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May 19, 2005

Mr. James Mayer
Executive Director
Little Hoover Commission
925 L Street, Suite 805
Sacramento, CA 95814

RE: Governor's Reorganization Plan to Create a Department of Energy

Dear Mr. Mayer:

On behalf of the Sempra Energy companies, I am pleased to provide you with our comments regarding the Governor's proposed reorganization plan to create a Department of Energy. Also included is the bio of our witness, Tom Brill, Assistant General Counsel of Regulatory Policy, who will present our testimony on May 25.

Please feel free to call me should you have any questions. We appreciate the opportunity to participate in this important endeavor.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Carolyn McIntyre".

Attachments

Governor's Energy Reorganization Plan

Comments of Sempra Energy
Submitted before the Little Hoover Commission
May 19, 2005

Witness: Tom Brill
Assistant General Counsel
Sempra Energy

Introduction

Sempra Energy is encouraged by the Governor's proposal to streamline California's energy agencies. The problem with the current system is not the fault of the individual agencies. Indeed, the current leadership at both the California Public Utilities Commission and the California Energy Commission has demonstrated great resolve and tenacity in addressing the significant energy issues the State faces. Instead, the need for streamlining is caused by the existing basic structure, which invites duplication and forum shopping. The Governor's plan correctly identifies this as the source of the problem.

The Governor has also correctly identified the structural flaws that exist and the solutions that are needed in energy policy-making and regulation:

- Reduce overlap, duplication, and conflict among agency decisions and policies.
- Improve efficiency and regulatory speed.
- Prevent misuse of process (e.g. forum shopping) that the current structure encourages.
- Ensure greater consistency in state energy policy

Just a few years ago, the State was unable to issue a permit for critically-needed major electric transmission into Southern California. Certain individuals at the CPUC (who are no longer there) defeated a cost-effective project (even though its defeat was expected to impose significant costs on customers), based on patently unrealistic resource planning time horizons, particularly for transmission. These resource planning horizons were inconsistent with those that had been employed by the CAISO, which had found the project to be needed. The failure to permit that facility has, in fact, raised costs to electric consumers in the State.

Now the State struggles with whether it will have adequate electricity supplies in the region but it is also facing the added costs and increased customer electric rates that result from its failure to add needed infrastructure to reduce congestion. SDG&E will soon be proposing a new project to add the needed infrastructure and relieve its customers from the rate impacts caused by the State's failure to site the needed facilities in 2002.

Confusing inter-agency handoffs, regulatory duplication, delay, or disagreement must not bog down the process the State uses for reviewing new infrastructure proposals such as a new transmission line. Accordingly, the Governor's proposal to reform energy regulation in the State is particularly timely.

What are the state's greatest challenges in developing a cohesive energy policy? How does the state's organizational structure impede or enable the resolution of those challenges?

The state's greatest challenge will be coordinating the resource planning roles of the new Department of Energy and the CPUC in a way that creates regulatory certainty and ensures consistency in regulatory decisions. To that end, the current voluntary cooperation between the CEC and the CPUC that resulted in the development of the State Energy Action Plan should be converted into a mandatory element of the State's resource-planning process. This requirement

could be expressed as either a part of the development process of the biennial Integrated Energy Policy Report or as a new implementation phase following the adoption of that Report. The Governor's Plan recognizes the importance of this kind of coordination by continuing the current provision of the Warren-Alquist Act that makes the President of the CPUC an ex-officio member of the CEC and by adding the provision that the President/CEO of the California ISO should also be an ex officio member of the CEC. In any event, some additional steps are needed to ensure adequate coordination between agencies.

One example of the need for coordination involves the CPUC's procurement planning role under AB57 (Public Utilities Code Section 454.5), which has been, and continues to be, an essential element of the State's plan to bring stability back to the California electricity market, in this case by providing utilities with greater regulatory certainty and ensuring customers adequate resources. Nevertheless, under the Governor's proposal, both the CPUC and the new Department of Energy will have resource planning roles, just as they do today. These activities need to be coordinated to ensure that the intent of AB57 is not frustrated, and to ensure that any siting process for new infrastructure is not hampered by conflicting decisions. Thus, to the extent possible, a single coordinated set of planning activities should be pursued rather than two independent ones.

The potential for inconsistency may not always be initially apparent - - but the cost to California consumers can nevertheless be very real. For example AB57 creates a statutory obligation to preserve the confidentiality of market sensitive information in order to avoid creating circumstances where customers' interests are compromised, and rates increased, because of inappropriate disclosure of that information. AB57 provides that:

“The commission shall adopt appropriate procedures to ensure the confidentiality of any market sensitive information submitted in an electrical corporation's proposed procurement plan or resulting from or related to its approved procurement plan, including, but not limited to, proposed or executed power purchase agreements, data request responses, or consultant reports, or any combination, provided that the Office of Ratepayer Advocates and other consumer groups that are nonmarket participants shall be provided access to this information under confidentiality procedures authorized by the commission.”

