

FERC Technical Conference
Review of Wholesale Electricity Markets
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Prepared Comments of
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Mr. Chairman, Commissioners

Thank you for taking the initiative and the time to listen and speak to us on where electricity market reform stands and where it is heading. We all see the number and frequency of reports that largely misrepresent the state of the market. If we try to read and understand just the opening page of each one, we will not have time for anything else. So, we appreciate the opportunity to sum up our response in a single day. In addition to what Dr. Casey presented, I will focus on the transition to the challenging future.

In a nut-shell, California is well past the 2000/2001 crisis and has made tremendous progress on several fronts. The California ISO is also working today to help the state address a challenging array of environmental objectives. Yet, we remain distant from longer-term future goals because the ideal goal posts are continuously moving. In my brief address, I will speak briefly to each – our progress since 2001, current efforts to address California's environmental objectives, and a vision for reaching those ideal goal posts.

As my colleague Dr Casey mentioned, California has made great progress since 2001.

- Net new generation after counting for all retirements since 2001 outpaced demand growth by almost 5000 MW – an amount that exceeds the total new generation added in California in the entire decade of the nineties.
- Average wholesale energy cost when normalized for 2004 fuel cost is the lowest since restructuring.
- The reliability of the generation fleet is higher than ever with a forced outage rate below 3%.
- Reliability costs dropped 75% over the last three years.
- Operators managed a record peak demand 6 years ahead of forecasts without forcing any customer interruptions.
- The value of the transmission investment between what is already in the ground, under construction, and well into the state process is over \$8 Billion.

Today the electricity industry faces major new challenges that are driving a transformation in how our industry will meet future electricity needs. Independent operators are especially well positioned to address these challenges, many of which are already arising in California.

In my state, policy makers are addressing a collection of environmental initiatives with direct and profound impacts on the electric industry. California law requires 20% RPS by 2010 and is aiming towards a goal of 33% by 2020. That represents renewable nameplate capacity totaling about 14,000 MW within the next few years and 26,000 MW by 2020. At the same time, greenhouse gas from all sources must be reduced by 30% by 2020. In addition, a proposal is pending before water quality regulators to ban once-through cooling technology in all coastal generating plants. These plants represent nearly one-half of in-state generating capacity.

The California ISO's Strategic Plan is well-aligned with these goals and we are actively addressing these challenges in several ways.

- We have reduced the transmission financing burden on generating plants in remote areas with a policy proposal made possible by your unanimous vote of approval.
- We will facilitate the interconnection of new generation, which are mostly renewable, with a process that, with your approval, will significantly streamline the effort and allow the most viable projects to advance. As we experiment with these new rules, we expect new challenges so you may see more from us on this. As always, though, we truly appreciate your diligent analysis of the proposals we present and your staff's tireless efforts with us and our market participants.
- We recently completed conceptual transmission planning to identify possible transmission additions needed to meet a 33% renewable portfolio standard and presented it to state policy makers. It is the beginning of an effort to understand the magnitude of the transmission additions that will be required in the next decade.
- We are actively involved in the greenhouse gas regulatory design to facilitate alignment with competitive markets and a future regional and national framework for compliance with greenhouse gas reduction requirements.
- We are examining our markets and operations to ensure that we are providing incentives for investment in those services and facilities that will allow the existing fleet to function, deliver new infrastructure additions in time, and facilitate the integration of intermittent generation.
- We are explaining the critical need to maintain the present capability of the generation fleet, which is essential for the integration of renewable generation. These efforts include informing policy makers about the interaction among the state's environmental goals and with electric system operations, and the importance of coordinating their efforts to ensure that their objectives can be achieved.

I am proud of the collective efforts of all the state agencies to address these issues in an integrated manner and understand the role of the California ISO in helping the state achieve its vision of the cleanest air and cleanest water on the planet without compromise to the reliability of the electric supply.

Future success for us and the entire industry will require innovations in the operation, planning, market design, and regulatory framework in order to keep the lights on at a just and reasonable price. What worked in the past will not be enough for the future, if even suitable. The gap is not indicative of a deficiency but reflects the continuous movement of the goal posts.

You already know the desperate need for a proper, financially binding day-ahead market, proper congestion management at the detailed locational level and market rules that bring all generation, transmission, and demand response on equal footing in competition to produce the least cost outcome. All of these will be advanced to some extent with the implementation of the Market Redesign and Technology Upgrade. But the question is what else? Instead of going through specific initiatives to fill the gaps, let me share what I believe the attributes of a properly functioning electricity market should include, so while we assess the progress on its own merits, we also assess where we are relative to the finish line:

- 1) **Greater Benefits from Resource Adequacy Program.** California's current resource adequacy program looks forward only one year and does not incorporate the products

required to take advantage of available technologies on the supply and demand sides. A multi-year framework will allow for meaningful cost-benefit comparison among alternatives, including new generating plants, retirement or repowering of existing plants, new demand response technologies, and transmission upgrades.

- 2) **Lower Ratepayer Risk.** A primary motive behind electric restructuring in the 1990s was to shift investment risk from ratepayers to investors, yet today's practices rely disproportionately on ratepayer risk to underwrite new infrastructure investment. For investors to assume these risks, however, market rules must be uniform in their implementation and application to all suppliers and consumers.
- 3) **Consumer Participation and Benefits.** Consumers should benefit from price transparency and competition among generation, demand response, and transmission alternatives. In California, demand response is provided largely by regulated programs designed to shave peak load under emergency conditions. Demand should be able to compete with traditional generating resources to meet operational needs, and consumers should have options for providing demand response and receiving compensation whenever it is economically and practically feasible.
- 4) **Market Power Mitigation.** Market power has been characterized largely by a limited amount of suppliers, but when the buyer has that power, product standardization and price transparency will be keys to achieving the benefit of competition.
- 5) **Regional Coordination.** The most economic future resources lie outside the boundaries of most states and service territories. It will be essential to achieve greater regional coordination in order to minimize consumer costs.
- 6) **Regulatory Innovation and Flexibility.** Changing resource mixes and demand participation are rapidly changing the electric system operating environment. Opportunities will be lost without greater innovation and flexibility, especially with regard to second tier regulations affecting the electricity efficiency and reliability.

I am sure this list can be extended but if you were to ask me how close we are to these objectives, I would say we are quite distant. Some of the solutions are in your own hands while others are up to the states. The purpose of today's meeting is the former. In this regard, I offer the following comments:

- We are proud of our achievements so far and honest about what is left.
- Organized markets are better positioned than other models to meet the challenges of the future.
- The gap between where we are today and our ideal goal posts will always exist because the goal posts themselves will always move, and from what we see, they are moving today faster than ever.