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Assembly Joint Oversight Committee on Lowering the Cost of Electric Services

Assembly Joint Oversight Committee

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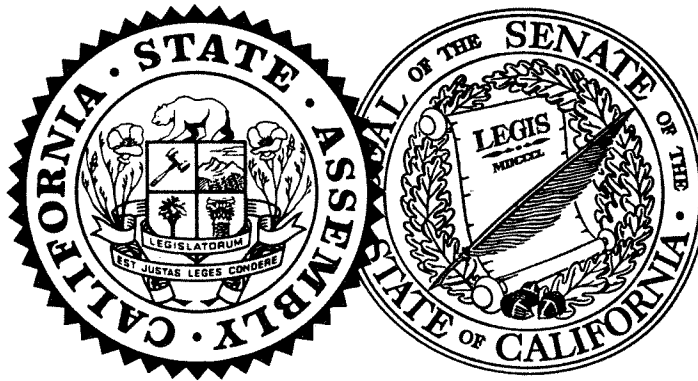
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CALIFORNIA LEGISLATURE
ASSEMBLY JOINT OVERSIGHT COMMITTEE
ON
LOWERING THE COST OF ELECTRIC SERVICES

ASSEMBLYMEMBER BYRON D. SHER, CHAIR

OCTOBER 28, 1994

STATE CAPITOL BUILDING
ROOM 4203



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CHAIRMAN SHER: Thank you and good morning. Welcome to the first meeting of the Legislature's Joint Oversight Committee on Lowering the Cost of Electric Services. This oversight committee was created by the Legislature pursuant to Assembly Concurrent Resolution 143, which assigned the committee three main tasks: First, the committee should ensure that any proposals made by the California's Public Utilities Committee for restructuring industry the electric services industry or adopting Performance Based Regulation (PBR) mechanisms which meet certain criteria which are outlined in the resolution. Let me just read some of the more important ones. The first criteria was establishing a just reasonable fare and equitable rate treatment that significantly reduces rates for the national average for all consumers, classes and assist California's economic competitors.

Secondly, establishing performance standards that ensure that utility's performance is one of the most efficient in the nation.

Thirdly, promoting fair competition and customer choice in the generation and purchase of electricity through nondiscriminatory transmission access and utility and ratepayer indifference to the ownership of the source of the electricity.

The fourth, promoting public health and complying with federal and state environmental laws and regulations. Also, providing for electric resource diversity and cost-effective energy efficiency investment, among other criteria which are listed on page four of the resolution. So that's our first task.

Secondly, the committee should ensure that the Legislature is properly consulted and involved in policies proposed by the California Public Utilities Commission to deregulate the electric services industry.

And thirdly, the committee should provide a mechanism for the Legislature to work with the Governor, the Public Utilities Commission, the Energy Commission and other parties on the most effective strategy for achieving lower utility rates, fair competition, improved environmental protection and resource diversity.

This morning, we begin to implement the resolution and perform our assigned tasks with an overview of why electric rates are high in California and with descriptions of the various proposals which have been put forward to address the problem of high rates.

First, this morning we will hear from economists and researchers from the Lawrence Berkeley Laboratory on the nature of the problem. Following that, we will hear from a representative of the Public Utilities Commission of who's now famous, some would say notorious "Bluebook" created all the interest in restructuring and performance base rate-making and, of course, was the primary reason that Assembly Concurrent Resolution 143 was introduced and passed by the Legislature. And, of course, when we hear from the PUC in legislative committee hearings we make it a rule also to hear from the Energy Commission so they will follow the PUC representative.

Then, we will hear from various parties who have advanced their own

restructuring proposals to promote competition and reduce the high cost of electricity. And finally, we will hear from customer groups, non-utility generators of electricity, environmental and labor groups, municipal utilities and other interested parties about their perspectives on the implications of these various proposals. It goes without saying that this is an important and controversial topic. Many interest groups are involved in the debate over how to lower electric service costs in California. Indeed, we received over 40 requests from persons who wanted to testify at today's hearing. In order to accommodate these numerous and diverse perspectives we have had to limit the time for many of our witnesses today. In the letters of invitation I suggested that it would be helpful if witnesses would summarize their testimony at the hearing rather than reading lengthy statements. I would reemphasize this request by asking that with exception of the overview presentation at the outset and perhaps a little bit more time to hear from the Public Utilities Commission representative who's going to update us on where the commission is on this matter. Apart from those, all witnesses should try to limit their testimony to five minutes or less. That way we can ensure that the committee will hear from as many witnesses as possible this morning.

I'd like to welcome members of our committee who are present. As you know, this is a busy time for legislators many of whom are in their campaigns for election, but we do have with us Senator Leonard, who is a member of the joint committee, and also Assembly Member Baca, who is not a member of the committee but who is an interested observer and of course we welcome his participation. We expect others to arrive and hope that they will be here soon. The fog has presented a problem for some of the legislators who had planned to be here from Southern California. Senator Leonard, would you like to make a brief opening statement?

SENATOR LEONARD: I don't have a long prepared statement. I'll take your admonition just to thank you and the Legislature for their leadership in looking at this most important topic. When we look at the competitive advantage other states might have in areas like worker compensation and other things, we tend to ignore the very pragmatic costs of energy that other states public and private utilities offer to their customers and I think that's very much a consideration in our own economic climate and I commend the leadership of the Public Utilities Commission for an attempt to find ways to bring about a more competitive environment and I'm pleased to see its brought forth the kind of response that it has and I think this committee is an excellent forum to hear all of those competing proposals so I thank you.

CHAIRMAN SHER: Thank you. Assemblyman Baca?

ASSEMBLYMEMBER BACA: Thank you very much for the invitation for sit here as an observer. I appreciate your comments that you said. I look forward to hearing the different witnesses that will talk about lowering the electric rate. I think it's an interest in the state of California as we look at competitive market. But at the same time that we look at the quality of service that we have to provide and the cost of this to the ratepayers. I look forward to hearing the testimony this morning.

CHAIRMAN SHER: Thank you very much. With that we can get started with

our witnesses. First, our overview and our witness is Mr. Severin Borenstein who is the director of the University of California Energy Institute and with him, I believe are Mr. Edward Kahn and Carl Blumstein. Welcome gentlemen. Thank you for being here.

SEVERIN BORENSTEIN: Good Morning. I'm Severin Borenstein. I'm the director of the University of California Energy Institute and a Professor of Economics at the University of California Davis. I am also a co-director...

CHAIRMAN SHER: Since you're right at the beginning, let me just welcome Assemblywoman Gwen Moore, also a member of the committee. Welcome Gwen. Sorry.

SEVERIN BORENSTEIN: I'm also co-director of the university's program on workable energy regulation. With me today are Edward Kahn who is going to take care of the slides from Lawrence Berkeley Laboratory who is the other co-director of the program on workable energy regulation and Carl Blumstein, who is a researcher at the UC Energy Institute and Associate Director of the California Institute for Energy Efficiency. We have been asked by the consultants to the committee to give an introduction to the issues that the committee faces, an overview, particularly to address three questions: Whether California has high electricity rates; that one should not take very long; Why California has high electricity rates; and finally, what can be done about it.

To start out, yes, California does have high electricity rates, among the highest in the country. The map that is included with the testimony that you received shows electricity rate, average electricity rates in the United States, California is in the highest cost area, the black area, along with states in New England, Alaska and Hawaii. For the most part, the states with the lowest rates, the Northwest and parts of the southeast and south, have large hydroelectricity and coal generation. California has some hydroelectricity, slightly more than the national average but as you know we burn no coal in California for electricity generation and consume very little electricity that is generated with coal. California has nuclear power plants generated on the order of 30% of the electricity for the state. That is somewhat above the national average. If we go back to the map of the U.S., what we'll see is that the single factor that probably ties together the states with the highest electricity rates is the generation of power by nuclear generators. That's true in New England and California. It's also true in the Chicago area and in Michigan where power rates are also comparatively high. So prices in California are high. They are among the highest in the country. To some extent this can be attributed to what I would term endowment factors, factors that California is stuck with and has to simply live with such as the presence or absence of certain natural resources. We do have hydroelectricity, we don't have the cleanest burning coal or particularly any other coal. Population densities which affect the cost of generating electricity, environmental, the environmental vulnerability of the state. The endowment factors we can't do much about, but there have also been policy choices made in the past that have had significant affect. Probably the most significant is the choices of electricity generating technology, particularly decisions to build nuclear power plants that have, after the fact, turned out to be extremely costly. It is also the case that California has implemented the

Public Utility Regulatory Policy Act by generating bids for electricity particularly in the mid 80's and making commitments to purchase electricity that has turned out to be very expensive. The state has also chosen to regulate public utilities in much the same way that most other states do to rate of return regulation, a process that we have found to generate real inefficiencies in many cases in the choice of generating methods and the inefficiency of production.

Finally, California has chosen to invest in conservation and energy and efficiency programs that require investment from the state that have lowered consumption to some extent but have required payments that are reflected in the bills. Those past choices have all contributed to the electricity rates we have today. I think, although probably nothing one can say on this is noncontroversial, I think it is generally recognized that the nuclear power plants have probably made the largest contribution to raising and keeping our electricity rates above the national average.

So that's my quick overview of that we do have electricity rates that are higher than the national average and why we do. Let me give a quick overview now of what the possible solutions are and what can be done about the rates under various proposals.

The first and probably least controversial proposal I'll talk about is Performance Based Regulation. This is an attempt under the more traditional regulatory structure that we've had to give power companies more incentive to produce efficiently. The rate of return regulation, cost of service regulation it's also been called, generates very weak incentives for lowering costs. The Defense Department has learned this in procurement of and we have seen some of the same effects in rate of return regulation in Public Utilities. The Performance Based Regulation is designed to improve those incentives, particularly to give firms the incentive to lower cost by rewarding the shareholders of these companies with the savings that they would generate. The most extreme version of these would be what's called price-cap regulations. Simply that the company is given a maximum price they can charge and allowed to keep whatever cost savings it can generate. That obviously generates very strong incentives to minimize costs but it has a problem that regulators have had difficulty credibly committing to maintaining the prices that they have set. Particularly if it turns out costs are substantially higher than anticipated the regulator is likely to allow an increase in prices rather than permit financial distress of the utility and if costs are substantially lower than anticipated political pressure will generally cause the regulator to reevaluate and attempt at least to lower the prices of permitted.

This tradeoff of credibility and cost incentives is at the heart of the Performance Based Regulation. The milder or revised proposals that exist now generally allow the regulated company to keep some proportion of cost savings and make them liable for some proportion of increased cost, but not 100%. We've had a brief experience with Performance Based Regulation in California, Pacific Telephone is under PBR, Pacific Corp is under a PBR for providing electricity in some counties in far northern California and the three largest investor-owned utilities are all proposing PBR's of one sort or another.

More controversial, of course, is the move to a more competitive electricity generation system. Technology changes over the last 20 years have encouraged competition. Nuclear power plants have turned out to be more expensive than anticipated. The decline in natural gas prices has made smaller scale generation more cost competitive. Improvements in transmission technology, in particular, coordination technology through increased computerization, have made it more feasible to integrate multiple generators into the grid. The early attempts at competition that you're aware of, of course, under PERPA, were the standard offer contracts in the mid-80's, some of which turned out to be quite expensive and the legacy of which is part of the cost of our high electricity prices today.

More recently there has been a move towards allowing Public Utilities to announce the quantity of power they need and have independent power producers and other generators bid for that. Although this is a clear improvement, I believe, over the standard offer contracts, the problems have still arisen that we have difficulty comparing bids for different types of power. Most importantly, probably, transmission remains a difficult and complex issue. Transmission is probably the most difficult issue that, technological issue faced in moving towards a competitive electricity system. Technology still dictates some centralization of control in transmission. The simple science of electricity transmission does as well. Transmission on any part of the electricity grid can affect the quantity and cost of transmitting on all parts of the grid. So it is not, so a disaggregated grid would not be feasible. There are, of course, when transmission is controlled by a company that also produces power there are potential conflicts-of-interest that have certainly have led to complaints in the bidding for electricity from power producers who have tried to acquire transmission and have said that they have been prohibited or charged prohibitively high prices. An important part of any move towards a competitive power system will be integrating non-discriminatory and transparent prices for transmission.

The most controversial issue, of course, with competition, would be what to do with the generating facilities that have turned out to be much more costly than anticipated which falls under the general category of stranded investment. Many of the generating facilities, particularly the nuclear power plants, produce power at an average cost that is well above the competitive price of electricity today. This obviously wasn't anticipated at the time they were built but has turned out to be the case. If retail competition were permitted in the state, these power plants would probably still be viable operationally but would not recover their full costs. The difference between the costs that will be recovered under normal amortization and the cost that would be recovered in a competitive system is generally referred to as what would be stranded investment by a competitive system.

Some of the standard offer contracts would also represent a loss that one could think of as a stranded investment in those contracts. Who should cover those stranded investments is probably the most controversial issue this committee will face and goes to the heart of the question of what unwritten contract between the ratepayers and the government, on the one hand, and the Public Utilities on the other hand says. That is, what was the commitment made to the Public Utilities at the time that they built these? One of the proposals that

has surfaced in dealing with these issues is simply to delay competition to allow the stranded investments to be recovered either at the normal rate or through some sort of accelerated depreciation. Although that would allow these costs to be recovered, that is a policy decision. It isn't avoiding the problem, it is making the choice that the ratepayers will cover those costs over the period that had previously been prescribed.

If that's chosen however, they'd still face as a problem of bypass. Some producers have and continue to bypass the electric system to produce on their own and that's a natural economic phenomenon that's going to occur when the cost of competitive generation is much higher than the ratepayers are being asked to pay. Obviously, few residential consumers will bypass but industrial users have the demand that makes it possible for them to bypass.

Bypass will force the issue of competition even if the policy is formulated to try to delay it, so this is an issue the committee and the Public Utility Commission is going to have to face. The basic fact is someone has to pay for the mistakes that were made. They may not have been mistakes at the time the decisions were made but certain investments have turned out to be much more costly, generated power that's much more costly than today's competitive rate. That might have been due to mistakes at the time, it is certainly in part due to the decline of natural gas prices in the 1980's.

One possibility for covering these stranded investments, if the committee and the Public Utility Commission decide that the shareholders should be repaid for all of the stranded investments is some sort of electricity service surcharge. The PUC, in its proposal, referred to a competition transition charge. More generally, this would be, what as an economist I can only term an excise tax. It would be an addition to the price of a kilowatt hour of electricity that would go towards, one use of it would be to go towards covering stranded investments.

An issue that has received somewhat less attention but certainly it will arise if we go to a more competitive system or even under PBR is the treatment of certain public good and social programs, such as subsidies for low-income consumers, research on energy efficiency, programs to encourage end-use efficiency, etc. These are programs that, the benefits of which are not fully internalized by the company and the companies might very well not have an incentive to continue these programs and recent actions on the part of the Public Utilities have indicated that that indeed is the case. They would not want to continue the funding at the current levels.

An electricity service surcharge could also address this. Again, this would be an additional charge per kilowatt hour. Some of the funds generated by that could go towards financing end-use efficiency, research and development programs, and so forth, to the extent those are determined to be of sufficient value that they should be continued.

I have to raise one issue that as an economist I don't know that much about of legal jurisdiction, but obviously it's one that will have to be addressed and many of the witnesses you'll talk to today will have opinions on it. There are clearly issues of authority of control of transmission lines and the prices for

transmission. There are also clearly issues of who has the authority to set an electricity service surcharge, whether the CPUC could do that itself or whether that would require the Legislature.

And finally, there's the question of how municipal power companies should be, what rights they have and how they can be treated under a move towards more competitive electricity.

So, in conclusion, California does have high rates, among the highest in the country. Mostly, this is due to past decisions that have not turned out as well as we had hoped they would at the time. To some extent it's probably due to endowments. The proposals for Performance Based Regulation and Competition are likely to benefit consumers but on their own they are not going to bring our rates down to national average.

The simple fact is that some mistakes were made in the past in investments and technology. If the ratepayers are to pay for those mistakes through the rates, that is going to keep our rates high until those mistakes have been paid for. If someone else, either the taxpayers or possibly the shareholders were to pay some part of that, obviously the electricity rates could be lowered more quickly.

The gains from moving to a more efficient Performance Based system or a competitive system that encourages greater efficiency in production are real but they are not probably the major difference between our rates and the rates in the rest of the country. The major difference is the cost of these historical, these decisions that have been made in the past. Still, competition is upon us. The pressures to move towards a more competitive system are going to continue, bypass is going to create increasing pressures to deal with these systems as some consumers threaten to bypass and receive reduced rates in order to prevent bypass. That is going to mean the remaining consumers have to pay an increasing share of these historical costs.

Thank you.

CHAIRMAN SHER: Thank you very much. That's an excellent beginning for us, a very good overview. We have your statement prepared for other members of the committee and I think it's an excellent basis on which we can start our discussions. Let me start, I have three questions I'd like to put to you. One relating to Performance Based Regulation, the second to what you said about stranded investment, and the third that relates to what you call the social programs and public goods. I would include diversity and environmental issues as well.

First, on the Performance Based Regulation which you list as one approach to trying to do something about the high cost of electricity. My question is that, what I really want to know is that compatible with the other approaches you talked about which are designed to introduce more competition. In other words, if the Public Utilities Commission should move to adopt the pool approach where everyone sells their energy into the pool, including the utilities who are asking for this Performance Based Regulation, or as some have suggested in the new world of competition, utilities don't sell any energy in

their own service area generated by themselves. If that's the way it turns out, what is the role of Performance Based Regulation? Isn't that a way in which it's determined how much the utilities be allowed to earn on their generating facilities?

SEVERIN BORENSTEIN: Well, we have to distinguish retail competition from wholesale competition in this case. If we move to assist them, as we are moving to of greater wholesale competition, that is not inconsistent with the PBR necessarily. These companies will remain generators of electricity. To some extent, they will remain distributors and owners of transmission lines and there are costs to doing that that the companies can...

CHAIRMAN SHER: I'm not talking about the transmission or distribution, I'm talking about their generating facilities. If we go to wholesale competition, they will be, to the extent that they are going to generate electricity, they would sell it into the pool and I thought what they'll get for the power is not some formula adopted by their regulatory agency.

SEVERIN BORENSTEIN: That's right. On the wholesale side, if we go to a pool or an active trading market where the prices are well understood, we wouldn't need a PBR for that part for regulating that aspect of the company because their cost would be completely transparent.

CHAIRMAN SHER: Therefore, does it make any sense to move ahead with PBR until it is determined what kind of system the PUC is going to propose and adopt for generation and how it's priced?

SEVERIN BORENSTEIN: Well, that depends on how quickly this process is going to move. If it's the case that we will in the next six months or a year have definitive outcomes to the structure of the wholesale electricity market, then delaying PBR for that part of the system probably makes sense.

CHAIRMAN SHER: Under the PUC Bluebook proposal it was indicated, I think, that this was going to move very quickly and that some kind of proposal or competition was going to be crafted by the PUC and be in place very soon. So, I think you've answered by question. I have this kind of nagging question about whether it makes sense to move ahead on the PBR track at the same time it looks like there's going to be restructuring that introduces its competition on the generating facility. Now PBR may still work on the other functions that investor-owned utilities will continue to carry on.

All right. Let me go to my second question which relates to stranded investment. In your testimony, -- I'm going to give the other members a chance in a minute. I just want to do these three questions.

On the stranded investment question, you indicate that that's the most difficult problem. I think we all understand that it is a difficult problem and if the decision is made that the investor-owned utilities, as we move to a new system, are entitled to recover all of these stranded investments. You suggest that, if that's true and the investors and utilities don't have to bear any of those costs, that we're not going to be able to bring electricity rates in California down to the national average and so, I guess what I'm asking if the

determination is made as the PUC indicated in the Bluebook that the investors should be protected with respect to these investments, will the surcharges, or you used the "T" word, we wouldn't call it a tax here, we would call it something else, but you can say that. Will that be so high that the benefits of competition, if you put a surcharge or this excise tax on top to deal with the stranded investments that the restructuring really won't produce the benefits that the large industrial users and others are agitating for because the surcharge will eat up the savings the competition has brought.

SEVERIN BORENSTEIN: Well, I'm not sure I would phrase it that way but the surcharge would be a significant part of the difference between national average prices and our prices today. So if that surcharge were placed on electricity to make the shareholders whole our rates would not drop to close to the national average. A significant proportion of the difference would remain.

CHAIRMAN SHER: Well, if that's true and if the threshold decision is made to impose the surcharge or some version of that, is the restructuring that introduces competition worth it because you don't end up having lower electricity rates?

SEVERIN BORENSTEIN: Well, I would argue it is worth it because we still are going to get improved efficiency in the operation of the system.

CHAIRMAN SHER: It's worth it for other reasons but not because consumers are going to pay less rates.

SEVERIN BORENSTEIN: Well, consumers are not going to pay the national average price. They will pay less, I believe, but there is no magic potion as I said in my testimony. This isn't going to suddenly give us rates equal to the national average rate. Somebody's got to pay...

CHAIRMAN SHER: Not suddenly. It might happen eventually when all of these mistakes are paid for.

SEVERIN BORENSTEIN: Right. And I believe that when that point comes, which may be a decade away, or more, we will have lower rates if we move now to a more competitive system than if we continued under the current system.

CHAIRMAN SHER: But nobody should be operating on the assumption your going to have this drop-off in rates quickly.

SEVERIN BORENSTEIN: Somebody has to pay for what's been done...

CHAIRMAN SHER: You can say that directly in your testimony. All right. My final question relates to these public goods, social programs, the adopted policy of the Legislature that we should have diversity of sources of energy in California. The adopted policies of the Legislature that we ought to care about how the power is generated and be interested in cleaner generation. All of those things, would you want to give us an initial view of the various proposals we are going to hear about them today, the wholesale, the retail wheeling, variations of those? Which of those is better suited to deal with these other concerns, these other policies that are currently reflected in

California law and regulations?

SEVERIN BORENSTEIN: Any system that gives the power companies a strong incentive to cut costs and gives them the freedom to make the decision of how to cut those costs is going to give them an incentive to eliminate these social programs, let's call them broadly. Whether it's initiated under a strong Performance Based Regulation or retail competition or wholesale competition without any sort of explicit adder for these programs is going to give the company strong incentives to eliminate these programs. We've already seen this begin to happen. The IOU's have reduced their funding and have proposed to further reduce their funding for many of the research and development programs. So...

CHAIRMAN SHER: And it accelerated the depreciation schedule on some of these high cost facilities in order to stabilize the rate. You've got to give up something if your going to accelerate, is that right? That's an example of that?

SEVERIN BORENSTEIN: Yes. Yes.

CHAIRMAN SHER: Okay. Ms. Moore.

ASSEMBLYMEMBER MOORE: Let me see if I can follow-up a little bit because I'm still trying wrestle with the notion of the stranded investment. In your definition or in your mind does stranded investment include both profit and original investment?

SEVERIN BORENSTEIN: Stranded investment would include the full cost of the investment in which I would include a normal return on that investment. So, yes. I think what a lay person would call profits, if it's a fair profit, yes.

ASSEMBLYMEMBER MOORE: Well, wait a minute now. Who's going to make a determination of whether it's fair or not.

SEVERIN BORENSTEIN: Well, the CPUC has been doing this for the last many years.

ASSEMBLYMEMBER MOORE: Actually, you're saying that whatever is out there regardless to in our mind to try and get down the cost and move them to a different direction, that if it's out there and it's the rate of return that was established by the Commission, that should be included in the stranded investment.

SEVERIN BORENSTEIN: I think that that is a policy... I would include that in the definition of the stranded investment. It is a policy decision that this committee should and I'm sure will address of how much of that stranded investment the shareholders should be reimbursed for.

ASSEMBLYMEMBER MOORE: All right. Because that was the other part of my question -- should recovery of the stranded investment include both the return of capital and the return on capital?

SEVERIN BORENSTEIN: I think that the... I would say yes, it should treat those equally. What proportion of that sum it should be reimbursed to the shareholders is a policy question on which, I think, there are strong and good arguments on both sides that you will hear today that would be a real efficiency effect if the government or the ratepayers were seen as abdicating a promise they made to the utilities to cover these costs. On the other hand, if these costs continue to be covered through high electricity rates, it obviously has certain effects on the impact of the state's economy which are part of why we're here today. So I think there are strong arguments on both sides and at its heart to that question goes to what is the contract that exists between the public and the Public Utilities?

ASSEMBLYMEMBER MOORE: You're a cautious testifier.

SEVERIN BORENSTEIN: I don't have, I have not reached a strong opinion on what proportion of the stranded investments the shareholders should be reimbursed for. If upon learning...

ASSEMBLYMEMBER MOORE: Let me ask the question a little different. Do you think they ought to be reimbursed 100% of whatever? You said what portion so I'm assuming that there may be something in your mind that says that maybe all is not necessary, particularly since the goal is to lower electric rates.

SEVERIN BORENSTEIN: Well, the goal is clearly to lower electric rates in the long run. I would not say that failing to reimburse something less than 100% today is necessarily going to be the best road to that goal in the long run. It would clearly change the incentives for future investment in government regulated industries, or even government influenced industries. If there is a long-term commitment that exists and if it is well documented, I don't know the legislative history well enough to say this, but if it does exist and it was well understood that ratepayers should cover all prudent investments then, I think the argument for 100% reimbursement is strong. If, on the other hand, there was an understanding that some costs might be determined to be imprudent or if they just turn out to be a bad investment, shareholders do have some of the responsibility, then less than 100% reimbursement would be, I think, a reasonable outcome.

ASSEMBLYMEMBER MOORE: So then, can I take it that if it's somehow determined that it was a bad decision or a bad deal that maybe there ought to be some revisit that it clearly can be demonstrated that that decision contributes heavily to the high rates of any given company?

SEVERIN BORENSTEIN: Well, there's no doubt in my mind that those decisions contributed heavily to high rates that exist today. They are the reason. They did turn out to be mistakes after the fact. Everyone knew at the time they were made that they could turn out to be mistakes after the fact, but it is not clear to me that at the time they were made it was stated that if they did that the shareholders would be expected to bear some of that burden.

ASSEMBLYMEMBER MOORE: Clearly that wasn't...

SEVERIN BORENSTEIN: Well, it depends on what risk the shareholders were expected to bear at the time the decision was made..

ASSEMBLYMEMBER MOORE: Very well.

