Assessing the Risks of Competition," October 25, 1993; and Prudential Securities Electric Utilities Competitive-Risk Study, "Ready or Not, Competition Is On Its Way"; and Fitch Research, "Electric Utilities' Competitive Risk."

COM/*

- Consumers--including individuals, businesses, towns, cities, communities, and organizations--seek customized, highly disaggregated products and services to best fit their individual needs;
- Consumers choose from a broad array of competing service providers to manage their energy portfolio, including the utility, nonutility firms, marketers, brokers and others;
- Consumers face market-based prices for competitively delivered products and services, and regulated prices for residual monopoly services; and,
- Consumers enjoy a wide array of innovative new products and services designed to manage risk.

In the move toward increased competition and reliance on market forces in the electric services industry, both nationally and abroad, considerable focus has been given to the importance of spot markets and other market tools. For example, in the United Kingdom, the government created and now regulates an electricity spot market, known as "the Pool," as part of its privatization and restructuring efforts. We find certain attributes of the Pool particularly appealing. For example, it provides industry participants with a market price for electricity each half hour. This component of the Pool provides consumers with price signals that help to increase the efficiency with which consumers make use of electric services; these same prices provide generators with signals that help to increase the efficiency with which new power plants are constructed.²⁵ The Pool also ensures that the nation's stock of generating plants is subject to economic dispatch, and the requirements of system control and coordination. Equally attractive in our view is the Pool's function to separate the physical generation, transmission and receipt of electricity from the financial consequences of bilateral contracts aimed at an allocation of market opportunities and risks. The separation of physical transactions from the risk of contract failure with respect to the "contracts for differences" adds both stability and reliability to the delivery of a commodity we continue to

²⁵Under the UK electric system, government does not determine whether resources are "needed." Those decisions are left to the marketplace. Government continues to undertake environmental review of proposed plants, however.

COM/*

regard as a necessary.

To some extent, the pool could be considered as offering a "bundled" service package of 1) spot market for electricity, 2) coordination and transmission services and access,²⁶ 3) voltage support and system reliability, and 4) back-up power in case of non-performance by generation service providers. A UK-style pool may minimize transaction costs for consumers choosing direct access as well as mitigating the financial and operational risks that might otherwise be inherent in traditional bi-lateral arrangements between buyers and sellers.

We recognize that in other commodity markets, the design, development and operation of a spot market, and other market tools, are left to the marketplace. We recognize as well that a working spot market, and other financial instruments, can significantly lower transactions and information costs, and facilitate competition. Nonetheless, given the apparent benefits of the UK's Pool, we ask parties to comment on whether we ought to foster an environment in which the market develops and operates these mechanisms and tools, or whether the competitive market we hope to foster as part of this proposal in fact depends on the Commission first establishing a spot market, UK-style Pool, or other market instruments. In particular, we ask parties to address whether the successful implementation of our direct access proposal depends on a mechanism similar to the Pool established in the UK to address the vital link between the move to increased reliance on bilateral, or multi-lateral contracts, and the need for system reliability.

Getting From Here to There

We offer for comment our *long term* proposal for the electric services industry. Like

²⁶Physical operation of the transmission system in the UK is done by a single firm, owned by the country's distribution companies. Although England currently utilizes only one Pool, it may be more efficient to designate more than one Pool if necessary to reflect the various sub-markets for energy that may exist due to transmission constraints.

COM/*

EPAct, we envision an increasingly competitive, more efficient energy services industry. Our vision foresees a significant broadening of the participants who enjoy access to a competitive commodity market for power. Moreover, we propose what we believe are the changes required to solve the inadequacies that currently hamper the industry and California's regulatory framework governing it.

Our vision will not emerge, nor will we attempt to force its emergence, overnight. We recognize that the road to our ultimate vision is neither short nor easily travelled. We believe, nonetheless, that the foundation exists on which to foster a more consumer-oriented, competitive industry and grow the state's economy. Since the challenges facing California's electric services industry are similar, and in some cases identical, to issues the Commission has already addressed, or is currently addressing, as part of the transition to increased competition in the natural gas and telecommunications industries, the Commission is well-situated to guide and manage the transition.

Consistent with this Commission's constitutional duties, our proposal affirms this Commission's long-standing mandate to ensure that all consumers receive adequate, safe, reliable and reasonably priced electric service. Our proposal recognizes and embraces California's commitment to resource diversity and environmental quality. In the next section detailing our proposed implementation strategy, we briefly describe how our policy proposal ensures that the Commission will achieve these goals.

Finally, the Legislature can greatly assist in bringing the state the benefits our proposed vision promises. We intend to work cooperatively with the Legislature and will propose a legislative package designed to facilitate consumer choice through direct access and increased competition in the electric services industry.

COM/*

**ACHIEVING THE VISION: AN EVOLVING REGULATORY COMPACT
AND A TWO-TRACK STRATEGY FOR CHANGE**

Strategy Summary

We propose a two-track strategy to achieve our vision. First, in those areas of the electric services business which exhibit natural monopoly attributes, or where market power persists, we intend to replace our traditional cost-of-service regulatory framework with alternatives better focussed on utility performance and efficiency. Second, in those areas of the business where competition offers a superior means of organizing the development, delivery and consumption of services, we intend to replace the traditional regulatory framework with the discipline of market forces.²⁷ We intend to pursue the first track through the utilities' current initiatives to establish performance-based regulation in California; pursuit of the second track requires further evolution of California's regulatory compact and fundamental changes in the state's current regulatory framework.

Finally, our proposal focusses explicitly on the need to manage the transition to increased competition; we offer a long-term, staged implementation strategy designed to ensure that California achieves its vision in a manner that is fair to all stakeholders. And like our proposed vision for the industry, our implementation strategy is explicitly consumer-oriented. Key among the principles of fairness guiding our proposed implementation strategy is our continued commitment to prevent the inequitable shifting of costs among consumers, irrespective of whether those costs arise from uneconomic utility assets or from attempts to subsidize services with the hopes of gaining competitive advantage and market share. In addition, we are committed to ensuring that, in the end, the program we adopt does not

²⁷Those areas of the business we consider ripe for competition include generation services, energy efficiency services, and what is commonly known in the natural gas industry as the "merchant" function, which might include in the electric services industry power brokers, marketers and other service providers. We believe the attributes tied to electric distribution (increasingly referred to as the "wires business"), transmission, and system coordination and control services require that these areas of the business continue under regulation, albeit a form of regulation better suited to more competitive conditions.

COM/*

sacrifice the utilities' financial integrity.

We summarize the key components of our proposed strategy as follows:

1. ***The proposed regulatory strategy for direct access in California's electric services relies on two parallel tracks.***

The first track applies to consumers who wish to continue to receive bundled utility service. This track seeks to replace traditional cost-of-service regulation with alternatives more precisely focussed on performance and efficiency, goals traditional regulation has difficulty achieving. The second track applies to consumers who elect to take advantage of the competitive markets for generation services. This latter track replaces traditional economic regulation governing generation services with the disciplining forces of competitive markets.

As California moves to consumer choice through direct access, a principal concern of this Commission will be to ensure that utilities do not shift costs between direct access and utility service consumers. We will institute a proceeding to explore how to construct accounting barriers between the costs of serving utility service and direct access consumers; that proceeding will include the identification, and fair allocation of, any uneconomic utility assets. We propose to leave the current allocation of costs among consumer classes intact; that allocation will serve as the program's starting point.

2. ***The utility retains its traditional obligation to serve only for those consumers who elect not to choose direct access, opting instead to continue to receive bundled service from the utility.***

Under our proposal, these consumers are known as "utility service" customers and would include, in the first stage of the proposed transition strategy, all but the largest consumers. The utility continues to provide traditional bundled services (generation, energy

COM/*

efficiency, coordination and system control, transmission and distribution). The utility procures generation and energy efficiency services from competitive markets and from existing utility assets. The utility retains the option to construct new generation facilities to serve these consumers.

3. *Consumers who elect to participate in the direct access program will have the freedom to procure generation services directly from nonutility service providers.*

These consumers are known as "direct access" customers. The utility no longer enjoys an exclusive franchise for direct access consumers. Commensurately, we propose to modify the utility's duty to serve in this more competitive sector. We propose to allow regulated utilities to compete to provide generation services to direct access consumers, recognizing that regulatory oversight is necessary in this case to mitigate the utility's market power with respect to ownership of transmission. Under our proposal, the utility is obligated to provide transmission and distribution services on a nondiscriminatory basis to direct access consumers who require such services.

4. *The direct access classification is a voluntary one.*

In the early stages of the transition, the Commission will define a minimum eligibility level that consumers seeking direct access status must meet. Beginning **January 1, 1996**, direct access will be available to customers receiving service at the transmission level (50 kilovolts and greater.) By **January 1, 2002**, we propose to make *all* consumers eligible for direct access. Eligible consumers are not obligated to become direct access consumers. Eligible customers who do not choose direct access may remain utility service customers and will continue to receive bundled, regulated service from the utility, including generation services.

COM/*

5. *The utility remains the provider of last resort for all consumers.*

Direct access consumers wishing to return to the tariffed, bundled utility service, may only do so after providing the utility notice of no less than twelve months. The utility may waive all or part of the twelve-month requirement. A direct access consumer that has returned to the utility service classification must give the utility an additional twelve-month notice before returning to direct access status. The utility is required to provide service to consumers who wish to return to the utility system in less than twelve months, but who do not receive a waiver. The utility is not required, however, to offer service to such customers at the tariffed rate. Rather, the returning consumer must fairly compensate the utility for the incremental costs incurred to provide service until the twelve-month notice period has expired.

We believe these requirements are necessary and appropriate in order to 1) ensure the utility has ample opportunity to plan to meet demand, and 2) prevent uneconomic decisions that might otherwise arise if consumers could choose without restriction between the tariffed "utility service" price and the market price direct access consumers face.

6. *For direct access customers, the Commission will focus on ensuring nondiscriminatory transmission, distribution and coordination and system control services.*

We believe rigorous competition in the generation sector offers a superior means of ensuring reasonable prices for generation services when compared to traditional regulatory methods.²⁸ Transmission and distribution services, as well as system control and coordination services, will continue to receive regulatory oversight.

²⁸During the transition, we propose that the utility not be allowed to charge prices which fall below the company's marginal cost or exceed the current tariff.

COM/*

7. ***The proposal fundamentally modifies the regulatory structure governing utility resource procurement—the Biennial Resource Plan Update proceeding is eliminated.***²⁹

The State's current resource planning apparatus, including the Update proceeding, regularly establishes, under prescriptive rules, the amount of capacity the utilities subject to competitive auction. Our proposal significantly modifies the utility's obligation to serve direct access consumers, as well as the utility's resource procurement obligations. For utilities choosing to compete to provide generation services to direct access consumers, we propose to no longer allow the utility to enter into ratebase capital expenses used to develop, operate or maintain generation resources. Instead, the utilities' shareholders will bear the risk and enjoy the rewards related to the delivery of those services. The Commission will closely monitor the effect of utility participation in order to protect against the potential for self-dealing and cross-subsidization. We recognize that the proposal to allow utilities to continue to buy and sell generation services requires considerably greater regulatory oversight than would otherwise be necessary if the utility were solely a buyer. At this time we propose to relax somewhat our goal of reduced regulatory burdens in order to allow utilities to participate in this market.

We propose to eliminate the Update and establish new policies governing resource procurement which more accurately reflect the realities of an increasingly competitive market for electric services. Our proposal fundamentally alters the regulatory system governing resource procurement. The Commission and the Legislature, who share responsibility for establishing resource procurement goals and policies for California's investor-owned utilities, have traditionally played a considerable role in promoting resource diversity and environmental sensitivity in the development and operation of electric generating resources. Despite the state's success in enhancing resource diversity and maintaining environmental

²⁹Our proposal to eliminate the Update proceeding in no way touches upon the disposition of the solicitation currently pending before the Commission.

COM/*

quality, these important goals will continue under any restructured resource procurement program.

California's Regulatory Compact Must Evolve

The state's regulatory compact represents the means by which California has historically developed and implemented regulatory strategies designed to bring the benefits of electric services to the state's consumers. Based on the industry's traditional organizing principle, in which vertically integrated utilities represented the principal, if not exclusive provider of electric services, that compact served a useful purpose. Most argue that the compact, despite its shortcomings, served the state well.

The traditional compact is composed of several key components. First, it grants the utility monopoly franchise rights. Second, it ensures the utility's financial integrity by granting it an opportunity to recover reasonably incurred expenses and earn a fair return on its investment. In return for these privileges, the utility is subject to regulation by this Commission according to jurisdiction granted it under the state constitution and by statute; with that jurisdiction comes the Commission's duty to ensure the utility provides safe, reliable and reasonably priced service to all consumers within its monopoly franchise according to terms and conditions which do not unduly discriminate against any consumer.

Since the circumstances surrounding the industry have changed dramatically over the past two decades, and since the pace of change is likely to accelerate, we are convinced that California's regulatory compact must also change if we expect the state's consumers and California's economy to continue to benefit from this vital industry. The compact's tenets were never intended to be, nor have they remained, fixed. Rather, they have rightly evolved to correspond to the changes any industry and economy inevitably undergo. With this proposed strategy, that evolution continues.

COM/*

Nonetheless, the Commission's fundamental and enduring duty to protect California's consumers of electric service remains unchanged, and will persist during, and subsequent to, the transition to direct access. Yet, the means used to ensure adequate protection must change to better reflect increasing competition and a rapidly changing market structure.

This does not mean we intend to, nor will we, abandon our oversight of the industry, or abdicate our fundamental duties and responsibilities. Nor should parties construe our proposal as one which looks blindly to competitive markets as a regulatory panacea. Rather, our strategy recognizes and welcomes change. It recognizes that competitive markets, where they exist and function reasonably well, offer a superior regulatory tool when compared to command-and-control regulation and government central planning designed for an era that has passed and will not return. It emphasizes a significant shift to a considerably streamlined and more efficient, more rational regulatory approach. That shift is both appropriate and necessary in order to keep pace with changes already underway and likely to arise in the future. In short, our strategy offers an organizing principle that explicitly recognizes, and responds effectively to, the challenges this state faces; it ensures adequate, if not superior consumer protection; and, as important, it offers considerably greater potential for the state's consumers and its economy to benefit from electric services.

We recognize that as competition develops, the balance of this Commission's enduring duties will shift somewhat, focussing more on maintaining the integrity of the marketplace where competition is preferable to traditional regulation, while at the same time ensuring the same, or higher, degree of diligent oversight in those sectors of the industry less susceptible to competitive forces.

A Two-Track Strategy For Reform

In the first track of our proposed strategy, we propose to replace cost-of-service regulation with performance-based regulation, thereby altering the means by which the

COM/*

traditional regulatory compact is upheld and just and reasonable rates are ensured. In the second track we propose to alter the regulatory compact itself.

The First Track: In the Absence of Competition, Replace Traditional Cost-of-Service Regulation with Alternatives Better Focussed on Performance

A bundled utility service package, offered under price, terms and conditions approved by this Commission, must remain as a viable option for consumers. Moreover, for consumers who prefer direct access but who are not yet eligible, bundled utility service is likely to remain their only viable service option. We intend to replace cost-of-service regulation with performance-based regulation. Doing so neither changes the compact's tenets, nor threatens fulfillment of those tenets. We make this change for several reasons.