At present the CEC is not subject to AB57, and is, therefore, not required to honor this confidentiality provision. In practice, the CEC has also declined to do so. This frustrates the purpose of the confidentiality provisions of AB57. It has resulted in orders by the CEC to release market sensitive information that the law requires the PUC to keep confidential. This, and other similar conflicts that may not yet be apparent must be reconciled in favor of protecting consumers from the consequences of inappropriate disclosure of market-sensitive information. Both the PUC and the Department of Energy should adhere to the consumer protection measures of AB57 that requires preserving the confidentiality of market sensitive information.

An additional challenge that will result from the new organizational structure is results from the fact that under the proposed Energy Agency Reorganization, the Department of Energy will be responsible for permitting new infrastructure, but, to the extent that the infrastructure is owned by a regulated utility, the CPUC will be responsible for providing for rate recovery. Denial of recovery of reasonable costs incurred in constructing new infrastructure that has been permitted

and found to be needed by the new Department of Energy would essentially constitute denial of the project. In order to avoid this outcome, the CPUC must provide for reasonable rate recovery of investments in projects approved by the Department of Energy, and should not force utilities to re-litigate issues already addressed by the Department of Energy.

Finally, the State has significant need for adequate energy infrastructure and faces the critical challenge of streamlining its process for approving addition of that infrastructure.

Does the Governor’s proposed reorganization plan solve these structural deficiencies? Does the plan create any new challenges for developing and implementing a cohesive energy policy?

The Governor’s plan is a clear step forward and creates the opportunity to solve the structural deficiencies noted above. Sempra Energy respectfully submits several specific additional proposals to address these challenges.

Coordination of Resource Planning Roles. As mentioned above, the state’s greatest challenge will be coordinating the resource planning roles of the new Department of Energy and the CPUC in a way that creates regulatory certainty and ensures consistency in regulatory decisions. Despite the best efforts of both agencies to create a single, coordinated planning process, there may be unforeseen circumstances in which one agency may unilaterally make findings of the need for a particular facility. In that event, the utility should be able to rely on those findings before both agencies without being forced to re-litigate the question of need that has already been addressed. Thus, in order to promote efficient process for identifying and permitting needed infrastructure, if either the PUC or the new Department of Energy determines that infrastructure is needed, then that determination should be honored by the other agency. This will allow the State to avoid duplicative process before infrastructure can be added, and to avoid ratemaking or resource plan disputes that could contradict other agency findings.

Coordination between the resource planning roles of the new Department of Energy and the CPUC should be ensured through adoption of the following amendments:

- 1. The Code needs to be amended to require coordination among the agencies respecting resource planning and to create a single, unified resource planning process coordinated among the agencies.*
- 2. The Code needs to be amended to provide that, in order to promote efficient process for identifying and permitting needed infrastructure and avoid duplication and re-litigation of issues, if either the PUC or the Department of Energy determines that infrastructure is needed, then that determination should be honored by the other agency.*
- 3. The Code needs to be amended to provide for consistent protection of market sensitive information used in resource planning, whether by the CPUC, who is currently obligated by AB57 to provide such protection, or by the Department of Energy, where no similar statutory protection currently applies.*

Ensuring Consistency in DOE Decisions and CPUC Ratemaking. As mentioned above, under the proposed Energy Agency Reorganization, the Department of Energy will be responsible for permitting new infrastructure, but, to the extent that the infrastructure is owned by a regulated

utility, the CPUC will be responsible for providing for rate recovery. Sempra supports the transfer of jurisdiction over the siting of transmission facilities from the CPUC to the Department, provided that the Department conducts its permitting activities through the offices of the Energy Commission as presently constituted and pursuant to the provisions and practices that have been developed under the aegis of the Warren-Alquist Act. (See Public Resources Code Section 25000, et seq., and Title 17 of the State Administrative Code.) The Energy Commission has demonstrated its ability to perform timely review of permit applications for generation under the terms of the Act and its relevant regulations and the reorganization should be implemented in such a way as to not disturb the tradition or commitment of resources that has evolved at that agency with respect to siting matters.

The CPUC is already required to assure rate recovery of transmission plant additions because the Federal Energy Regulatory Commission makes the determination that the costs should be recovered. Under federal law, the CPUC must provide for that cost recovery determined by the FERC. The CPUC should likewise honor in its ratemaking process the Department's determination that new infrastructure should be added, and should provide for the recovery in rates of the reasonable costs of such infrastructure, including a reasonable return on that investment, without any further assessment of the need for that infrastructure. This necessary objective would be accomplished through the adoption of the following:

Amend the Code to require the Commission to (1) allow the recovery of, including a reasonable return on, the investment in infrastructure determined to be needed, and permitted by the Department of Energy, and (2) accept the Department of Energy's determination of need for such infrastructure and other findings made in issuing a permit, without the need to conduct further hearings related to those findings.