CHAIRMAN SHER: Well, I think Ms. Moore is alluding to the fact that with respect to this understanding that existed at the time these facilities were constructed that perhaps the understanding was changed with respect to certain facilities from the original understanding. You talk about reasonable and prudent investment with respect to some facilities maybe that was changed after the facility was built in certain cases. But we'll get to that. She also called you a cautious witness. That's what we wanted you to be. We invited you here to be our objective witness who would describe the situation to us and lay the groundwork for the advocates who state their own proposals and tell us how there going to deal with these issues. I know as an academic you're very comfortable having that role and saying on one hand but on the other hand I've been known to do that myself.

Mr. Baca?

ASSEMBLYMEMBER MOORE: Very often.

ASSEMBLYMEMBER BACA: Thank you, Mr. Chair. If I may follow-up on one of the questions that you asked based on the Performance Based Regulations as we look at lowering that rates in competition right now the effects that it may have on the municipalities and others in the two different types of jurisdictions regulations that we have. Does that also make a difference because of the nonprofit organization offering verses a profit offering the services that would be available under the Performance Rate Regulation? Would that affect us and what effects would it have? And then what are we actually looking at when we're looking at short- and long-range plans and the services that are provided by the supplier and provider based on the Performance Based Regulations that we have for a nonprofit verses a profit as well and the effect that it has on the consumer?

SEVERIN BORENSTEIN: Okay. My knowledge of jurisdictional issues and the legal issues of municipals is not very strong. So I will address this sort of from the economic point-of-view of how they might behave under these changes. Performance Based Regulation doesn't have a natural application to a government-owned or operated or a nonprofit of this sort that's directly answerable to the government for its charter. The efficiency improvements for which there is an attempt to pursue with PBR in the IOU's are pursued through other methods in municipal or state-owned or government operated agencies. So it doesn't have an obvious application to me that I understand.

EDWARD KAHN: In some jurisdictions where these services are provided by publicly-owned entities, there are attempts made to link, let's say, the compensation of senior managers of the firm to some sort of performance requirement. That's just a substitute for the arguably stronger incentive of tying shareholder returns to the Performance Based criteria.

CHAIRMAN SHER: All right. Well, that frequently happens.

ASSEMBLYMEMBER MOORE: Keep asking.

CHAIRMAN SHER: Senator Leonard?

SENATOR LEONARD: I'm interested in a historical perspective on pricing which I did not see in your otherwise very comprehensive analysis. Would this map dated April, 1994, look much different twenty-five years ago?

CARL BLUMSTEIN: Actually, that's dated 1992, but, I think that...

SENATOR LEONARD: ...at the bottom of this page, so you're... Oh, it's from a book published in '94 and the chart of '92. Okay.

SEVERIN BORENSTEIN: ...from '92. Actually, my knowledge of this is not going to be as strong as that as Carl's, so I'm going to...

CARL BLUMSTEIN: It's my understanding that regional differences were substantially less pronounced twenty-five years ago.

SENATOR LEONARD: So the phenomena you described of our natural endowment and some of the fluctuations there, drought and other factors, and then some of our public policies, both mistaken and unconscious, I guess, have changed the ratio, the relationship, just within the last twenty-five years? Is that a fair conclusion?

CARL BLUMSTEIN: It's my understanding, yes.

SEVERIN BORENSTEIN: I think that that is clearly the case, that the decisions that have been made in the last twenty-five to thirty years, actually, have been the principal reason for the difference between our costs and the rest of the county.

SENATOR LEONARD: And the rest of the country. Thank you very much.

CHAIRMAN SHER: Ms. Moore?

ASSEMBLYMEMBER MOORE: Along that same line, would you say ten years ago or, let's say ten years ago, that it would have looked any different?

EDWARD KAHN: I'd say ten years ago it would have been a little less extreme. Ten years ago not all the nuclear facilities or all the private power projects were recognized in rates and fuel prices were probably a bit higher than they are today, so this spread really has to do with recognition of high cost projects which were authorized under the expectations of very high fuel prices, coming out at a time when the fuel prices have gone down instead of going up.

ASSEMBLYMEMBER MOORE: So the late '80's, I guess, is when you really would have seen the pronounced change that we are now experiencing.

EDWARD KAHN: Yeah, I think that's correct.

ASSEMBLYMEMBER MOORE: Any idea, because there's obviously a great debate going on as to whether the standard offer contracts contribute substantially. We know that they contribute somewhat, but do they contribute to the extent that some believe, to the high cost of electricity rates in California?

EDWARD KAHN: They're clearly an important factor. I think it also needs to be said as Dr. Borenstein pointed out in his testimony, that this is a problem to the extent that they do contribute, and it's not a small extent, a good deal of this problem will be ameliorated through the contractual mechanisms in these contracts. They are expected to come down in price over the next five years. And that will be one dividend that the state will get.

ASSEMBLYMEMBER MOORE: I guess my question still is centered around as they come down in the next five years, will that be substantial to the extent that it may eclipse the need to do something else?

EDWARD KAHN: I don't think it will eliminate the problem. It will not bring our prices down to national average levels, but it will be significant.

CHAIRMAN SHER: All right. Well, I want to thank you for your excellent testimony, your response to our questions. We'll be in communication as we proceed with our deliberations of the committee and I'm very grateful to all of you for your written statement and your oral presentation. At this point, we are going to turn to our next witness. Unfortunately, President Fessler of the PUC could not be with us today, but Mr. Peter Arth, General Counsel, will present what I understand to be President Fessler's testimony. These are his words you're going to give us, although when we ask you questions I'm not sure you can give us his response, unless... I know you know him very well, then maybe you can. So ...

PETER ARTH: In a position of great jeopardy, I'm glad to be here nonetheless, Mr. Chairman.

CHAIRMAN SHER: Well, proceed please.

PETER ARTH: Actually, at your request President Fessler had prepared a rather extensive statement, and that is being distributed to you and I certainly hope that it is not only included in the record but you get a chance to read it because it does go from the first question you asked, that is, why are rates so high to the intermediate question, "What can we do about it?" and then it spends a fair amount of time on what, I think, we will try to focus on in our few minutes here today, that is, what has happened since the Bluebook was launched in April of this year and how we responded to the rather kinetic response in terms of the committee we now sit before and to take a look at where we're going in the near term, especially with the deadlines that exist in ACR 143 that have the Commission undertaking evidentiary hearings and reporting to you on some pretty big issues. I want to introduce Paul Clanon, who is the Assistant Director of the Commission's Advisory and Compliance Division. If we do have some time to get into what is in the Bluebook, I wanted to have Paul available to answer technical questions. I think you've described it fairly well, and it's really with no reluctance at all that we shear away the first

half of President Fessler's prepared remarks because the first panel was truly excellent. We saw no major areas of disagreement as to the diagnosis as to why rates are high in California. One of those items on the list that needed to be looked at was rate-of-return type regulation. One of the items in the Bluebook is Performance Based Rate-making and maybe we'll get a chance for you to ask your question again to Paul as far as does that make sense to go forward with that in the context of the second leg which is a proposal, and I underscore proposal, to look at direct access as a means to move into this competitive environment.

CHAIRMAN SHER: Could I interrupt you right there? Since the the joint hearing that we had and since you've issued the Bluebook, I've had a number of conversations with President Fessler and he insists that the Bluebook is a staff proposal. It's not a Commission proposal. Would you verify that?

PETER ARTH: Actually, in the part of the testimony that I'm going to present to you, that phrase appears. It was issued by the Commission in two formal dockets. In other words, they initiated both a formal investigation and that was to resolve disputed issues-of-fact and a rule-making, and obviously the target was the two items that we mentioned and the bigger target is direct access. I don't know if there's a clear distinction drawn.

CHAIRMAN SHER: Those proceedings were designed to give the public and interested parties an opportunity to comment on the staff proposal?

PETER ARTH: Well, I think there was obviously a sense of vision, and the word vision for better or for worse...

CHAIRMAN SHER: Whose vision though? That's what I'm asking you. Whose vision is embodied in the Bluebook?

PETER ARTH: Well, maybe it will best serve now for me to put on my President Fessler's format and talk about that. And to get back to the question, "What has happened since the Bluebook was issued?" And this will be in the first person. In May, at a combined hearing of two important Assembly committees, several members expressed concern that the Bluebook reforms might be adopted as final Commission orders without consulting the Legislature or taking sufficient time to explore the goals and concerns of the broadest variety of stakeholders. Both Commissioner Knight and I appeared to assure you that notwithstanding the unfortunate statement in the staff proposal, the Commissioners, as ultimate decision-makers, had no intention of reaching any judgment until such time, and with such consultation as we deem necessary to get it right. I would now like to report on our activities since the date of that hearing.

By the time you convene this initial inquiry, the five members of the Commission will have held no fewer than five full panel hearings. And for those who are not familiar with that term that means all five commissioners sitting in bond. These hearings which have ranged from one to two full days are remarkable for the variety of participants from within and without California. Indeed, individuals and parties have come forward from beyond North America to congratulate the commission for its recognition of the

technological changes which mark the generation of electricity and the potential which competition has to place long-term on downward pressure on rates in California.

Utility and non-utility generators have been joined by witnesses who represent industrial, commercial, agricultural and residential ratepayers. Academic critics, financial commentators and institutions such as the New York Mercantile Exchange have been joined by spokespersons for labor and environmental concerns. I'm also happy to report participation of representatives of economically disadvantaged Californians. It goes on to state, and I'm going to shorten this somewhat, the extent of the full-panel hearings. They have been in Los Angeles, two days in that part of Southern California, here in Sacramento for a day, San Francisco for two days and most recently, in San Diego. There has been a real effort to share with the public what has gone on in the hearings. We have used video recordings. We have paper transcripts for those who need that format. All the materials available to the committee and any interested members of the Legislature has been widely shown on CalSpan and made available by local cable companies as community service programming.

Besides the full panel hearings, individual commissioners have gone throughout the state. They have gone, in essence, from Eureka to San Diego. Dan, himself, has held nine forums. Each have been attended by two to three hundred interested Californians. He personally conducted two to-date, first in Eureka and more recently in Fresno, and at each more than fifty persons spoke while many others listened and were content to leave statements.

CHAIRMAN SHER: I want to apologize for interrupting but that's important and we've got it here in writing. Even more important is the next part of the testimony. What you have learned and even more important than that, is where is the Commission in the process?

PETER ARTH: Let me move along.

CHAIRMAN SHER: Okay.

PETER ARTH: In what he has learned, he spends a fair amount of time again describing direct access as one model compared to various wholesale marketing reforms. I won't go over those. The snapshot sitting where he has sat through these full panel hearings is this. "In presiding over the entirety of each full panel hearing and in holding the aforementioned public forums, I have yet to be told by a single witness that the inquiry is either untimely or unworthy. The phrase, 'it ain't broke so don't fix it' has yet to be uttered. Californians of every ratepayer class complain of electric rates and concur that our economy is daily hobbled by our competitive disadvantage when contrasted with neighboring jurisdictions. While reform is greeted with enthusiasm there is great praise for the reliability of our current system and strong, cautionary statements that it must not be risked in any restructuring. In addition, the social and environmental goals which have marked our recent history are broadly applauded even as some expressed doubt that they can any longer be afforded or born by investor-owned utilities. The challenge to reevaluate these programs and to more adequately and fairly support those

deemed worthy of continuation is squarely before us and the Legislature."

I would conclude by going to what's next which he describes as a work in progress. As we near the end of October, I can report that we have completed full panel hearings on both the wholesale and retail markets. No decision has been made and we have yet to explore the jurisdictional transition cost and environmental consequences issues which are implicated if we attempt to optimize the wholesale market and intensified if we were to seek to implement any form of direct access. This agenda is a logical outgrowth of the fact that one cannot rationally address these critical implementation issues until there has been a basic decision on the reach of the reform attempt. A reform which leaves the utility and places the sole purchaser in the wholesale market for resale to all classes of ratepayers will have one set of consequences. A reform which empowers direct access will have others. The extent, if any, which a commission-framed reform would depend on the repeal modification or enactment of statutes cannot be determined in the absence of our making this critical policy choice. The basic outline of the implementation issues has begun to emerge and I can report the following. This is an issue that Mr. Borenstein deferred on that of jurisdiction. In fact, that is the conflict that causes Professor Fessler not to be with us today. He is at the Federal Energy Regulatory Commission and he is working through an approach that is described in his testimony and is further described in testimony that I have distributed that he gave before Congressman Sharpe's committee. The concept is based on the fact that California is not an island. We are part of a grid that interconnects virtually all investor and publicly-owned utilities in twelve western states, two Canadian provinces and two Mexican states. The concept that he is putting forward is one that he entitles cooperative federalism which builds on the jurisprudence of Mr. Justice McKenna, the second Californian to sit on the United States Supreme Court. The notion basically is, yes, there are jurisdictional overlaps but at the same time there is plenty of jurisdiction to go around as we work with our federal colleagues to move in the direction we want to go and that is obviously an ongoing issue that involves us, the American Bar Association, the Federal Department of Energy and clearly will involve the Legislature as well.

On the issue of transition costs, again, in his statement President Fessler states a major provision of ACR 143 calls upon the Commission to hold evidentiary hearings on the dimension and allocation of transition costs and to report to the Legislature not later than January 31st. We will, of course, comply. You will recall, that prior to the adoption of the Concurrent Resolution I suggested that such a focus was premature since it was impossible to determine the amount of what are termed transition costs in the absence of the Commission framing a final reform proposal. All witnesses anticipate that a reform limited to the introduction of Performance Based Ratemaking would result in little, if any, a more ambitious goal of enhancing competition at the wholesale level might, and I emphasize that term, occasion such a claim. Any attempt to sweep beyond the wholesale market to empower consumers in what have heretofore been utility monopoly markets would almost certainly result in the claim that certain assets were now overvalued while purchase power obligations were onerously given market clearing prices for electric generation. Given the assurance that no final orders will be framed prior to January 31st, I respectfully urge the committee to take immediate steps to extend this deadline

for our reporting obligation until a proposal has been framed. Failing such action we have no choice but to order the responding utilities and all interested parties in the hearings which many condemn as premature and ill-focused. At this point I would simply note, for your information, and those of the parties in the audience last night, in fact, the two assigned commissioners, Commission Fessler and Commissioner Knight, did issue a joint ruling on this issue. So it is in the mail to all of the parties and it is going to be our best effort at holding evidentiary hearings between now and the first of the year so that we will be in the position to comply with that provision in the Joint Resolution. But again, it is simply our effort to comply with not only the spirit of the resolution but the letter as well. We have serious misgivings about it and that is something we would want to pursue with you.

ASSEMBLYMEMBER MOORE: I'm sorry. Excuse me. What did they issue?

PETER ARTH: They issued a joint-ruling that basically invites parties to respond to the issue of the competition transition surcharge. That is, for respondent utilities and others. It obviously is going to be a rough cut, but it's going to be 'You tell us what you think it is,' 'You give us an idea of the allocation' and it's going to be a start.

ASSEMBLYMEMBER MOORE: Do we have a copy of that ruling?

PETER ARTH: Yes, we didn't distribute it but we have copies.

ASSEMBLYMEMBER MOORE: We'd like to see it before you get away.

PETER ARTH: Absolutely.

CHAIRMAN SHER: Let me say, after you finish your testimony I want to pursue this with you. I believe that the impetus for this ruling, as you call it, is the January 31st, 1995 deadline in the ACR for the Commission to submit certain information to the Legislature and to conduct an evidentiary hearing on it. And so this is laying the groundwork, but in our dialogue that will follow the completion of your testimony I want to tell the members of the committee as well as the assembled audience what is being discussed in terms of perhaps postponing that date if and when we know when the Commission is actually going to frame its order. But we'll get into that. I want him to finish his testimony this morning, then we'll pursue this because this is an important point.

PETER ARTH: Excellent Mr. Chairman. And I'm nearly done. The one point that President Fessler wanted to make with regard to the transition costs is that some view the issue as a new burden which may be imposed on ratepayers as a consequence of the Commission's restructuring effort. I respectfully disagree. What we are discussing is the degree to which utility-owned generating assets or purchase-power obligations may exceed prices which consumers would pay if they were free to shop an open market. Those costs are on the system even as we speak. They are a burden and an opportunity cost on California's economy which we seek to recognize and address. We did not create them and the abandonment of this restructuring effort cannot make them go away.

Editorializing, I think that seems to comport with the answers that you heard at the previous panel.

The last point is on environmental consequences and concerns. At the present time we have pending a motion by the Natural Resources Defense Council that we initiate a CEQA review of the Bluebook proposal. While we have yet to formally rule on that motion, I can make several basic points.

First, the Commission will fully comply with California's Environmental Review Mandates. It is the law and we follow the law. But what that will entail is entirely dependent on the nature of the reform which we eventually seek to accomplish. As with the earlier observations respecting transition costs, it is the reform which will give us a project against which to apply the statute.

That completes his comments on the environmental issue and his prepared testimony other than to thank you very much for the indulgence you've extended to us.

CHAIRMAN SHER: All right. Thank you. The most critical point that we need to explore President Fessler comments on in his testimony, I think in several places, talks about the difficulty the Commission has in responding to the ACR mandates, if you will, or requests if you want to soften it, that the Commission supply certain information to the Legislature with respect to the proposal. On page eight of your testimony, he says, "...it's almost impossible to tell you what we're going to do about "transition costs" until we frame our proposal." But, of course, ACR 143 was formulated in response to the Bluebook which indicated that the Commission was going to take action even though this may be a staff proposal but the original indication was they were going to take action in August, 1994. Then we heard about that slipping into October, so naturally the Resolution was framed in a way to require quick response. I think he's quite correct in suggesting that it would be most helpful to everyone to give this information to the Legislature once the Commission has decided what its vision is, what proposal it's going to suggest. Of course, at that time the Commission will want to give the rest of the world, the public, an opportunity to comment and the Legislature will want to have an opportunity to respond to it. But, in this testimony on page eight, we now see this statement given the assurance that no final orders will be framed prior to January 31st.

Has the Commission formally acted and decided that there will be no order or is that President Fessler's appraisal of the situation?

PETER ARTH: I would answer that it is an appraisal of a single Commissioner who is one of the two assigned Commissioners and it probably is based on looking at the calendar. Realistically, that probably is a safe statement to attribute to the full Commission, although no formal vote has been taken.

CHAIRMAN SHER: All right now. Does that suggest that we may see a final proposal on February 1st? Can you tell us anything about when the Commission does anticipate issuing a final proposal? Because we need that in order to adjust the dates which President Fessler directly has asked me to try to

persuade the committee and the Legislature to do. We can't do that now obviously. We're not in session. But, at the beginning of January when we're back in session if we had some firm dates in mind as to when the Commission expects this and would commit that its proposal won't be forthcoming and we also need to know what the initial proposal is going to be. Is it going to be a draft proposal and not a final proposal so that there will be an opportunity for the public to respond to it and I'm sure the Commission itself will want to have hearings on it before it becomes final. But we want to have an opportunity here to have a look at this proposal with the underlying premises and date upon which its based which are called for in the Resolution. So can you give us these dates?

PETER ARTH: I cannot give you the dates. I can say that that's an entirely reasonable request and set of observations and this, I think, is the mechanism, part number three of what we're about here. But the ruling is something that the two assigned Commissioners just produced in the last 72 hours and I think the next step is probably going to come as this effort cranks up. And maybe Paul is in a better position. There's a large amount of internal planning to provide the dates.

CHAIRMAN SHER: Okay. Let me just say I agree with the statement in President Fessler's testimony that it doesn't make a lot of sense to do an environmental review of the Bluebook proposal if the Bluebook proposal is no longer extant. I mean, if it's not going to be what the Commission comes up with. It also doesn't make a lot of sense to look at the transition costs of retail wheeling if what the Commission ultimately is going to propose is not retail wheeling. But I feel the Legislature had to, in a sense, protect itself because all that was out there at the time we were in session and were responding was the Bluebook which looked like a pretty firm proposal, whose ever proposals they were, whether they were the staffs or the Commission and a pretty firm timeline for moving fast. Over and above that there were statements of individual Commissioners quoted in the press about moving quickly and not letting these proposals lose their luster, I believe, was the expression I saw quoted in the newspaper and so we had to move quickly on these. If that's not the situation anymore, it's incumbent on the Commission in a formal way to let us know that and if we can get those kinds of assurances and get an actual firm date then I'm in a position to ask the committee to adjust our deadline in a way that I think the Commission would find more reasonable. Yes, now did you want to say something?

PAUL CLANON: I was just going to say that sounds like a heck of a fair proposition to me. There is a very active internal effort now going on at the Commission to try to figure out what the best next steps are. We have ACR 143 which is a pretty good list of the sorts of issues the Commission was going to have to look at anyhow. We've got the Commission's own processes, we've got ...

CHAIRMAN SHER: Once again, Ms. Moore suggests, I think correctly, that you should just for purposes of the record, identify yourself.

PAUL CLANON: My name is Paul Clanon. I'm assistant director for energy and environmental stuff in the Commission's Advisory and Compliance Division.

CHAIRMAN SHER: Thank you. I think you've answered the question. All right, Ms. Moore.

ASSEMBLYMEMBER MOORE: So we can leave here today knowing that the Bluebook is nothing more than the figment of the staff's imagination.

PETER ARTH: I know that's one of those rhetorical questions.

PAUL CLANON: I'll defer to Pete on that.

ASSEMBLYMEMBER MOORE: I just want to be comfortable in leaving here with... Now we had a whole hearing on the Bluebook back in March or May or whenever it was, shortly after it came out and there was no implication then that it was just a figment of the, or the wish list or the staff and so I just want to know if this is indeed now the position of the Commission that it is not their idea and that we don't have to worry about the implications that are involved in it. And I'm reading the Commissioner Fessler's statement so we don't have to worry about direct access, at least, at this point.

PETER ARTH: Well, you have the date of December 31st and beyond that...

ASSEMBLYMEMBER MOORE: But then we start worrying December 31st.

PETER ARTH: Well, I think the Commission owes the parties and you a procedural ruling that will pretty much answer that question.

ASSEMBLYMEMBER MOORE: Wait a minute now. They're not just stringing us along and having us do busy work when they've already made up their mind now, are they?

PETER ARTH: Well, no, but the notion is that policy choices are before them and you're going to hear the rest of the afternoon, some very substantial differences in these broad reforms and somehow they're going to need to sort through them and all of the issues that you have set forth in the Resolution as to the impacts of those. So what I am saying is I think it will be educational to everyone to see how we go about it.

ASSEMBLYMEMBER MOORE: Let me ask you this. Does the order at FERC on Wednesday beginning an investigation into power foods, does that reduce the need to press forward with a final PUC report or proposal?

PETER ARTH: I'm not familiar with a specific docket. This is the area of overlap as far as the jurisdiction that FERC has asserted, the jurisdiction that the state...

ASSEMBLYMEMBER MOORE: It's wholesale power. It's wholesale power reform at the federal level.

PETER ARTH: Yeah, I'm not aware of any...

ASSEMBLYMEMBER MOORE: And I'm looking at Section A of our wholesale market reform, does it make any sense for us to, if FERC is looking to make

significant changes at the same time we are which obviously would or could pre-empt or have significant impact on anything we propose to do. Is there some thought about how we reconcile what's going on at the federal level with what goes on at the state level?

PETER ARTH: Well, the sessions that I've been to...

ASSEMBLYMEMBER MOORE: I know we're the trend setters and fans usually follow us but in this instance...

PETER ARTH: The sessions that I've been to on this issue portray a single car with a single steering wheel and two hands on the steering wheel. One of the state commissions and another of FERC and again, the lawyers can argue at length as to the overlap. We're optimistic that this is going to be done on a cooperative basis rather than a tug-of-war.

CHAIRMAN SHER: I want to come back to the ruling that was issued last night. I haven't had a chance to read it obviously but the first sentence says, "This ruling sets evidentiary hearings on subjects related to electric utilities uneconomic assets and obligations. So it's going to be evidentiary hearings on stranded investment type questions.

PETER ARTH: That's a fair reading.

CHAIRMAN SHER: The Commission, certainly President Fessler, thinks it's a bad idea to do this because you can't really do it without knowing what the proposal is and each proposal will have different implications for stranded investment so this is not a good thing to be doing, but then he cites ACR 143 so he's laying it off on 143 as forcing him to do this bad thing. He doesn't want to do it, it doesn't make any sense, it's wheel spinning. There are a lot of proposals out there and they're going to have to do an evidentiary hearing on the implications for stranded investment of all of these knowing that some of them are inconsistent and the Commission, when it finally reaches and "crafts" in his words, a proposal, it's only going to be one of those. But in the meantime we are going to have evidentiary hearings on a variety of possible proposals. Wholesale, retail, so it's a bad thing to do but ACR 143 forces us to do it. That's the way I read this. Now, what I want to know is, building on our earlier conversations, if when we're back in session in January we have an opportunity to push the dates in the Resolution back based on firm assurances from the Commission they aren't going to do anything dramatic or drastic until a later date where they will craft a proposal, then you can be more focused on the implication that for stranded investment and these environmental issues and so forth. Would it be the Commission's policy, or policy is the wrong word, intention to recess these evidentiary hearings or are they just going to go full speed ahead and give us something in the alternative by January 31st that may not be very useful?

PETER ARTH: My instinct would be to say that they would try to do the decision path that makes sense; not waste the parties' time and not do this in bad faith. I mean that the notion is that we have a timing problem that's the basis of the appeal. The information is valuable. I don't think there's a hostility to having the information.

CHAIRMAN SHER: Well, I know, but what we find is we are on a merry-go-round here. The Commission issues a Bluebook in the spring of 1994 laying out certain dramatic proposals for restructuring the electric service industry in California and moving away from traditional ratemaking procedures as well as traditional ways in which electric services have been delivered to consumers with an indication they're going to move very quickly in doing this. The Legislature, to try to become involved in what we consider an appropriate way, rushes to adopt a Resolution which sets up this committee and sets certain dates so that we can get into to the game. Now the Commission rushes to set up these evidentiary hearings which they think are a bad thing to do and wasteful of time and energy in response to ACR 143. I'm looking for a way to get off the merry-go-round and do it in a way that's more rational and cost-effective for the Legislature and for the Commission.

ASSEMBLYMEMBER MOORE: Byron, can I ask...

CHAIRMAN SHER: Well, let's get a response and then we'll let you follow that.