First, prices for electric services in California are simply too high.³⁰ The shift to performance-based regulation can provide considerably stronger incentives for efficient utility operations and investment, lower rates, and result in more reasonable, competitive prices for California's consumers. Performance-based regulation also promises to simplify regulation and reduce administrative burdens in the long term.³¹ Second, since the utilities' performance-based proposals currently before us leave both industry structure and the utility franchise fundamentally intact, consumers can expect service, safety and reliability to remain

³⁰As part of the process leading to the issuance of this proposal, a variety of stakeholders and experts offered useful insights in an attempt to explain why California's prices are so high. Many argued that the utilities' overhead expenses are higher than utilities elsewhere in the country; that the utilities' assets--nuclear assets in particular--are uneconomic; that the contracts utilities signed with qualifying facilities over the past decade as part of this Commission's competitive procurement program are uneconomic; that the costs related to all forms of regulation in California are higher than in other states; and that legislative and Commission mandates are more extensive and costly than those imposed on utilities in other states. The program we propose, from direct access to performance-based regulation, to working with the Legislature to examine the need for reform of certain P. U. Codes, attempts to address each of these factors.

³¹We say this recognizing that in the short term, completing our obligations under the traditional framework, while ushering in a new framework, will require additional resources.

COM/*

at their historically high levels. Third, the utilities' reform proposals are likely to provide an opportunity to earn that is at a minimum comparable to opportunities present in cost-of-service regulation.³² Finally, performance-based regulation can assist the utilities in developing the tools necessary to make the successful transition from an operating environment directed by government and focussed on regulatory proceedings, to one in which consumers, the rules of competition, and market forces dictate.³³ This is of critical importance in our view. Competition and change in the electric services industry are to a large degree taking place outside the purview of both state and federal regulators. California's utilities must develop the consumer-oriented skills that firms in highly competitive markets regularly face.

We look to the utility-initiated reform proposals to implement the first track of our strategy. We reject at this time attempts to devise a single, uniform approach which must apply to each utility. Despite the positive response to the utilities' recent solicitations, the State's planning apparatus, including the Update proceeding, is in our view outmoded, unnecessarily lengthy and too costly. We do not intend to relive that experience as we implement the first track of our strategy. Instead, each utility may offer proposals to best meet its particular circumstances, though any proposal must meet the broad goals and requirements established in our final policy statement, as well as any legislative requirements applicable now or at the time we approve the utility proposals. We will allow the utilities'

³²Our views are tempered by the recognition that performance-based regulation is not without shortcomings. For example, many point to the fact that while PG&E's Diablo Canyon nuclear facility has performed remarkably well, the costs PG&E's consumers incur as a result of the performance agreement's design features are troubling. As such, we intend to ensure that the utilities' performance based proposals promise benefits to consumers, as well as to shareholders, in the event of superior utility performance.

³³We note that under our vision for the future, nothing would prevent service providers from competing with the utility to offer bundled service options. These providers would necessarily have to secure some services from the utility (e.g., distribution, control and coordination services, and perhaps, transmission services), but could secure other services, including generation and energy services, from alternative providers. This competitive threat will apply additional downward pressure on utility costs, and further help to ensure reasonably priced services for the state's consumers.

COM/*

proposals ample opportunity to operate in order to evaluate the results in a comprehensive and meaningful way. In so doing, we will obtain a broader and richer understanding of what works, what doesn't, and why.

***The Second Track: Where Competition Exists, or the Potential for Competition Exists,
Replace Economic Regulation with the Discipline of Market Forces***

Recent competitive solicitations for power by California's investor-owned utilities, the state's publicly-owned utilities, and other utilities across the nation highlight the intense competition that already exists in the generation sector of the electric services industry. These results demonstrate that the opportunity exists to exploit more effectively and efficiently what amounts to the untapped potential for robust power markets in California and in the West. The reforms enacted by Congress in 1992 took the first important steps to fulfill that promise. Our proposal follows in those steps by taking the additional actions necessary to replace outdated regulatory mechanisms governing the generation sector with market forces and competition.

- Beginning **January 1, 1996**, all consumers who receive service at the transmission level will be eligible to choose freely and directly from alternative providers in the competitive market for generation services. This group will be required to designate by **July 1, 1995** whether they intend to elect to participate in the direct access program.
- Having gauged the success of, and made any necessary modifications to, our program, we will expand eligibility to consumers taking distribution from the utility at the primary level beginning **January 1, 1997**.
- Beginning **January 1, 1998**, consumers taking distribution at the secondary level will be eligible to choose direct access.
- Beginning **January 1, 1999**, all commercial customers will be eligible.
- By **January 1, 2002**, depending on the success of the program, we intend to broaden eligibility to include *all* consumers.

COM/*

We ask parties to comment on our proposed schedule governing eligibility.

To facilitate the move to consumer choice through direct access, we will work with the Legislature to amend those sections of the Public Utilities Code necessary to exempt California-based generation service providers wishing to offer retail service from regulation as public utilities by this Commission. Though we recognize implementation of our proposal does not depend on amending the Code in this way, we believe doing so will greatly enhance entry into the competitive market for generation services.

Despite the competitive nature of the generation sector, the natural monopoly character of electric distribution and system control and coordination demands that this Commission's fundamental duty and powers to protect consumers remain intact, even for direct access consumers. We do not intend to allow the utility to use these vital functions to unfairly treat consumers who choose to tap the competitive generation market.

EPAct gives FERC explicit authority to mandate wholesale access to the transmission system and determine the appropriate arrangements governing wholesale access. We welcome FERC's new authority in this area. We have for some time recognized that the lack of transmission access can present a significant impediment to a competitive electric services market. Our transmission investigation, begun in 1990, has at its core the explicit goal of establishing transmission access arrangements that are both fair to the provider and not unduly discriminatory to those requesting service. More recently, in a letter to the leadership of the Legislature describing his proposal to reorganize California's energy agencies, the Governor proposed to "...centralize the task of opening the transmission grid to all users in our Public Utilities Commission."³⁴ We look forward to working with FERC to develop the transmission pricing policies necessary to support a more competitive electric

³⁴Letter from Governor Wilson to Senators Roberti and Maddy, and Assemblymen Brown and Brulte, December 1, 1993.

COM/*

services industry.

At the same time, the State of California, through this Commission and other regulatory bodies, has extensive jurisdiction over siting and certification of new power plants and transmission lines constructed in California. EPAct explicitly reserved state jurisdiction over siting and environmental review. Furthermore, FERC recognizes state regulatory jurisdiction over retail franchise matters, including compensation for stranded generation investment to serve retail customers.³⁵ We believe FERC shares our goal of increased competition in the electric services industry and we intend to coordinate with FERC where necessary to ensure the successful development of our direct access program.

To foster the expeditious development of fair and open transmission access, FERC has expressed its support for an industry-led solution through the formation of regional transmission groups, or RTGs. We join enthusiastically in that support. However, any RTG seeking our support must demonstrate that its governing principles leave ample room for adequate protection of California's consumers by this Commission. But despite widespread support for industry-led solutions such as RTGs, many aspiring RTGs hoping to receive FERC approval seem unable to form a consensus among the numerous interest groups around the guidelines governing formation and operation.³⁶ We are hopeful that any historic, potentially parochial differences that may have existed among parties and plagued efforts to establish open transmission access in the past will not hamper the successful formation of RTGs. We believe RTGs can transcend issues which in the past may have hindered

³⁵See United Illuminating Company, 63 FERC ¶61, 212, Rehearing. denied, 64 FERC ¶61, 087 (1993).

³⁶We note that any RTG seeking FERC approval must satisfy a minimum set of threshold requirements set forth in FERC's recent policy statement on RTG formation. From our perspective, key among those is the requirement that potential RTGs "...involve the states in whatever way is most effective...particularly in the formative stages...to ensure that the RTGs governing agreement recognizes that actions taken by RTG members under an RTG agreement ...[are] consistent with state and local law." (64 FERC ¶61,138, p. 15, mimeo.) California's utilities should recognize that FERC's policy comes in addition to this Commission's requirement that the RTG bylaws leave ample room for consumer protection.

COM/*

wholesale transmission access in the industry. Moreover, we believe RTGs can accommodate direct access to all consumers and prefer that the utilities look principally to RTGs as the primary means for establishing direct access. Finally, we hope other states will consider direct access proposals. This would help to facilitate efficient consumer power markets in the West by potentially minimizing the potential for regional differences. We will work with our colleagues in other states to help create a better understanding of our proposed strategy.

Direct Access Requires Ratemaking Reform

We offer consumers the opportunity to tap the competitive generation market because we believe that competition in that sector is vibrant, and promises to do a comparable, if not better, job of disciplining prices when compared to traditional regulatory approaches.

Under our proposal, direct access consumers must nonetheless continue to secure some services from the utility, including distribution, system control and coordination, and any other ancillary services required. Most are likely to require transmission services from the utility, at least in the near term. To ensure the utility offers reasonable prices for these services, we propose to initiate an investigation to disaggregate, or "unbundle," the current utility service package into discrete services, and assign prices to those services. In addition to serving the purpose of ensuring just and reasonable rates, this service unbundling proceeding will help to achieve at least three other important goals.

First, it provides consumers with the information necessary to assess whether to continue to receive generation services directly from the utility or look to the competitive market for electric generation services. Second, consumers must face appropriate price signals if we hope to avoid fostering perverse economic incentives. Those signals should reflect the marginal cost of providing service. We cannot be certain that consumers in a competitive market receive appropriate signals without unbundling services and costs. With

COM/*

services and prices unbundled, we propose to allow the utility to compete to retain and increase its market share in generation services. This would include allowing the utility to negotiate prices directly with direct access consumers. Under our proposal, the price the utility negotiates may not fall below its marginal cost of providing service. Finally, as described below, the programs we propose are explicitly designed to harness competition *without* cost-shifting, and *without* uneconomic bypass. Unbundling services and prices will help to prevent both.

This Commission has gained considerable experience in the natural gas and telecommunications industries with respect to the importance of unbundling in the face of competition, and the steps necessary to accomplish the task. That experience will assist us as we move to implement direct access in the electric services industry. The Commission's long-standing ratemaking policies grounded in marginal cost principles will facilitate the task of unbundling.

Direct Access and The Duty to Serve

The utility's historic obligation to provide safe, reliable, reasonably priced electric service extends to all consumers within the boundaries of its designated franchise. For all practical purposes, the duty to serve under the traditional compact requires the utility to provide service on demand according to rates, terms and conditions approved by this Commission. The duty to serve represents one of the most important components of the regulatory bargain and significantly differentiates the utility from its nonutility competitors. California's investor-owned utilities have lived up to this specific obligation under the compact well; their exemplary performance with respect to ensuring reliable service, in both certain and uncertain times, has benefitted the state's consumers. But in an industry whose organizing principle is grounded in direct access, the duty to serve must evolve.

Under our proposal, the utility retains the traditional duty to serve for consumers who

COM/*

continue to receive bundled, tariffed utility service. This includes consumers who choose not to exercise their option to pursue direct access and those not yet eligible to participate as part of the transition.³⁷ We propose to modify substantially the utility's duty to serve for consumers who choose to participate in the direct access program. Modifications are necessary to ensure that the compact is fair to all stakeholders and reflects the realities that competition and consumer access through direct access promise.

To allow eligible consumers to choose without restriction between the regulated price for bundled utility service and the price offered by the generation services market may severely reduce the utility's ability to plan for, and reliably serve, its remaining customers. Absent modifications to the compact's traditional duty to serve, consumers may make choices about electric services which they find economically attractive, but which are undesirable with respect to the broader goal of allocating society's resources efficiently. That is, the consumer may choose to leave the utility franchise because the *regulated price* the utility charges is higher than the price offered in the generation market for comparable service, despite the fact that the utility's *marginal cost* of providing the service is actually less.³⁸ This Commission has aggressively developed policies to discourage what is referred to as "uneconomic bypass" in each of the industries we oversee. As such, uneconomic bypass by no means represents a novel challenge to California's utilities, or to this Commission. Indeed, our policies designed to deter uneconomic bypass in California's electric services industry have enjoyed considerable success.³⁹ Yet despite this success, we are nonetheless

³⁷Again, under our proposal, all consumers enjoy the opportunity to choose direct access on January 1, 2002.

³⁸Generally, this occurs when, as is currently the case in California, the utility's average cost of providing service exceeds its marginal cost.

³⁹Those policies apply in our Expedited Application Docket and are described in D.87-05-071. They allow the utility to negotiate prices with consumers credibly threatening to bypass; those prices cannot fall below the utility's marginal cost of providing the service. This policy expressly supports *economic* bypass, but leaves with remaining consumers the responsibility to compensate through higher rates any losses the utility incurs due to price discounts. With the threat of bypass diminished we closed the docket in 1990. (See the Division of

COM/*

concerned about two troubling aspects of those policies. With the threat of bypass on the rise again, we believe it is appropriate to revisit those policies.

First, we are not comfortable with the fact that consumers represent the sole contributor to the costs of increased competition and bypass; that is, consumers are expected to bear one hundred percent of the financial burden resulting from any revenue shortfall created by competition in the form of discounts offered to consumers threatening bypass. Second, we do not believe the utility faces sufficient incentives to negotiate aggressively with consumers since shareholders are effectively shielded from the financial consequences of discounted prices.

Given these concerns, we believe the time is ripe to distribute more equitably the costs associated with increased competition in the electric services industries. In so doing, however, we believe it is comparably important to enhance the utility's ability to compete aggressively for market share and discourage uneconomic bypass. Finally, we see no reason to alter the Commission's long-standing policy of not impeding *economic* bypass of the utility's system.

With these considerations in mind, we propose that the following principles comprise California's policy governing its investor-owned electric utilities' duty to serve in a new era marked by consumer choice through direct access:

- The utility may compete to retain direct access consumers based on disaggregated prices and services.
- The utility may negotiate prices with direct access consumers which diverge from tariffs for generation and generation-related services (e.g., coordination and system

Strategic Planning's report, pp 78-79).

COM/*

control services, backup services, etc.). Those prices will receive streamlined regulatory scrutiny and enjoy expedited approval procedures. The terms and conditions governing pricing flexibility will be established as part of the service unbundling proceeding we propose. At a minimum, we propose to allow the utility to freely negotiate prices with direct access customers as long as those prices do not exceed current tariffs or fall below the company's marginal cost.

- Utility shareholders will contribute to the full recovery of revenue shortfall and receive the gains resulting from any price discounts the utility offers consumers. We will establish a revenue or price cap framework to govern utility operations related to direct access service. Like caps applied in other industries (and proposed by California's utilities in their PBR initiatives), the framework will include a formula which explicitly accounts for inflation, productivity, and events beyond utility control (the so-called "z factor"). In addition, the framework will include a symmetric band, comprised of a floor and ceiling, governing utility earnings. The ceiling will limit the aggregate amount utility shareholders may earn, while the floor will limit shareholders' exposure to revenue losses due to increased competition.
- Direct access consumers will contribute to the recovery of the uneconomic portion, if any, of the utility's generating assets resulting from our new competitive framework. Direct access consumers will make that contribution in the form of a "competition transition charge" assessed as part of the demand charge. We will open a proceeding to establish the mechanism governing the competition transition charge.