Streamlining Infrastructure Permitting/Siting Process. The Governor's plan recognizes the need to consolidate and simplify the permitting process for new infrastructure projects. Historically, roadblocks to achieving the Governor's goal have consisted of duplicative processes and determinations on the issue of need are typically delayed pending completion of the environmental review process. All of this has made it more difficult to achieve approval of needed infrastructure.

As previously discussed, to the extent that the CPUC makes a determination in its resource planning process (which we recommend be a consolidated effort between the CPUC and the Department of Energy) that new infrastructure is needed, the Department of Energy should accept that determination to avoid duplicative process.

In addition, the Department of Energy should not delay any need determination while it waits for the environmental review. Thus, it should be appropriate to bifurcate a need determination from the environmental review for a proposed project. Furthermore, the Department should not use the process currently used by the CPUC (or the similar process currently used at the CEC) in which the utility conducts a "Proponent's Environmental Assessment" prior to applying for the permit, only to lead to the CPUC's own environmental review thereafter. Such an approach is unnecessarily duplicative and time-consuming. The Department should use a single, coordinated process to conduct environmental review as quickly as is feasible.

Furthermore, the proposal has confused the definition of transmission facilities that are subject to the permitting process. Currently, CPUC General Order 131-D and a long line of CPUC decisions have defined the parameters of what types of facilities require permitting. With the transfer of this function to the Department of Energy, this well-thought-out history has been thrown into question. The proposal further confuses matters by making an unnecessary change to Public Resources Code Section 25107 to expand the definition of “electric transmission line”. This expansion is not a necessary part of the Governor’s plan, its purpose is never explained, and, in one shot, it appears to undo all of the foundation work long ago done at the CPUC to define what should be subject to a permitting process.

In summary, remaining challenges to streamlining the state’s permitting process for new infrastructure would be met through adoption of the following amendments:

- 1. The Code should be amended to provide that the Department of Energy must separate the assessment of the need for proposed natural gas or electric infrastructure from its environmental review whenever doing so would expedite or simplify the permitting process.*
- 2. The Code should be amended to provide that, in establishing the procedures for permitting, the Department of Energy must not require duplicative process or documentation to facilitate the environmental review of a proposed project, and must use a single, coordinated environmental review process.*
- 3. The proposed deletion from Public Resources Code Section 25107, defining “electric transmission line” is unnecessary and inappropriate and should be abandoned. The Department of Energy should continue to recognize the scope of transmission projects subject to permitting as defined by the CPUC’s General Orders and past decisions absent further process that justifies changing this scope.*
- 4. The Code should be amended to provide that, to the extent that the CPUC has defined in its General Orders, decisions, or other process, for the definition of facilities subject to CPUC permitting under the current process for Certificates of Public Convenience and Necessity, the Department of Energy should retain that same scope absent further process that justifies changing the scope.*

What impact might the new organizational structure have on the price and reliability of energy in the state? How will the structure affect the ability of investor-owned utilities to provide reliable and efficient energy?

If the challenges identified above are addressed through adoption of the amendments submitted by Sempra Energy, and regulators demonstrate an ability to expeditiously site and authorize new infrastructure projects, the state would benefit from downward pressure on prices and increased reliability. If, however, the resource planning roles of the new DOE and CPUC are not coordinated, if the reorganization fails to ensure that DOE decisions and CPUC ratemaking decisions are consistent, and if the permitting process for new infrastructure proposals is not

successfully streamlined, investor-owned utilities - - and all load serving entities - - will be hampered in their continuing efforts to provide reliable and efficient energy.

Conclusion

The Governor's Proposed Plan does not propose to take all steps that are necessary to stabilize energy markets in the State. The recommended revisions that Sempra Energy has proposed in these comments are not all of the actions the State needs to take either. California needs regulatory stability. The current regulators under the leadership of the Presidents of the CPUC and the CEC have worked hard to advance – and we commend them for that effort. But that work is not yet completed.

For example, the State needs to finish reform of its wholesale markets. It needs to put in place a workable, and working, resource adequacy process that avoids cost stranding and free-riding by non-jurisdictional entities to assure that adequate electricity reserves are in place and new capacity is built when needed. The State needs to eliminate the retail cross-subsidies provided for under AB1X that give inefficient and counter-productive price signals to consumers. Sempra Energy will continue to press for these changes, regardless of the process reforms the State decides to pursue. However, we commend the governor for his efforts to initiate needed reform and to emphasize the need for a process that allows adequate infrastructure to be added to California, when needed.