PETER ARTH: The short response is we are too. And it's really unfortunate that we have the merry-go-round. I think it would be easy enough to get past this fairly quickly so that again we are working as a partnership and looking at transition costs on a basis that fits the policy choices before you and before us.

CHAIRMAN SHER: Okay. Well, this ruling itself, I already have a note from a party that suggests that it's going to become a point of controversy in itself because there are going to be people unhappy with the fact that as described in the ruling the Commission will decide which utility witnesses are subject to cross-examination and which aren't; which parties can cross-examine and which can't; limitations on the discovery process, so it's going to become, there is going to be a whole debate now that will rage around this ruling that was issued last night. So that's bad from my point of view.

PETER ARTH: But in fairness to the Commission, we would not be in a favorable position if we simply ignored the deadline, and the assigned Commissioners chose not to do that.

CHAIRMAN SHER: That's what I said, it's part of the merry-go-round. We would not have been in a very good position if we had ignored what looked like the time schedule on which the Commission was operating when it issued its Bluebook. That's where it all started, let's not forget. Ms. Moore.

ASSEMBLYMEMBER MOORE: I just was going to ask you, what was your reading of the Resolution itself? What do you think it was that we were seeking to do?

PETER ARTH: I read it to say two things. One, that I think Chairman Sher has clearly described.

ASSEMBLYMEMBER MOORE: I don't want to hear what Chairman Sher -- I want to hear what your reading of it was.

PETER ARTH: Okay. That the Commission was moving far too quickly to a major reform and was doing it on such a pace that they would not adequately consider both state policy and state statute as well. That there was not the comfort factor for those that have worked so hard for those policies that they would be thoughtfully dealt with before the reform occurred. The other is simply to develop a mechanism to have effective oversight, because this, as much as there was a fast track field, it's obviously a huge project that other states are watching, other parties are watching, if it is direct access, it has major issues to it, so to lay out a longer track that would have the Legislature talking to the Commission as it goes forward on whatever policy choice it takes. So it's both a short term message and a long-term message.

ASSEMBLYMEMBER MOORE: It was centered around the notion that there appeared to be a policy decision that had already been made that was not well founded, in fact, in method and that's what we were attempting to do. And I read the proposal, the rulemaking that was issued last night in much the same manner as Mr. Sher, because it seems like now that we're just making you do busy work on a bunch of proposals that may or may not go anywhere and that you're going to have to do all this work and because of what we have asked in the Resolution that you won't be able to give full attention to the really important issues and I think it's unfair and secondly, I think it does a disservice to the effort that you're making to move forward on policy that's much needed and changes that would benefit everyone if it followed a course that gave proper discourse and other kinds of things to that process and I think that you won't do it under this rulemaking given the changes that have occurred in the sense that the Commission no longer recognizes the Bluebook as the reform that we initially thought it would be. So somehow we've got to rectify it because I think that the rulemaking is not going to do what we initially intended to do and that should make us all feel comfortable with whatever Resolution comes forth because it will be based on solid ground.

PETER ARTH: Well, the beginning and the ending of President Fessler's statement has him coming in good faith and I assume that's for the whole Commission.

CHAIRMAN SHER: Well, okay, I think we've got to move along. Our time... I trust you will take back our concerns to President Fessler and I might even go so far as to suggest they might want to reconsider this order that was issued last night if we can make them comfortable enough that we can, on a consensus basis, find a better timetable for the activities that each of our bodies have to carry out so that we can make such an evidentiary hearing more useful if and when the Commission has indeed crafted what is its thinking about how we should go forward.

PETER ARTH: Thank you.

CHAIRMAN SHER: Thank you very much. Okay.

ASSEMBLYMEMBER MOORE: Just let me say one final thing and I just don't want to walk away with you thinking that we think that the transitional costs are so complicated. We know that the complication is more political than

complex and I think that it's something that we all ought to be mindful of.

CHAIRMAN SHER: All right. Thank you. Next witness is Chairman Imbrecht. Thank you for being here witnesses and welcome Chairman Imbrecht.

CHARLES IMBRECHT: Thank you. Mr. Chairman and Members, I'm very mindful of your admonition about trying to be succinct. I have a prepared statement that goes into these points in some detail but I would like to emphasize a few issues that we think are critical to this entire debate and perhaps put some of the previous discussion in context.

One thing I think it's important to emphasize and that I don't mention in my prepared statement is that while it is true that California, in fact, has higher rates than the rest of the nation, it is not true that for the vast majority of our consumers electricity represents a burdensome cost in comparison with the rest of the nation. Because, in fact, the cost of electricity service as we all know is a combination of both rates times consumption and in conjunction with all of you on the dais, the regulatory agencies of the states and the Legislature and the executive branch have successfully attacked over the last fifteen years the issue of consumption in California so successfully, in fact, that our consumption is well below national averages in virtually every sector. And as a consequence, every independent measure whether its energy costs or electricity costs per dollar of state gross product or per capita costs show us well below the national average, not above it. Now that doesn't, in any way, undercut the importance of attacking the other half of the equation, namely the rates because we ought to be able to benefit from lower rates as well as we currently benefit from lower consumption.

I offer those comments only to put in context this overall debate so that we don't wring our hands unnecessarily and conclude that, in fact, California's energy policies have been an abject failure over the last decade. In my judgment that simply is not true.

Secondly, I would like to compliment the Public Utilities Commission. I know that we and they don't always see eye-to-eye. But quite frankly, I think they have moved in a very prudent and responsible fashion in dealing with this issue. I want to emphasize that we would support their request for an extension of the January 31st deadline and I also think they should be complimented for initiating one of the most fundamental intellectual debates that has occurred in public policy in this state for many, many years. It has brought together an extraordinary collection of experts throughout the nation and there has been a remarkable coalescing, in my judgment, just in the last few weeks of opinion on some of the key issues that you have heard described up until this point in time.

What I want to work off of is the last page of my prepared testimony which is a brief series of five principles that we have tried to reflect in our testimony. We've had a high-level team at the Energy Commission that has spent an extraordinary amount of time trying to understand and make sense and hopefully provide some assistance to you in your deliberations as to the appropriate approach to provide equity and the best outcome for the citizens of California.

I should emphasize that over the last decade we have consistently, as I know most of you are aware, been strong advocates of economic efficiency through increased competition in every energy sector within the state. We have attempted in our filings before the PUC to enunciate fundamental principles that the debate should cover in terms of ensuring equity.

First, and most important one is that regulatory reform and restructuring should attempt to maximize customer choice for all customers. Purely, from a political perspective, if we apportion the benefits of this exercise unfairly between all the customer classes in the state, I see it as a nonstarter. And so, with that issue in mind, I would emphasize as well that in dealing with the so-called stranded investment question, we should reject any of the concepts that contemplate rationing of access to the benefits of restructuring over an extended period of time. Some of the proposals contemplate that one class gets the benefits six, ten, or even twelve years before the entire group of customers in California have access to the benefits of increased competition. We do not believe that that is necessary and we think that the discussion and the coalescing of viewpoint remarkable changes in the opinions of a number of the utilities in the state and other stakeholders in the last few weeks and months is drawing us closer to a relative consensus on the appropriate approach to take.

Transition costs can be dealt with in a variety of fashions and that will be addressed by, I know, other speakers that will be appearing before you. I would just note that from our perspective the proposal embodied originally in the San Diego Gas and Electric proposal now largely embraced by many of the other players that we should deal with this with an equitable transition charge across all customer classes is the most likely way to ensure fairness amongst all the consumers of the state. But one of the other intriguing proposals that I believe Mr. Caldwell will be addressing later today is the consideration of possible divestiture of the existing utility assets that are undervalued and that have great appreciation possibilities as a means to mitigate that transition fee and also to buy down, if you will, the stranded investment and deal with that compact we've heard so much about between the utilities and the public sector in the state. I urge, but we don't have a formal position on that yet and frankly there's a lot of analysis that needs go forward. I think it's an intriguing concept that deserves your attention.

I would note that way back in 1985 I testified on behalf of the Energy Commission urging FERC to open up wholesale wheeling and competition of the wholesale markets throughout the United States. For many historical reasons independent, nondiscriminatory operation of an access to the transmission system and other critical facilities is essential for a fair, competitive market. And one of the, I think, important coalescing of viewpoints in the last few weeks is the fact that all of the utilities, in essence, are moving towards a position of agreeing to, in essence, divestiture of their control of the utility system to opening up the black box that has been the impediment for allowing a more competitive wholesale market over literally decades of litigation between municipal utilities and investor utilities and now more recently between independent energy producers and those that have transmission rights. We think it's absolutely essential to have an independent operated system to ensure, in essence, that you have a noninterested traffic cop so that

pricing and availability of transmission issues are viewed as being handled on a fair basis and not on a self-interested basis.

I'd also emphasize, and you'll hear more debate on this, but we have spent an extensive amount of time trying to analyze the differences between pooling and bilateral contract proposals. We believe that both are compatible, that we can have both and that they will maximize choice and maximize competitive benefits and there's further explanation of our views on that in my prepared testimony.

And finally, with respect to the areas that you have traditionally looked to the Energy Commission for implementation on broad public policy questions I will note for you that over the rest of this fall in a series of proceedings, some of which we have publicly noticed and others which will be noticed shortly, we will be considering some of the subsidiary issues associated with broad public policy considerations. Mainly, how do we insure the continuity of the demonstrably cost-effective demands on management or energy efficiency programs that have been a hallmark of California energy policy for an extended period of time.

Secondly, how do we insure that there continues to be a diverse resource base and that we don't, by looking to price signals alone, end up with an all natural gas future over the course of the remainder of this century. We believe that it is important from a long-term insurance policy perspective that we continue to have a diverse resource base and I would add that there are a series of subsidiary issues that spin off into all kinds of other public policy implications.

Just briefly, think through what happens if the 66 biomass electric generation plants that we have in California are forced to close down because they are not competitive? What does that mean in terms of implications of air quality, buyer suppression and our forests as well as land use and solid waste landfill? It's a very complicated issue and candidly it's going to be difficult to unscramble that egg but it's a question that someone needs to address.

And finally, as was indicated in your first presentation we already seen indications from the utilities that there's an effort in terms of down size and restructuring to abandoning some of the historical consensus items that we generally viewed as being economically efficient and societally beneficial. Not the least of which is collective research and development with respect to advanced transmission and energy generation technologies. To the extent that we conclude that those continue to be societal beneficial, we have to explore some of the other options for insuring that they are reasonably financed and that they continue to retain within California that very unique nexus, if you will, of high salaried, high technology technical experts that frankly many of whom reside in your own district Mr. Chairman, that, I believe to be critical to the ongoing leadership of California both in terms of producing technologies for our own state but also for export opportunities abroad. I'd be happy to take any questions.

CHAIRMAN SHER: Thank you for your testimony. We appreciate it, particularly your five principles. I only have one question. These five

principles that you have enunciated, do you offer them simply as guidance to your good friends at the PUC as they move forward to craft their proposal or do you suggest that they ought to be embodied in legislation as, if you will, design criteria for any proposal that might come out of the PUC? Can they be reduced to ...

CHARLES IMBRECHT: I think they can be but I don't think that is necessarily the preferable approach. I'll tell you, Mr. Chairman, I've had an opportunity to have several private conversations with members of the Public Utility Commission in recent weeks. Last week Commissioner Fessler and Conlon and I participated in a Broad Western Regional Interstate Meeting on the implication of these issues. I frankly feel quite strongly that we have moved much more closely towards consensus on how to resolve some of these questions. Obviously, there is still a lot of public debate that has to take place but as I think I say in my prepared testimony I've become increasingly optimistic that we can have it all. We can protect...

CHAIRMAN SHER: That's true. But what you're telling us is in your conversations with President Fessler and the other commissioners they've said, "Trust us, we will select these five principles and what we are about to do."

CHARLES IMBRECHT: It's been more in the context of having detailed discussions about where they see the debate evolving and as well as what we perceive to be the evolution of the debate. The fact that investor-owned utilities have come increasingly close to one another in terms of positions that generally reflect these principles gives me added confidence that we may be able to come out of this with a fair degree of consensus.

CHAIRMAN SHER: Mr. Baca?

ASSEMBLYMEMBER BACA: Can you define a question on one of your principles that you have outlined here, define number two, "All customers should be provided equal and fair access to the benefit of competition? At the same time there should be no rationing or competitive benefits." What do you really mean by this?

CHARLES IMBRECHT: Well, initially some of the utility proposals contemplated dealing with stranded investment and I think your first witness touched on this as well. Dealing with stranded investment by extending out over an extended period of time access to competitive market benefits for various customer classes. And actually, the Bluebook contemplated a similar approach.

ASSEMBLYMEMBER BACA: Industrial versus...

CHARLES IMBRECHT: Industrial first, then large commercial, and then medium commercial and then, ultimately residential. In our judgment that raises some basic fairness and equity issues and it really is dependent upon an assumption that you have to deal with stranded investment through the continuation of embedding, in your rate structure, those historical costs that have already been described as being uneconomic and in which we agree with that conclusion.

The alternative approach embodied in the proposal initially enunciated by San Diego contemplates dealing with those costs with a transition charge that's applied equally across all customer classes. And, as I indicated, there is yet another innovative approach that suggests some possibility of perhaps buying down that transition charge through partial divestment of some existing utility assets.

For example, the transmission system is unquestionably carried on the utility books way under value and there is fair debate that some of the right-of-way assets have significant appreciation value above and beyond their use simply for high voltage transmissions. There's no reason, for example, why we can't be contemplating stringing fiber optic cable on utility rights-of-ways and selling those rights to other interested parties. In fact, the one advantage of that proposal is it's the only one that, in essence, puts new money into the system. The rest of the debate is how you move the chess pieces around on the chess board. So to the extent that that's a viable option, it ought to be given consideration.

ASSEMBLYMEMBER BACA: How will the average ratepayer know what this means to them out there. I mean, it's foreign to them. They don't know what's going on.

CHARLES IMBRECHT: Well, the average ratepayer in our judgment, just as was the case with natural gas, will enjoy substantial benefits through increased competition. And, in fact, it is also likely that we're going to see a whole series of new cottage industries spring up with different providers offering different types of service to different groups of customers. Heretofore, we've kind of offered on this assumption that aside from large industrials everybody wants generic electricity as opposed to red, blue or green electricity; different rates of service, different times of service, different qualities of service. Do you really need the assurance of no interruption at any time for your household service if you were willing to pay for something less than total reliability? Shouldn't you have that choice in the marketplace? In our judgment there will be people that will aggregate various customer classes whether it be folks living in a condominium complex or apartment complex or given neighborhood and in essence go out into the marketplace and purchase a type of energy service that those customers deem appropriate for their own use.

ASSEMBLYMEMBER BACA: That's true and as far as choice goes one of the common complaints that I heard last night on the plane coming down, I had this conversation with someone that talked about deregulation, the effects on the telephone industry of the amount of long-distance services that are available. Fifty-four percent of the average consumer doesn't know which one to get so how do they know what's cheaper for them but yet there is choice. But that's a problem they have out there and this is a little bit different but at the same time it's going along the same lines. The consumer out there is still wondering, "Well, yes, there's choice, but which one is cheaper? We've got 54 different choices. Who provides that information to us?"

CHARLES IMBRECHT: Well, frankly the customer will still have a choice of

retaining utility service...

ASSEMBLYMEMBER BACA: But who will provide the information of the lowest cost? See that's what they're saying out there even with that choice. They don't know.

CHARLES IMBRECHT: I understand.

CHAIRMAN SHER: We're going to have to move on, I think. Ms. Moore, you have a final question for Mr. Imbrecht?

ASSEMBLYMEMBER MOORE: Let me see if I can phrase this delicately. Often on the federal level California has not been seen as speaking with one voice on issues and I know you know that and I just wonder as we go through this restructuring obviously everybody in the country, as you point out in your comments, is looking at California and this is probably stimulated the most interested dialogue among folks about what we're doing here in California. Is the Public Utility Commission going to be the voice of California? Is it the Energy Commission? Who speaks for California on this issue?

CHARLES IMBRECHT: I think in the context of discussions they refer clearly to the PUC has, that responsibility and I should add that I believe President Fessler has had extensive discussions with Betsy Moore, the Chairwoman of FERC, trying to work out some of these jurisdictional difficulties. Some of the orders they issued earlier this week appear to be first steps in resolving some of those questions, at least from our perspective. We think our job, and I might add the hearings that we're doing have been scheduled in consultation with the Governor's office as well, to try to provide a complementary forum and a place to develop consensus on some of these other subsidiary pieces. The PUC has a lot on its plate; stranded investments, transition charges, how you set up the overall structure of the market, how the pool will functionally operate, who will own it, etc., are all big questions and they still don't address resource diversity, demand side management, collective warranty and so forth. So what we're going to try to do with our proceedings is develop some consensus within the community that's affected in each of those areas. Hopefully, with the appeal we can then present that to the PUC and perhaps simplify their own workload.

ASSEMBLYMEMBER MOORE: So, some of the environmental and other kinds of things that put California in the forefront over the last 25 years in terms of our policies related to those kind of activities will still remain with the Energy Commission and you will pursue them in line of competition and those other kinds of things and then present your hearings and your recommendations on those proceedings to the Commission.

CHARLES IMBRECHT: Well, Ms. Moore, until the members of the Legislature change the law, I deem it my obligation to support and shepherd the various public policy issues that you've delegated to us and those were the ones that I emphasized at the conclusion of my remarks. If you tell us that those are no longer important societal or economic objectives obviously we'll change course but until you do so it seems to me it's our obligation to try to find a way to make continued pursuit of those policies compatible for the more competitive

environment.

ASSEMBLYMEMBER MOORE: I think that's extremely important and I'm just trying to be sure that as we get carried away with competition that we don't forget some of our obligations and commitments of the past and just want to be sure that those are being looked for and I have great confidence in your leadership in that area.

CHARLES IMBRECHT: Thank you, Ms. Moore. I have not addressed another area that's really not our bailiwick per se but I'm sure others today will get into the question of some of the social program issues, lifeline rates and so forth.

CHAIRMAN SHER: There are witnesses who, I think, are very concerned with... Thank you for your testimony. All right now we are going to call forward the next group of witnesses, those who have actually made their own proposals in this restructuring debate starting with Mr. Robert Glynn from Pacific Gas and Electric. Mr. Glenn, welcome. I'm going to ask, now I know that's we've slipped about an hour in our schedule. I think what we're going to try to do is to hear from each of the people under item four on our agenda who have proposals and then we hope we can finish that by 12:30 or a little bit after and then I think it probably would be a good idea to take a half hour break to let people get a sandwich and then we'll come back and do the rest of it so Mr. Glynn, let's start with you.

ROBERT GLYNN: Thank you very much Mr. Chairman and members for inviting Pacific Gas and Electric Company to present our views on the changing electric industry in California and to describe the proposal that we have submitted to the California Public Utilities Commission in that regard.

Restructuring of industries that have been at one time been monopolies is something that is not new. And it's been driven greatly by customers making their preferences known to their policymakers, customers in the marketplaces for each of those former monopoly service industries and restructuring of the electric industry in California is similarly something that's not new. Certainly something that was not dreamt up just before the Bluebook was issued in April of this year. The competition in the electric industry and some of the changes for it have been moving forward during the last two decades. A couple of quick examples of that; it was in 1978 that the Public Utilities Regulatory Policy Act invented, if you will, a new class of electric generators who now in California provide a very large fraction of the electric energy consumed in California. It was during the '70's, '80's and '90's that a number of interstate transmission projects were built. Some with single owners and multiple users and some with multiple owners and multiple users. In the mid to late 1980's the western systems power pool which is the largest spot market wholesale electric power pool filed with the federal Regulatory Commission to begin it's experiment, an experiment which was finally converted it into an operating pool with the last court, a challenge cleared through the FERC just last year. And the Energy Policy Act of 1992 pushed more towards wholesale competition, transmission access and created another new class of electric generation industry competitors, the exempt wholesale generators. All of these things have moved towards the existence in California today of what appears to

many, including PG&E, including many customers as a workable, competitive electric generation market and customers seek to access that.

The proposal that Pacific Gas and Electric Company issued in response to a long series of matters before the PUC, the Yellowbook which was an early 1993 description of change potential in regulation and then the Bluebook was based on the objectives that the CPUC in each of their various colored books issued objectives that ought to frame transition from one regulatory reform to another. The customer should receive the benefits of competition that the safety and reliability of the electric system shouldn't be compromised, that social environmental programs so valuable in California should be continued, that smaller customers or those that choose not to avail themselves of such access should not be burdened with any of the costs associated with the onset of competition and that the financial integrity of utilities should be maintained. PG&E sees the value in each and all of those objectives and has included and embodied them in our proposal. The CPUC raised in its documents the issue of transition cost recovery and it was that fact and their approach to providing some time for this transition to take place that led PG&E to propose the use of transition time rather than explicit transition charges to deal with the costs of our own generating assets that were priced above market.

Our proposal includes explicit transition costs recovery for the over-market costs of electric power supply contracts which we hold and regulatory assets. We propose that the environmental and social program costs continue to be born by all California electric consumers and that there not be a mechanism, intentional or unintentional in this process, that allows some consumers to escape their fair share of funding those programs and we propose very clearly that there not be cost shifting between any classes of customers as a result of any part of this transition.

The most recent enhancements of the proposal that we've made were described in this weeks Full Panel Hearing that the California PUC held in San Diego where responding to comments that we heard in a number of the earlier Full Panel Hearings we said that if the grid operator relationship with PG&E is an issue that we would separate that relationship from PG&E and let grid operation be independent. We also indicated that notwithstanding what we believe about the degree of openness of our electric transmission system that because others are concerned about it and because of the FERC's policies on that have become increasingly clear that PG&E intends to file a full open access comparable service tariff with FERC. Our proposal contemplates moving forward with the first customers who would have the opportunity to use direct access either on January 1st, 1996, which we selected because it was the CPUC's date or soon thereafter as regulatory approvals are gathered. And the reason that we did that is because we agree with many who say it's going to take time to develop the protocols and rules of the road and metering an information handling systems to handle the millions of electric consumers in California, but we know how to deal with the larger retail customers because we already deal with similarly sized wholesale customers.

So the PG&E proposal provides true customer choice through direct access starting very soon. It preserves the opportunity for environmental social program costs, programs to be maintained and costs to be financed by all. It

provides a mechanism for insuring the financial integrity of the utilities and it proposes to build firewalls between customer classes so that there would not be cost shifting among them. Thank you.

CHAIRMAN SHER: Thank you. Those are, I think, excellent principles that we'll be discussing but it was my understanding at one time, at least, that I understood the PG&E proposal to be one that would not cut in until the year 2008 and that if that were done the utility would recover these investments and there would be no stranded investments, at least in generating facilities. But now you say that the direct access can occur as early as January 1st, 1996, so that's a modification or was I mistaken in what I originally understood.

ROBERT GLYNN: It's not a modification although a number of folks have characterized the PG&E proposal as a delay proposal. In fact, the PG&E proposal is the only one that said on January 1st, 1996, there should be direct access and we're prepared to move forward.

CHAIRMAN SHER: Well, then, there will be a problem about stranded investment because of the customers that have direct access somehow have to participate in paying off these stranded investments, isn't that right?

ROBERT GLYNN: The PG&E proposal characterizes stranded investment in two broad categories. The first of which is the stranded investment which results from our own investment in our own company assets and we have said we will not seek transition cost recovery for that cost. That the program duration that we have laid out will provide us some opportunity to recover those transition costs; however, as each class of customers becomes eligible for direct access and to the extent that those customers choose to buy their power elsewhere we will eat those costs. That's been a part of our proposal since it was first put forth in June of this year.

CHAIRMAN SHER: But those who stay on your system, they get to share in those costs ...

ROBERT GLYNN: Well, as the first witness pointed out the costs, there's not an increase of costs for anyone associated with any part of the PG&E direct access proposal. Those costs are in the system now, so there's no one whose bearing any additional costs because of the transition to competition.

CHAIRMAN SHER: It would be a big break for those who can at an early date take advantage of direct access. I mean, if for no other reason than because they are going to escape paying for these uneconomic facilities if I may call them that.

ROBERT GLYNN: In a relative sense, the customers who exercise the direct access option earlier would achieve those benefits earlier but all customers will have access and the opportunity for direct access long before the end of the economic life of those assets, so there is no ...

CHAIRMAN SHER: Would you say that violates Chairman Imbrecht's second point which is that all customers should be provided equal and fair access to the benefits of competition at the same time?

ROBERT GLYNN: The idea that Chairman Imbrecht puts forth is one that others have also put forth. The difficulty that it presents is that no one thinks that direct access can be offered to all California electricity consumers in a reasonably short-term. Even the United Kingdom who started with the fact of a single entity, a single regulator, no existing contracts to deal with, no difference between utility ownership, no significant sources of supply outside their borders. Their program very carefully laid out step-by-step implementation that has run off the rails already in two areas. One of those areas is on their forward pricing index which has been essentially suspended or capped by their regulator and more recently as the customer class.....
.....
100 kilowatt and above that was direct access eligible on April 1st, came into direct access opportunity. They've had tremendous difficulty and I'm told have not billed a great number of those customers since April. So it's going to take time to handle the millions of customers. So the difficulty with adhering to the principle that Chairman Imbrecht put forward is that means that no one would get the benefits that competition at the generation level accessed directly by customers offers.

CHAIRMAN SHER: Okay. One other question, in the Sacramento Bee this morning you're quoted as saying, "The others," that is the people that we are going to hear from in a minute are advocating a wholesale bureaucracy? We are the only utility that is advocating the customers get choice. We want to elaborate on what's wrong with the proposals of those advocating a wholesale bureaucracy? Tell us what you mean by that.

ROBERT GLYNN: The fraction of the interested parties who support inventing a new wholesale pool seem to believe that there are some economic efficiencies that aren't yet captured by the existing myriad of wholesale pooling entities that exist throughout the western United States and that some new invention is required in order to capture those economic efficiencies. As a practical matter today, each one of the utilities dispatches all of its own generation and the contracts it has within the context of the contracts and agreements that govern the purchases and within the physical and economic operating characteristics of the units to reduce the incremental moment-to-moment cost of running their systems. Above and beyond that a great number of utilities have formal exchange agreements between them under systems like the California Power Pool where if there are economic efficiencies that are not already captured within one company's boundaries, they can get captured between several companies' boundaries. And in the late '80's and early '90's the western systems power pool formed and that's an entity that includes virtually every state west of the Mississippi, a few states east of the Mississippi and some Canadian provinces. It includes investor-owned, municipal-owned, federal, power broker, power marketer, virtually every element of the industry. And they have the opportunity to exchange on a spot market basis, transmission and generation resources. So the wholesale market is combed pretty thoroughly on a pretty regular basis already.