It is critical to recognize a key component of our proposal. The utility is *not* at risk for the total revenues customers eligible for direct access currently contribute to the utility's revenue requirement. On the contrary, the actual amount at risk is a fraction of that contribution. Under our proposal, the utility is at risk *only* for those revenues

COM/*

tied to the *economic* portion of the utility's generating assets, and any overhead tied to the delivery of generation services. We do not propose to place at risk the *uneconomic* portion of the utilities generating assets.⁴⁰

We propose the following methodology to determine the extent to which the utility currently holds uneconomic assets. We propose to use the utilities' system marginal cost of generation to determine the market value of *each* utility plant.⁴¹ Individual plants whose marginal cost falls below the system marginal cost will have a positive market value; those whose marginal cost exceeds the system's will have negative market value. If the net difference between the utility's stock of economic and uneconomic assets is positive, then there is a gain to be distributed between consumers and shareholders. If the net difference is negative, those losses will be reflected in the "competition transition charge" assessed to each customer's demand charge.⁴² When assessing the charge, we propose not to allow any class' overall allocation of generation costs or amortization schedules to exceed current levels. That is, we will not allow the determination of uneconomic assets to act as a forum for shifting generation costs, uneconomic or otherwise, among classes or across generations. Finally, we will examine the need to establish a time-table to recover any uneconomic costs which corresponds with our scheduled expansion of direct access to all consumers. This option may ensure that we do not jeopardize the ability of the utility to recover any uneconomic assets identified.

⁴⁰We intend to include in our investigation into uneconomic assets consideration of any costs related to existing utility obligations under ISO4 contracts, as well as costs tied to any long term fuel contracts the utility may hold.

⁴¹We propose to use the utility's marginal cost of generation as a proxy for the market price of electricity in determining the market value of each power plant.

⁴²In addition, we propose to consider establishing an additional line item to reflect the cost of funding utility programs to which competing nonutility providers are not subject (e.g., economic development rates, low-emission vehicles, and programs designed for low-income consumers). To the extent the utility continues to fund these important programs, we believe direct access consumers should continue to contribute.

COM/*

With respect to any additional financial exposure our program may impose on the utility, several aspects of our program and current utility strategies help to mitigate that exposure. First, each of the state's IOUs has begun to take steps to reduce costs. Second, we provide the utility with the tools necessary to compete aggressively to retain and expand market share in generation services, and discourage uneconomic bypass, further moderating the utility's financial exposure. Third, we expect the utility's competitive position to improve, and its financial exposure to decrease somewhat, as energy payments made to QFs holding ISO4 contracts fall from prices based on forecasted fuel prices to prices based on the utility's actual avoided cost. Fourth, we will account for any incremental risk our direct access proposal imposes on the utility in the next cost of capital proceeding. Finally, both PG&E and Edison have aggressive, successful power producing affiliates.

- The utility remains the provider of last resort for *ALL* consumers. *However,*
 - 1) direct access consumers who subsequently wish, for whatever reason, to return to the status of tariffed, utility service customer may only do so after having provided the utility notice of no less than twelve months. The utility has the discretion to waive any, or some portion of, the twelve month requirement; but,
 - 2) the utility must provide generation services to direct access consumers who wish to return to the utility system in less than twelve months and to whom the utility has chosen not to grant a waiver. In this case, the utility is not required to offer service at the tariffed rate. Instead, the returning consumer must fairly compensate the utility for the costs actually incurred in arranging for and delivering service until the twelve month period has expired. Finally, the returning customer must also provide the utility with notice of not less than twelve months before again exercising eligibility for direct access.

COM/*

With these guidelines, our proposed strategy governing direct access achieves several goals. First, it provides the utility with the flexibility necessary to plan effectively and ensure reliable service. Second, it promises to increase efficiency and lower rates, since competition tends to discipline costs more effectively and efficiently than regulation. Third, by establishing a mechanism which discourages uneconomic bypass, allows economic bypass, and more fairly distributes the costs of bypass, our proposal offers the potential for a better allocation of resources and a more equitable distribution of any costs tied to competition.

Finally, by including them as an explicit line item in the demand charge, our proposal addresses directly any uneconomic assets resulting from the transition to increased competition, and prevents any shifting of those costs among consumers. We will formally identify the magnitude of the potential costs, if any, attributable to uneconomic assets. We do not intend to tolerate cost shifting among California's consumers of electric services in the transition to direct access. This principle has guided, and will continue to guide, this Commission's structuring of prices for utility electric services rendered for some time. We intend to remain vigilant in our continued pursuit of that principle. To guard against cost shifting from the outset, we will not revisit the allocation currently assigned to the different consumer classes. We propose that those commitments remain intact.

We now turn to the effects our proposal might have on the Commission's ability to achieve the state's enduring goals for the industry.

Fairness to the Utility

We believe the shift to performance-based regulation and the components of our proposed direct access program maintain or enhance the utility's opportunity to earn.

Direct Access, Integrated Resource Planning and Efficient Infrastructure Investment

Some suggest that EPAct offers states and the nation a conflicted vision. This alleged

COM/*

conflict appears to stem from E Pact's clarity of vision with respect to increased reliance on competition as the means to increase benefits for consumers on the one hand, and its encouragement of integrated resource planning on the other. Some see competition as fundamentally incompatible with government-sponsored central planning, which is how many have come to view integrated resource planning (IRP). We disagree that robust competition and rational IRP cannot co-exist.

This being said, we believe there no longer remains a place in the competitive vision that E Pact articulates and fosters for the complicated, government-sponsored central planning California has practiced. The laws that created and now dictate planning in California were more necessary and appropriate when vertically integrated, investor-owned monopolies dominated the electric services landscape; when the nation faced an imminent threat to its security of supply; when inflation was high; and when utility demand forecasts and construction costs were high as well. None of these conditions remains.⁴³ Most significantly, the utilities face a mature, financially and technically competent, and considerably influential nonutility power industry, which increasingly includes utility affiliates.⁴⁴

The most striking evidence that California's current integrated resource planning process must now change came with the response of the nonutility power industry to the state's investor-owned utilities' recent solicitation for power contracts.

⁴³We recognize that there is always some possibility that the nation's security of supply may be threatened. However, the likelihood is significantly less that the electric services industry will fall prey to the sort of supply disruptions experienced during the 1970s. The impressive increase in the diversity of California's electric services infrastructure and considerably improved gas supply have played a vital role in diminishing that likelihood significantly.

⁴⁴Edison's affiliate, Mission Energy, and PG&E's affiliate, U.S. Generating Co., are two of the world's largest and most successful independent project developers. U.S. Generating Co. qualified for more than 700 of the approximately 1,400 MWs of power contracts in SDG&E's and Edison's recent solicitations.

COM/*

Clearly, the results of the auction administered by this Commission have not come absent considerable challenges, difficulties, and shortcomings. But two things are clear. First, the supply of competitively-priced power is considerable. The offers for capacity were *six times greater than the amount requested*.⁴⁵ Second, the government-sponsored process used to predict "what the utility would do" has little or no bearing on what the market has, and is willing, to offer. Most notable among the results is the remarkable disparity between the price the current planning process estimated California's consumers would have to pay for renewable resources and the actual price offered by the market. In some cases, the market offered renewable electric services for less than one half the price estimated by the State.⁴⁶ Similar disparities exist between the price the State forecasted for fossil-fired resources and the price the market actually delivered.

Given the intense competitiveness and size of the current generation market, and the difference between government forecasts and market realities, we propose to eliminate the state's current procurement process, the Biennial Resource Plan Update (the Update). Rather than spend what are increasingly scarce State and private resources on "forecasting," or "predicting," a competitive market waiting to be tapped, California should instead embark on an investment strategy which exploits that market directly for the benefit of the state's consumers. Doing so would allow the State's resources and private capital to be directed to other, more productive uses providing vital services, creating jobs, and improving California's economy.

Faced with the same intense competition in the marketplace for natural gas, this Commission, the Energy Commission, and Governor Wilson support a policy which looks to

⁴⁵PG&E, Edison, and SDG&E solicited bids for approximately 1,360 megawatts of capacity; combined, they received offers exceeding 8,600 megawatts.

⁴⁶If the state had relied solely on the government planning process rather than join it with a competitive auction, California's consumers would face significantly higher prices for the valuable, competitively-priced renewable resources in which the state's utilities are now poised to invest.

COM/*

the market to determine incremental capacity investment. California has properly rejected government-sponsored capacity and investment planning for the natural gas industry. Given the evidence of comparable competition in electric generation in California, the West, and across the country, we believe California ought to pursue a comparable "let the market decide policy" for incremental investment in electric generation services.⁴⁷ We believe California can pursue this policy without compromising the state's goals for the industry.

We do not believe our proposal to establish direct access and consumer choice in California's electric services industry conflicts whatsoever with the fundamental spirit of integrated resource planning. It simply achieves it in a new, more effective and less burdensome way. We believe the spirit of IRP is, and ought to be, grounded in best business practices and sound public policy: *Carefully consider a wide-range of investment options, balance short-term and long-term goals, quantify as many costs and benefits as possible, and do not ignore those factors which resist quantification.*

We find ourselves in considerable agreement with the Public Utility Commission of Texas, which recently required Houston Light & Power, as part of its resource evaluation, "...to solicit and evaluate proposals under which it would provide self-service wheeling within its service territory for the purpose of deferring or eliminating the need for the proposed...[power] plant."⁴⁸ Logically, the Texas Commission effectively--and appropriately--found self-service wheeling to be a legitimate and pertinent option in

⁴⁷We recognize this shift in policy requires amending and/or eliminating some current statutes. We are prepared to work closely with the Legislature and the Administration to craft the legislation required to make this important policy shift.

⁴⁸Public Utility Commission of Texas, Order in Docket No. 12138, "Notice of Intent of Houston Lighting and Power Company for a Certificate and Convenience and Necessity for Advanced Gas Turbine Projects," December 22, 1993.

COM/*

integrated resource planning.⁴⁹ We therefore disagree with those who assert that direct access through consumer choice conflicts with, or is contrary to, integrated resource planning's basic principles; rather, we believe the policies we propose are fundamentally consistent with the spirit of integrated resource planning since it includes, rather than excludes, opportunities to increase the efficiency of the development, delivery and consumption of electric services.

We encourage parties to propose alternative frameworks based on "let the market decide" to replace the Update. While we do not intend to establish a formal collaborative process, we further encourage the utilities to work with all of the state's stakeholders to devise such a framework prior to making any formal filing with the Commission. Like the performance-based regulation initiatives, we will not at this time consolidate any utility resource procurement proposals, or attempt to impose a single, uniform framework on each of the states' IOUs. We inform the utilities, however, that for those choosing to remain in the business of constructing, owning and/or operating power plants, investment in those plants will necessarily receive considerably greater regulatory scrutiny than would procurement by utilities who have voluntarily exited the new generation business, as PG&E has thus far offered to do. For utilities who no longer invest directly in power plants, we intend to engage in the minimum necessary oversight.

Our concern with allowing the utility to remain as both buyer and seller of generation services stems largely from experience with competition in the natural gas and telecommunications industries. We choose not to propose that the utilities divest themselves of their generation or transmission assets at this time. We are not yet convinced that absent divestiture in the electric services industry, consumers will necessarily be deprived of the benefits of competition our proposal seeks to create. We ask parties to comment on whether

⁴⁹Self-service wheeling refers to the situation in which the entity providing the power also consumes the power at another site.

COM/*

the competitive market we hope to foster necessarily depends on ordering the utilities to divest themselves of generating assets. Parties should look to the Commission's and California's experience in the natural gas and telecommunications industries when responding. We further ask parties to comment on whether a competitive market for generation services depends, at a minimum, on this Commission ordering the utilities to create separate accounts for its generating and transmission assets. Finally, we ask parties to comment on whether prohibiting the utility from offering generation services within its service territory represents a preferable alternative to divestiture or separate accounts.⁵⁰

Environmental Quality, Fuel Diversity and Energy Efficiency

We believe our proposal will assist in statewide efforts to improve environmental quality and resource diversity. First, under our proposal resource additions pursued in California do not escape the requirements of California's Environmental Quality Act (CEQA), which represent some of the strictest and most effective environmental safeguards in the country. In addition, our proposal builds significantly on Southern California Edison's "green pricing" proposal.⁵¹ Dubbed "Accelerating Renewable Resource Development Through Customer Choice," Edison's "green pricing" initiative would allow consumers to *choose* to pay somewhat more for electric service, promising to devote the surcharge directly to the acquisition of renewable resources. By choosing to pay the surcharge and support investment in these resources, consumers would enjoy, according to Edison's proposal, the

⁵⁰Finally, we note that nothing prevents the utility from requesting that the Commission entertain utility-sponsored proposals to create separate generating or transmission affiliates, or divest themselves of generating and/or transmission assets.

⁵¹David Moskovitz, of the Regulatory Assistance Project, is one of the original designers of "Green Pricing." See "'Green Pricing': Why Not Customer Choice?," The Electricity Journal, October 1993. Though Edison met extensively with stakeholders, the company ultimately decided to postpone filing an application implementing the proposal.

COM/*

added benefits associated with enhanced air quality and increased fuel diversity.⁵²

The consumer's ability to choose directly among products and services to achieve particular social objectives is far reaching and expanding. Our proposal follows the spirit of Edison's consumer-oriented approach to environmental quality and resource diversity, but does so, we believe, more directly and effectively. Rather than require reliance on a single provider--the utility--from whom to secure "green electric service," our proposal allows consumers to choose from a wide array of "green" service providers, marketers and brokers, just as consumers currently choose, for example, among a wide variety of products using recycled materials and "socially responsible" investment portfolios. Thus, our proposal, like Edison's, appropriately places greater reliance on consumer choice; it differs from Edison's, however, to the extent it allows "green consumers" to choose among a potentially wide array of competing "green service providers."⁵³

Finally, we believe the time is ripe to begin to work with the Legislature to reexamine current laws requiring that a portion of the utility's infrastructure investment be set aside for renewable resources. Through direct access and consumer choice, our proposed policy offers market incentives and signals to invest in resources which contribute to both increased fuel diversity and the success and competitiveness of renewable energy service providers.

⁵²Clearly, since the utility cannot direct electrons generated at a particular plant to a specific end user, those choosing to pay the higher, "green tariff" would not receive "green electrons" produced by the renewable resource. Rather, the consumer choosing the tariff contributes to rendering the overall infrastructure, and the services it supports, more diverse and less polluting. All consumers would enjoy those benefits, whether they choose the "green price" or not.

⁵³Our proposal differs from Edison's in another important respect. Our proposal does not assume *a priori* that services offered by renewable resources are necessarily more costly than other services. Our proposal therefore does not *require* consumers to pay more for generation services provided by renewable service providers. Rather, the price paid is determined through negotiations in the competitive marketplace between the seller and the buyer of "green services."

COM/*

Our proposal also furthers the state's and this Commission's continued and aggressive efforts to promote investment in cost-effective energy efficiency. With respect to utility service customers, each of the utility's performance-based ratemaking initiatives focusses directly on exploiting opportunities to increase the efficiency with which energy services are delivered and consumed. Those initiatives continue to include a regulatory mechanism which breaks the link between utility sales and revenues. We expect those mechanisms to focus solely on lost revenues directly attributable to energy efficiency programs. This represents a marked change from the Energy Rate Adjustment Mechanism (ERAM), which allows recovery of revenues lost for reasons other than those related to energy efficiency programs. With respect to direct access consumers, we believe our proposal provides considerable incentives to invest in energy efficiency and offers an approach to achieving energy efficiency goals that California ought to test.

Our extensive efforts to establish competitive procurement policies for energy services delivered to utility service customers shows that a vibrant market exists for energy efficiency services. We agree with those who assert that energy efficiency services represent a strategic asset when competing for market share and attempting to prevent bypass. We believe that both the utility and independent energy efficiency service companies (ESCOs) can and will compete aggressively to provide services to all consumers in California, irrespective of status as a utility service or direct access consumer. But we expect particularly intense competition among providers vying to provide energy efficiency services to consumers who choose the direct access route.

We believe these incentives are sufficient to forego, on a trial basis, reliance on a decoupling regulatory mechanism for utility service to direct access customers. Thus, we propose to discontinue the energy rate adjustment mechanism (ERAM) and all other balancing accounts and rate adjustment mechanisms for direct access consumers. In an era of increased competition, we believe the utility must become increasingly sensitive to the

COM/*

consumer. The utility can easily achieve this increased sensitivity without jeopardizing the state's energy efficiency goals. The utility is free to offer energy efficiency services to direct access consumers; however, just as will be the case for generation services, it may not finance these programs through rates charged to utility service consumers.⁵⁴ We are convinced that this approach merits experimentation. We will closely monitor the results, and make any changes necessary to ensure California and its investor-owned utilities remain a leader in energy efficiency.

Finally, we expect and will require the utilities to subject to competitive solicitations all future demand-side management programs designed to serve those who remain utility service consumers.

We will continue to refine our regulatory policies governing utility demand-side management in our consolidated rulemaking and investigation. The vision and strategy we propose today for the electric services industry, and the rapid changes underway in the industry, require that we continue to scrutinize those policies closely.

Safe and Reliable Electric Service

Breaking the link between ownership and use of the electric transmission grid represents the cornerstone of our proposed vision and strategy. We do not, however, propose to diminish the importance of, or need for, system control and coordination. Under our proposal, the utility's stewardship of, and responsibility for, system control and coordination remain intact, as does its obligation to provide safe and reliable service. Moreover, ensuring safe and reliable service represents one of this Commission's most fundamental duties. We will not allow any reforms to compromise either safety or

⁵⁴We ask parties to comment on whether we should alter our current policy and require shareholders to bear the risk and receive the gain of all utility investment in energy efficiency, irrespective of whether the program targets utility service or direct access consumers.

COM/*

reliability.⁵⁵

The Pursuit of Broader Social Objectives

This Commission and the Legislature have increasingly called upon California's investor-owned electric utilities to engage in activities which in certain instances reach beyond the goal of simply providing safe, reliable and reasonably priced electric service to achieve other vital, though considerably broader, objectives. These mandates designed to support important social goals include, among others, investment in electric and other low-emission vehicles, subsidized rate structures to promote economic development, and programs to assist low-income consumers.

We fully support the goals of these programs and promote utility activities in each. We will not tolerate any retreat from our continued efforts to ensure California's consumers, including our low-income citizens, enjoy universal access to a basic, affordable and up-to-date package of electric services. And while we strongly support programs which strive to achieve broader social objectives, we believe the time is ripe to reexamine the appropriateness of mandating that the utility act as the principal agent charged with designing, implementing and bearing the costs of those programs. Competition and restructuring in the electric services industry is for the most part taking place beyond the reach of regulatory jurisdictions. As competition's hold on the industry tightens, and the pace of change quickens, the ability of the utility, or any other service provider, to absorb unilaterally the costs of these programs, and simultaneously compete for consumer loyalty and market share, will diminish significantly.

For both types of programs--low income programs with a direct link to the electric

⁵⁵Again, we are cognizant of the fact that voluntary, regional transmission groups offer a superior alternative to the "single utility" control and coordination model, and as such, we can expect these groups to replace existing institutional arrangements. Our proposal in no way conflicts with the premise on which RTGs are founded, nor should direct access frustrate their formation.

COM/*

services industry, and programs designed to achieve broader social objectives--we believe California ought to examine alternative funding arrangements. For example, the state might establish fees to which all consumers of electric services are subject in the form of an "end user surcharge." Alternatively, these programs might be more effectively and efficiently funded through the State's general fund, or some combination of the two might be pursued. We intend to work with the Legislature and other stakeholders to explore and implement alternative funding mechanisms for these important programs. At this time, we propose to establish, as part of each consumers demand charge, a separate line item reflecting the costs of these programs. In this way, all consumers will contribute to the delivery of these important services.

Conclusion

Two parallel tracks comprise the strategy we propose to achieve our vision. One continues with the utility initiatives designed to replace cost-of-service with performance-based regulation. The second implements consumer choice through direct access. The two work together to achieve in a much more effective and efficient manner the Commission's, and California's, goals for the electric services industry.

This two track approach serves an additional, equally significant function. It ensures that the transition to direct access in the electric industry takes place in a well managed and responsible, yet responsive manner. It is principally for this reason that our proposal initially limits the number of consumers eligible to choose directly among service providers through direct access. The program we propose allows a sufficient number of consumers to choose to participate, thereby establishing a meaningful "first step." It is of sufficient size to establish meaningful information and data, on the basis of which this Commission intends to assess in a thorough manner the effectiveness of its program, and make any modifications and/or changes required. In addition, since we spread eligibility over a multi-year period, our proposal allows ample time for stakeholders to plan, adjust and develop strategies.

COM/*

Finally, because our proposal places what we roughly estimate to be less than five percent of each utility's revenues potentially in risk at the first stage, our proposed strategy represents a measured approach, and does not threaten the utilities' financial integrity. Our proposal represents a significant yet necessary departure from the past. We prefer a "soft-landing" to our new destination; our proposal ensures it.

The following section provides our proposed schedule implementing direct access through consumer choice.



PROPOSED IMPLEMENTATION

Our strong preference is to deliberate and establish fundamental, guiding policies at the beginning of a process, not at the conclusion. In our view, many of the difficulties faced by this Commission in the past stem at least partly from the failure to clearly identify and subsequently adhere to an overall policy formulation. This policy statement marks the end of our informal policy deliberations and the beginning of our formal policy review. The following section outlines the next steps which bring us to the most challenging stage of this process.

Table 1 is a proposed schedule for the steps necessary to consider this policy statement and implement the strategy it defines. Implementation efforts requiring additional Commission proceedings are shown on the table in **bold-faced** type. Below, we provide further explanation and detail on each step required for the implementation of this policy statement. We recognize that the implementation will require further refinement and we look forward to any comments that parties may have on either the scope or detail of the Commission's future efforts.

Proposed Schedule and Road Map

- With the issuance of this proposed policy statement, parties are given 30 days to submit **written comments**, and 15 days to submit **reply comments** on the policies proposed in this document. The Commission will then hold a **full panel hearing** on June 14, 1994 to allow parties to present oral arguments before the full Commission. Further full panel hearings will be scheduled for July 1994 if deemed necessary.



**TABLE 1
PROPOSED IMPLEMENTATION SCHEDULE**

Comment Period on proposed policy statement: <ul style="list-style-type: none"> • written comments (30 days) • reply comments (15 days) 	Begins: April 20, 1994	Completed: May 20, 1994 June 6, 1994
Full Panel Hearing to allow parties to present oral arguments	June 14, 1994	
Policy statement issued which determines: <ul style="list-style-type: none"> • eligibility level for direct access • utility participation in generation market for direct access consumers 	August 1994	
Investigation opened into cost allocation and potential for uneconomic utility assets	Begins: September 1994	Completed: May 31, 1995
Investigation opened into unbundling and pricing of utility services for direct access	Begins: September 1994	Completed: May 31, 1995
Eligible transmission level consumers seeking direct access notify utilities	July 1, 1995	
Performance-based regulation proposals for utility service customers implemented		Completed: January 1, 1996
CPUC works with Legislature on amendments to resource procurement mandates		Completed: January 1, 1996
Transmission level consumers who have chosen direct access are free to purchase generation services from nonutility providers	January 1, 1996	
Investigation into success of direct access program and reasonableness of expanding eligibility to include all customers	Begins: July 1, 1996	

TABLE 1
(continued)

Primary level consumers eligible for direct access	Begins: January 1, 1997	
Secondary level consumers eligible for direct access	January 1, 1998	
All commercial consumers eligible for direct access	January 1, 1999	
All consumers eligible for direct access	January 1, 2002	

The Commission proposes to complete and issue a **Final Policy Statement** during August 1994. The policy statement will define several crucial aspects of the Commission's reforms including:

- 1) The eligibility level for the initial group of consumers wishing direct access to nonutility generation supplies. (This has initially been set at the transmission level but is subject to discussion and modification during the deliberations on the policy statement.)
 - 2) Whether we ought to permit utility participation in the generation market for direct access consumers. (The proposed policy statement has initially allowed continued utility participation in the generation market for direct access consumers along with a commensurate level of regulatory oversight. But again, we anticipate that this will be a subject of some debate during the policy statement deliberations.)
- The Commission will open an **Investigation** to examine the potential for and allocate the uneconomic portion of the utility generating asset base. This will not include shifting

COM/*

current allocations of generation costs from one consumer class to another. This proceeding will also establish the price/revenue cap formula, as well as floors and ceilings, governing utility earnings in the direct access market. The proceeding should begin as soon as possible after the conclusion of the policy statement and must be completed by May 31, 1995 so that eligible customers may choose direct access by July 1, 1995.

- The Commission will open an **Investigation** to examine unbundling utility services. Interactions with FERC will be particularly important for transmission services required by direct access consumers. This proceeding should begin as soon as possible after the conclusion of the policy statement and must be completed by **May 31, 1995** so that eligible customers may choose direct access by July 1, 1995.
- Eligible consumers seeking direct access must notify the utility by July 1, 1995 of their intention to either remain utility service customers or become direct access customers. This date strikes a reasonable balance between the need to know as soon as possible so that potential uneconomic assets can be determined and the need to give consumers the time necessary to make an informed decision.
- Performance-based regulation proposals from electric utilities are in various stages in the Commission's formal review process. To the extent these programs form the basis for the regulatory framework for utility service customers we hope to complete them by the implementation date of January 1, 1996.
- The Commission must immediately begin to work with the Legislature to amend existing mandates which can restrict the ability of utilities to compete to serve direct access consumers.

COM/*

- On January 1, 1996, eligible transmission level consumers that have notified the utility will become direct access consumers and are free to purchase generation services from nonutility providers or the utility, if they wish. Eligible consumers who have chosen to remain utility service consumers will have to give utilities twelve months notice after January 1, 1996, if they subsequently wish to become direct access consumers.

- On July 1, 1996, the Commission will open an **Investigation** to assess the success of the direct access program and to determine the reasonableness of expanding eligibility.

- We propose to expand eligibility to the direct access class as follows:
 - 1) Customers taking distribution from the utility at the primary level will be eligible January 1, 1997
 - 2) Customers taking distribution at the secondary level will be eligible January 1, 1998.
 - 3) All commercial customers will be eligible January 1, 1999.
 - 4) All consumers will be eligible for direct access by January 1, 2002.

COM/*

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E), San Diego Gas and Electric Company (SDG&E), Southern California Gas Company (SoCalGas), Southern California Edison (Edison), Sierra Pacific Power Company (Sierra), and Pacific Power & Light (PP&L) are named respondents to this proceeding; respondents shall file comments on these proposed policies. Interested parties may also file comments.
2. Comments shall be filed in the Commission's docket office by May 20, 1994, and reply comments shall be filed by June 6, 1994. Both comments and reply comments shall be served on all parties on the service list for this proceeding.
3. Two copies of all comments and reply comments shall also be submitted (one on paper and one on 3.5 inch disk in Word Perfect or ASCII format) to the Division of Strategic Planning.
4. All parties wishing to be on the service list for this proceeding shall notify the Commission's Process Office and the Division of Strategic Planning by letter within ten days from the date of mailing of this order. A service list shall be created and distributed within twenty days.
5. The Executive Director shall serve a copy of this order on each respondent as well as on all appearances in I.89-07-004 and I.90-09-050 (investigations on the Biennial Resource Plan Update) as well as A.92-10-017, A.93-12-029, A.94-03-008, and A.92-12-006 (performance based regulation applications of SDG&E, Edison, PG&E, and PP&L, respectively) .

This order is effective today.

Dated April 20, 1994, at San Francisco, California.

DANIEL Wm. FESSLER
President
PATRICIA M. ECKERT
NORMAN D. SHUMWAY
P. GREGORY CONLON
JESSIE J. KNIGHT, Jr.
Commissioners

I will file a concurring statement.
/s/ DANIEL Wm. FESSLER
Commissioner



APPENDIX A

SUMMARY OF PROPOSED POLICIES FOR CALIFORNIA'S ELECTRIC SERVICES INDUSTRY AND ITS REGULATION

1. Despite increased competition and restructuring in the electric services industry, the Commission's enduring mandate remains intact: to ensure California's consumers receive reasonably priced, environmentally sound, safe and reliable electric service.
2. As market forces play an increasing role in the delivery of electric services, the Commission's enduring duty to protect consumers broadens to that of maintaining the integrity of the marketplace in the competitive sectors of the industry, while continuing to exercise adequate oversight in those sectors where competition is absent or insufficient.
3. Where competition is absent or insufficient, the Commission seeks to replace traditional economic regulation with alternatives better focussed on performance and efficiency ("performance based ratemaking"). The Commission will do so through the utilities regulatory reform proposals currently pending. The Commission will not require that a single performance based ratemaking mechanism apply to each utility.
4. The Commission seeks to substitute traditional economic regulation with the discipline of market forces in those areas of the electric services industry where competition, or the potential for competition, exists.
5. Consumers should face market-based prices for products and services delivered in competitive sectors of the electric services industry, and tariffed prices for services delivered in sectors where competition is either absent or insufficient.
6. The Commission will continue its commitment to ensuring California's consumers of electricity, including low-income consumers, enjoy universal access to a basic and affordable package of electric services which reflects and keeps pace with innovation in the broader, competitive market for electric services.
7. California's consumers shall gradually enjoy direct access to nonutility generation suppliers, marketers, brokers and other service providers; that access should be to the most efficient, environmentally sound electric services infrastructure available.
8. Consumers who choose to procure generation, and generation-related services, directly from the competitive market shall be known as "direct access consumers."

9. Consumers who choose to continue to receive bundled, tariffed service from the utility shall be known as "utility service" consumers.
10. The Commission shall prohibit cost shifting between direct access and utility service consumers during or after the transition to direct access, consumer choice and increased competition in the market for generation services.
11. Direct access consumers shall contribute to the recovery of past costs prudently incurred on their behalf and stranded as part of the transition to direct access and consumer choice.
12. Recovery of stranded costs shall occur through a "competition transition charge." This charge shall be included as part of the demand charge.
13. The utility shall not subsidize the costs of developing and delivering one product or service with revenues accrued from the sale of another product or service.
14. The direct access classification shall be voluntary. Eligibility for direct access shall be staged, with customers receiving distribution service at the transmission level enjoying eligibility January 1, 1996. Customers receiving service at the primary level shall be eligible for direct access January 1, 1997, and secondary level customers shall be eligible January 1, 1998. All commercial customers shall be eligible for direct access January 1, 1999, and all remaining consumers shall be eligible by January 1, 2002.
15. To provide improved information to consumers and facilitate competition and choice in the direct access market for services, the utility shall disaggregate, or "unbundle," the current utility service package and attach prices to those services. The prices assigned to those services shall reflect, to the extent practical and appropriate, the utilities' marginal cost of providing service.
16. The utility shall provide direct access consumers with transmission, distribution, system control and coordination, and other ancillary services at price, terms and conditions which are not unduly discriminatory.
17. This Commission supports the formation of regional transmission groups as the means to ensure access over the electric transportation infrastructure. The governing agreement of any such group of which a California utility is a member must not threaten this Commission's mandate to protect the state's consumers of electric services.
18. With direct access, the utility no longer enjoys a retail monopoly franchise with respect to the procurement of generation service and generation-related services. Commensurately, the Commission shall modify the terms and conditions governing the utility's traditional duty to serve, including those under which the utility shall act as provider of last resort for direct access consumers.