CHAIRMAN SHER: Let me give you... You won't be back. I think we're going to hear from them, at least, as these wholesale pools have been described to me that they combine the direct access availability to customers through

these contract for differences approach. Do you want to anticipate that argument and tell us why that is not really direct access or is that your view?

ROBERT GLYNN: It's certainly my view that that's not direct access. I believe when you hear from customers you'll hear very clearly that they don't feel it's direct access. Customers want to buy from a supplier and as we found in the restructuring of the natural gas industry, they like to buy directly from a supplier and have the utility be the transporter so when natural gas industry deregulated and frankly many of the same parties were participants in that restructuring change, customers had the opportunity to access the gas supply of their choice. There's no pool, there's no contract for differences from a pool price, they simply buy according to whatever form of economic and financial instrument they choose and they hedge that purchase or don't hedge that purchase depending on their own corporations risk acceptance.

A contract for difference is a difference from an index or something and that index is not necessarily what any one customer is buying. In fact, it's kind of a vanilla like average of what everybody's buying and the customers that I talked to don't want to buy off an average vanilla index. They want to make a deal and live with its consequences and they have competition in their own markets and they want to be very successful and they feel that they'll be better buyers for their own account than the utilities will.

CHAIRMAN SHER: I'm sure we'll hear a response to that subsequently.

ROBERT GLYNN: We probably will.

CHAIRMAN SHER: You did say in your formal statement that PG&E's prepared to divest itself of the transmission facilities. Is that right?

ROBERT GLYNN: That's not what I said. What I said was PG&E is preparing to make a filing with FERC for an open access comparable service tariff which will put to bed, one hopes forever, the issue of whether or not the grid is adequately open...

CHAIRMAN SHER: Who would control the operation of the access?

ROBERT GLYNN: We said that we would be willing to spin that off.

CHAIRMAN SHER: That gets to my question. Would that create a new bureaucracy to deal with that?

ROBERT GLYNN: It would be the same folks with the same computers but they would be owned by independently Pacific Gas and Electric Company.

CHAIRMAN SHER: You don't see that as a bureaucracy but you see the wholesale pool as ...

ROBERT GLYNN: I see creating something new as a bureaucracy. In other words, creating some brand new entity as creating a new bureaucracy; particularly one that has its own new set of regulatory...

CHAIRMAN SHER: So you're saying that the bureaucracy would be the existing bureaucracy at FERC that would control the open access to the transmission?

ROBERT GLYNN: Well, the regulatory relationship is a FERC regulatory relationship.

CHAIRMAN SHER: But the ownership would be retained by the utilities?

ROBERT GLYNN: For the transmission system?

CHAIRMAN SHER: Yes.

ROBERT GLYNN: Yes. That's the way I see it.

CHAIRMAN SHER: Is there some other entity that has to be involved in this open access or that's it?

ROBERT GLYNN: The concept of FERC open access comparable service tariff is that then any eligible entity can use at a predetermined just and reasonable price terms and conditions.

CHAIRMAN SHER: You don't need anybody to run that, is that right? I mean to oversee that?

ROBERT GLYNN: If you mean to oversee the implementation of the tariff, the folks who do that are already in place. I mean, that work is already done. Lots of people use the PG&E electric transmission system today. There is nothing new required to have that tariff filed.

CHAIRMAN SHER: Thank you. Thank you for your testimony. I appreciate it. Okay. Why don't we have our next witness, Dr. Eugene Coyle from TURN. Then next will be Mr. Foster who I see has arrived from Southern California Edison.

EUGENE COYLE: Good morning.

CHAIRMAN SHER: Good morning.

EUGENE COYLE: Good afternoon. We have a proposal that is not direct access. It is called community access. I want to describe that to you. But first let me make a few perhaps rebuttal remarks to what I've heard today.

First of all, the PUC has heard from us that we would prefer competent traditional regulation. Not what we've had from the PUC for the last ten or fifteen years but real cost-based regulation with the elimination of all the adjustment clauses and balancing accounts that keep the PUC continually in session. We propose a basic rate case every two years for each utility.

CHAIRMAN SHER: But if I understand that, if I may interrupt, what you're saying in response to President Fessler's statement that was read to us. Nobody says in the response "if it ain't broke, don't fix it." Everybody says

it's broke and it needs to be fixed, he says. You're saying that what's broke is the way the PUC is implementing the current ratemaking?

EUGENE COYLE: Exactly.

CHAIRMAN SHER: And you want to stay with the current ratemaking at your position, but you want to fix the PUC.

EUGENE COYLE: That's right. Clean up all the accounts that require enormous litigation.

CHAIRMAN SHER: How does that tie in with this community access then, that seems...the backup position?

EUGENE COYLE: I just wanted to correct that because we've told the Commissioners in their Full Panel Hearings about that position. Mr. Glynn didn't mention the year 2008 in response to your question. But that's still the date, I believe, that they would give the residential customers the opportunity for choice. We're talking about 14 years during which time they would basically lay off with recalling transition charges onto the existing customers.

CHAIRMAN SHER: Well, he said as they're currently paying them. These charges, anyway, because those facilities are on their rate base so he's saying he won't be any worse off and some other people will be better off, is what he was saying, I believe.

EUGENE COYLE: Right.

CHAIRMAN SHER: You don't like that?

EUGENE COYLE: No, I don't. We don't.

CHAIRMAN SHER: Didn't think you would. Okay.

EUGENE COYLE: And then Assemblyman Baca raised a good point which is that even if you offer choice to everybody all at once some people are not going to be served by that. Either because they don't have the information to exercise a choice but more importantly, I haven't heard any credible statement since April that aggregators, or anybody else is actually going to go door-to-door and sign up customers to be served by this retail competition. The cost of acquiring those customers, that is the marketing cost, is just too high for that to happen and we've seen in the gas industry that it hasn't happened in spite of a lot people saying that it would and a lot of people saying they'd be in that business. It just hasn't happened. So that's the reason that we have an alternative which we call community access. This is not direct access. It's a wholesale competition where any independent power producer or utility could offer to sell power at wholesale to a political entity, a community, either an existing city or water district or any other viable political entity. All the customers within that community then would have to buy through the community. This would include the residential and the industrial customers, as well. They would get the benefits of the wholesale competition that wouldn't

have the elimination of the residential and small businesses from the game because you eliminate the marketing cost to reach them. So our proposal, which would require legislation to implement is that we don't go to direct access but we go to community access.

Let me make one other remark on PBR.

CHAIRMAN SHER: I understand that community access would be that the community would be created and individuals in that community could not go make their own deals, they'd have to do it through the community? Is that right?

EUGENE COYLE: That's exactly right. And there are two reasons for that. One is that in an industry like electric power where you have a lot of overhead costs, from time-to-time there is excess capacity and when a power plant owner has excess capacity they're willing to offer really good deals to employ that capacity. We see that in the airlines where they have really low fares for the elastic part of their market. So that what we see if the customers within a community could go out, they'd be cherry picked from time-to-time by the independents when capacity was in excess. They'd come back and the community would have to afford them service when capacity was short.

The second reason for it is a political one. We think that if you offer communities the opportunity to form themselves in this way, the pressure to actually form them and to go out and buy wholesale power cheaply will come from the big customers within the community and the city councils or whoever the boards are that make the decision will get the pressure from those customers. If they are free to go off, the rest of the community may never see the opportunity.

CHAIRMAN SHER: You wouldn't force anybody to create such a community would you?

EUGENE COYLE: No.

CHAIRMAN SHER: So suppose no community is created in my area and Hewlett-Packard and Varian and Associates get together and form their community, would that be a community of a kind you had in mind?

EUGENE COYLE: Well, I guess I'm hoping to rely on your wisdom for that here in the Assembly and the Senate that I guess there is a possibility of sort of sham communities being formed that way.

CHAIRMAN SHER: So you would want the Legislature to define what a community is and make sure it wouldn't be the first community that gets set up. They've got a community and anybody else would not include those components, is that right?

EUGENE COYLE: Right, yes.

CHAIRMAN SHER: So you'd look at the Legislature to define what is an appropriate community?

EUGENE COYLE: Yes, sir.

CHAIRMAN SHER: Good luck. Go ahead.

EUGENE COYLE: I was going to say something about PBR because it was sort of described here this morning as if it were all to the good. There are two PBR's. There hasn't been, as far as I can tell, any testimony by the utilities about how they're going to perform better in the future if they get this type of regulation. It's just that somehow there's some vague incentives out there and it's interesting that here the utility executives come in and they're drawing over a million dollars a year in salary and they come and say that well, we're not performing now but we'll perform later. What we see as PBR really being about is discrimination between customer classes and PG&E's on the record that they want to segment the market further and discriminate between classes so we see PBR as a really dangerous thing for small customers because they're going to cut prices to their big customers and try to make it up on the less elastic small business and residential customers.

There is a good form of PBR in that we have a proposal with others in a coalition called CARE which is to simply tell the utilities, "lower your rates 5% a year for the next 5 years. We don't care how you do it. You perform but these are the constraints on you and that's what we consider a good form of PBR.

CHAIRMAN SHER: Okay. Are you finished?

EUGENE COYLE: Yes.

CHAIRMAN SHER: Thank you very much. All right. Mr. Foster for Southern California Edison. Have you got a plan for us? Okay. Welcome to northern California Mr. Foster.

BOB FOSTER: Thank you. It's good to be back, Mr. Chairman. I want to stipulate that I'm not one of those executives that make a million dollars a year. That's a substantial amount at home apparently. In the interest of time, I know that you are over your allotted time at this point and I think the questions were related to mostly on our proposal on Poolco. I'd like to talk first about what we think creates high rates in California. And secondly, about the Poolco proposal in particular.

CHAIRMAN SHER: You didn't hear our initial witness who described and has given us a paper on what's the cause of high rates in California, I don't know if you've seen that but if you are responding to that and disagreeing whether we want to hear that but we don't want a treatise on what causes higher rates because we've already heard that. But you can give us your spin on it.

BOB FOSTER: Well, I haven't heard it but I'm sure I disagree with it.

CHAIRMAN SHER: This was our objective academic, you know. This person had no ax to grind.

BOB FOSTER: Well, the problem is there are distinctions among utilities.

I was told the gist of that testimony and ...

CHAIRMAN SHER: This was not a witness from the utilities.

BOB FOSTER: I understand that, but I'm saying there are differences among utility companies as to why rates are higher in one utility as opposed to another. And at least, from what I've heard relative to nuclear comments from that testimony, that is not the largest cost on our system.

CHAIRMAN SHER: Is it part of the cost?

BOB FOSTER: Oh, absolutely.

CHAIRMAN SHER: And it's part of the reason for high rates?

BOB FOSTER: It is part of the reason for high rates.

CHAIRMAN SHER: Okay, what else?

BOB FOSTER: The major cost on our system in terms of high rates, pushing rates higher over what would be the national average that are the excessive overpayments for mandated contracts to independent energy producers.

CHAIRMAN SHER: In five years will that problem be ameliorated?

BOB FOSTER: Part of the problem will be ameliorated in actually by the year 2002, the energy payments for those contracts go to market, or go to avoided costs. The other side of the problem and one that's not generally known is that the capacity payments for those contracts continue on for the 30-year life of the contract and to give you an idea of what the difference is right now you could buy capacity on your market for about \$60 a kilowatt year. We're paying, on average, \$180 per kilowatt year and that goes on for 30 years.

CHAIRMAN SHER: You will have these contracts part of your "stranded investment" as we move to this competitive...

BOB FOSTER: That is correct and I might also add that my shareholders make nothing on those contracts. We have no opportunity to earn anything.

CHAIRMAN SHER: Okay. Now tell us about your plan.

BOB FOSTER: Tell us about my plan? You're really disturbing my order here. I don't know what to do here. I would like to make one comment if I might, Mr. Chair.

CHAIRMAN SHER: Okay.

BOB FOSTER: And that is relative to the CARE report. I had intended on giving you a fairly lengthy rendition of why the CARE report is inaccurate and quite frankly, worthless, relative to California rates. I will only say that I submit to you read, the cross-examination before the PUC on the economic sciences witness and I think that report has been fairly well refuted. It does

not take into account major factors in California, for example. It left out the fact that there are payments to QF's in California. It did not deal with the fact that California does not utilize coal to any substantial degree which clearly increases costs in California. And it didn't normalize for a host of other things. In fact, the method they used, they employed, was a method called the Colley Bodmer method which I'm sure will soon become a household word. In any case the founder of that method Edward Bodmer, if you will, this is a quote from him. "The CARE report incorrectly interprets the results of inappropriate regression methods that contain numerous computational errors and omit important factors." And under cross-examination, they said the CARE report, their analysis anyway, demonstrated they made no comment about whether any management changes or any efficiencies in management occur and made no recommendations on how to reduce costs. So we really think its been pretty well refuted under cross-examination.

CHAIRMAN SHER: That's the first time its been mentioned at this hearing and I'm not sure that the other members of the Legislature that are here know what that is. I happen to know because I have a copy of the report and I have a copy of Edison and other utilities communications with the PUC about the report. But, I mean, obviously it goes to your view of how high California electric prices are as compared to the rest of the country.

BOB FOSTER: Rates are higher here than the rest of the country and there are basically reasons of QF contracts, coal and mild climate and a very strenuous DSM program, which is reduced energy use in this state. We still have to have fixed facilities to meet peak load. It's no great secret why rates are higher here.

CHAIRMAN SHER: But they don't have to stay that way because you have a plan.

BOB FOSTER: Absolutely not. We have a plan.

CHAIRMAN SHER: All right.

ASSEMBLYMEMBER BACA: Mr. Chair, if I may ask...

CHAIRMAN SHER: Yes, Mr. Baca.

ASSEMBLYMEMBER BACA: Going back to the cost factor, you indicated mandated costs for contracts, can you tell us what the average length of the contract is because I believe the public is not aware as we look at price...

BOB FOSTER: The contracts, they vary under the length of the terms of the contracts or 30 years. The energy payment portion, the ones we are talking about permanently are standard off of four fixed energy payment contracts. The energy payment portion of those contracts are fixed for ten years. They are fixed payments that are based on a sliding scale on a forecast of oil prices that started in the mid '80's at around 30 plus dollars per barrel that will end up in the year 1999 at \$100 per barrel. We are paying right now for energy produced under those contracts as if the barrel of oil equivalent of \$75. Oil is under \$20 on the world markets. That's the terms and the prices. Thank

you.

This issue, first of all I think the Public Utilities Commission deserves some credit for, I think a bold step in moving towards competitive markets, I think with the issuance of the Bluebook, it certainly has started a debate, I think a meaningful debate, one in which obviously a number of parties are engaged in which a number of interests have a great deal at stake. And we welcome the move to a competitive market. We think that will, in fact, force costs down. It will tend to put a downward pressure on rates. It will make utility companies more efficient and I think it will correct some of the difficulties that command in control regulation, prescriptive regulation, has had in California. We think the move to a market system is, in fact, a positive one and will help all consumers. We think there ought to be three principles when you do that and we have disagreed with the Bluebook in the manner in which they seek to have direct access. We think three principles ought to guide any implementation to a competitive market and the first is equity and that is that all customers, not just a few, all customers ought to receive the benefits of competition.

CHAIRMAN SHER: At the same time?

BOB FOSTER: As soon as they can.

CHAIRMAN SHER: Well, then all... as soon as there are benefits everyone should share in them.

BOB FOSTER: There are ways in which you can transfer benefits from competition to all customers today. We do that on the wholesale market I think as Mr. Glynn described.

CHAIRMAN SHER: I don't know if you heard Chairman Imbrecht. That's his principle number two. So you agree with that?

BOB FOSTER: It's actually our principle number one. So we're ahead of him now, I think. Sorry, Chuck.

CHAIRMAN SHER: Did you know what his principle number one was?

BOB FOSTER: I shudder to ask.

CHAIRMAN SHER: Restructuring should attempt to maximize customer choice for all customers.

BOB FOSTER: Now, I would put equity ahead of that. And I'll talk to him about it later.

CHAIRMAN SHER: I don't know that he ranked these, actually, so...

BOB FOSTER: The second is opportunity. We think the customers will benefit to the greatest extent from competition and that utilities should have a fair opportunity to participate in that competitive market on a level playing field.

And third is cost recovery. Past investments and obligations incurred to meet customer needs must be honored in order to treat fairly those who have invested in previous utility structure and those costs ought to be placed in a transition charge and born by all customers.

With those principles I think you can frame a system that really will operate to benefit all Californians. And we have suggested a system called Poolco. And you can call it anything but basically you can call it Harvey if you want but I mean basically it's a system which will dispatch generation and transmission in the most efficient manner and will provide for the benefits of competition at the wholesale level and also allow for direct access and make sure that those benefits are transferred to all customers. You heard today, that what we need is that customers want choice, they want direct access and clearly there is no doubt that if you went to a bilateral contract world, it is clearly more difficult to start with three or four million transactions. In fact, it's probably impossible to do that in a bilateral world. And so, the scheme is to have the largest customers go first. The problem with that is, and this occurs with quite frankly the large customers and the marketers that are out there that want to extract the efficiencies in the market and take some of them for themselves is that they want to go out there and lock up the most efficient generators. I mean that's the reason they want direct access. And the problem is that those efficiencies then are not available to the rest of the customers.

In a pooling arrangement all the generators compete among themselves and they all put power into the pool. Everyone takes power out of the pool and so what you do is you place the efficient generators, those efficient generators which would otherwise have a propensity to be locked up, in fact, are in the pool and that power gets transferred.

CHAIRMAN SHER: So that, if I may interrupt, is your main objection to both the proposal that appears in the Bluebook with the staggered timetable for direct access to different categories of ratepayers. And I assume it's your main objection to the PG&E proposal that we heard a few minutes ago which also suggests you can't do it all at the same but it gives immediate direct access to some consumers.

BOB FOSTER: That's correct. Let me also dispel something here. We tend to view this as if I contract with, for example, if I am XYZ Manufacturing Company and I contract with Montana Power Company that somehow I'm going to get Montana Power Company's electricity.

CHAIRMAN SHER: Nobody ...

BOB FOSTER: Well, that's simply not the case. We all know that electrons flow according to laws of physics and we can't interrupt that.

CHAIRMAN SHER: Can we get a different price?

BOB FOSTER: It's all a financial arrangement. It's all...

CHAIRMAN SHER: I think everybody understands that...

BOB FOSTER: All Poolco does is separate the physical transfer of electrons from the financial arrangements. You can have a contract for differences in a pooling arrangement that provides you all the benefits of direct access.

CHAIRMAN SHER: The PG&E witness suggested that the customers don't want to contract with the pool, that their availability of a bilateral contract is somehow warped if it's indexed to this pool price which is an average price of everybody selling into the pool. You don't see that as a problem?

BOB FOSTER: No. They could have a contract for differences with a generator which is below the pool price and that generator would return that difference to them. It's a contract around the pool.

CHAIRMAN SHER: Just as if they had bought it directly from them and they paid their bills not to the Poolco but to the ...

BOB FOSTER: That is correct. Every proposal for direct access has a system coordinator or dispatcher or some central unit that dispatches power. You have to have that. The electric system needs to be balanced and you have to have control area services. That flow needs to be managed.

CHAIRMAN SHER: On your second principle the opportunity, I think you were saying that the investor-owned utilities ought to have the opportunity to sell into the pool if they can compete. Is that right?

BOB FOSTER: That's correct.

CHAIRMAN SHER: And so you don't see anything wrong with the utilities selling power in their own service area that they generate in that area?

BOB FOSTER: No, because the possibility of self dealing is eliminated with an independent pool operator. It's an independent company, it dispatches your generation and dispatches transmission. So those decisions which could, if you said the utility has the distribution transmission system and also owns generation, you could favor your own generation.

CHAIRMAN SHER: And your third principle then, second principle is if the utility has, if I may use this expression, economic assets that will enable them to be competitive in the pool. That's fine, they ought to have that opportunity but to the extent they have uneconomic assets so that they'll lose out in the competition, those should be treated as stranded investments and a mechanism should be created to reimburse the utility for those.

BOB FOSTER: That's correct. Those investments were made under a different regulatory regime where a bargain was struck between the state and investors and on our system, for example, the largest amount of stranded investment occurs on independent energy produced contracts, on those QF contracts I talked about. I mean, I don't know what we would advocate getting out of those contracts. We would.....

CHAIRMAN SHER: What else will you tell us?

BOB FOSTER: Well, I think you've hit most of the essay. It is important to note that Poolco would not be a utility company. It would not be owned by a utility company. It would be an independent entity. It would be regulated by the state. It is not a massive bureaucracy. It basically requires computers and phones. It does not require a massive bureaucracy. And I would submit that most of that, in fact all of that, is being done today. Every proposal has a system dispatcher or system coordinator involved in it. All those functions are being conducted today.

CHAIRMAN SHER: Then the diagrams, and there have been many, that have been presented to me, they show the Poolco being regulated not by the state but by FERC.

BOB FOSTER: It would be under FERC's jurisdiction. That's correct.

CHAIRMAN SHER: Okay, any questions? Senator Leonard?

SENATOR LEONARD: Help me out here. The Poolco idea is both the regulator of the market of electricity and also the wheeler of the power itself?

BOB FOSTER: It's not the regulator of the market, it would hold an hourly or half-hourly auction among generators and it would make the market, if you will.

SENATOR LEONARD: It has an economic function and I guess the broker making the market? Commodities exchange?

BOB FOSTER: That's correct. It does not regulate that market.

SENATOR LEONARD: Okay. And on the other side it would wheel the power?

BOB FOSTER: It would dispatch transmission according to efficiency.

SENATOR LEONARD: Does your plan, is it necessary that it own all of the grid or does it just have guaranteed access to all the grid?

BOB FOSTER: It would not own the generation or the transmission. It would have control of the generation and transmission. It would not own it. You separate control from assets.

SENATOR LEONARD: In your definition transmission, is that to my house?

BOB FOSTER: That's distribution.

SENATOR LEONARD: It's the distribution grid and then...

BOB FOSTER: That is still to be, under almost any proposal I've seen, the distribution and transmission of electricity is to be regulated, be a regulated entity as it is today.

SENATOR LEONARD: Say that again.

BOB FOSTER: It is to be a regulated entity, much as it is today.

SENATOR LEONARD: From the grid to the meter?

BOB FOSTER: That is correct.

SENATOR LEONARD: Okay. Thank you.

CHAIRMAN SHER: Ms. Moore.

ASSEMBLYMEMBER MOORE: Under the Edison proposal, talk to me a little a about the pool price. What would the pool price be?

BOB FOSTER: I have no idea.

ASSEMBLYMEMBER MOORE: I mean, I'm thinking more conceptually.

BOB FOSTER: The pool price would be very mercurial. It would vary from every half hour and it would have fairly large swings, according to time of day, according to available...

CHAIRMAN SHER: I think it would be the market clearing price that would come in to satisfy the demand and then everybody who sold in would get that price.

BOB FOSTER: That's correct.

ASSEMBLYMEMBER MOORE: Now do all generators, regardless of their bid, get whatever the price is?

BOB FOSTER: What the pool does is manage supply and demand. So let's hypothetically say that we're a thousand megawatts of demand and you had 1500 megawatts of supply, you would hold an auction and let's say the prices came in from two to three cents. The three cent power would match with your thousand megawatts a load. All the generators under that, they would get paid the three cent price and the five hundred megawatts that does not clear that market is idle, it does not generate into the pool.

ASSEMBLYMEMBER MOORE: So wait a minute. So regardless of what their bid is and if I bid considerably lower than the three cents, I'd still get the three cents?

BOB FOSTER: That's correct.

ASSEMBLYMEMBER MOORE: Sounds familiar.

BOB FOSTER: What might it sound like? Now, what you're trying to do is provide an incentive for future generators.

ASSEMBLYMEMBER MOORE: Well, I mean, sounds familiar. Thin is thin.

CHAIRMAN SHER: Mr. Foster, I want to make sure... Have we reached the point where the Edison Plan is essentially the same as the San Diego Gas and Electric Plan?

BOB FOSTER: It's very similar.

CHAIRMAN SHER: They both have this wholesale pool? They both have the opportunity for direct access through the contract for differences?

BOB FOSTER: That's correct.

CHAIRMAN SHER: And I know there's a difference in San Diego because there's not enough transmission capacity to bring into that service area all that's needed. Is that the only difference? So you'd have to deal with that additional increment that clearly at the outset the utility would have to provide?

BOB FOSTER: I believe that's correct. I guess to quote Yogi Bear, "Our similarities are quite different."

CHAIRMAN SHER: Okay. They're next so let's bring them forward to see if you've described what is their plan.

BOB FOSTER: Thank you very much.

CHAIRMAN SHER: Thank you for your testimony.

ASSEMBLYMEMBER MOORE: Do you have anything for us in writing?

STEVE DAVIS: Yes, I do.

ASSEMBLYMEMBER MOORE: May we have it?

CHAIRMAN SHER: Maybe we'll, Mr. Julian. we'll make copies for all the members here. Yes, welcome, Mr. Davis, Director of Regulatory Affairs for San Diego Gas and Electric.

STEVE DAVIS: Thank you Chairman Sher and members of the committee. A lot of what Mr. Foster said I had planned on talking about. I won't duplicate the commonalties, I will try to show distinctions or differences. But I would like to start out, I too, was going to talk a little bit about a recent CARE study that has been referred to and...

CHAIRMAN SHER: Don't do that because we know you don't like it...

STEVE DAVIS: In May I appeared before you and I suggested that the independent study that I felt was needed thoroughly answered why rates are indeed high in California and you've heard various experts and you'll have various reports coming to you suggesting the reason why. We have advocated an independent study and when the CARE report initially came out I was very

excited about getting my hands on that. I wanted to see if there was something in there that provided value to the debate. Well, it took me two months to get ahold of it, and then I had to sign a nondisclosure agreement and then I looked at it and found out why they didn't want anyone to see it.

CHAIRMAN SHER: I know and you said all that in your letter to the PUC...

STEVE DAVIS: So my point is, I still believe that there is a need to really begin to understand why rates are high.

CHAIRMAN SHER: Let me ask you this, generally, do you disagree with anything that Dr. Borenstein said in his testimony to us about why rates are high in California?

STEVE DAVIS: I think he gave us some good concepts and some good foundation. I think you need to go into much greater detail and analytical evidence to find out why indeed that is correct. It will differ by utility. My utility has, he referred to some mistakes in judgments. In San Diego, unless we start getting about five times the amount of rainfall we get, we're not going to have hydropower.

CHAIRMAN SHER: San Diego, I think you told me yesterday, was saved from a mistake in judgment by the Energy Commission. Is that right?

STEVE DAVIS: As it relates to adding another nuclear plant, you're correct. And also, is it a mistake that we don't burn coal in this state? There are some that say we're glad we don't burn coal because of air quality concerns. So, that's not a mistake in judgment in my eyes. I think we need to address this utility by utility and really take a good look at why rates are indeed high.

In 1985 my company's rates were second highest in the nation, 13 cents a kilowatt hour. When you worked in San Diego for my company, you didn't tell your neighbor where you worked. It wasn't a very pretty sight back then. Today we stand before you as the lowest IOU in the state. We have reduced our rates by 25%. We are under performance-based ratemaking today. We filed a rate decrease two weeks ago and my expectation is to end 1995 with rates lower than we have today.

CHAIRMAN SHER: So would you say in San Diego it ain't broke so don't fix it?

STEVE DAVIS: No, absolutely not. We view performance-based ratemaking as we have said all along as a mere bridge to competition. As we now enter the Energy Policy Act aftermath of 1992 what we're saying is now it's time to be focused on the wholesale market and largely what you heard Mr. Foster talk about Poolco, the similarities, the two proposals are essentially the same. There are some structural differences between the two. For instance, we suggest that we would separate out our generation component completely into an affiliate. Also, the transmission ownership of this system we suggest that it could actually be divested and I think you're going to hear from Mr. Caldwell a proposal about that. So from the structural perspective there are some minor

differences but foundationally as to how the pool would operate we're in lock step. But we view that component as an evolutionary progression to greater competition to begin to reduce rates and you've heard people talk about principles and again, one thing that we have said all along, my company, competitive benefits of the wholesale market must go to all of our customers. Secondly, the benefits go to customers at the same time.

CHAIRMAN SHER: Imbrecht principle number two.

STEVE DAVIS: That's correct.

CHAIRMAN SHER: Okay.

STEVE DAVIS: Also, the pool mechanism will still allow for public policy choices to be made by bodies such as yourself in a manner in which people cannot bypass that. It's not fair to have one certain class of customer able to go around that and not pay for their share of those sociatable objectives or this proposal would provide for everyone paying for that.

CHAIRMAN SHER: To make that concrete, what you're saying is that California wants diversity, it can require the pool to buy at a certain percentage, wind power whatever...

STEVE DAVIS: Or it could require the distribution company to take 15 percent of its power requirements from a renewable resource. I mean, there are various ways to do that and this is an efficient way to do that.

CHAIRMAN SHER: But I would suppose you would be urging it's easier to do it through a pool than it is to do it through a distribution system because there's going to be a distribution system whatever the plan that's adopted.

STEVE DAVIS: Correct. Absolutely. Another concern and principle for us is that we need to insure and maintain our current system reliability and customer reliability. We feel that the pool again allows that. It's dispatching the system based upon efficiency and economy and rather than dispatching is based upon a series of agreements between generators and customers.

CHAIRMAN SHER: I misspoke, Mr. Lipper points out to me. You couldn't do it through the pool because FERC will control the pool so you have to do it through the distribution whatever plan's adopted.

STEVE DAVIS: Yes, FERC would be the controller of the pool so what you would basically do, as I said, the distribution company would be the one in which you would need to ...

CHAIRMAN SHER: PG&E says, of course, they've got a distribution system as part of their plan but you could do the same thing with them. So that it's not an advantage for your system if it in all cases these policies are reflected through the way the distribution is regulated.

STEVE DAVIS: Again, part of our proposal is the separation of our

business to generation transmission and distribution and it makes it a lot cleaner and more efficient by just making that policy choice go to the distribution level where everyone is hooked up to.

CHAIRMAN SHER: But our goal here is to try to educate ourselves about which of these proposals is floating around there will best be able to reflect these policies that we now have and we may seek to continue. So, I'm asking you does your plan have any advantages over the PG&E retail wheeling plan, direct access plan?

STEVE DAVIS: Well, I think it provides greater clarity and efficiency in promulgating societal objectives on a distribution company. Again, we would separate it out; distribution, transmission and generation. Now, that's not to say you could not do that in a fully bundled or vertically integrated utility company. We're doing it today.

CHAIRMAN SHER: Well, their plan doesn't contemplate the fully integrated company in the future. I mean, they're plan is moving away from that. Their plan, as I understand it, might lead to a point where the PG&E is not providing any of the energy generated by them for customers in their service area.

STEVE DAVIS: I'm just saying in looking at their proposal I have not seen that separation as my company has proposed.

CHAIRMAN SHER: All right. Anything further?

STEVE DAVIS: No. Any questions?

CHAIRMAN SHER: Do you see under your plan and what we heard from Mr. Foster that one pool could be created for (a) for the whole state? One pool for the Edison and San Diego service areas? Would that work better?

STEVE DAVIS: We have said that...

CHAIRMAN SHER: Or a pool for each.

STEVE DAVIS: We have said that a pool could be up and running for an area the size of our service territory. However, we've also said that the larger the area, the greater the opportunity for economies and efficiencies, so we would certainly support a broader pool, a broader transmission network, broader competition in the generation sector. But it could work on a smaller level.

CHAIRMAN SHER: Thank you very much.

STEVE DAVIS: Thank you.

CHAIRMAN SHER: Any questions? All right, our final witness in this group is Mr. Caldwell, who is the technical director of the Center for Energy Efficiency and Renewable Technologies. Welcome.

JAMES CALDWELL: I'd like to put up one chart.

CHAIRMAN SHER: Okay. I've been trying to give names, in my own mind, to these different proposals and so far I guess I had on the PG&E retail wheeling delayed at least for some customers, TURN's easy, they gave us their own label, community access, Mr. Foster is Poolco, I guess San Diego Gas and Electric is also Poolco although I think they describe it as Poolco plus efficient direct access and your plan, as I understand it, is refinancing of the utility costs. Is that a good label for it?

JAMES CALDWELL: That's correct.

CHAIRMAN SHER: Okay, tell us about it.

JAMES CALDWELL: I'd like to start going back to where we began the hearings here and try to quantify it a little bit about what these costs are by function. We've heard a lot about distribution, we've heard a lot about transmission and about generations so what do we spend and where and what could we spend in the future? And the first graph there shows essentially what we're spending now, the distribution of the 23 billion dollars or so that the state spends on electricity and the second graph shows what we could do relatively shortly under what we believe is our proposal. And the savings we are talking about is 4.7 billion dollars. Now when you break those down functionally, we can see the top bar there is the distribution system. That's when we talk about PBR. That's generally what we're talking about regulating and what we're saying there is under PBR we can achieve some efficiencies and over time we will get rid of the fat that is marbled throughout the meat in that sector. What we're showing here though is, and what most people have said today is that PBR will not reduce rates today. I'll come back to the middle bar in a minute.

The bottom bar is generation. Clearly, that's where the action is. That's where the brass ring is. That's what Dr. Borenstein talked about and that's what most of the witnesses have talked about. And the issue before us is how to get from here to there. If we're going to reduce rates, that's the nut we have to crack right there.

The middle bar in transmission you can see is relatively minor in terms of its cost contribution. It's extremely important in this sense that it is the gating item and the item that controls the access from one to the other; and therefore, is the mechanism to shift costs from one to the other and if we mess up the transmission function, it's not so much the transmission cost that will be incurred but we will end up shifting costs from generation to distribution and if we envision a future where distribution is regulated, monopoly generation is competitive. What we will do is set up a regime where we can shift the risks under the regulated portion and shift the profits out into the unregulated portion and that's a prescription for disaster.

Now, the problem that we face on how to get from here to there is not lack of direct access. It's not lack of economic dispatch or variable costs through a pool and it's not principally QF costs and it won't be solved by burning more coal. Let's get it straight. The problem is the promise of fixed cost recovery for existing generation without regard to the market value for that generation. That's the principle cause of the problem. And it doesn't reside

in one of us, it resides in all of us.

In the handout that I gave I listed five principle things. I could go on and list ten. The point that I want to make, first of all, is that we all bear a piece of that. Everyone's generation is a piece of that and we all must solve it together if we're going to do it. We cannot solve it piecemeal. We cannot solve it utility by utility. We cannot solve it plant by plant. We have to solve it together. One significant reason for that is as well as some uneconomic assets we also have some super economic assets embedded in our mixed. And if we try to solve all the uneconomic assets by giving people their money back and then say now generation is competitive then what we've done is create a tremendous windfall for those. So we need to solve these questions together.

The second point I want to make on the fixed cost issue is that not all fixed costs are sunk and not all sunk costs are stranded but we're treating them that way today. We're treating all of our fixed costs as if they were sunk. We've heard today that they're all stranded. They're not all stranded and they're not all sunk. We are incurring fixed costs. We are making new decisions every day about what fixed costs to incur, about what capital additions to make to our plants. And that's the problem that we have to address. We have to get that decision subject to market forces.

The third point I want to make is one that disturbs me a lot about the PUC's ruling last night and the discussion that was held earlier here. CERT filed a motion last week to require the PUC to start hearings on this issue of fixed cost recovery because we were concerned about the piecemeal nature of the way it was coming up. And the point is that this fixed cost recovery and who they are and where they are and what we should do about them is the key input to the process. It's not a policy outcome. It's the key input. We have no way of determining what the results of our policies will be or what kinds of structure we set up unless we have the input information and without that information we're not able to choose between alternatives so to say we're going to make our alternative choice and then come back later and figure out how much it's going to save, to me is just...

CHAIRMAN SHER: I want to be sure I understand this point and get it clarified. So you disagree with what I said that this is a bad thing to do. This is a good thing to do. It's the right thing to do and we ought to be looking at this question of stranded investment with respect to all the proposals that are out there because that will help us decide which is the right one.

JAMES CALDWELL: That's correct.

CHAIRMAN SHER: And so you think they should go forward with that and they...

JAMES CALDWELL: Yes, they should have gone forward six months ago...

CHAIRMAN SHER: And they don't need to... And they should do it in the alternative.

JAMES CALDWELL: That's right.

CHAIRMAN SHER: Look at all of these proposals and look at how they handle the stranded investments and what impact that will have on future prices of electricity.

JAMES CALDWELL: All of the various proposals are about how to distribute those costs. Okay. We can have a discussion about how to distribute those costs but first we have to say what they are and if we don't know what they are how can we tell how to distribute them. And those who want to go ahead early without making that determination, what they're really saying is let's go ahead and let me start. Then you determine the costs.

CHAIRMAN SHER: So why are you upset if they're doing it? Is it the way they're doing it?

JAMES CALDWELL: They're not doing it at all. And as you pointed out they don't want to do it until the end. They don't want to face the problem. They don't want to face what the problem is. They don't want to get their hands around it. They don't want to try to discover what it is that we need to do to fix that. That's what we need to do.

CHAIRMAN SHER: You're suggesting that they PUC is on a track to craft a proposal where they don't have the information they need in order to come up with the one that's going to do the best job of lowering electricity price in California.

JAMES CALDWELL: That's correct.

CHAIRMAN SHER: How long would it take them to do that?

JAMES CALDWELL: I think we don't want to confuse precision with accuracy. In order to come up with precise answer, we can argue about it forever. We can come up reasonably quickly with a very, very good estimate and I think that's what's required. And that estimate can be done, I think, within workshops, could be done by the January 31st deadline.

CHAIRMAN SHER: So why do you say that they aren't doing it? Is it something that you read in this order that suggests to you that they aren't doing it?

JAMES CALDWELL: Well, as I said, I think we filed a motion two weeks ago asking them to start this process. Last night we come up with this thing and as you characterized it, it was damning that idea with faint praise. It said, "Well, this is something that we don't want to do. It's really a bad idea, but because you made us do it, we'll do it. And what we're suggesting is they should have wanted to do it a long time ago and it wasn't ACR 143 that should have compelled them to do it, it was getting the information to get the right answer.

CHAIRMAN SHER: Well, forget the reason for it, if they're going to do it

is it...

JAMES CALDWELL: That's great.

CHAIRMAN SHER: Are you applauding?

JAMES CALDWELL: Yes. And I just didn't want to leave the impression that what we ought to do is just sort of dismiss it.

CHAIRMAN SHER: Okay. All right. And they can do it. Given the situation they're in, they can look at the different alternatives and they can deal with this question and provide by January 31st that information to the Legislature.

JAMES CALDWELL: We would say that it's possible. I think to get into the distribution of how to solve the problem or who's going to bear these things is a political discussion that has to take place afterwards. I would despair of that taking place by January 31st, but the analytical detail as to what it is, I think can be done properly.

CHAIRMAN SHER: Well, you know, these political questions the PUC doesn't get into those. That will be here in the political body after we hear what they've proposed.

JAMES CALDWELL: Well, this is a political problem and there will be a political solution.

CHAIRMAN SHER: Okay. Then we obviously ought to be a part of that...

JAMES CALDWELL: That's correct.

CHAIRMAN SHER: ...because we are politicians. Okay. Go ahead. Tell us about your plan that you would like to have them also look at in terms of this problem of stranded investment.

JAMES CALDWELL: Our plan starts with a clear vision of what the division between these and what the functions of these functions are. And we think it's very important to start with that vision first. We're talking about a transition to a more competitive environment or those kinds of vague things doesn't get it. That's what gets us into the jurisdictional issues. That's what gets us into the cost shifting issues. We need to be clear about the separation of these functions and what our vision is, is a disaggregated utility structure. Where there is a disaggregation between generation, transmission and distribution. And the generation level, most of us agree and I don't think you've heard anything today that would say anything different, should become a competitive commodity. And we believe that means that investors and not ratepayers should be at risk for field diversity for environmental footprint, etc. We also believe that all costs, those fixed and variable costs need to be recovered at market rates. In the transmission area, we believe it's simple to say that this is a regional monopoly and we ought to start treating it as such. We ought to stop treating it like a bunch of Vulcan nations where each individual utility has their own transmission and then tries

to guard that transmission and tries to use that transmission to keep someone else from having some competitive advantage. We need to put transmission together into a regional monopoly and start treating it as such. It will become a FERC regulated common carrier with nondiscriminatory access and pricing and it should have and it will have state and regional oversight. And we believe the transmission should also be responsible for the measurement of the environmental impacts of generation. This is the place where the information counts and this is where we can act on that information in our oversight capacity.

The distribution portion becomes a disaggregated local monopoly with state, PUC or municipality regulated cost of service provider under PBR regulation if that's what people wish. The distribution should be responsible for mitigation of end use deficiency market failures, should be responsible for the social and low income programs but it should be under local control.

And the deal, how do we get there? Our proposal is that we sell the transmission assets and we sell those transmission assets at a multiple of the embedded costs. Now we sell the transmission assets first so that we can begin this disaggregation process. And we sell them in a multiple of their embedded costs, something below their replacement cost and something like their market value. And we use that money. We use that cash that we have raised to cover the stranded generation assets and to give the rate decrease to the people.

On the transmission side of the equation, we get financial leverage. We get it from a longer term, no financing, a lower interest rate and higher debt premium because transmission is a much less risky asset than generation is. We also can get a premium for the hard asset value, the real estate value of the transmission. It would be similar to what you would do as a consumer if you began to get into trouble with your monthly payments that you'd incurred on a credit card and that's what we've done. We incurred these generation assets on our credit card. We're paying for them at something like an 18% fixed charge rate or an 18% interest rate. And the first thing anyone tells you to do when you go in with a problem, a work-out problem is refinance. Refinance your credit card debt, put it on your home equity. Where is our equity? Where is the assets that we have that has some collateral that we can use and that's the transmission. And that's what we say it on that side of the equation.

On the generation side of the equation, we have the same premium for hard asset value. Since we're going to transition to this competitive market where those generation assets are part of the competition, then the real estate value, the premium for those assets can reside with the owners of those assets. There's also a discount for cash in doing this that replacing one regulatory promise to pay with another regulatory promise to pay in some drawn out transition service charge is guaranteed to be viewed with skepticism by the markets and that skepticism will be translated into a higher risk premium, higher interest rates - worst financial conditions for the utilities.

And finally, that's the way we can get to a market test for our new fixed costs. Not just the old fixed costs but for the new fixed costs. And we believe that this leverage that we get on both sides of the equation from the transmission to the generation allows us to incur maybe a 3/10th of a cent

increase in transmission rates and that's going to support a 2 cent per kilowatt hour drop in our generation cost. That's the way we get a rate increase and that's the way we transition to a new world.

The other side, after we've made this sale is that generation rate base is set to zero. That guaranteed fixed cost recovery for generation is over. Any mistake that is made in the future will not be warned first by the investors, not by the ratepayers. The contracts will be cashed out and renegotiated and uneconomic assets will be retired.

The third piece of the deal has to be this disaggregation. The distribution monopoly has to be forbidden from signing long-term contracts with affiliated generation. We have to break the vertical problem of shifting risks one way and shifting profits the other way. And I would compare this to Dr. Borenstein's excise tax and I would also say to Assemblywoman Moore that we want to do is we want to return the cash to the shareholders and let them earn the return.

CHAIRMAN SHER: Let me just see if translating it into concepts that I understand better. The way this process would start is that an independent entity would be set up to handle the transmission. Is that right?

JAMES CALDWELL: Correct.

CHAIRMAN SHER: And would go to the financial market, borrow money on a long-term basis at a favorable rate of interest ... right?

JAMES CALDWELL: Yes.

CHAIRMAN SHER: Okay. Now it's going to take this money and it's going to buy from each of the investor owned utilities in California...

JAMES CALDWELL: And we believe it's also important and this is a very important point that I think hasn't been said today is is that the municipal utilities in this state must be brought up to equal footing. That sitting here just talking about the PUC will not work. Municipal utilities are one third of the load in this state. They own a significant piece of the assets and...

CHAIRMAN SHER: But do they own transmission?

JAMES CALDWELL: Yes.

CHAIRMAN SHER: So they're going to have to sell their transmission?

JAMES CALDWELL: They're going to have to be involved in the process.

CHAIRMAN SHER: But what does that mean? I thought...

JAMES CALDWELL: Someone's going to opt out. I mean it's not necessary to every last piece of transmission.

CHAIRMAN SHER: The transmission entity is going to own all the

transmission line.

JAMES CALDWELL: All the transmission that is voluntarily sold. In other words, if you want to raise the cash to cash out your stranded assets then this is the way you get the stranded asset recovery.

CHAIRMAN SHER: Okay.

JAMES CALDWELL: If you want to keep it where you are, that's your problem.

CHAIRMAN SHER: Okay, if that's your problem and you don't get anything for stranded investments, so everybody is going to want to do this presumably who has these standard offer four contracts or nuclear power plants.

JAMES CALDWELL: And it's more broadly than that. It's not just nuclear and it's not just QF contracts.

CHAIRMAN SHER: Okay.

JAMES CALDWELL: What I've read throughout this.

CHAIRMAN SHER: Okay. Now each utility then will get a different price for its transmission facilities depending on how much of those uneconomic stranded investments they have because you're going to pay them out this way. There not all going to get the price based on the market value of those power poles and lines then. The transformers...

JAMES CALDWELL: We're suggesting that they get the price based upon the value of the transmission. It just happens that we can set that value high enough so that we can cover the generations to make...

CHAIRMAN SHER: Would it be the same for each utility?

JAMES CALDWELL: No.

CHAIRMAN SHER: So I'm going to get more for the same, let's take comparable units of transmission. Edison might get more for it's than...

JAMES CALDWELL: No. For comparable units of transmission they would get the same value.

CHAIRMAN SHER: But suppose these stranded investments are much bigger with certain utilities as compared to others. How does that work out?

JAMES CALDWELL: I think the remarkable thing when you look at the numbers as we've looked at it that the ratio of stranded investment to transmission book value for the three investor-owned utilities is remarkably similar.

CHAIRMAN SHER: It has difference components but it has...

JAMES CALDWELL: But the number is about the same. Now maybe that's a

testimony to consistently bad regulation or something, I don't know, but it's remarkably the same.

CHAIRMAN SHER: It is remarkable to me because they have a different quantity of transmission facilities and they have different stranded investments but putting it altogether they'd all get paid in effect the same thing for their, on a comparable basis...

JAMES CALDWELL: The same multiple over their embedded costs.

CHAIRMAN SHER: If they choose to participate, it would pay off all theirs.

JAMES CALDWELL: Now the municipal utilities are not the same. There's considerable diversity among the municipal utilities and if you get that far the one person you might hear from today, Jan Schori, would probably be helped least by this proposal of all the major utilities in the state. Doesn't mean they wouldn't be helped by it but they would be helped least or less likely than the rest of the utilities in the state.

CHAIRMAN SHER: They would all keep their generating facilities?

JAMES CALDWELL: Yes.

CHAIRMAN SHER: And the ones that are noncompetitive they'd sell them off for whatever they can get?

JAMES CALDWELL: Shut them down or do something with them or sell the real estate...

CHAIRMAN SHER: You wouldn't even look at that, as I understand...

JAMES CALDWELL: That's correct.

CHAIRMAN SHER: What you're saying when you buy it you're going to buy it based on some market value of these transmission facilities.

JAMES CALDWELL: You would obviously have to look at that in terms of making the decision. The market will have to look at that in terms of how it views the transaction. It will have to look at both sides of the transaction. It has to look at what is the value of what's left and was that enough money to compensate the shareholders for, if you will, breaching this contract.

CHAIRMAN SHER: I thought you said this stuff magically all works out on your calculations, that I thought you said you're not going to set the price for the transmission facilities based upon what the stranded investments are. You're not going to look at the fact that PG&E owns Diablo Canyon in deciding how much you're going to pay PG&E for their transmission facilities.

JAMES CALDWELL: PG&E will obviously look at that and the market will look at that when we try to decide what happens to PG&E stock. Clearly, we can also make a determination about that that is separate from this transaction.

CHAIRMAN SHER: Wouldn't this be a negotiated contract between this new transmission entity and PG&E as far as what PG&E's going to get for, or whether they're going to decide to participate in?

JAMES CALDWELL: We think that the construct here is a grand deal and that the formula for the transmission sale is similar for all utilities.

CHAIRMAN SHER: Well, you say that but I thought you said it was voluntary with each utility and so PG&E may feel that it has to bargain for a higher price for its transmission facilities that come out as you say they will.

JAMES CALDWELL: Then it's going to have to...

CHAIRMAN SHER: But then Edison would.

JAMES CALDWELL: It's going to have to convince everyone in that transaction that they deserve that and it's also going to have to convince the market that the price for the transmission that results is viable in the future. It's also going to have to convince it's own shareholders that it got enough and that's where the tension is.

CHAIRMAN SHER: I've taken more time than I should. I'm going to have to study your plan a little more carefully and see if I can... They said you gave us something and I guess this is the document.

JAMES CALDWELL: That's clearly a simple outline. I mean I have obviously the next level of detail down and I've committed to the PUC to a third level of detail down. The issue turns out to be in the numbers and that's why what we're saying is again that what we want to do is begin to hold evidentiary hearings. Not just on our plan, necessarily, but on the numbers that underlie what the conclusions that we drew and that's what we need to do to go forward.

CHAIRMAN SHER: If I understand you though, what you're saying is that if your system, if your plan is adopted, it's voluntary with each utility whether to participate, those that don't stay under current ratemaking structure. Is that right? Those that participate get into this new world so...

JAMES CALDWELL: They get into the new world and for that they get some cash. If they don't then they have to take care of their own stranded investment their own way. They have to eat it basically.

CHAIRMAN SHER: There won't be any stranded investment if we discontinue with the current system.

JAMES CALDWELL: That's correct.

CHAIRMAN SHER: They'll recover it out of their rates.

JAMES CALDWELL: That's correct. They will be encouraged to join.

CHAIRMAN SHER: Okay. Well, it's interesting. Thank you very much for

your testimony. At this time I promised you a break. We have one witness who we are going to hear right after the break who has to go back to San Francisco. He says he has one minute of testimony so we're going to accommodate him and ask Mr. Gamboa to come forward from the Latino Issues Forum who's listed under the next item on our agenda. Welcome. Sorry to squeeze you in this way but in order to accommodate you we're going to have to ask you to be very brief.

JOHN GAMBOA: I'll be extremely brief. First of all I'm John Gamboa, I'm the executive director of the Greenlining Coalition which is a multiethnic coalition. I was formally the director of Latino Issues Forum.

CHAIRMAN SHER: I should have said and Greenlining. You're no longer with... You're representing Greenlining.

JOHN GAMBOA: That's exactly right.

CHAIRMAN SHER: Okay. Thank you. Sorry about that.

JOHN GAMBOA: Very similar organization except it's multiethnic. It includes Asians and African-Americans among others.

First of all, I want to thank the committee and yourself, Mr. Chairman, for holding these meetings and for allowing me to address you on such an important issue. And I'll be extremely, extremely brief.

Our organization and our constituents are not opposed to competition if it's fair competition although we would like to see a little more cooperation and a little less competition if it's going to be competition like it's been before in other cases of deregulation. Our community has suffered disproportionately and I'm talking about the at risk consumers, the low-income, poor limitingly speaking and recent immigrants have suffered disproportionately from deregulation in this country. For example, in deregulation of telephone services in 1980, the Latino community in this state had penetration, had telephone service of 90%. Today it's down to 80%. That's what's happened because of deregulation. The actual cost of residential services has gone up astronomically and has frozen people out and frozen the most at risk consumers. The effect of this is that about half a million children do not have access to emergency services through 911. That was the effect of deregulation of the telephone industry.

Another effect of deregulation is that there is, in fact it addresses Assemblyman Baca's question, "Who protects the consumer?" There is no protection. In deregulation of the telephone industry, the low-income consumers were found to have suffered from Pacific Telephone's marketing fraud to the extent of 50 million dollars that had to be refunded plus fined 16 million dollars.