19. The terms and conditions of the duty to serve should include appropriate notice requirements governing direct access consumers' ability to return to the status of utility service consumer and guidelines governing the prices the utility may charge any returning consumers.
20. The utility may choose to compete to retain and increase market share with respect to generation services sought by direct access consumers.
21. The utility is granted pricing flexibility to compete effectively for direct access consumers. Prices negotiated between the utility and direct access consumers shall not exceed the utilities tariffed rate or fall below the utility's marginal cost of providing service.
22. Utility shareholders shall bear the risk of any revenue shortfall resulting from discounted prices to direct access consumers. Shareholders shall also have the opportunity to gain from increased earnings. The Commission shall limit the amount shareholders stand to lose or gain according to a ceiling placed on earnings, and a floor placed on losses. The floor and ceiling shall be included as part of a price or revenue cap ratemaking framework governing direct access utility operations. The price or revenue cap framework shall explicitly account for the effects of inflation and productivity.
23. The utility may choose to continue to construct, own and operate power plants.
24. Shareholders shall bear the financial risks related to, and have the opportunity to earn rewards resulting from, incremental power plant construction and operation. The price or revenue cap ratemaking mechanism governing direct access utility operations shall limit consumers' financial exposure to the risks of utility power contracts signed with generation service providers.
25. The procurement programs of utilities who continue to construct, own and operate plants will require and receive considerably greater regulatory scrutiny than those programs offered by utilities who exit the power plant business.
26. Procurement programs of utilities who choose to exit the commodity business altogether will require and receive the least scrutiny by this Commission.
27. The Biennial Resource Planning Update proceeding is eliminated. The Commission shall not regulate the procurement practices of utilities on behalf of direct access consumers. The Commission encourages the utilities and parties to work together to craft proposals to replace the Update for utility procurement on behalf of utility service consumers. Those proposals should focus on exploiting the competitive market to acquire least cost generation services, while respecting requirements related to procurement contained in the Public Utility Codes. Parties should file those proposals with the Commission for approval. The Commission will not require that a single resource procurement program apply to each utility.

28. This Commission remains committed to the efficient use of society's natural resources, generally, and its energy resources, specifically. The Commission remains further committed to maintaining, and when appropriate, enhancing, environmental quality in the state.

29. Utility performance based ratemaking initiatives which propose regulatory mechanisms designed to delink utility earnings from sales must focus uniquely on revenues forgone as the direct result of energy efficiency programs.

30. On a trial basis, regulatory mechanisms designed to delink utility earnings from sales shall be discontinued for utility operations in the direct access market.

31. Shareholders shall bear the risks and reap the reward of utility energy efficiency services offered to direct access consumers. The Commission shall closely monitor the results of these efforts and shall make any changes necessary to ensure California and its investor-owned utilities remain a leader in energy efficiency.

32. The Commission shall consider policies requiring that utility shareholders fund all utility energy efficiency programs.

33. The utilities shall obtain competitive bids for all future demand-side management programs designed to serve utility service consumers.

Appendix B

List of Organizations Responding to February 3, 1993
Division of Strategic Planning Report *California's Electric Services Industry,
Perspectives on the Past, Strategies for the Future*

Comments submitted March 15, 1993 by:

Association of California Water Agencies

Bay Area Rapid Transit District

California Cogeneration Council

California Department of General Services

California Energy Commission

California Large Energy Consumers Association

California Public Utilities Commission, Division of Ratepayer Advocates

Center for Energy Efficiency and Renewable Technologies

Department of the Navy, Office of the General Counsel - Western Division

Destec Energy, Inc.

Electric Utility Research

Enron Power Marketing, Incorporated

Richard Hirsh, Professor, Department of History, Virginia Polytechnic Institute

Independent Energy Producers Association

Industrial Users

The Magma Power Company

Municipal Utilities (Northern California Power Agency, City of Anaheim, The Power Agency
of California)

National Power PLC

Natural Resources Defense Council

Pacific Gas and Electric

Pacificorp

San Diego Gas & Electric

Sesto Lucchi

South Coast Air Quality District

Southern California Edison
Southern California Gas
Strategy Integration
Toward Utility Rate Normalization
Utility Consumer's Action Network
Utility Design, Inc.
Watson Cogeneration Company

Appendix C

Agendas and Participants in Full Panel Hearings on DSP Report

Public Utilities Commission

STATE OF CALIFORNIA
505 VAN NESS AVENUE
SAN FRANCISCO, CALIFORNIA 94102

Daniel M. Hessler
PRESIDENT

April 12, 1993

TEL: (415) 703-3703
FAX: (415) 703-1758

To Interested Parties:

We appreciate the thoughtful comments of the many parties who responded to the Division of Strategic Planning's study: California's Electric Services Industry: Perspectives on the Past, Strategies for the Future. With the benefit of those comments, we have crafted topics for three full panel hearings. I have included the agenda and participants for the *first* hearing. I provide a thumbnail sketch of the agendas for the second full panel hearing in May, and the third in June. Specific, detailed agendas for the May and June full panel hearings will follow.

Full Panel Hearing #1: April 22, 1993.

"Identifying Challenges and Opportunities Confronting California"

We will dedicate the first hearing to the question of *whether* the challenges and opportunities facing California and the electric services industry warrant reform of our current regulatory framework. To ensure that our decision is a well informed one, we intend to explore with hearing participants the specific reasons for which regulatory reform might be warranted. In particular, in light of current challenges and those we can expect in the future, we wish to examine the applicability and appropriateness of the traditional regulatory compact, and the programs and policies developed to date to uphold the compact.

Full Panel Hearing #2: May 25, 1993.

"Crafting a Vision for California's Electric Services Industry"

Contingent upon the information provided and views expressed in the first full panel hearing, we will focus the discussion in the second day on the need to reexamine our goals and objectives for the industry and for regulation. Drawing on the challenges and opportunities identified at the April meeting, we intend to explore with participants the role of the utility and alternative visions designed to guide the development and delivery of electric services in California. The information culled will aid us with the ultimate and vital task of articulating a comprehensive policy framework for the industry.

To the extent reform is warranted, it is vital that we first establish a clear and comprehensive set of policy goals and priorities, to which we will turn as the basis and

context for crafting regulatory reform strategies. Accordingly, we will therefore devote a portion of the second hearing to a discussion of the criteria the Commission ought to use to assess the merits of alternative reform strategies. Strategic Planning's report and the comments received propose regulatory goals as well as criteria for weighing various strategic options. Those proposals offer a meaningful foundation on which to begin the discussion.

Full Panel Hearing #3: June 24, 1993.

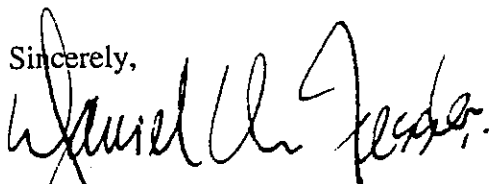
"Exploring Alternative Reform Strategies"

The final hearing builds further on the preceding two. In the third session, we will draw on the four strategies proposed in Strategic Planning's report as a working *framework* for our exploration of strategic reform. However, we do not intend, nor do we expect participants, to limit discussion to those options offered in the report. Instead, we encourage participants to build on the useful information provided in the report to craft still other specific reform strategies should they so chose.

A discussion of the extent to which any proposed strategy meets the goals, priorities and criteria identified in the second session represents a critical component of the third hearing.

I and my colleagues on the Commission look forward to your participation.

Sincerely,



Daniel W. Fessler,
President

**AGENDA
APRIL 22 FULL PANEL HEARING**

"Identifying Challenges and Opportunities Facing California"

Format

Three panels will make up the first hearing. The Chief Executive Officers of the Southern California Gas Company, San Diego Gas & Electric Company, Pacific Gas & Electric, and Southern California Edison, have graciously accepted the invitation to share their views on this vital Commission undertaking. They will join the Commissioners to comprise the first panel.

The second panel is devoted to a discussion of the *current* array of challenges and opportunities facing the state and the industry. The panel discussion will be preceded by brief presentations by industry participants, experts, and observers.

The third and final panel will focus on challenges and opportunities we can expect in the *future*. Like the second panel, brief remarks from individuals who possess pertinent expertise and experience will provide context and act as a catalyst for the dialogue among panel members.

Panel members have been selected to provide the Commission and participants with a broad-ranging set of views. The members reflect interests with expertise and experience in areas of particular significance to California; equally important, they bring experience and knowledge from other regions that will be of great use to California and to the Commission as the important task of crafting a vision and exploring strategic options moves forward.



SCHEDULE

OPENING REMARKS OF COMMISSIONERS 9:30 to 9:40

PANEL ONE: Dialogue with Chief Executive Officers 9:40 to 10:10

Thomas A. Page	San Diego Gas & Electric Company
Richard C. Clarke	Pacific Gas & Electric Company
Richard D. Farman	Southern California Gas Company
John E. Bryson	Southern California Edison Company

PANEL TWO: Identifying Current Challenges
and Opportunities 10:15-11:15

Presenters:	Hon. Terrence Barnich	Illinois Commerce Commission (5 Minutes)
	Edward Sheets Executive Director	Northwest Power Planning Council (5 Minutes)

Panel Members: Commissioners

John Fielder Vice President Regulatory Policy and Affairs	Southern California Edison
Jacqueline Pfannenstiel Vice President Corporate Planning	Pacific Gas & Electric
Karen Edson	Industry Consultant
Michel Florio Senior Attorney	Toward Utility Rate Normalization
John Thorndike Managing Director Investment Banking	Merrill Lynch

Maurice Brubaker
Consultant

Federal Executive Agencies

Elena Schmid
Supervisor

Division of Ratepayer Advocates

Robert Resley
Director of Electric
Resource Development

San Diego Gas & Electric

Jerry Jordan
Executive Director

California Municipal Utilities
Association

BREAK

11:15 TO 11:30

AGENDA QUESTIONS FOR THE SECOND PANEL

1) Many parties assert in their comments that neither the "natural monopoly" character of electric generation nor the utility's monopoly franchise persists in the contemporary electric services industry. Yet the utility's duty to serve flows directly from its status as monopoly provider.

Is the utility's duty to serve in conflict with the erosion of the utility's natural monopoly status and its exclusive franchise?

Is there currently an imbalance in the compact between the utility's duty to serve and the customer's "duty to purchase?"

To the extent any such imbalance exists, is the current regulatory compact well-equipped to respond to them, or are broader reforms necessary?

2) Cost-of-service regulation arose principally during an era of vertically integrated natural monopolies, when the utility enjoyed a considerably more secure franchise. In their comments, some parties point to unbalanced financial and regulatory incentives brought about by cost-of-service regulation with respect to utility operating and investment decisions governing plant construction, energy efficiency, and power purchases.

To what extent do such imbalances exist under the current regulatory structure?

Can the current regulatory framework generally, and its ratemaking approach in particular, accommodate any imbalances identified, or do they merit a broader examination of alternatives to the current framework and approach?

3) The report and some parties assert that current ratemaking practices, and many if not all of the balancing accounts and rate adjustment mechanisms, leave the utility with a) weak incentives to develop and deliver services in the most efficient manner, and b) inadequate flexibility to respond to competitive pressures. The current system is further criticized as fostering costly, burdensome, and fragmented administrative procedures.

To what extent do these assertions pose threats to California and the state's electric services industry? How much of a problem, if any, do balancing accounts and rate adjustment mechanisms pose specifically?

Does cost-of-service regulation continue to have a role in California, or should the Commission explore regulatory alternatives?

4) The report, and several parties' comments, suggest that the rate-cost gap generally, and high rates in particular, pose significant threats to the industry and to the state. Some parties assert in their comments that rates can be lowered, and the gap progressively closed, through means currently available under the existing regulatory framework. Others assert that structural reforms are required to ensure that rates diminish and the gap between the cost of providing service and rates charged for service closes over the long term. Finally, other parties suggest that both approaches are necessary.

How vital is it to close the rate-cost gap discussed in Strategic Planning's report and in comments submitted by parties?

To the extent that closure of the gap is desirable, can that occur through refinements to existing proceedings, accounts and mechanisms, or must broader structural reforms with respect to ratemaking and resource procurement be pursued?

5) Strategic Planning's report and some parties' comments point to the potential for tension among the emergence and pursuit of competition in the industry, increased reliance on market-based solutions, and the continued pursuit of broader social objectives.

Can the current regulatory framework continue to accommodate these programs in light of the market forces and changes in industry structure unleashed during the past two decades, or are structural changes in ratemaking necessary?

Are there alternative means of funding these programs other than through rates?

PANEL THREE: Looking to the Future 11:30 to 12:30

Presenter **Ashley Brown** Ohio PUC
(5 Minutes)

Panel Members: **Commissioners**

Michael Shames Utility Consumer Action Network
Executive Director

Barbara Barkovich California Large Energy Consumers
Consultant Association

Bruce Foster Southern California Edison
Regional Vice President

Robert Glynn Pacific Gas & Electric
Senior Vice President
& General Manager, Electric
Supply Business Unit

Ed Texeira Division of Ratepayer Advocates
Director

Roger Sant AES, Inc.
Chief Executive Officer

Robert Resley San Diego Gas & Electric
Director of Electric Resource
Development

Ralph Cavanagh Natural Resources Defense Council
Director, Energy Project

S. Dave Freeman Sacramento Municipal Utility District
General Manager

John Thorndike Merrill Lynch
Managing Director
Investment Banking

AGENDA QUESTIONS FOR THE THIRD PANEL

Strategic Planning's report and parties' comments identify several trends which carry with them significant implications for the industry and for regulation.

The report suggests that these trends translate to the likelihood of increased competition within the electric services industry, leading to a growing risk to utility market share--both existing and incremental, and mounting pressure for greater customer choice through retail wheeling arrangements.

These trends include, among other things, reform of the Public Utility Holding Company Act and the Federal Power Act under the National Energy Policy Act of 1992; increased interest in and reliance on regional resource procurement and transmission planning groups; technological advances which allow increased bypass of the utility system; greater reliance on utility auctions for the acquisition of demand- and supply-side resources; challenges the industry faces meeting environmental standards; increased utility plant retirement; and the potential for further electrification.

- a) **Are the trends identified, or other trends parties wish to discuss, likely to alter the structure of the industry; or can we expect few changes?**
- b) **What are the implications of these future trends for the regulatory compact; and specifically the utility's duty to serve in a more competitive environment? Do they suggest that reform of the compact is desirable and/or necessary?**
- c) **Building on discussions from the first panel, to what extent do the trends described in Chapter VII of Strategic Planning's report, or other trends, warrant a reexamination of the State's regulatory framework governing the industry? Can the state's current programs governing ratemaking and resource procurement accommodate changes that are likely to occur?**
- d) **To what extent does the continued pursuit of social programs (e.g., low emission vehicles; programs for low-income consumers; economic development goals) mesh or conflict with the industry structure that is likely to emerge in the future?**

PUBLIC UTILITIES COMMISSION

STATE OF CALIFORNIA
505 VAN NESS AVENUE
SAN FRANCISCO, CALIFORNIA 94102

DANIEL WM. FESSLER
PRESIDENT

TEL. (415) 703-3703
FAX (415) 703-5091

May 14, 1993

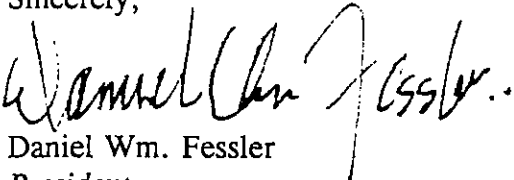
To Interested Parties:

At our full panel hearing that took place on April 22, 1993, a sizeable majority, if not all, of the participants responded affirmatively to the hearing's key question: Is it appropriate and preferable to *explore* regulatory reform?