In the area of deregulation of gas, I've handed out to you a chart that was part of the talk given by Bruce Henning, the Chief Economist of the American Gas Association at a recent conference and I point this out to you because it certainly points out the problem that happens to the poor and the residential customers in deregulation. As you see in this chart in 1984, the well-head

cost of natural gas was \$2.60 per million cubic feet. It's decreased to \$2.01, a 25% decrease. Everybody has benefited except the residential customer. Again, the residential customer takes the brunt. I think the best example of what happens in deregulation when our communities' interests are not taken into effect in the beginning is a deregulation of the savings and loan industry. The savings and loan industry as you know was a fiasco, was a fraud...

CHAIRMAN SHER: Mr. Gamboa, I don't want to break into your flow but, I mean, obviously your going to come to the point that we're interested in which is your view on electricity. Is the bottom line that because of what we've seen in these other areas that we should not deregulate electricity or is your message that it's okay to go forward, examine this and bring competition in but we need to lock into the law guarantees that the residential consumers will enjoy the benefits just as the other consumers?

JOHN GAMBOA: Basically yes, but I think its more important than that. I think what we need to do and I think what you've started doing is to assist and encourage the at-risk consumer body to be part of the process. That's whats been lacking. What's wrong with the Bluebook? The Bluebook, in fact it connotates sad the color blue and it's certainly sad for our community. It does not address the problem. That particular proposal impacts our community negatively in a terrible way. It destroys all of the social contracts and gains we have made over the last 30 years. The importance, I think, and what I want to emphasize is the importance of slowing down the process. Doing the outreach in a sufficient way so our community can understand the issue, can participate and represent itself. None of the speakers that were up here today and none of the speakers that I see following except from our organization are proposing that or are speaking up for the people down on the bottom. We look to you to protect us and to give us the assistance to be able to have a voice in that.

CHAIRMAN SHER: Well, I think the representative from TURN would suggest that that's their perspective, they share your perspective for all the consumers, the small consumers as well as the large.

JOHN GAMBOA: TURN is a wonderful organization that represents the consumer body in total. Our organization represents the little seat consumer that sometimes gets lost, the most at risk consumer, people that are most often defrauded and market abused and that is shown by history.

CHAIRMAN SHER: Okay. I can assure you that that's going to be our intention to bring everyone in as we exercise our oversight responsibility.

JOHN GAMBOA: If I may, Mr. Chairman, just briefly what I'd like to do is make a recommendation. I've heard people recommend hearings on special issues regarding around stranded investments and pooling. I think we need also special hearings to see what the effect is on the little seat consumer. I urge you to have such hearings. Thank you.

CHAIRMAN SHER: All right. Thank you. Thank you for that message. Thank you for coming today. We're going to take our break now. I think we'll come back at 2:00. We are going to start promptly at 2:00 and I think we'll be able

to go expeditiously through the rest of our witnesses if now they react to what they've heard and we stick to our five minute limit.

BREAK

(Chairman Sher and beginning of Kevin Williams not on tape.)

KEVIN WILLIAMS: ...population of fifteen million people of color. There is a very important need to insure that that populace of this great state is heard and participates in these discussions to the greatest extent possible. As I was about to say some call or refer to the deregulation proposal on discussion as the Bluebook proposal. Since the Halloween holiday is next week I want to recharacterize the Bluebook proposal as the "Trick or Treat" proposal.

In the African American, Latino, and other communities of color, if history has ever repeated itself the electrical companies will get the treat and the communities of color will get the trick. The proposal is based on an outdated Reagan trickledown economic theory and it didn't work 14 years ago and it won't work today. Survey of the African American community shows no support for deregulation. CPUC has never disputed that deregulation is not in the best interest of small consumers of color and I think it was Mr. Baca that pointed out that so-called choice for people of color may very well be illusory. Regulatory history indicates that competition without establishing fair rules leads to unfair results. For example, breaking up AT&T telephone monopoly resulted in lowered long distance rates benefiting large business users but higher rates for residential, local services. The effects of these rate changes on the availability of phone service and low-income communities were devastating. A recent analysis of census data showed that 20% of black children under the age of six live in homes without phones. A different industry, for sure, but if you deregulate the chicken so will you deregulate the egg. Research also indicates that where people of color are concerned easing regulations and allowing competition among the electric companies may result in higher and poor service for the following reasons: First, competing for larger consumers, utilities will reduce rates to the lowest possible cost for electrical customers. To make up for the loss of revenue, utilities may increase rates for smaller customers, minority and low-income homes and businesses who lack the bargaining power and information to demand the same competitive rates.

Secondly, the service needs of smaller customers including small minority businesses may be neglected in pursuit of keeping larger companies happy. Thirdly, rate assistance programs for income customers may be reduced or eliminated. Companies that provide rate assistance for higher costs than those that do not. To stay competitive, utilities may cut costs that do not increase revenue. And finally, because small customers are captive customers of utilities until the year 2002, they will be stuck with higher rates imposed by utilities which unlike the competitive have lingering costs that still need to be paid off. Each of the latter will have a staggering consequence on African American communities.

In closing, only those balanced positioning of the disinfranchised and the

powerful corporate interests will competition work to benefit all Californians. We believe that there has been insufficient outreach, in fact, there needs to be an inverse reaching out to insure that all Californians play a role and participate in decisions that are being made that will affect their lives from now to perpetuity. We appreciate the opportunity to have a chance to at least bring some of the concerns that have been brought to us in communities of color in the bay area. The first hearing that I attended I was absolutely astounded at the fact that outreach has been considered advertising in the federal register. People who are low-income living in public housing don't have accessibility nor do they read the federal register. So we believe that additional hearings just as on the other issues where side hearings may be held should be convened to address the plethora of concerns that confront people of color with regard to small business, minority business, contracts, all the other social incentive programs that may be impacted by this trick or treat deregulation. And I thank you.

CHAIRMAN SHER: Thank you and next we have Linda Filchev.

LINDA FILCHEV: Thank you, Mr. Chairman and committee members. I'm going to focus my discussion on costs which is after all the driving force behind the Bluebook proposal and behind the hearings today. Now, supposedly, the commission's desire in issuing the Bluebook proposal is to reduce costs but the key question here and the key question for our constituency is this, reduce costs for whom? Which class of consumers are we talking about when we say we want to reduce costs?

You know, it's my perspective sitting here in the audience and also sitting in at some of the PUC hearings that if you were to just sit in on these hearings you would think that the only class of customers in this state are large industrial commercial customers and that there are no residential and low-income customers in California. From the perspective of our constituencies, we stand to lose if any portion of the Bluebook proposal is adopted. Our view is that we'll end up as captives of the utilities, as Mr. Williams has pointed out, and that our bills are going to increase.

Another issue here that's supposedly in the background of this debate is the desire to stimulate the California economy so that California can remain competitive. The Commission has linked the well-being, the economic well-being of California, with large industrial and commercial interests. That's all very well and fine, but the fact is that in the recent years of down-sizing it's been small business, the small business sector that's created jobs for Californians and that's particularly the case in communities of color. So it's a fallacy, this notion that savoring big business is going to help the state. We need to look at the needs of the small business community and particularly the minority small business community.

One of the problems with the debate so far is this; electricity under the Bluebook proposal is viewed as a commodity, a commodity not that different from bushels of wheat or tons of iron ore to be bought and sold on the market. The reality is that electricity is a basic necessity and in this state it has been a vehicle for achieving important social policy. Programs have been created in recent years that benefits all of California. Unfortunately, in the context of

this debate these programs, programs such as LERA, Demand Side Management, The WMDVBE Program, these programs are now discussed as if they are a burden contributing to increased costs and burdening competition. As a result these equitable programs which have brought tangible benefits to our communities are now at risk. In one sense they've become scape goats. Our view is that programs such as LERA, WMDVBE, DSM, are programs that are cost-effective. Last year alone, the WMDVBE program, that's the Women Minority Service Disabled Business Enterprise Program created one billion dollars worth of contracts for women-owned and minority-owned businesses. I ask you to consider the cost, the human and the economic cost of eliminating such a program.

With regard to to the LERA Program, last year 1.1 million households participated in that program. That's only one-third of the eligible households in the state by the way. The average cost to the residential customer of LERA was 16 cents a month. Again, I ask you to consider in the course of this debate the cost of eliminating a program such as LERA which has helped one million people pay their electricity bills.

Another cost to consider and a cost that the utilities should consider as well, is what is the cost of shutting off people's power. There are administrative costs associated with shutting people's power off and turning it on again and to my knowledge no one has yet to study the cost to the state, both human and economic costs, of having households living without electricity for any period of time. We don't know how many people had their power shut off last year, for how long and what the consequences were. In fact, rather than putting a program such as LERA at risk, I suggest that the appropriate dialogue concern itself with increasing the LERA Program to bring it in par with Universal Lifeline Service in the telephone industry which offers a 50 percent rate break as opposed to just 15.

CHAIRMAN SHER: I am going to ask you if you can to summarize, but in doing so the point that I am most interested in, are you saying that this restructuring should not go forward because these valuable programs will be sacrificed, or, on the alternative are you saying you don't take that position but if the restructuring does go forward these programs must be preserved? Which of those two or both?

LINDA FILCHEV: Well, our view is there are many aspects of the Bluebook proposal that will be devastating for our communities.

CHAIRMAN SHER: But I'm more particularly interested in the general concept because I see the PUC back... If we just focus on the Bluebook, you're going to not be focusing on what's likely to emerge from all of this so I think it's important for me and the committee generally to know, are you saying that you oppose any introduction of this competition and direct access because you fear that it will lead to the loss of these programs or are you saying make sure that if these programs go forward, the proposal goes forward that the programs will be saved?

LINDA FILCHEV: In a general sense, our view is that to the extent that savings can be captured we do not oppose competition and deregulation and restructuring so long as those savings are passed on equitably to our

constituency and that includes low-income people and communities of color.

CHAIRMAN SHER: Okay. That's fine. That's what I wanted to know.

LINDA FILCHEV: Okay, at the present time we don't see a direct access plan that would be workable because of this problem of market leverage. But again, to the extent that savings can be captured and passed on. Sure we support that if it brings us lower rates as well.

CHAIRMAN SHER: Good. That's what I wanted to hear. Do you have anything else you wish to say?

LINDA FILCHEV: Well, I'd just like to end by emphasizing that, you know, in addition to considering the cost of kilowatt hours, we need to consider the human costs as well and I would also like to reiterate Mr. Gamboa's request that this committee hold a hearing addressing the concerns that I've raised addressing low-interest concerns, the concerns of community of color and the equitable programs that are now in place.

CHAIRMAN SHER: Okay. Thank you very much. Thank you both. All right. We are going to continue with the customer perspectives and so our next witness will Dian Grueneich from her own company. And you tell us which consumers you represent and what your perspective is if you will.

DIAN GRUENEICH: Thank you. My name is Dian Grueneich with Grueneich Resource Advocates. I am appearing today on my own behalf. In general I've been representing consumer interests at the PUC and in the Bluebook proceeding, I've specifically been representing the interests of state agencies as consumers. So that certainly is coloring my remarks today.

There were three areas that I was going to touch upon briefly. I guess four with my introduction. The first initial point is that I think overall it's fair to say having sat in many meetings with customers that we continue to be concerned about our perspective being addressed at the CPUC in the whole restructuring proceeding and we thank you for having us today. And certainly as the Commission proceeds with its proposals and with its report to the Legislature in response to ACR 143, one of the things that we're really going to be looking for is were there some listening to the customer perspective. Let me give you one example of why we get into this situation that as I think you may be aware we have going on now at the CPUC a formal hearing on what is one of the two aspects of the restructuring, the PBR Performance Based Ratemaking Proposal and I'm not going to get into the merits of Southern California Edison's proposal. That's the case going on now, but in response to questions as to what consultation Edison had with customers in designing that proposal the answer was none. They didn't talk to customers and so what we're looking at is as we're now saying PBR is one of the mechanisms where is going to be the form in which we can have some significant input.

The other perspective I bring is that I do not believe this is some magic win, win situation for everyone, that we simply discover ways that we can all come out better than under the existing system. I do believe that there are going to be some losers and one of the very significant roles that I see this

committee playing is in helping to identify who those losers are and to see what instruments can be developed to help cope with that. Whether those who are winners are truly getting a fair share and those who are losers what mechanisms we can develop but I think there clearly are going to be some losers.

Quickly, the three substantive points I was going to address was what I just alluded to was Performance Based Ratemaking. My understanding is that you will be having a separate hearing on it so I won't go into detail other than having spent a great deal of time now looking at the issue. One thing that I think is important to understand is that contrary to what may be the initial reaction to PBR is that under PBR shareholder and ratepayer interests are not necessarily aligned and as we are starting to explore some of the mechanics of getting into it it's clear that there are real tradeoffs. And what we're also dealing with I think is that in ACR 143 with regard to PBR there were some clear policy items which the Legislature, I think, was asking for a response from the Commission as it is starting to set up PBR, what are the Commission's goals and policies?

CHAIRMAN SHER: Can I break in there because you obviously are involved in the PUC proceedings. Is there a document or documents that in a comprehensible, fairly simple way, describe the PG&E and Edison PBR proposals that could be presented to this committee and the members of this committee so that we can understand the proposal or is it part of a much larger rate application thing that is incomprehensible to all but the experts who participate in this.

DIAN GRUENEICH: There is not a document now that I know of but my bet is if you ask for one you'd get one.

CHAIRMAN SHER: Do you think we could get a two or three page description of the PG&E and the Edison PBR proposals?

DIAN GRUENEICH: Yes. And I think I would add to that probably the SDG&E one because that's one that's actually been implemented but I think that's important and I'd be happy to work with the other parties.

CHAIRMAN SHER: And who would we ask?

DIAN GRUENEICH: I would probably ask the proponents of the utilities and then, I'm sure you would get responses as far as comprehensiveness.

CHAIRMAN SHER: Okay. Thank you.

DIAN GRUENEICH: On PBR, the other point that I was going to make, was one of the issues that has come up with the Edison PBR that I think we're looking for guidance from certainly the Commission and any help with the Legislature is that, as I was mentioning, ACR 143 sets forth some policy items that the Commission should be considering presumably in the context of PBR as well as direct access. We're in the middle at the PUC of a specific decision on the mechanism and an issue as arisen like in so many of these issues should we understand what are the policies and goals we are trying to achieve with PBR

first and then look at the specific proposals or are we in the context of the proposal somehow going to sort this out? I think I join with many people who say looking back on it we sure wish we would sort out some of these policies but one of the concerns we have with our limited resources is we may go through these PBR proceedings and then suddenly at the end start to address some of the policy issues of where we're going and be told, "Well, let's redo the whole proceeding."

CHAIRMAN SHER: I don't want to be misunderstood about what I asked for previously. I know that the PG&E, for example, has given us, given my staff an explanation of the general reasons for PBR and what its designed to achieve and I have in my possession some overheads that were presented as part of the proceeding, but what I'm talking about are the benchmarks, the target. Is that reduced to writing anywhere that a lay person could understand what it is that would be the Performance Base that Edison is asking for so you could look at it and see what percentage of the savings, if they're realized will go to the benefit of the shareholders and what percentage translated into expected dollars? You know, a nice simple explanation of what precisely it is that people who are not intimately familiar with the proceeding could understand?

DIAN GRUENEICH: We're, I think with Edison, we're up to 57 witnesses in six weeks of hearings so my thought is the best thing is to make the request for the document to be prepared page limit, etc., because if you just ask for information that's already out there, you know, hundreds of pages may suddenly emerge.

CHAIRMAN SHER: I'm looking for the primer that actually....

DIAN GRUENEICH: What I can offer is we have actually put together for the Edison PBR a chart of the major parties to the proceedings, their various positions on revenue-sharing on benchmarks, on risk factors, things like that.

CHAIRMAN SHER: That's their position. I want PG&E's proposal, is there a proposal to which they're reacting that has the hard figures in it in terms what these benchmarks against which their performance are going to be measured? Is that set down, I shouldn't ask you these questions but...

DIAN GRUENEICH: It is set down. There is some discussion that they've asked for it to be put on hold. There is some discussion they may withdraw it because of the interrelationship with 143 and is it something they want on the table at this time since it's not actually being...

CHAIRMAN SHER: Well, go ahead with your presentation.

DIAN GRUENEICH: But I would be happy to work with the other parties to get the information to you.

The second point that I was going to make was with stranded investment that I firmly believe it should not be addressed in a piecemeal fashion in that Jim Caldwell is absolutely right that when you start to look at it there are going to be write-ups as well as write-downs and we've got to make sure that we get the benefit no matter what system we do of looking at it as a coherent piece

and that's one of the reasons why, I think, just about every customer group has protested the proposed settlement with Edison on accelerated depreciation for San Onofre. That that to us is exactly the wrong sort of approach to be taking to take out a piece of the puzzle one aspect, get that dealt with in some sort of piecemeal fashion and say well let's now deal many months later with the rest of the restructuring. We think it needs to be done in a coherent fashion.

With regard with the ruling, I did want to say that I actually think that substantively I do agree with the PUC saying, "Let's get out on the agenda and let's start some hearings on stranded investment. So I don't disagree with their view that we should get some hearings started on this now and I think that since we are not in a situation where we have a consensus view on different proposals, it makes as much sense as anything to say under different proposals what would stranded investment look like and certainly what's the magnitude of it? I also happen to believe since there really has been no discussion of stranded investment at the Ombonk Hearings really that we should also get out what are various positions as far as who should bear the risk with it. In other words, I would go further than just saying what's the magnitude of stranded investment. I would say what are the argument for it being solely a ratepayer responsibility? What are the arguments for it being shareholder as well and I happen to fit in with the camp that says I think that there is some pretty strong arguments that the shareholders need to pick up some costs. I certainly disagree strongly with this view though that the CPUC is on the right track to say that they are going to limit cross-examination and who can participate in the hearings and discovering that sort of thing. I think we're all going to be looking to getting a little bit broader investigation.

The third area that I did want to touch upon and again I know this goes to my understanding of this will be another hearing that the Legislature is looking at is the whole issue of DSM renewables and R&D and the point that I wanted to make is twofold: one is that everyone is saying that in the new world, whatever that new world is, they'll support it. I mean I don't know what if a single party and I think I've read just about everybody's pleadings in the Bluebook case, I don't know a single party that said no we won't support it. So to me, this is the time to, I don't know whether we start a parallel set of hearings or whether at some workshop effort but that again says, "Okay, there are a couple of different paths we can be taking, what do we need to have in place in the mechanisms under those different paths to keep in place the DSM, the renewables, the R&D since everybody says they want to be there? In other words, what I see is it's time to start moving into some details to know if it workable. I personally believe it is.

CHAIRMAN SHER: You see nothing you can tell that says that people think all of those programs that are currently being sponsored, some through rates, should continue?

DIAN GRUENEICH: I'm sorry.

CHAIRMAN SHER: You see no descent from the proposition that in the new world of restructuring that the DSM should continue the diversity that supported zero emission vehicles, the low-income, you haven't seen anybody descent to any of that?

DIAN GRUENEICH: I was restricting, let me clarify and apologize. I was restricting my comments to the DSM, the renewables, that level. I personally am a little bit of a cynic when it comes down to signing on the dotted line how much it's really supported, but what I...

CHAIRMAN SHER: You would say that's true of our next witness. She going to confirm that the large industrial users support continuation of those programs even if it means the rates will be slightly higher for their members?

DIAN GRUENEICH: What I have been told is that they do support DSM programs and diversity and so what I...

CHAIRMAN SHER: We'll verify that just in a minute.

DIAN GRUENEICH: So what I... And let me also say in the Bluebook I do represent the Department of General Services who does support direct access and our position has been we also do support DSM and renewables and what I'm saying is, I think, now is the time to, in essence, put our feet to the fire. In other words, let's see the specific proposals. We've had about nine months of, you know, yes, we'll support it. What does it look like? What are the funding mechanisms? What are the levels of funding, that sort of thing is what I'm saying.

And the other point I was going to make with regard to the whole area of DSM and renewables is a point that I know you are fully aware of is that in the meantime with all this debate the programs are in shambles and a grave concern that I have is that in the brave new world which I actually happen to think more competition in DSM does make an awful lot of sense, if we've lost a lot of our infrastructure and it takes us three years to get the new world what happens in the meantime? And we've not been particularly successful in getting this, having any sort of attention and so my hope is, you know again, through this committee we can get a little bit of light shed on the need to actually have some policy support in the here and now and some actual support for these programs.

CHAIRMAN SHER: Okay. Thank you very much for your testimony. Next witness is Karen Edson, representing Californians For Competitive Electricity. You can tell us who those Californians are and whether they indeed support all of some have called, "Social Programs" and are prepared to pay their fair share to support them.

KAREN EDSON: Mr. Chairman, Assemblyman Baca, I'm Karen Edson here representing California For Competitive Electricity. That group, Assemblyman Sher, includes not every Californian although we would like it to include every Californian, is made up of the California Manufacturers Association, the California Large Energy Consumers Association, the California League of Food Processors, the Independent Energy Producers Association, Destech Energy, El Paso Natural Gas and Wickland Oil Company. This is a group of power producers and consumers that came together in the belief that restructuring offered really a historic opportunity to the state of California to achieve much greater efficiency in the electricity sector.

Let me begin by in many ways responding. I feel a certain burden here as I think the only witness on the list who includes, has industrial consumers among the constituency. A certain obligation to respond to the impression, I'm afraid, that may have been left by earlier speakers and that is that somehow there's a jailbreak here, that there is this interest on the part of industrial consumers in California to escape their fair share of state program costs and stranded costs. As a matter of fact CCE, Californians For Competitive Electricity, took great care at the outset in the formation of their group to establish a set of principles that they would then apply in the evaluation of the competing proposals many of which you've heard described today. And among those principles are that all consumers must benefit in this process. That there must be equitable ways to make sure that all consumers reap the benefits as well as bear their fair share of the stranded costs that we're talking about.

Secondly, CCE has also come to grips with certain environmental principles and has taken the position that it supports mechanisms to ensure that a restructured market is consistent with energy conservation and environmental and renewable resources policies. This is a group that believes that California can lower its electric rates through restructuring and that restructuring should be measured against the following two main objectives: one is that you can achieve it through the following ways: one is that utility generation assets should be priced at market value and second that California should achieve vigorous competition in the generation market by (a) eliminating self dealings, and (b) giving consumers direct access to generation through nondiscriminatory cost base transmission rates.

Now recognize, these consumers are sophisticated consumers of power in California, they understand that there are stranded costs that will have to be digested, if you will. They take these positions in their long-term interests to bring competition to bear to the benefit of the entire state.

CHAIRMAN SHER: Let me just break in there because your organization includes the independent producers as well.

KAREN EDSON: Yes it does.

CHAIRMAN SHER: Nonutility producers some of which have called alternative energy suppliers...

KAREN EDSON: Yes.

CHAIRMAN SHER: So you disagree with the statement that our consultant, not disagree but you would disabuse him of any concern he's talking about stranded costs and one way to deal with it is what he calls, economists call an excise tax to pay for those and he has a sentence here on page thirteen, "Alternative suppliers of electricity, however, are likely to argue that in ESS that tax unfairly penalizes them for mistakes that the utilities and regulators have made in the past." You don't think you would make that argument. You'd think that as we go into this new era that all of the producers and their customers more particularly, should share in paying for the mistakes that the

utilities and the regulators have made in the past?

KAREN EDSON: CCE and all of its members recognize that QF contracts are among, portions of those contracts are among, the so-called stranded costs in this market. Their view is that those are indeed contracts subject to all of the same conditions and treatment as any other contract in that market and that they will be addressed in manners that flow from that.

CHAIRMAN SHER: And that all consumers will share in bearing whatever burden flows from that?

KAREN EDSON: Yes.

CHAIRMAN SHER: How about Diablo Canyon?

KAREN EDSON: Well, there will be clearly major stranded costs associated with nuclear plants and other utility assets and if you examine the CCE's principles you'll note that they take a position very similar to the one just articulated by Ms. Grueneich which is that there needs to be a sharing of costs between consumers and shareholders. That's not to say that consumers bear none of those costs.

CHAIRMAN SHER: Okay. Once that's decided though, once that certain part of it, whether it's 100%, if that's the decision or 70% that your organization's view is that your members should take their fair share whatever portion of it is assigned to consumers?

KAREN EDSON: Yes.

CHAIRMAN SHER: Good.

KAREN EDSON: And let me now, if this would be of use to you, speak to some of the competing proposals that...

CHAIRMAN SHER: Okay. That would be of use.

KAREN EDSON: As I mentioned at the outset, CCE supports direct access to the generation market by consumer interests, supports consumer choice in that fashion and its' belief in that has a number of aspects but one of the many reasons is that its critical in the competitive market, they have many sellers and many buyers. Now we know that there are many sellers in the generation market. People tend to talk about how, "Oh yes, we know now that there's competitive generation market. We've seen it." Just as important in the competitive market is having many sellers which is something that direct access may get for you.

Among the proposals that is now receiving the most attention is the Poolco proposal and various versions proposed by San Diego Gas and Electric and Southern California Edison. And we have a couple of significant concerns about that. One is establishing a pool through which all transactions move one way or another. It really forecloses market innovations which would work to the detriment in many ways of all consumers in California. For example, just

Monday of this week, PG&E announced that it has reached an agreement with DESTECH Power Systems, a major independent power producer to provide wholesale network access to their system. As this suggests, this transaction has occurred and is occurring really ahead of the restructuring that's underway and holds a promise of some very innovative kinds of transactions that might occur in the market if the state instead suggests that all transactions must be handled through a pool you foreclose that kind of market innovation.

Secondly, in forcing all the transactions through the pool, its also possible that you are stifling competition in terms of some of the service refinements that might otherwise be available. Some customers may want higher quality service than the system would normally provide and may be willing to pay more for that.

CHAIRMAN SHER: They could buy it separately, couldn't they?

KAREN EDSON: Well, it's not clear through the Poolco proposals whether that kind of mechanisms would materialize. Perhaps they would but its...

CHAIRMAN SHER: But the electrons are going to be funneled through some central mechanism whether its the pool or the utility or whatever...

KAREN EDSON: Yes.

CHAIRMAN SHER: I mean you're not going to have a direct line from the generator to the consumer.

KAREN EDSON: No. That's absolutely right and in fact, we believe that pools will be law. That you will have pools.

CHAIRMAN SHER: So the service has to do somehow with receiving the electricity, is that right, the setup at the consumers place of business?

KAREN EDSON: There may be physical equipment that's necessary to help support certain levels of service.

CHAIRMAN SHER: Yes. But I'd say why couldn't that be offered and sold directly, separately.

KAREN EDSON: Well, it's possible there'd be ways of doing that through Poolco but as I understand it Poolco envisions a mechanism which clears all generations through the pool at a single price.

CHAIRMAN SHER: Do you agree with Mr. Glynn from PG&E that the pool approach is not truly direct access?

KAREN EDSON: Yes.

CHAIRMAN SHER: And because you've got this melded price that you don't really have generators selling directly to the consumer at a price they negotiate where the consumer pays directly to...

KAREN EDSON: Right. And you don't allow this kind of service definition that I'm describing.

CHAIRMAN SHER: So the way it seems to line up now I see over here in one column that Edison and San Diego Gas and Electric, I got PG&E and the Californians For Competitive Electricity in this other column. Have I got that right?

KAREN EDSON: I suppose you can look at it at that level. I certainly am eager to tell you that CCE does not endorse PG&E's proposal in all its aspects and...

CHAIRMAN SHER: Some problems with the proposal.

KAREN EDSON: There are areas of agreement.

CHAIRMAN SHER: Okay. Well, you are going to tell us about it at some point.

KAREN EDSON: Well, I think the timing inherent in the PG&E proposal is one obvious problem we would have. But I just wanted to mention beginning with Poolco that there are some difficulties there and others that involve the pricing mechanism itself that I'm really not able to address very clearly for you but I think it merits further examination.

Second, with regard to the proposal Mr. Caldwell has put forward, I like many other observers find it quite intriguing. I think though that there are some important considerations about the state's ability to implement that and the possible implications this truly has to be a national kind of proposal. Keep in mind the Federal Energy Regulatory Commission has a longstanding policy of cost base transmission rates. The inherent and the sell off of the transmission system is a market based transmission rate and it's difficult for me to conceive of a system where you would have that in California but cost ... rates elsewhere so I think you set up a whole series of changes that are essential to actual implementation.

That really takes me through the substantive comments I wanted to make about the proposal. I just want to reiterate that there are long-term benefits that can be achieved in this market and really a tremendous opportunity for the state if the Public Utilities Commission and this Legislature can see clear to follow through with a very orderly process. We very much appreciate this hearing, having an orderly thoughtful process is really essential to any kind of satisfactory outcome in this and are looking now to the Commission to see some better definition of what process and mechanism they may have in mind. The order that was released this morning is something new to us that we're still examining. It's not clear to us that it provides the kind of definitive that I think would really help us bring some better kind of order to the debate.

CHAIRMAN SHER: Do you have a prediction on how soon we'll see a proposal crafted by the Public Utility Commission for restructuring? Do you want to give me a date?

KAREN EDSON: Can I give you a decade?

CHAIRMAN SHER: Sure, I mean if its a decade...

KAREN EDSON: Well, my experience has been that the Public Utilities Commission does not move swiftly. My hope is that you can keep this proceeding on track. In fact, timeliness is one of the most important things that, I think, needs to be achieved. We've not seen timely decision-making from the California Public Utilities Commission in a variety of areas that I hesitate to get into here.

CHAIRMAN SHER: So you're telling us we should needle the Commission to move faster?

KAREN EDSON: Absolutely.

CHAIRMAN SHER: Okay. Thank you for your testimony. All right, the next witness is Mr. Ed Texeira, who is the director of the Division of Ratepayer Advocates from the California Public Utilities Commission. Welcome.

ED TEXEIRA: Thank you. I'll be brief. I understand the time constraints that you have. I'd like to make three points only.

First of all, we believe that the Bluebook is an incredibly valuable document. It started a fantastic dialogue. At least it started a dialogue and there are not many people who agree with it completely but it has something I believe for everyone.

CHAIRMAN SHER: Speaking for myself I'm prepared here in public, to stipulate that so that each witness doesn't have to say what a great thing the PUC did and it... Okay.

ED TEXEIRA: Well, just to say one thing. One thing it did do, it did focus the debate on reducing electric rates and that was an incredibly valuable contribution because that was not the policy in California before that document.

Second, on PBR's. We believe that PBR's will provide a more effective tool for regulating utilities than the traditional cost of service regulation. And further, you made a request on what the various PBR's, outlines of them. We'll be glad to provide your committee within a week or ten days of an outline of the various proposals including kind of an overview of what PBR's are.

CHAIRMAN SHER: I would appreciate that and I be more appreciative if it shows what PG&E and Edison say should be the targets, the benchmarks against which they will be judged because from my limited exposure to this. I hear that the debate's going to center around not so much whether this is a good idea, I think people generally agree that it is, but the real debate is where do you set the benchmarks so that you know how much the investors profit from exceeding the benchmarks and how much the ratepayers do.

ED TEXEIRA: Certainly. We'll present their proposals and then we'll have a little analysis of it to answer your question. You would not be able to get that from just looking at the proposal so we'll give you a brief analysis with it and we think we can do it within five or six pages probably.

CHAIRMAN SHER: Good. For each one?

ED TEXEIRA: No. No. In total. This will be an overview and a summary rather than a detail...

CHAIRMAN SHER: But, I mean, won't it be different for the two utilities? Are their proposals for PBR identical?

ED TEXEIRA: There are similarities and there are differences. There probably are more similarities than differences. And we'll also show you the San Diego proposals, the original, our proposal, the Commission's, etc. We will try and present something comprehensive but in an overview basis rather than in great detail, if that's the desire of the committee.

CHAIRMAN SHER: That's fine. I would appreciate that.

ED TEXEIRA: Finally, on transition costs. It is clear that transition costs should be shared by all ratepayers. I believe before this committee last May, the question was posed of me, "What percentage should the shareholders pay of the transition costs?" I believe I responded somewhere between zero and fifty percent. I was unwilling to be more precise than that.

Along these lines now and there was a little bit of criticism from two witnesses ahead of me on the Edison settlement that we have partially completed. And the point of our settlement with Edison on the SONGS, transition costs, if you can phrase it that way, was that it was important that there be some shareholder contribution to the SONGS, transition costs. And that is why we were willing to end as a settlement. If you want an estimate, there is controversy on what the estimate would be, our estimate of what the Edison shareholder hit would be would be somewhere between ten and fifteen percent.

CHAIRMAN SHER: Let's pause for a minute on that. You call it a settlement to deal with the transition costs. That assumes that we are going to transition to something new. This is really Edison getting ready for the restructuring, is that right?

ED TEXEIRA: Yes.

CHAIRMAN SHER: And trying to deal with their own stranded investment by making it less in the near term by writing this down faster.

ED TEXEIRA: Yes.

CHAIRMAN SHER: And in order, by writing it down faster, that would have had an adverse affect on rates and to compensate for that they decided to eliminate some other programs that had costs so that it would balance out in

its impact on rates, is that right?

ED TEXIERA: There were separate pieces in the arrangement. The SONGS arrangement, because of other things that were happening, would not have resulted in a ratepayer increase. In addition to that...

CHAIRMAN SHER: You mean accelerated amortization of the costs so that that had been by itself there would have been no impact in the coming year, or two years, on rates?

ED TEXIERA: Because there were other things happening at the same time.

CHAIRMAN SHER: Happening independent of anything that was part of the settlement?

ED TEXIERA: Yes.

CHAIRMAN SHER: So why did they need to scrape these other programs that some people say were sacrificed on the alter of whatever?

ED TEXIERA: This is separate from the DSM question. This was the ACRA and the SONGS 1 amortizations that are taking place. Two of them are separable.

CHAIRMAN SHER: How about the general point that the previous witness made that this is really, it's transition to what we're talking about here, introducing competition restructuring. Is it a mistake to start dealing with that piece of it through this proceeding in isolation from what the whole general restructuring is going to be as ordered by the PUC.

ED TEXIERA: In a perfect world, it would be better to handle the transition costs not on a piecemeal basis. The world is not perfect and we wanted the precedent of principle established that the shareholders would participate. The Commission's Bluebook did not give us any comfort on shareholder participation and we wanted the precedent established.

CHAIRMAN SHER: So your participation for the Division of Ratepayer Advocates, you were scared by the Bluebook too?

ED TEXIERA: We love the Bluebook. We could not predict how the Commission is going to respond and would act when push came to shove.

CHAIRMAN SHER: Okay. I think that we've gone as far as we can with that question. I appreciate your testimony. Thank you for being here today. Have you anything further?

ED TEXIERA: No. That's all.

CHAIRMAN SHER: Okay.

ED TEXIERA: Thank you very much.

CHAIRMAN SHER: Okay. Our final witness from the consumer end of this is Jerry Bloom from the SPURR, School Project for Utility Rate Reduction, and he's cloned himself. There are four of them. Do all of you want to talk? Who's the spokesperson? You're going to speak for the group? Okay. Five minutes.

JERRY BLOOM: Good afternoon. My name is Jerry Bloom. I am appearing this afternoon on behalf of consumers. Specifically, I'm joined by Dr. James R. Solberg, who's managing director of School Project for Utility Rate Reduction. SPURR represents 150 school districts in California. He is also here on behalf of the regional energy management coalition who represents an additional 180 school districts. Together these districts provide educational services to 2.3 million students in the kindergarten through the twelfth grade. I'm also joined on my right by Mr. Neil Carmen, assistant vice president of the Center of Health Resources which is a subsidiary of the Hospital Council of Southern California. Together with the Hospital Council and northern and central California, the Hospital Council of Southern California represents 450 hospitals, health care facilities, and medical clinics. These consumers appear before you this afternoon to stress the absolutely critical need to lower costs of electric services to all California consumers. There doesn't seem to be any doubt on anything we've heard today on that point. Although you may have traditionally heard from the industrial community we are here to tell you that schools and hospitals are suffering from a high cost of electricity and these high costs have an adverse impact on their ability to offer health care and educational services. For example, California public schools pay over 300 million dollars annually for their electric power, a 25% reduction in energy costs equal to 75 million dollars would allow the public schools to hire 2,640 new teachers. The California hospitals pay approximately 250 million dollars annually for their electric power. A 25% reduction for them would allow them to hire 1,240 new nurses.

I'm also appearing this afternoon on behalf of Jefferson Electric, who through partnership with these consumer organizations will provide customized electric service at a lower cost. Given the opportunity through restructuring Jefferson intends to provide customized service to industrial, commercial and to residential customers. While it is acceptable that large industrial customers will benefit from competition, residential, commercial and the small industrial customers must also benefit. As recognized by the Legislature in ACR 143, the high rates are a contributing factor to the economic problems in the state. While some claim, and you've heard it this morning, that the issue is really total cost and not rates, it simple is not true for people who use a lot of electricity. They use a lot of electricity and the rates are high. They are suffering and what we have to do is simply lower the rates. The CPU has initiated the Bluebook and let it be clear that we applaud their leadership and their efforts.

CHAIRMAN SHER: They stipulate that. You didn't have to say that.

JERRY BLOOM: Right.

CHAIRMAN SHER: Okay.

JERRY BLOOM: While one of the critical things in the debate seems to be

not shall we have change, shall we bring competition, but how to do it. We'd like to offer you today a model for you to consider. This model which is now shown on the screen shows: 1) that the competition is the mechanism for change that will lower rates for all consumers. The question is what type of model. You've heard a lot today about PoolCo verses direct access. The hospitals and the schools believe that we have to have competition at both the wholesale and the retail level for the benefits of competitions to reach hospitals, schools and the residential consumer. Specifically, with a PoolCo only approach there will be no guarantees that a benefits of competition, in fact, will trickle down to these other customer classes. Our diagram specifically isolates a merchant function which will be performed by service providers. This competitive service will provide hospitals and schools with services that are unavailable in a PoolCo system.

CHAIRMAN SHER: I'm just going to interrupt because then I won't have to go back to it. They argue that, for example, that in the pool suppose in a given period the average rate in the pool is 8 cents a kilowatt hour. They argue there would be nothing to prevent through the hospitals or schools going directly to a power supplier and entering into a contract for 5 cents a kilowatt hour and that while they would pay 8 cents into the pool they would be reimbursed 3 cents from their contracting party. Why couldn't that work?

JERRY BLOOM: I guess the question we would ask is what their talking about are contracts for differences and if you could have a direct contract between the consumer and the seller of the commodity whether they can establish the terms and conditions, why set up a system that forces them...

CHAIRMAN SHER: Well, you say why do it but they say their reasons for doing it and you can have these direct bilateral contracts where you can go out and find the best deal possible.

JERRY BLOOM: I think the key reason for not doing it just through a PoolCo is that it blocks the innovation that can occur when the buyer and the seller can establish their own mechanisms, their own prices, their own types of service they want by having a direct contract.

CHAIRMAN SHER: You mean you buy more than just the electrons in the price?

JERRY BLOOM: Absolutely. And you stifle the innovation as the prior speaker talked about even just the PG&E and DASTEC agreement. What you do is you stifle the competition if you would force everyone to buy out of a pool at pool terms...

CHAIRMAN SHER: How do you like the PG&E plan?

JERRY BLOOM: We also, in terms of direct access, we are firmly in support of direct access. In terms of the plan there are specifics as well, such as the timetable that we would disagree with; however, we clearly are in favor of the direct access approach.

CHAIRMAN SHER: So its much like the previous witness we just heard,

Californian For Competitive Economy. So we'd put you in the PG&E column as a subset, that you like the plan with direct access but speed it up.

JERRY BLOOM: Yes. But we also have a few twists of our own to add to that.

CHAIRMAN SHER: It makes us very hard for us up here, all these twists, but go ahead.

JERRY BLOOM: One of the things that I was just discussing with you is the fact that we wanted to highlight which you have not heard from others is this merchant function and it goes to your questions a moment ago on the pool idea. Because of this merchant function, by providing the direct access, you can have information services, sales functions, things like DSM and other programs, that can be factored in in terms of customizing programs that would be in service that would be offered directly to the customers.

CHAIRMAN SHER: Well, let me ask you about that as long as you bring it up. That's DMS services if the customer wants it. Right?

JERRY BLOOM: That's right.

CHAIRMAN SHER: Suppose the Legislature wants DSM for everybody. Would these direct access people pay their share for that?

JERRY BLOOM: Yes. I think..

CHAIRMAN SHER: Under your plan?

JERRY BLOOM: Yes. Not only would they pay that share, but we think as you said this morning we don't want to use the "T" word but if we talk about sir charges and things, it's a real misnomer to say and we think it's incorrect to say that you can only cover social programs, environmental concerns and things through a centralized wholesale power market. In fact, it would be our position through competition if we get away from, for example, funding DSM programs on a cost basis as we are now and put a competitive market into the offering their services, will not offer the same services, will offer better services and we'll be able to offer their services at a lower cost. There's no reason why if competition helps the generation sector and helps in the other types of functions of different sectors, that it won't help them providing DSM and social programs. What we have now is a flowthrough of those costs with no way or no incentives to do them effectively or efficiently.

CHAIRMAN SHER: Competition for DSM as well as for generating?

JERRY BLOOM: Absolutely. The next thing we'd like to point out is that, and it goes right to the point you were making is that we have to look at stranded costs and you've heard a lot about stranded costs this morning and anticipating your question would we agree that the stranded costs are a problem? Yes. Do we believe that they have to be absorbed and spread throughout and equitably shared? The answer is yes, of course, as well. What we are worried about is that we have this bugaboo that says we've got stranded

costs and there so large and they're so uncontrollable that we can't go forward with the program. We do think there's costs. We do think these are very difficult issues, but we need to identify them, identify them carefully and correctly and move on with the program. The big thing is to get the ball rolling and to keep things moving ahead in terms of dealing with those issues.

We do believe that California is at a critical crossroads. It cannot afford to delay the implementation process. If we move cautiously and carefully, we will get there. We're not going to get everything correct. We're not going to answer every single question. More importantly, we can't get into endless debates trying to decide what the market will or will not do. If there's one thing we've learned with the other industries that we've deregulated, gas, telephone, any of them, is that whatever we think is going to happen we're going to forecast it wrong, we're going to project it wrong. Let's get together, let's work together with the Legislature and the PUC and the California Energy Commission and set up a program and start implementing it and see where we go.

In terms of there's been a lot of questions today about what do we do in terms of the very near term. We do have a position on that and that is that the Commission should issue some type of policy decision that shows us and starts limiting the debate, focusing the debate, I think would be a better term for it. We need to start having some decision-making that starts directing the proposals. We need to get on with the stranded costs and unbundling investigations that were, in fact, developed in the Bluebook proposal but we also can't wait and hold back on the initial policy statements or some of the policy determination until all these investigations are completed. That process will not only lead to as others have feared, some difficult or task in terms of, for example, looking at stranded costs. If you look at, are we talking about a five-year phase and are we talking all customers, or are we talking certain customers. That will influence what types of stranded costs and what we're looking at so we need some direction and some focus in terms of the debate. That can come through some directives from the Commission. It may not even need to be a final decision.

CHAIRMAN SHER: What I hear you saying is, "Let's get on with it. Let's trust the market." But at the same time you tell us that every time we've tried to predict or how it was going to come out we've been wrong every time and of course, what California's being asked to do is to abandon a traditional way of setting rates and supplying electric services and so it's kind of a dramatic change that's being proposed here and you say we don't know what we're going to get. We can't know, we've guessed wrong every time.

JERRY BLOOM: I think you've hit on a very astute nuance. That's exactly the point. Instead of having the regulators and the Legislators trying to figure out and predict what the market will do and probably guessing wrong, we have to have the confidence to let the market start making determinations. Let the market determine if we need a pool. If a pool develops naturally in the marketplace, bravo! But don't have a regulatory established pool. If the market sets up aggregation and customers and provides the types of services, what we don't want to say is that we have to figure it out and try to legislate and regulate ourselves into a marketplace.

CHAIRMAN SHER: Your pillar of faith though is the market. Trust the market and it will all come out okay.

JERRY BLOOM: With appropriate guidance and oversight by the Legislature and the PUC. That's correct.

CHAIRMAN SHER: You're a very good witness. Said all the right things. Thank you very much. Thank you all. Is that it? Yes, I think... five minutes so I'm going to call it it. Thank you very much. Well, that completes customer perspectives. Now we're going to invite two witnesses who represent non-utility generator perspectives, although, in a sense we already heard from one through that group through those who have joined Californians For Competitive Electricity, but now we're going to get them directly. I guess John White, are you going to go first or Jan? Did you, you're on the agenda first John, so we'll start with John White, Executive Director of CERT, Center For Energy Efficiency and Renewable Technology.

JOHN WHITE: Thank you for having us here today and thank you for having this committee and thank you for having ACR 143. And I thank you for getting the PUC to launch this investigation of stranded costs which we think despite the rhetoric in the letter is a very important development.

One of our concerns, quite apart from all of the points that have been made today, is that whether this is now a staff proposal or not, this is a proposal that has already had a very, very large negative impact quite apart from all the academic and consulting expertise that has now been deployed in California. In the near term, we have lost momentum in some very crucial areas. So I think it's important that as we try to develop a response that we recognize we've already had some assumptions begin to take hold and one of the reasons we supported the motion or introduced the motion on the stranded costs is because the piecemeal approach to restructuring potentially is devastating as one grand blue or purple or yellow book. In the near term, the utilities are slashing DSM budgets quite apart from the rhetoric that says they still support it and think it's important. We are seeing, in specifically the Edison rate case, proposals for major cuts in DSM, major cuts in research and development, people getting laid off already. We've also got loss of low-income programs. We think that's the wrong signal to send given the track record of these programs, particularly DSM.

Our group includes both environmental interests, environmental groups, energy efficiency providers and renewable technology developers. And in unrelated proceedings such as the DRPU we are seeing a continued loss of momentum, a loss in new markets that otherwise had been found to be cost-effective and needed and beneficial to the ratepayers and every single proceeding before the Commission and before this body. And yet, no action is taken. So what we have is the markets for renewables drying up in California, new markets, people going overseas, DSM losing momentum. Whether or not this particular proposal goes forward, these are things that have happened and are happening so one of our biggest concerns has been the cart before the horse mentality that seems to, up til now, have pervaded the Commission's deliberations of having the policy be adopted before the answers and the evidence is in as to what the

implications of the policy will mean, both from the standpoint of equity as well as from the standpoint of protecting the states policy interest.

I think that we've heard from the parties' general support as Ms. Edson said, for the principle for renewables and DSM being included in the new structure. On the other hand, we already have some pretty good examples of what works. I think SMUD's programs from a supply and demand side, remain a model of how to go about acquiring resources and what resources to acquire. We think that in any pool or any market mechanism that has developed there has got to be a way for things other than price, short-term price to be factored in and one of the things that we are hopeful of this committee doing, is to insure that whatever parachute is strapped on the back of renewables and efficiency interests before we jump out of the plane, we need to be sure that parachute's going to open and that in fact there's going to be renewables actually result in the portfolio of the California supply system.

Dr. Borenstein's presentation this morning mentioned strategic differences and assets within regions. I would argue that for California we have a special base of resources this state that offer not only the opportunity for economic development and clean environmental benefits from our substantial efficiency programs we already have and our substantial renewable resources that we have available to be deployed. These technologies not only are assets to our ratepayers, but they are assets to our strategic economic future. The whole world is watching California with respect to restructuring. They used to watch us with respect to renewables and DSM. I think the job of this committee is to insure that whatever restructuring occurs that, in fact, these strategic technologies find a place and that at the same time some of the other witnesses that have spoken about the importance of equity considerations between and among customers be essential and I for one think that the Legislature's role in this process is crucial. I also think that it's important that we maintain some diligence with respect to the evidence that people are throwing around. One other thing that is supposed to be a casualty of restructuring as Integrated Resource Planning. As a lot of the academic experts say, "Well, we won't need that anymore because the market is going to decide everything and all we have to do is create either bilateral markets or pools and we will have enough of certainty and enough rationality in the market and what I would caution you is that Integrated Resource Planning, where we look at the life cycle costs to society as well as to the ratepayers, has proven very valuable at giving discipline and transparency to the assertions of what's cheap and what's expensive and what pollutes and what does not and I don't know what mechanism necessarily would come forth with respect to restructuring in this regard. All I know is that the results of knowing what things cost and who's going to bear the risk and what things cost over not just the first year when the price of gas is low but over the thirty-year life span of some of these projects that somehow we've got to find a way to include that in any new structure and I think that one of the things that I hope that the committee can do is maintain its oversight of this process. I think the role that has been played up to now at focusing the debate and getting the criteria, the design criteria I think you spoke of, that I think is something that's going to need to continue.

I also think that we need to be mindful of the many other related perceivings

that are going on outside the restructuring debate such as PBR, such as the cost recovery, such as these cuts in DSM programs and the BRPU and look at all of them at the same time because essentially we could have a virtual restructuring and an implicit abandonment of the policies that I think all of us share at a rhetorical level. The question is whether we can maintain those policies in practical level. Thank you.

CHAIRMAN SHER: ...comment and get your reaction. I mean your giving this committee a rather formidable assignment. You want us to be the oversight committee for everything that's going on at the PUC. I know that President Fessler would not welcome that.

JOHN WHITE: I think that just merely providing another venue and an opportunity for evidence to be presented and views to be shared. I'm not saying that you need to do their job for them. But I do think there is a role for the Legislature to play, both with respect to the policies under which this restructuring occurs and ultimately the institutional restructure of the implementation of restructure.

CHAIRMAN SHER: I'm kind of floundering around about how we can best play the role that you think we ought to play and you know, we propose and enact laws and I've had enough experience to know that when you're dealing with another agency like the PUC that we can say do a "Thou Shalt Not" law. You shall not do this unless it has these features but it's very difficult to write those requirements into the law in a way that you can have any comfort level that they're going to do what you intended them to do. I mean, I tried to do it in some other areas such as, as you know, something called reclaim and you write the language and get it through the Legislature but then will it be applied by the other body in a way that carries out what you were trying to get at.

JOHN WHITE: I think you shouldn't underestimate the influence you've already had on the proceeding. I know sometimes a Resolution is often thought of as not as big a deal as a statute but in this case, because you embodied the concerns of so many of the parties and gave a signal, I think you had an important effect. The other example I would give rather than reclaim is maybe the work that Senator Rosenthal did with respect to the merger, the proposed merger with Southern California Edison in San Diego where I think the statutory requirements bore significantly on the ultimate outlook.

CHAIRMAN SHER: I don't like that analogy particularly because, you know, we know what the outcome was there and I don't want anybody to think that what we're about here in this committee is designed to kill anything and...

JOHN WHITE: Let me make clear that one of my concerns is that we not have an endless transition because in the meantime, renewables and DSM are losing faster than anybody else, so...

CHAIRMAN SHER: So for that reason you want to move ahead.

JOHN WHITE: I think providing a mechanism for the parties to come together and put cards on the table and ask tough questions, answer tough

questions, is a very salutary effort. And I think the PUC is actually beginning to borrow some of those techniques and beginning to look for not so much a winners and losers scenario is something that might actually have some ability to bring people together.

CHAIRMAN SHER: And you think that what we saw happen last night with this evidentiary hearing on stranded costs is calculated to let all the people put their cards on the table and bring them together?

JOHN WHITE: Certainly it's better than doing it a piece at a time and I think there still needs to be some recognition of organic relationship between the Legislature and the PUC with respect to policy. I think that's beginning to happen.

CHAIRMAN SHER: Okay. Jan Smutny-Jones.

JAN SMUTNY-JONES: Thank you Chairman Sher. I'm Jan Smutny-Jones from the Independent Energy Producers and we are happy to be here today. Obviously independent energy producers in this state are a significant component in the electricity market. We provide about 60,000 jobs that have been retained in this state as a result of the 14 billion dollars worth of investment in independent power in this state over the last decade so obviously, we believe that independent power is, in fact, the competition.

About 11 months ago we had a biannual resource competitive auction which led to bids of projects cost between four and five cents and whether or not the benefits of that cheap power become in the future is directly related to what the Public Utilities Commission ultimately does and decisions that this Legislature makes with respect to the future of the industry.

The reasons that we are in the fifth year of a biannual process at the PUC has to do with the fact that the process as we know it now is broken. That we have a problem, basically a conflict of trying to put monopolies into a competitive world and it just doesn't work. We believe that the Commission has obviously opened up an opportunity for us to try to change that paradigm and that's really what's important.