Based on that response, we will hold a second full panel hearing to address the critical task of crafting a vision for California's electric services industry. It is our firm belief that a clear vision of industry structure must precede the redesign of California's regulatory framework. As such, we intend to explore alternative regulatory strategies at our third hearing scheduled for June 24th.

I have included the agenda and list of participants for the second full panel hearing: "Crafting a Vision for California's Electric Services Industry." We will hold the hearing in the Commission's auditorium on May 25, 1993. I and my colleagues look forward to your participation.

Sincerely,



Daniel Wm. Fessler
President



AGENDA

"Crafting a Vision for California's Electric Services Industry"

Auditorium of the California Public Utilities Commission

May 25, 1993

10:00 A.M. to 3:30 P.M.

Chapter VII of the Division of Strategic Planning's report identifies several key trends and events which combined are likely to influence the structure of the electric services industry. These include the National Energy Policy Act of 1992; increased competition in the market for generation, energy efficiency, and transmission services; continued technological innovation; the increased development and significance of regional markets; and the gap in California between the rates charged for electric service and the cost of delivering service. As a result of these trends and events, Strategic Planning's report envisions a future industry structure with the following characteristics:

- o An increasingly decentralized and highly competitive generation sector.
- o Nondiscriminatory transmission access linking utility and nonutility providers to markets throughout the West.
- o The maturation of spot and futures markets for generation services.
- o Some customers enjoy limited, though direct, access to both utility and nonutility electric service providers.
- o The increased potential for self-generation and threat of bypass of the utility system by consumers to whom a growing number of competitive service options becomes available.
- o An electric utility market share increasingly at risk within its service territory.
- o Increased and aggressive participation by California's investor-owned electric utilities in markets outside its service territory, both within the U.S. and abroad.

The primary focus of the discussion among panelists and Commissioners is the perceived role of the utility in the changing industry structure. Commissioners will therefore ask panelists to address the following questions:

Do panelists agree with the perspective on industry structure offered in the Division of Strategic Planning's report, or do you regard an alternative industry structure more likely? How should, and to what extent can, policymakers influence industry structure?

Given your view of industry structure, what specific duties ought the utility assume or abandon with respect to consumers and nonutility service providers? What modifications, if any, does your view suggest for the utility's duty to serve?

Does your view of the industry structure, or the view offered by the Division in its report, pose specific difficulties for a utility expected to act as competitor in a commodity market, provider of energy efficiency services, and promoter of important social objectives (such as low emission vehicles, economic development, and assistance to low income consumers)?

SCHEDULE

I. OPENING REMARKS OF COMMISSIONERS

II. PANEL ONE

10:00 A.M. - Noon

Presenter: Philip R. O'Conner, Ph.D.
Chairman & President

Palmer Bellevue Corporation

Panelists: Commissioners

Jessica Laverty
Minority Counsel

U.S. House of
Representatives Energy
& Commerce Committee

Donald Felsing
Senior Vice President

San Diego Gas & Electric

Donald Vial

Economist

Robert Glynn, Jr.
Senior Vice President

Pacific Gas & Electric

Terry Thorne
Senior Vice President

ENRON

Charles McCarthy
Senior Vice President
(Invited)

Southern California Edison

LUNCH BREAK:

Noon - 1:30

PANEL TWO:

1:30 - 3:30

Panelists: Commissioners

B. Jeanine Hull
Vice President

LG&E Power Systems, Inc.

Michael Shames
Executive Director

Utility Consumer Action Network

Barbara Barkovich
Energy Consultant

Barkovich & Yap

S. David Freeman
General Manager

Sacramento Municipal
Utility District

Ralph Cavanagh
Director, Energy Project

Natural Resources
Defense Council

William Hogan
Professor
John F. Kennedy School of Government

Harvard University

Public Utilities Commission

STATE OF CALIFORNIA
505 VAN NESS AVENUE
SAN FRANCISCO, CALIFORNIA 94102

Daniel W. Fessler
PRESIDENT

TEL: (415) 703-3703
FAX: (415) 703-1758

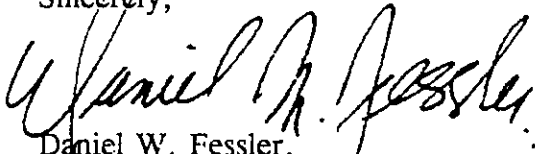
June 11, 1993

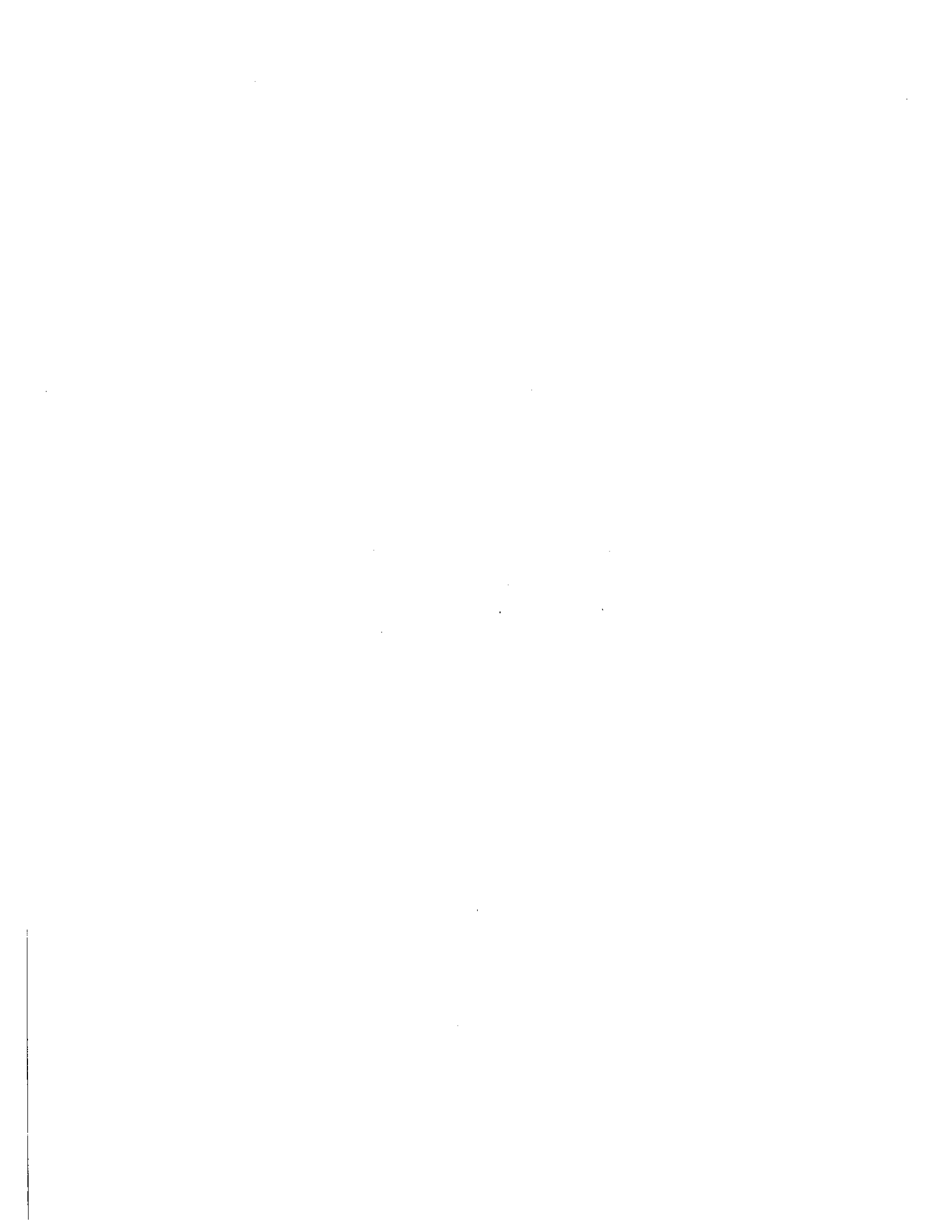
To Interested Parties:

On June 24, 1993 the Commission will hold its third hearing on California's electric services industry. The hearing's focus will be regulatory reform strategies designed to meet the challenges posed by the changing nature of the industry.

The hearing will take place in the Commission Auditorium from 9:30 A.M. to approximately 3:15 P.M. I have attached an agenda and list of participants.

Sincerely,


Daniel W. Fessler,
President



AGENDA

FULL PANEL HEARING BEFORE THE CALIFORNIA PUBLIC UTILITIES COMMISSION JUNE 24, 1993 9:30 A.M. TO 3:15 P.M.

"Exploring Alternative Regulatory Reform Strategies for a Changing Electric Services Industry"

BACKGROUND

At the Commission's second full panel hearing, utility representatives and other panelists offered compelling visions for California's and the nation's electric services industry, and the role of the utility within that industry. Neither the utilities, nor the other industry stakeholders and experts participating as panelists, agreed however to a common vision for the structure of the state's electric services industry.

For example, Southern California Edison Company expressed its view that Californians would benefit most from an industry structure characterized by vertically integrated utility service providers. By contrast, Pacific Gas & Electric stated that the rapidly changing, highly competitive, electric services industry, and the Commission's reform efforts, have persuaded the company to withdraw altogether from the market for *new* generating facilities *within its service territory*. Like Edison, PG&E believes its vision is in the long term interest of the company's customers, its shareholders, and the state generally. Finally, San Diego Gas & Electric expressed support for, and believes both the company and the state will benefit from, either structure.

The Goal of the Third Hearing

Our third full panel hearing has two principal objectives: First, to provide each utility the opportunity to present and recommend to the Commission its preferred reform strategy in light of the company's vision offered at the May 25th hearing. Second, to allow Commissioners, with the participation of other industry stakeholders and experts, to explore, examine, and comment on the respective proposals.

This latter objective is of particular importance to the Commission. Amidst the dynamic and profound changes underway, and expected to occur, in the industry, the Commission's fundamental responsibilities endure. Of primary interest and importance to Commissioners therefore is the extent to which proposed reform strategies enhance or hinder the Commission's ability to fulfill its enduring responsibilities. At its core, the Commission's

principal duty, among others, is that of establishing the terms of service to which the state's consumers of electric service are entitled.

To achieve these objectives, utility representatives will present to Commissioners and a panel of industry stakeholders and experts their visions, and recommended regulatory strategies designed to accompany those visions. After each utility presentation, Commissioners and panel members will engage in a discussion, further examining each proposal. Each utility representative will be allotted thirty minutes to present its strategy. Each ensuing discussion will last 45 minutes.

The Components of a Reform Strategy

1. Why reform?

In Chapter VIII of its report, the Division of Strategic Planning identified several reasons for which it believes reform is warranted. The report further discussed the criteria against which any reform strategy ought to be assessed.

As the overriding impetus for reform, the Division's report asserts generally that the *ratemaking* and *resource procurement* programs under current regulation mesh neither with today's industry structure, nor with the structure California is likely to face in the future. In addition, the report points to more specific reasons for which reform in California is necessary. These reasons include:

- o The Commission's traditional cost-of-service regulatory framework provides weak incentives for the utility to operate and invest efficiently;
- o The Commission's current regulatory program leaves the utility with unbalanced financial incentives when choosing among investments in energy efficiency, utility-sponsored power plants, and services purchased from other providers;
- o The state's centrally managed utility resource planning apparatus is anachronistic and incongruent with the realities of an increasingly competitive electric services industry;
- o The Commission's current regulatory program consists of a multiplicity of balancing account, rate case, resource procurement and other proceedings, which, when taken together, tend to inflate costs and threaten the quality of public participation and Commission decision making; and,
- o The current regulatory program offers utility management limited incentives and flexibility to respond to mounting competitive pressures.

The potential effects of the problems identified by the Division are simple yet profound: Higher costs to California's consumers of electric services; a hindrance to the state's economic performance, job creation, and its recovery from the current recession; and, the inefficient use of our natural resources. It is these effects, as well as others raised in our first two Full Panel Hearings, that propel this Commission forward in its examination of regulatory reform.

As important as the specific problems identified in the Division's report are the two significant links it establishes. The first is the fundamental link between the financial incentives embedded in ratemaking and the potential effects those incentives bring to bear on utility management decisions governing operations and investment. The second is the link between the way in which financial risk is allocated between utility shareholders and consumers, and the effect that allocation has on the breadth and scope of Commission regulatory proceedings generally, and our oversight responsibilities specifically. Strategic Planning asserts in its report that the problems listed above demonstrate that the financial incentives embodied in the current framework, and the current allocation of risk between shareholders and consumers, may in some instances encourage utility decisions which could frustrate Commission efforts to further the state's interests.

The report further recommends that many of the problems currently prompting reform could and ought to be addressed by better aligning the utilities financial incentives with the state's goals and priorities. Strategic Planning suggests that in so doing, the Commission can put in place financial incentives which prompt the utility to operate and invest more efficiently, while continuing to provide safe and reliable service. Reforms of this sort, the report asserts, can reduce the regulatory burden associated with numerous ratemaking proceedings; allow the state to reduce the scope of central management of utility resource planning and acquisition; lower the cost of electric service to consumers; and spur economic growth in the state.

Utility representatives are expected to address the manner in which their proposals address the problems listed here, and others they might wish to raise.

2. A Context for Assessing Alternative Reform Strategies

As discussed briefly above, the Commission's long-standing constitutional obligations will endure as both the industry and the regulation that governs it undergo change in the future. These include universal service, safe and reliable service, and service which does not unduly discriminate among consumers.

In addition, statutory responsibilities placed with the Commission over the past century, though never static, must also be adhered to despite changing circumstances. The Division of Strategic Planning's report discusses in detail the duties and responsibilities which must be included in any discussion of potential reform strategies. These include maintaining

and improving the state's environmental quality; ensuring resource diversity in the electric services infrastructure serving Californians; and the pursuit of important social objectives such as assistance for low-income individuals, the Women, Minority and Disabled Veterans Business Enterprise programs, economic development and low-emission vehicle programs.

Finally, the Commission attempts to balance these vital objectives with still others, including efficient use of resources; minimizing administrative costs; maintaining the integrity and quality of public participation; and the use of and increased reliance on market- and performance-based regulatory solutions, when appropriate.

These fundamental obligations will continue. The Commission encourages the utilities as part of this hearing to offer their perspectives on reform strategies which allow the Commission to fulfill these obligations, while at the same time providing the utility with the flexibility to pursue individual corporate strategies.

3. Effectively Managing Change

Any changes to the Commission's regulatory programs governing the state's investor-owned utilities must be well managed. Experience in the rapidly changing telecommunications and natural gas industries demonstrate that the Commission's oversight and monitoring function in the face of change is of comparable, if not greater, importance. With regulatory reform, the Commission must remain apprised of what works, what doesn't, and why. The Commission, and the utility for that matter, must, during periods of rapid change, retain the ability to make mid-course corrections when required. To make strategic corrections requires timely and useful information. As such the utility representatives should propose as part of their presentations a general description of how the utility intends to evaluate the extent to which reforms have helped to further the state's interests.

AGENDA QUESTIONS

With respect to ratemaking:

Do utility strategies propose to retain the entire array of cost adjustment, or "balancing," accounts, rate cases, and other Commission ratemaking proceedings and mechanisms?

For those the utility believes ought to be eliminated, which, if any, alternative proceedings or mechanisms ought to replace them? Specifically, if the utility proposes to eliminate *ex post* reasonableness reviews, on what alternative mechanism does the utility propose that the Commission rely to fulfill its oversight responsibilities?

Do utility strategies rely on the Commission's traditional cost-of-service regulatory framework, or do they look to performance- or market-based ratemaking approaches?

With respect to resource procurement:

Do utility proposals attempt to realign the financial incentives embedded in investment decisions governing energy efficiency, utility-sponsored plant construction, and services purchased from independent providers?

Do utility strategies propose to retain the Commission's current planning and acquisition program, or to modify that program?

On what specific mechanism would the Commission rely to fulfill its oversight responsibilities under any modifications proposed?

With respect to consumer interests:

How does the utility proposal ensure universal service for consumers who do not enjoy alternatives to utility service?

In what manner does the utility-proposed strategy offer the flexibility necessary to tailor services in a way that responds to the specific circumstances of consumers and business? For example, does the utility propose increased pricing flexibility?

With respect to increased competition:

How does the utility strategy mitigate the pressure, or eliminate the need, for retail wheeling? And given the Energy Act's affirmation of competitive markets, how does the utility proposal strategically position the company for each of the various business functions it expects to pursue (such as generation, transmission, distribution, efficiency and others)?

How does the utility strategy provide the transmission access necessary to ensure its customers benefit from the Act's provisions encouraging increased wholesale competition in generation.

SCHEDULE

I.	OPENING REMARKS OF COMMISSIONERS AND INTRODUCTIONS	9:30 - 10:00
II.	PRESENTATION BY SAN DIEGO GAS & ELECTRIC	10:00 - 10:30
III.	DISCUSSION	10:30 - 11:15
	BREAK	11:15 - 11:30
IV.	PRESENTATION BY SOUTHERN CALIFORNIA EDISON	11:30 - NOON
V.	DISCUSSION	NOON - 12:45
	LUNCH	12:45 - 2:00
VI.	PRESENTATION BY PACIFIC GAS & ELECTRIC	2:00 - 2:30
VII.	DISCUSSION	2:30 - 3:15

PANEL MEMBERS¹

Ashley Brown	Professor, Harvard University
James Caldwell	Technical Director, Coalition for Energy Efficiency and Renewable Technologies (CEERT)
Phil Huyck	Senior Vice President, Trust Company of the West
Max Herbert	Secretary and Solicitor, National Power, PLC
Ed Texeira	Director, Division of Ratepayer Advocates
Dan Richard	Principal of Morse, Richard, Weisenmiller
Henry Riewerts	Fuel Manager, Nabisco, Inc.
Jack McNally	Business Manager, I.B.E.W., Local #1245, AFL-CIO

¹Each of the members will participate on all three panels.

Participants in June 24th Hearing

Ashley Brown

John F. Kennedy School of Government, Harvard University

James Caldwell

Coalition for Energy Efficiency and Renewable Technologies

Max Herbert

National Power, PLC

Phil Huyck

Trust Company of the West

Jack McNally

**International Brotherhood of Electrical Workers, Local #1245,
AFL-CIO**

Dan Richard

Morse, Richard, & Weisenmiller

Henry Riewerts

Nabisco, Inc.


Ed Texeira

**California Public Utilities Commission, Division of Ratepayer
Advocates**

Appendix D
Commissioner Questions
July 15, 1993

Public Utilities Commission

STATE OF CALIFORNIA
505 VAN NESS AVENUE
SAN FRANCISCO, CALIFORNIA 94102


PRESIDENT

TEL: (415) 703-3703
FAX: (415) 703-1738

July 15, 1993

To Interested Parties:


On June 24, 1993, the Commission conducted its third Full Panel Hearing on the state's electric services industry and the governing regulatory structure. During the hearings Commissioners heard representative views on: the problems now facing the industry and its regulators; the trends likely to continue to affect the industry; and the options for reforming the basic structure of electric services and its regulation. For different reasons, there was universal agreement that some measure of regulatory reform was required in the competitive world now emerging. There was less agreement on the need for structural reforms of electric utilities although a number of parties did call for it.

We stand convinced that comprehensive reform of the *status quo* is necessary. With the benefit of the information exchanged at the hearings and through written comments, Commissioners are now embarking on a review of regulatory reform options and the need for industry restructuring.

At the conclusion of the June 24 hearing we stated our interest in posing additional questions for consideration. Attached is a set of questions on various issues that we believe will provide necessary information for our continuing efforts. Supplemental comments containing your answers to these questions should be submitted by Monday, August 30 and should be no more than 35 double-spaced pages. Two copies should be submitted to each Commissioner's office (three copies for the President's office), with three additional copies also submitted to the Division of Strategic Planning. One copy should be sent to each party on the attached list.

We look forward to reviewing thoughtful and concise answers to the questions posed and anticipate a timely consideration of these important issues.

Sincerely,


Daniel Wm. Fessler
President

Enclosures

Questions Following Full Panel Hearings Before the California Public Utilities Commission on California's Electric Services Industry

Parties are invited to respond to the following questions in as specific and concisely detailed a manner possible. Comments should not exceed 35 pages. If parties' prior submissions provide sufficient responses, please reference them here.

A. The Regulatory Compact: Future Roles

1. Much was said during the hearings about the exclusive, or monopoly, franchise the utility enjoys within its service territory, and the utility's duty to provide universal service to consumers within that franchise.

- i) Should the utility be required to retain the duty to serve consumers who have competitive alternatives to utility service?
- ii) Must increased choice through retail wheeling be granted to consumers for whom the duty to serve is relaxed?

2. The Division's report discusses at length the fact that this Commission and the California Legislature require the state's investor-owned utilities to participate in programs designed to achieve important social objectives (e.g., development of low-emission vehicles and supporting infrastructure, Low Income Ratepayer Assistance program, and the Women, Minority, and Disabled Veteran Business Enterprise program). In some cases, the utility has of its own accord directly sought Commission approval to broaden its role based on the need to achieve particular social objectives. Since municipal utilities and unregulated competitors are generally not the subject of Commission or Legislative programs designed to achieve important social objectives, they generally do not incur the costs of these programs. As such, the utility may find itself disadvantaged as competition within the industry intensifies.

- i) What alternative means might the Commission and the Legislature explore in order to meet these vital social objectives without placing parties at a competitive disadvantage?

3. In the telecommunications and natural gas industries, the Commission's fundamental responsibilities under the regulatory compact endure. Nonetheless, the *means* by which the Commission fulfills its enduring responsibilities in those industries continue to evolve. In particular, where workably competitive markets exist in those industries, the Commission has looked increasingly to market forces to discipline industry activities, abandoning interventionist government central planning and forecasting techniques better suited to the realities of a bygone era.

- i) Do the current characteristics of California's electric services industry, and the industry structure expected in the future signal a need to modify the means by which the Commission fulfills its duties under the regulatory compact? What specific modifications ought the Commission explore?

B. Industry Structure

1. In response to the Division of Strategic Planning's report, some argue that developments in technology will accelerate the erosion of the utility's monopoly franchise, further threatening utility market share. Others claim that, in contrast to the telecommunications industry, technological change will play a modest and limited role in shaping the electric services industry during the next decade.

- i) To what extent are technological improvements expected to shape California's electric services industry over the next five to ten years?
- ii) To the extent advances in technology are expected to facilitate bypass of the utility system, do parties view that threat as significant enough to merit restructuring of the utility business to avoid the potential for massive stranded investment, and to position California for an increasingly competitive electric services industry?

2. The Division of Strategic Planning's report proposes four reform strategies, addressing both the industry and the state's regulatory programs governing the industry (see pp. 165-193). The strategies described in the report, though comprehensive, are clearly not exhaustive; rather, they represent proposals along a broad spectrum of options. Each, however, addresses the four fundamental subjects of any reform strategy: the regulatory compact, industry structure, ratemaking and resource procurement.

- i) What are the specific positive and negative consequences of each of the four strategies offered in the Division's report. Comments should address each of the four subject areas listed above. Against what specific criteria should assessments of each be weighed? How are your criteria similar to or different from those discussed in Chapter VIII of the Division's report?

- ii) During the course of the hearings, many parties suggested strategies not included in the Division's report. Please describe your preferred strategy (perhaps incorporating components of the Division's strategies), explaining specifically how that strategy addresses the subject areas and criteria mentioned above.

3. A significant portion of the three hearings focussed on the role of the utility. Specifically, Commissioners and participants discussed at length the question of whether the utility ought to remain in the market for new generating resources to meet incremental native load. In spite of the fact that the role of the utility in electric generation captured much of the discussion on industry structure, the Division of Strategic Planning's report and the ensuing hearings also addressed the utility's role in other segments of the industry.

- i) What specific benefits would accrue to California if the Commission bans investor-owned electric utilities from directly competing for the opportunity to construct new generating facilities to meet incremental load within their respective service territories?
- ii) Should the ban include utility proposals to repower and/or return to service existing generating facilities?
- iii) Should the ban further prevent the utility from competing in its own service territory through any "exempt wholesale generators" (EWGs) it might create consistent with Title VII of the National Energy Policy Act of 1992?

If so, through what other specific arrangements might the utility bring to its customers and shareholders the potential benefits of PUHCA reform with respect to "spinning-off" existing generating assets? Should the Commission explicitly encourage the utilities to form EWGs from existing generating assets under certain conditions?

- iv) What, if any, negative consequences might result from an outright ban imposed on the utility in the areas discussed in subsections i-iii above?
- v) If the Commission determines that such a ban is appropriate, what specific reasons, if any, should compel the Commission *not* to extend that ban to energy efficiency and other utility demand-side management programs?
- vi) Do parties believe that the utility, its shareholders, and the state's consumers of electric services generally would benefit significantly if the state's investor-owned utilities transferred their transmission assets to affiliates or subsidiaries regulated on a regional or federal level? Would competitive markets be enhanced and regulatory burdens lessened if the utility's role no longer included electric transmission, but instead focussed on retail distribution?

C. Ratemaking

1. Many participants to the hearings, and several who provided comments to the Division of Strategic Planning's report, agreed that under the current regulatory framework, the utility faces unbalanced incentives when choosing among investments in energy efficiency, electric transmission and distribution, utility-sponsored construction, and purchased power.

- i) Are these imbalances significant enough to merit reform of Commission ratemaking policies with respect to the financial risks and rewards tied to the various investment options listed above?
- ii) If so, what specific mechanism should guide such reform? Does a "price-cap" mechanism akin to the one established in the New Regulatory Framework governing the telecommunications industry represent a preferable alternative?

2. While several participants to the hearings spoke in favor of dramatically reducing, or eliminating, the use of utility cost adjustment and balancing accounts, the Commission heard little discussion of the reasons for retaining them.

- i) What specific reasons support retaining any of the Commission's current accounts? Why do parties believe the Commission should eliminate them?
- ii) If the Commission determines that cost adjustment accounts ought to be scaled back, or eliminated, should the Commission pursue such reform incrementally, or should a more comprehensive strategy be sought?

Would reform of cost adjustment accounts alter utility risk such that the Commission ought to revisit, or adjust, the utility's authorized rate of return?

3. The Division of Strategic Planning's report cites instances in which traditional regulatory pricing policies may frustrate economic efficiency goals, actually encourage uneconomic bypass, and hinder utility efforts to overcome competitive threats. The report further describes Commission efforts to mitigate these effects, noting that the changes made may not completely eliminate the problems, and in some cases, may create still others (see pp. 76-79 and 149-152).

- i) Given the increasing threat to utility market share, and the potentially growing number of competitive options available to consumers, should the Commission expand the utility's ability to price differentiate among customers? Is the current inverted rate structure compatible with an increasingly competitive electric services industry?

Or are the incentives embodied in the Commission's current policy governing the "interruptible rate" program, the incentives tied to its "Expedited Application

Docket,"¹ and the Commission's "Equal Percentage of Marginal Cost" rate design policy adequate to allow the utility to compete?

- ii) Do the Commission's EAD and interruptible rate policies place a disproportionate share of the financial risk associated with bypass on so-called "captive" customers, that is, on consumers who do not generally have the same degree of choice as large consumers of electricity, toward whom such policies are targeted?

Should shareholders bear the risk of all, or some portion, of the revenue shortfall associated with discounted contracts? What precise regulatory mechanism would govern the distribution of that risk, and the potential shortfall in revenues that might accompany it?

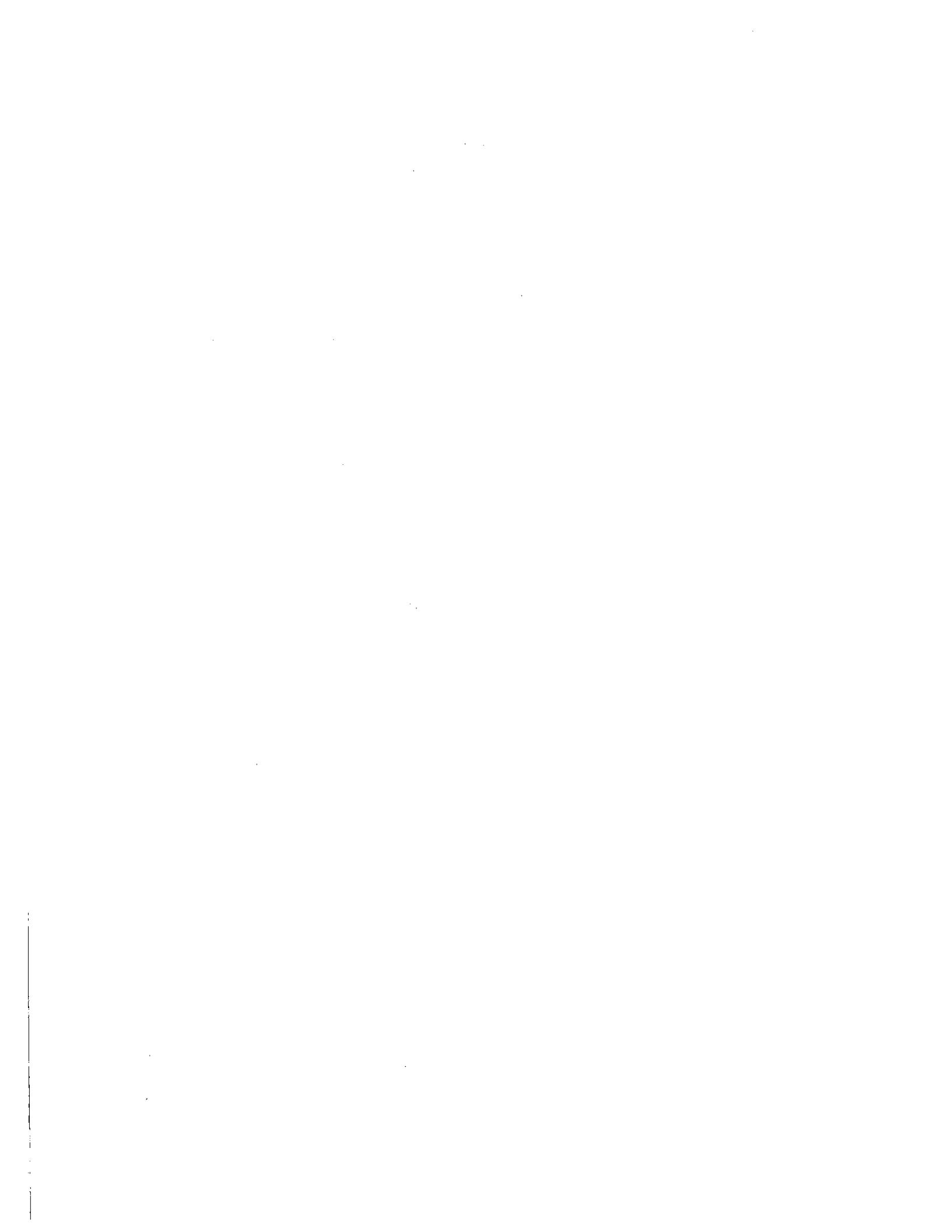
- iii) To the extent the utility is allowed greater pricing flexibility, should the Commission require the utilities to "unbundle," or disaggregate, the costs of specific utility services, thus providing consumers with a broader array of options while ensuring that the utility charges prices which reflect the cost of delivering those services?

D. Resource Procurement

1. Both the hearing participants and interested parties offering comments to the Division's report argued that California consumers will not accrue the benefits of a competitive generation sector absent nondiscriminatory wholesale transmission access, otherwise known as "wheeling." This Commission has long recognized the critical role of transmission access in the development of competitive wholesale markets for power. Recently, California's industry-sponsored effort to form a transmission organization, the Western Association for Transmission System Coordination, or "Watsco," has experienced difficulties reaching consensus on transmission access policy.

- ii) Must Commission acceptance of *any* resource procurement reform package be contingent upon the establishment of a workable solution to transmission access, or can the Commission delink resource procurement from transmission reform?

¹The Commission suspended its Expedited Application Docket for electric contracts in 1990.



Organizations Submitting Replies to the July 15th Questions:

American Wind Energy Association

Association of California Water Agencies

California Department of General Services

California Energy Commission

California Large Energy Consumers Association

California Legislature, Assembly Natural Resources Committee

California Manufacturers Association, California Cogeneration Council and
National Gas Resources L.P.

California Public Utilities Commission, Division of Ratepayer Advocates

Center for Energy Efficiency and Renewable Technologies

Department of the Navy, Office of the General Counsel - Western Division

Destec Energy, Inc.

Edson + Modisette

Richard F. Hirsch, Professor, Department of History, Virginia Polytechnic Institute

Independent Energy Producers Association

Industrial Users

KENETECH Corporation

Municipal Utilities (Northern California Power Agency, City of Anaheim, The Power Agency
of California)

National Power PLC

Pacific Gas and Electric

Pacificorp

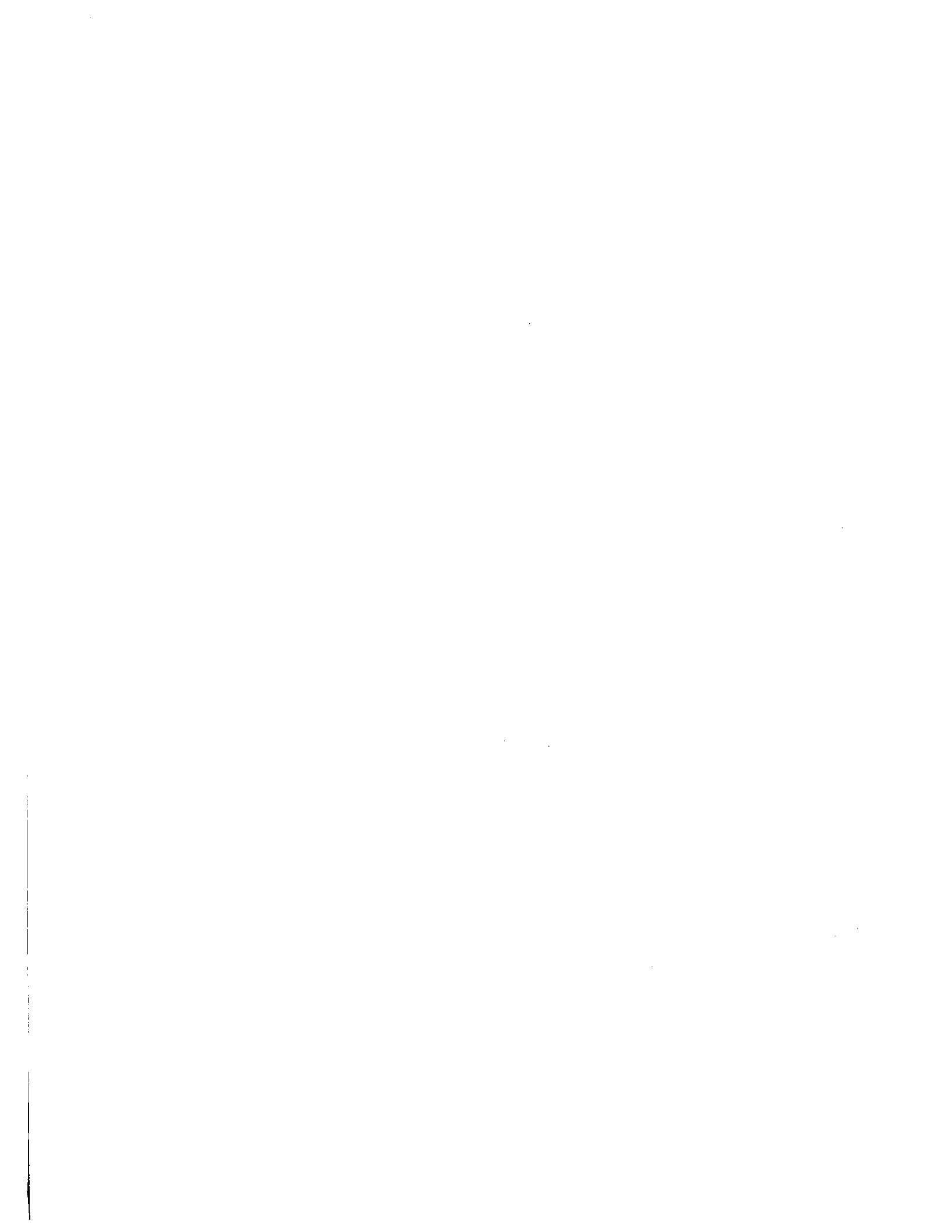
San Diego Gas & Electric

Sierra Pacific Power

Southern California Edison

Toward Utility Rate Normalization

Watson Cogeneration Company



Appendix E

Current Members of the Western Systems Power Pool



Western Systems Power Pool Members (1/25/94)

1. Arizona Electric Power Coop
2. Arizona Public Service
3. Bonneville Power Administration
4. British Columbia Hydro & Power Authority
5. Cajun Electric Power Coop
6. California Department of Water Resources
7. Central & Southwest Services
8. Central Louisiana Electric
9. City of Anaheim
10. City of Farmington, NM
11. City of Los Angeles Department of Water & Power
12. City of Riverside
13. City of Santa Clara
14. City Utilities of Springfield, MO
15. County of Los Alamos
16. Deseret Generation & Transmission Coop
17. Louis Dreyfus Electric Power, Inc.
18. Energy Services
19. Eugene Water & Electric Board
20. Hetch Hetchy Water & Power (CCSF)
21. Idaho Power
22. Imperial Irrigation District
23. Kansas City Power & Light
24. Metropolitan Water District of Southern California
25. Modesto Irrigation District
26. Montana Power
27. Nevada Power
28. Northern California Power Agency
29. Oklahoma Gas & Electric
30. Pacific Gas & Electric
31. Pacificorp
32. Plains Electric Generation & Transmission Coop
33. Portland General Electric
34. Public Service of Colorado
35. Public Service of New Mexico
36. Puget Sound Power & Light
37. Rocky Mountain Generation Coop
38. Sacramento Municipal Utilities District
39. Salt River Project
40. San Diego Gas & Electric
41. Seattle City Light
42. Sierra Pacific Power
43. Southern California Edison
44. Southwestern Public Service
45. Tucson Electric Power
46. Turlock Irrigation District
47. Utah Associated Municipal Power Systems
48. Washington Water Power
49. Western Area Power Administration (Phoenix)
50. Western Area Power Administration (Sacramento)
51. Western Area Power Administration (Salt Lake City)
52. Western Resources, Inc.
53. Westplains Energy



**ORDER INSTITUTING RULEMAKING
ON THE COMMISSION'S PROPOSED POLICIES
GOVERNING RESTRUCTURING OF CALIFORNIA'S
ELECTRIC SERVICES INDUSTRY
AND
REFORMING REGULATION**

FESSLER, PRESIDENT OF THE COMMISSION, CONCURRING:

I join my colleagues today in initiating a vital dialogue respecting the future of the electric services industry in California. The attempt to harness the forces of competitive generation while at the same time aligning the interests of all classes of electric ratepayers and the shareholders of our state's investor owned utilities presents a daunting challenge. Notwithstanding the difficulty, I am persuaded that the challenges addressed by our proposal are, in large part, already upon us. This being so, our task as a society is to adapt to changed circumstances while preserving our social values and aspirations. I thus agree with Governor Wilson that the traditional goals entrusted to this Commission—the assurance that Californians will have access to reliable, least cost and environmentally sound electricity—endure as the bedrock of our policy. They are not candidates for amendment. As a consequence I believe it vital that our proposal be seen for what it is, an altered strategy for the pursuit of constant goals.

In this context I write separately to expose two concerns that will occupy my attention in the months to come. They are: (1) fear that we are about to entrust the well being of California ratepayers to market forces

R.94-04- 031

I.94-04-032

which are not containable within our geographic frontiers and may not be congruent with any established governmental jurisdiction; and (2) insistence that we not lose sight of the one feature of what is popularly known as the "English model" that may prove difficult for us to replicate and yet which may be responsible for the success that restructuring effort has accomplished to date. Both are ultimately reliability concerns. The first arises in a macro or industry wide focus; the second in the micro or transactional level.

In the broadest sense any reform must take into account the issue of governmental institutions and their future role in the public/private partnership which must also evolve with altered circumstances. In yesterdecade the industry was contained in vertically integrated utility operations conducted within clearly defined service territories all within the jurisdiction of a host state. In such a climate the primary role for regulating the monopoly provision of a vital necessary fell to the several states and posed little strain on the federal system.¹ Thus the match between economic activity and governmental oversight was precise and well understood. Today, much has changed and the erosion of the integrated monopoly occasioned by both technology and revised conceptual thinking undermines the most fundamental assumptions of a regulatory order which must be changed.

As an abstract proposition I endorse reliance upon the forces of competition and agree that they represent a superior disciplinary force than can be supplied over time by any system of governmental estimate or planning of which I am aware. But to say that the era of command and control has passed does not prompt the conclusion that the generation,

¹I make this statement aware that the movement of natural gas and electricity across states touched upon issues of interstate commerce with the consequent role of the Federal Power Commission and its modern successor.

R.94-04- 031

I.94-04-032

transmission and distribution of this vital commodity has passed beyond the interest of society or the governance institutions which it has created to guard those interests. Herein lies a problem which we must surmount. The forces of a competitive marketplace for generation which have eroded the integrity of service territories are neither contained nor are they containable within the State of California. This being said I do not see the solution in the expedient of shifting responsibility to the Federal Energy Regulatory Commission or any other instrumentality of our national government. I reach this conclusion because I deem the market for electricity to be governed by a transmission grid which embraces more than a dozen Western states, two Canadian provinces, and the Mexican states of Baja California Norte and Sud. To describe the market is to depict the political problem. We have no institution or combination of institutions which can easily and effectively monitor industry performance within this market nor police against discrimination, anti-competitive practices, or unfair dealing.

There is an even more pressing reliability concern with bilateral transactions which was the topic of a recent conversation with my colleague COMMISSIONER CONLON which focused on what is popularly termed the "British pool." To my mind the pool is the heart and source of the accomplishments of that reform. A subsequent note from COMMISSIONER CONLON memorialized the major points of our discussion:

To some extent, the pool could be considered as offering a 'bundled' service package of (1) a spot market for electricity, (2) a coordination of transmission services and access, (3) voltage support and system reliability, and (4) back-up power support in case of non-performance by energy suppliers. Absent a government-created pool, a consumer wishing to choose as energy supplier would have to undertake separate negotiations for each of these four services, and the consumer's choice of

some of these services (such as the transmission path) may impose additional and unanticipated costs on other consumers. Although in the future each of these services may ultimately be separately packaged and priced competitively, it may be unrealistic that each will spontaneously be created during the transition period. Therefore, a pool may minimize transaction costs for those customers choosing direct access as well as eliminating the financial and operational risks that would otherwise be inherent in traditional bi-lateral arrangements between buyers and sellers.

While I may quibble with the assertion that the pool must be created by government, I agree with his observations and wish to develop my colleague's last point for it addresses the reliability issue.

In a recent issue of the *Electricity Journal* I outlined my concern that the substitution of purchased power for generation additions financed, constructed, owned and operated by a utility necessitates that society shift trust in the reliability and availability of that portion of the system from status to contract.² This shift poses particularly pointed implications for me as the only borrowed contracts teacher on this or any other utilities commission. I questioned whether we have in California a legal infrastructure capable of providing timely, informed, principled and predictable declarations of rights and remedial orders when, through circumstance or choice, a party fails, refuses or defectively performs on a contractual undertaking. To the extent that the British pool divorces the arrangements for the physical generation, transmission and delivery of electricity from the contracts which attempt to apportion economic outcomes, my fears of a

²Fessler, FROM STATUS TO CONTRACT: RELIABILITY CONCERNS AND INFRA-STRUCTURE WEAKNESS, 6 *Electricity Journal* No. 7, p. 33 (1993).

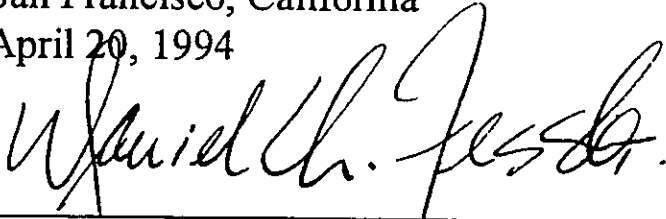
R.94-04-031

I.94-04-032

threat to the reliability in the face of inevitable contract failure are substantially reduced.³ Absent such a device, it is my position that we are ill-advised to shift reliance to bilateral contracting which will almost certainly feature parties legally domiciled in differing and distant jurisdictions. In the weeks and months to come I will be interested in the views of others as to whether these fears are factual or fanciful.

San Francisco, California

April 20, 1994



Daniel Wm. Fessler, *President of the Commission*

³Termed "contracts for differences," these private bilateral bargains have as their objective providing price stability over time to parties adverse to bearing the dictates of the spot market. They do not govern the actual physical transaction with respect to generation, transmission or delivery of electricity and thus the breach of a contract for differences occasions no threat to the security of supply. For practicable purposes, all physical transactions are done within the context of the pool. Delay or imprecision in providing a remedy for breach of a contract for differences is a serious matter to the immediate parties but poses little threat to the broader society. Indeed, the transparency of the cost of the commodity makes the calculation of consequential damages a rather straightforward proposition thus avoiding the burdens to the judicial system of having to devise equitable remedies at the insistence of a victim of breach for whom the damage remedy at law has proven inadequate.