I want to answer one question first since it was an issue that was raised earlier and it was also raised by your expert earlier this morning. IEP does not deny that some of the contracts are currently about what is identified as current market price. The interim standard offer for contracts which were developed in the early and mid '80's were, in fact, based upon utility oil forecasts of where oil is going over the next ten years. At that time, which was directly related to Senator Leonard's question about 40% of the state's power was being produced by oil. If you will recall in the early '80's, we were just coming off of our second middle eastern oil crisis and oil was very, very high. The interim standard offer for contracts, as you can see by this chart, have already begun to fall off and by the year 2002 are in essence gone. So this is, in fact, the self-correcting problem and, I think, one that does not really warrant any additional activity on the part of the Public Utilities Commission and certainly not the Legislature.

Also, to sort of put something in perspective here because I think it's important, in the fourth quarter of 1984 a short-run avoided cost in the PG&E service territory was 7.2 cents. Okay. This month in PG&E service territory short-run avoided cost is 1.6 cents. So there has been a significant drop in short-run avoided cost and I'm not saying we agree with that 1.6 cent number as the correct one but it is clear that avoided costs have dropped over time.

One last issue with respect to this. There are, in essence, two generic types contracts out there. One is the fixed-price contracts which we referred to earlier. The other a variable price contract which basically flooded the market. Now Edison is also involved in that market. They have about 11 hundred megawatts worth of contracts associated with their Mission Energy projects which are currently being paid a rate probably somewhere in the area of three and a half to four cents. That's just not Mission projects, that's the variable price contracts throughout the state so while there are obviously in the power purchase contracts are a component of higher rates, we would obviously firmly disagree that we are the principle cause of high rates in California. And certainly we would agree with Mr. Foster's analysis that the wholesale obligation of contracts would be foolish public policy.

Moving on in terms of what we see as the key issue here and that is regardless of what type of ultimate structure the PUC is able to come up with is that it precludes self dealings and cross subsidies. And that to us is really the good key problem. As I indicated earlier, we currently have an existing utility structure which has three components, generation, transmission and distribution. Certainly one of those functions, degeneration function, certainly susceptible to competition. I don't think it's really a competitive market now because I think of some of the defects we have in terms of trying to put this monopoly structure in the competitive market. So I think it's extremely important that the PUC, and to the extent that it is appropriate, the Legislature, move incentives forward basically to spin off generation assets from the transmission and distribution assets. Transmission and distribution from our viewpoint will always remain a monopoly. I don't think it makes a lot of sense that we don't see a lot of people clamoring to want to build wires all over California and that's probably appropriate. But we believe that the generation sector ought to be spun off and that ultimately the distribution utility or those on the distribution end should be economically indifferent to the source of the electron?

This is one of the principle reasons why IEP is not currently supporting Poolco because Poolco does not basically disaggregate that function. Utilities still remain on three sides of the transaction. They're generating, they're transmitting...

CHAIRMAN SHER: I was told recently that that's unavoidable in the San Diego service area now because of the constraints on transmission something to the effect of 3200 megawatts need there and the pool can only bring in on transmission 2000 megawatts so at least for some period of time, unless somebody's going to build some more transmission lines for their 1200 megawatts. Are you saying, you'll go in there and build them in the San Diego basin?

JAN SMUTNY-JONES: I have several of my members who have been trying very hard and SDG&E's been trying very hard to stop them from building generation in the San Diego area so they can sell power to San Diego. We would love that opportunity. I think the other problem we have here is that we don't allow, Mr. Foster I think earlier indicated that a lot of what goes on in the transmission system is driven by physics and we don't expect the Legislature to enact a law that...

CHAIRMAN SHER: Would you agree that you could not transmit from outside the area 3200 megawatts into San Diego?

JAN SMUTNY-JONES: I don't know that to be the case. What I do know is that there are opportunities in San Diego right now. I have two members right now with projects proposed to build in San Diego which would not require transmission lines from anywhere and we've had a very difficult time getting San Diego to enthusiastically open their arms and accept this power and a lot of that has to do with the current structure of the utility, frankly.

CHAIRMAN SHER: Well all I'm saying whether it's the utility itself or your members who build this 1200 that have to be local. They would have a heck of a leverage with the pool if you can't bring in the full 3200 from outside you've got to get 1200 whether it's your members 1200 or the utilities they have pretty good market power.

JAN SMUTNY-JONES: They would have pretty good market power and I think what that also suggests is an issue that is really not looked at in the discussion of Poolco in that in order to insure that there is not some sort of market power developing either in that set of circumstances or some other. You will need to superimpose some sort of regulatory process over that. And I think one of the questions we need to ask ourselves and you as a legislator specifically need to ask is, does basically supplanting the existing PUC regulatory structure with basically a regulatory structure that would be dominated by the Federal Energy Regulatory Commission, is that necessarily in anybody's best interest and the answer from my way of thinking is probably no. I think the problem we have I think is Poolco right now has sort of taken a life of its own and people are assuming that it really is sort of a panacea for a lot of complicated problems out there. The real problem that it does not resolve, however, is it does not really functionally disaggregate the utility. So ultimately the purchaser of the electron, the utility purchaser of the electron, is not economically indifferent as to the source of that electron and that it will ultimately matter a lot to that distribution utility as to whether that electron came from it, generation resource, or whether it came from one of my members. And that's the concern there, in the long run...

CHAIRMAN SHER: So your not, IEP is not in the Poolco column.

JAN SMUTNY-JONES: We are not in the Poolco column.

CHAIRMAN SHER: Are you in the PG&E column?

JAN SMUTNY-JONES: We have some difficulties with PG&E, obviously everyone's raised some questions with respect specifically to the climbing of

the PG&E direct access issue. We will be happy to supply some of our comments in terms of how we would see direct access working which is different than PG&E's to the committee, if that would be of some use. We are also...

CHAIRMAN SHER: We're looking for all these models out here and it's kind of like pulling teeth to get them so I can have my two or three or four that I can share with the committee and then we can look at the implications of each...

JAN SMUTNY-JONES: Well, they're kind of like a virus. They do sort of mutate very, very quickly so whatever you get one day may look very different. I think the other model that was spoken on today was the Newco which was Mr. Caldwell's model which we are also looking at with interest based upon the fact that it does have the effect of separating out the generation allowing that to be competitive from the transmission and distribution functions which we think obviously is the key issue there.

I also want to underline something that Mr. White said earlier and that is the importance of trying to get some stability put back into the system. I know that this committee has been informed in the past about the effect of the Bluebook upon utility stocks. My members, too, have been hit by the level of uncertainty. Obviously my members sell into competitive markets and to the extent that this issue remains uncertain out here it does lead to, the market's pretty suspicious about what they should or should not be doing in California. So I think it's important that we get on with some of the hard work ahead of us in terms of actually trying to create a new paradigm out there for utilities and we do it quickly rather than stretching it out over 5, 6, 10 years which has unfortunately been our experience in the past.

CHAIRMAN SHER: So we should needle the PUC to do the right thing by June 30th, 1995, is that your recommendation?

JAN SMUTNY-JONES: I would needle them to do the right thing by then, yes.

CHAIRMAN SHER: Is that date realistic?

JAN SMUTNY-JONES: As you recall I said I'm in the fifth year of a biennial process so I'm highly suspicious as to any dates certain here but I certainly think that what the Commission could do in the relatively near future is give the parties clear indications of which direction it's going to go. I happen to believe that if the Commission decided tomorrow that they were going to do the Bluebook as it's written, I frankly don't think that will happen, but if they were going to do that as written, it would entail probably a whole series of different evidentiary hearings to specifically work out some nuts and bolts issues like how do you unbundle services, how do you identify stranded assets, all kinds...

CHAIRMAN SHER: Yes, well that's fine. But I mean just the chemistry... I'm looking for the date when we should realistically give us the general proposal.

JAN SMUTNY-JONES: I think June '95 should be doable.

CHAIRMAN SHER: Okay, we'll shoot for it.

JAN SMUTNY-JONES: Thank you.

CHAIRMAN SHER: Thank you. All right. Next group of witnesses. Thank you for your testimony, both of you. On the agenda it's called The Environmental Perspectives. We're going to broaden that to the Environmental and Labor Perspectives and we have first Daniel Kirshner, from the Environmental Defense Fund. We're also going to hear from David Goldstein, from NRDC and then Ray Sanborn, Chairman of the Coalition of the Utility Employees. That's this group and we're making progress. I'm going to ask the sergeant, "Do you have a pad of paper over there for anyone who is not listed on the agenda who is going to want to give a very brief statement at the end of the process to let them sign your pad and then I can decide how much time each one can have." Mr. Kirshner.

DANIEL KIRSHNER: Good afternoon. I'm Dan Kirshner. I'm senior Economic Analyst with the Environmental Defense Fund.

First, I want to express the apologies of my colleagues, Tom Graff and John Krautkraemer, who are unable to be here today.

At the outset, I want to make it clear that The Environmental Defense Fund is in favor of reform and in favor of increased competition. We see environmental and economic benefits possible in this. We also think there's a lot of agreement out here about what has to happen in order to get there from here. That way, if we have to have a broadly acceptable deal, it has to be fair and we have to maintain environmental protection. I think those are some of the elements that just have to get across if we're going to get anywhere with this stuff. I'm pleased that you've heard mentioned of some of these issues of fairness in environmental protection from other groups such as the large customer representatives, Dian Grueneich, representing the state as a customer and Karen Edson, representing the Coalition for Competitive Electricity.

With respect to these environmental and energy efficiency goals they're for a large part legislatively mandated and that I think there's a broad agreement with regard to these goals.

Let me try to be a little bit more specific than I was in my prefiled written comments. As Dr. Borenstein said this morning under price competition, the incentives are to sacrifice spending on DSM as the utilities currently are doing. For example, under the pressure of current events PG&E has pledged a rate cap and right now environmental energy efficiency programs and outside management measures are in the same box with Diablo Canyon. That is, they're trying to hold the rates and they're trying to protect stranded investments and one of the sacrifices to be made right now happens to be DSM on the cutting block. Investments and energy efficiency shouldn't be in this box and they don't have to be and we don't need new Legislation and we don't need to say the "T" word or anything like that. What we need is something out of the CPUC to do something about this. So what we need to do is get through this transition. Right now we're in another land. We're stuck here waiting for something to

happen and I think there's everything to be said for getting them moved along a little bit, at least on a policy direction. Something that would make it clear that what's happening right now is not acceptable. Now, this is where direction can help. Maybe it's part of their plan. They say straight out, "We are going to maintain these mandates. We're not here to destroy the DSM program," but in the meantime they are going downhill. I think it would behoove them and us to get something on the table sooner rather than later and I think we don't need to have huge investigations but at least something to give us some idea. I think the Bluebook has been put up for discussion. There have been plenty of comments that there are certain things in there that are going to work or aren't going to work. There is some indication from the Commissioners of things that they're thinking are going to work and aren't going to work and we need to hear from them. Where are we going now? As I say and I think that I echo what John White said, "As long as we're in this transition it's not really serving any of us."

CHAIRMAN SHER: You know, that would suggest to me that we shouldn't have got in their way. We should have let them, in August, come out with their proposal, their vision and then you could have responded, you know, then that at least says where they're heading and you can say, "Don't forget DSM," and that ought to be factored in. Was it a mistake to slow them down and have them hold these hearings around the state on the Bluebook?

DANIEL KIRSHNER: I don't think, it's certainly not a mistake. I think they slowed themselves down well enough, I mean, they don't need any extra help. I think their original schedule is clearly unrealistic. I thank the Legislature for making that 100% clear to them.

CHAIRMAN SHER: Do I presume the 1995 date is the target or is that too late?

DANIEL KIRSHNER: I missed what that was about.

CHAIRMAN SHER: Well, we were trying, what we should be looking to see President Fessler talks about crafting the draft proposal recognizing they'll be a lot of nuts and bolts and hearings afterwards but what would be your view as to the target date for that crafted proposal being promulgated not as a final order but at least as a draft order?

DANIEL KIRSHNER: I don't know how soon we can get to a craft proposal. I'm thinking of something more interim, just some idea of... Do I still have to fight about DSM or are we in agreement?

CHAIRMAN SHER: Well, they're not going to spin off that and deal with that up front. They're going to talk about Poolco's and retail wheeling up front and then we're going to talk about, "How do you deal with stranded investments? How do you insure diversity? How do you deal with the environmental questions?"

DANIEL KIRSHNER: You hear a lot of people not talking about Poolco verses bilateral contracts. I mean, that's a side issue. When we get to competition, I think we can agree on that but we want to know what's going to happen. How

are we going to preserve fairness? I mean, if...

CHAIRMAN SHER: They should set aside how they're going to achieve competition, set that aside you are saying, is that right? And their main focus now should be how are you going to preserve DSM?

DANIEL KIRSHNER: Well, we're not going to be able to cut aside any of it. Essentially, I'm not on one side or the other on Poolco direct access and I don't think they are either, but I'd like to know.

CHAIRMAN SHER: I think I heard your message and I'm sure it fits in with the way I see this thing unfolding but what role do you think this committee has on what you would like to see? What could we do fast that would be useful? You say, there is a limbo out there or vacuum and it ought to be filled. What would you have this committee and the Legislature do now in the month of January and the month of February, 1995, when we're back in session?

DANIEL KIRSHNER: I'm going to overstep my bounds as to what anything I know about here but what I'd like to see and I don't know if it's in your power to do that, I'd like to see you have them outline where they're going and I'd like to see you provide direction if there is something missing from that outline that's important to the Legislature, let them know now. Then let them craft something more detailed that meets our requirements.

CHAIRMAN SHER: I guess I don't understand what it would, when you say where they're going, what that encompasses.

DANIEL KIRSHNER: Well, if I read the Bluebook carefully, what it says is DSM, the market will take care of it.

CHAIRMAN SHER: Yes, that's right. But what it really says is retail wheeling and performance based ratemaking. That's what it says and then they talk about what will happen to these workers and they say they're also concerned about preserving energy conservation programs, etc., etc., but they don't tell you how they're going to take care of that but it seems to me that the first step is either to confirm or deny that they're going to go forward with retail wheeling.

DANIEL KIRSHNER: I would like to know that.

CHAIRMAN SHER: Something in lieu of that. Something different than that.

DANIEL KIRSHNER: I think they're going to go forward with it and I'd like to think that...

CHAIRMAN SHER: Well, you just assume they are going to go forward.

DANIEL KIRSHNER: But I'd like to hear it from them. I mean, we'll all be better off.

CHAIRMAN SHER: I don't believe you are going to hear it from them. Everything I hear is that they're not going to go forward. That's my suspicion

anyway with retail wheeling. But anyway, I think we've gone as far as we can go.

DANIEL KIRSHNER: I guess we're in agreement we'd both would like to hear what they think they're going to do.

CHAIRMAN SHER: The question is what do we want to hear and I thought you were saying that they ought to focus on the things you are most interested in and have them tell you specifically what their vision is for that, those programs that you've worked on.

DANIEL KIRSHNER: I'd like to hear the other ones too but that would... I mean it would be better for both of us at some point and then we'd have something to react to...

CHAIRMAN SHER: Okay, thank you. So, is Mr. Goldstein here? I've been corrected. Dr. Goldstein. I should probably always say Dr. Goldstein and then you can correct me.

DAVID GOLDSTEIN: Thank you very much, Chairman Sher. I appreciate the opportunity to speak here. I appreciate the fact that there are hearings on this subject at all because I think the Legislature's involvement in this process has been very constructive. I particularly appreciate this hearing's focus on the cost of electricity service. We'd like to remind people that the cost of electricity service as Chairman Imbrecht was saying is the rate times the amount of consumption. The distinction is important because the policies affecting rates and the policies affecting consumption are different. California rates are higher than average but overall costs are lower than average because California energy consumption is lower. One of the reasons its lower has been the activities of this committee and Legislature as a whole and the two Commissions over the past 20 years. The next slide shows that the burden of electricity on the economy despite California's high rates is lower than for the rest of the United States and has been consistently lower for more than the past decade.

CHAIRMAN SHER: Why are all those large consumers leaning on us so heavily?

DAVID GOLDSTEIN: Because they see some economic gain to do it. Their leaning on the northwest, the lowest rates in the country just as hard as their leaning on you.

CHAIRMAN SHER: They see a way to bring costs down, don't they, that's what they want?

DAVID GOLDSTEIN: They would like to see any way that they can reduce costs. I mean, their profits go up if consumption goes down for the same output their profits go up as the rates go down. But the point is if you achieve low rates like they have in Bonneville service territory they're still saying the same thing. We need still lower rates. In other words, it's not that we've got higher rates than average if we came down to average we'd be fine. The problem would go away. You're getting the same advocacy from

industrial customers...

CHAIRMAN SHER: I'll never be satisfied until...

DAVID GOLDSTEIN: Well, that's what we're seeing.

CHAIRMAN SHER: Okay.

DAVID GOLDSTEIN: So this shows there's not a crisis in electricity costs due to rates; however, there is a crisis as a couple of speakers have pointed out in electricity consumption because of the response to the Bluebook because of utilities cutting back on DSM programs that have been successful in anticipation of what might happen at the PUC with regard to retail wheeling.

Let me go to the question of rates and ask why they're high. Two issues have come up today, uneconomic nuclear power plants and high cost independent power contracts. The point I would like to make with respect to these two problems is that both of them have been addressed successfully by policy years in the past and they're not going to recur. Uneconomic nuclear power plants were planned in California before 1973 when there was no public scrutiny over the cost-effectiveness of utility investments. By enacting the Warren Alquist Act, the problem that led to uneconomic nuclear power plants was solved. We had a process that when it was confronted with additional nukes it would have made the problem even worse than the late 1970's provided a forum where we could say these things don't make sense and we stopped them before the problem became a lot worse than it is today.

Another way of saying it is if the Warren Alquist Act had been enacted in 1967, we might have avoided this problem altogether by having a way to discuss the issue of the economies of nuclear power before it was too late. High cost independent power contracts as a previous speaker showed, the cost of those declined rapidly over time just due to the nature of the contracts. Secondly, the high cost contracts came about in the early 1980's when we thought oil prices were going up. And yeah, we overpaid for them but we also created a renewables industry in California that we might not have done otherwise. In other words, these high costs produced and much bigger response than we thought and made possible a move and concept to the next phase which is instead of competing independent power against uneconomic coal and nuclear power plants as we did in the early '80's, let's compete them against each other and come up with a lowest cost and that's the direction that I think we want to be moving in and we're already moving in without any radical changes in the regulatory structure. Now if some of the Bluebook is nonradical changes I'll get into that in a little bit.

CHAIRMAN SHER: Is that your position that there shouldn't be any radical changes in the regulatory structure?

DAVID GOLDSTEIN: Well, it depends on what you consider to be changes, Chairman Sher, because there's been a lot of evolutionary change over the past 15 years in regulation which, I think, is taking us in the right direction.

CHAIRMAN SHER: Let's focus in on NRDC's position on trying to promote

competition on the generation side. Is that restructuring by bringing more competition in on the generation side? Do you have a position on whether that's a good thing?

DAVID GOLDSTEIN: Yeah. Before I answer that, let me say that I think it's more important to promote competition between the supply side and the demand side because most of the uneconomic future choices, are choices that are currently being made that we could change are on the demand side. Retail wheeling creates competition that is limited to the supply side and thus, despite being called introducing more competition is actually restricting competition.

Now, with regard to your question of competition on the supply side, we would like to see moves towards greater competition. We think that the process that's going on at the PUC can lead in that direction. At the moment we're not in the Poolco column, we're not in any particular column. We think that the pool concept might be a starting point for several of these discussions. But I'd like to put that in a context and that is if we buy 100% of our power on the stock market, we're leaving ourselves open to a lot of problems with respect to insurance against catastrophic events, high prices, resource diversity, a lot of environmental issues and so on. So what we envision is the need to have some competitive contracting mechanism for long-term power contracts by a utility to a wide source of possible suppliers for part of the power supply and then something like a pool, some kind of short-term competitive mechanism for acquiring a certain percentage of power, probably smaller, in the short run so that your setting up competition between different suppliers who will sign 30-year contracts on one hand, competition in terms of short-run efficiencies or short-lead time projects on the other hand. Does that answer your question?

CHAIRMAN SHER: Sort of.

DAVID GOLDSTEIN: Thank you. On the consumption side, if you'll show the next slide, the Public Utilities Commission has been a leader in regulatory reforms over the last twelve years and particularly over the last five years to create a more competitive market among supply side and demand side by aligning societal benefit with private profit. In other words, if you're interested in utilities being part of a solution to reducing the states electricity costs, let's pay them for their success in reducing electricity costs. The more they save the more they get paid and that's basically what the collaborative tried to do on an experimental basis. This experiment was an immense success. 1.9 million dollars in carefully measured analyzed net benefits to California consumers in two and a half years of running the program. This produces a more competitive business environment in California because by allowing business customers to be more energy efficient there are a number of case studies showing how they become more globally competitive where plants might have closed down or moved or actually expanded...

CHAIRMAN SHER: Dr. Goldstein, I understand that you are very supportive and have been very instrumental in NRDC and these energy efficiency programs and also DSM but I'm not sure that that is telling us what we need to know for how we relate to the PUC and what's the ongoing discussion and if you could

translate it into that it would be more helpful to me. You don't have to sell energy efficiency programs to me. You don't have to sell DSM to me but I guess what you do have to tell me is where is NRDC on this ongoing debate that is going to be decided in a very short period of time?

DAVID GOLDSTEIN: Okay, we believe and the events since the Bluebook demonstrate in the real world in case there is any doubt in the theory that retail wheeling sets up competition in low rates rather than in energy services and causes utilities to cut back on their provision of DSM. We've seen PG&E and Edison propose or actually implement 40% cutbacks in DSM programs for 1995 which is a quarter of a billion dollars a year of net loss for every year that this continues going on. So we think one of two things would be constructive in solving this. Either to remove retail wheeling from the table of discussion until we can first come up with some mechanism, as Dan Kirshner was saying, to deal with the DSM problem or from our perspective simply to eliminate retail wheeling as an option from the discussion at all.

CHAIRMAN SHER: See the problem I had and think I had it with Dan himself was, this is not my view, but some would say that's the tail wagging the dog. I mean, this debate didn't start about DSM. The debate started with the issuance of the Bluebook which said, "Bring competition, restructure the electric services industry." You're worried about what's going to happen to DSM but you're not going to prevent that other discussion and the movement towards some kind of a proposal on something retail wheeling or something else from happening and so what would be most helpful to me is to say, "If it's going to be this then you ought to do this" about DSM or, "If it's going to be that" or you can't protect DSM if you go that way so don't let them do that at all. That's the kind of thing that would be helpful to me in terms of knowing what your position is given the program that you're interested in.

DAVID GOLDSTEIN: I believe that retail wheeling is an inappropriate solution regardless of the effect that it has on DSM, that it creates inequities and instabilities in the electricity system that are a bad thing even if we can protect DSM. I don't think that I will necessarily convince everyone else that that's right in enough time to prevent a quarter billion dollars a year in escalating of lawsuits from occurring so what I would like to see if we can do at the very least is to say a quarter billion is a lot bigger than any possible gains other than redistributing costs that are already sunk from one party to another which as we've seen from today's hearing is very controversial and there's no obvious way to do it.

This isn't the tail wagging the dog, this is the dog, this is the biggest element of economic inefficiency that has ever been identified in the California system. Sometimes...

CHAIRMAN SHER: I didn't mean it is terms of its effectiveness in terms of savings, I meant in terms of the dog that's out there, you know, and what issue is being looked at in that other forum. And you know, there is no way that we're going to stop them from looking at it. Are you saying that we should in the Legislature on an emergency basis in January try to adopt on a two thirds vote of each House a mandate on the Public Utilities Commission to stop selling DSM down the river?

DAVID GOLDSTEIN: Well, there's a question of political feasibility that you...

CHAIRMAN SHER: Well, yeah, that's right, but at least I want to know what you're telling we ought to do and then I'll make the judgment about the political feasibility of doing it.

DAVID GOLDSTEIN: Well, a quarter of a billion is a lot of money and lot of jobs and a lot of economic competitiveness. Is it worth losing it, that's a million dollars of business a day that we let go by with uncertainty. Is the loss worth it? What are we getting out of it? That's the question I would pose.

CHAIRMAN SHER: But in the context of this debate, that would translate it into "stay away from retail wheeling." So that I take it... I'm looking for the message from each witness on what it is we're talking about here. Not on some other subject.

DAVID GOLDSTEIN: Yeah, well I think that specific message "stay away from retail wheeling" makes a lot of sense for a variety of reasons that we can provide you with at great lengths.

CHAIRMAN SHER: Okay. Do you want to make one final comment before I call the next witness?

DAVID GOLDSTEIN: Yeah, I guess the final comment I would make, Mr. Chairman, is that NRDC along with San Diego Gas & Electric submitted a joint statement signed by about 40 participants to the Public Utilities Commission that addresses exactly the issue that I tried to bring up a second ago that at very least let's get going a discussion at the PUC to find out how the gains of DSM can be preserved regardless of what decisions are made on restructuring. So if there's any way the committee can encourage the Commission to take that process up, we heard what we find a reassuring level of consensus today on that one thing after all the things that are disagreed with that the intention even among proponents of so-called competition, is let's protect the gains that this state has in economic deficiency due to utilities ... through DSM.

CHAIRMAN SHER: Okay, I apologize if I was short with you. I'm just trying to translate what the witnesses say into something that's usable for me as I try to carry out the assigned task of this committee.

DAVID GOLDSTEIN: No, I appreciate that, Mr. Chairman. I think it was very constructive.

CHAIRMAN SHER: Okay. Thank you. All right, our next witness is Ray Sanborn and with him is Mr. Art Carter.

ART CARTER: Mr. Chairman, Mr. Sanborn could not be here so it takes two of us to take his place. I'm Art Carter, representing the Coalition of Utility Employees, and with me is Mark Joseph, with the law firm of Adams and Broadwell. The Coalition of Utility Employees comprises all of the investor-

owned utilities and the municipal-owned and operated utilities with approximately 40,000 members. Already this Bluebook has cost us considerably in terms of employment. PG&E has probably laid off 1,500 people. We anticipate before this whole process is over we'll probably lose between three and four thousand jobs without knowing what the impact will be in the other utilities. Before introducing Mr. Joseph who has appeared at many of the hearings offering expert testimony and to give you our own prospective on what ought to be done, I want to emphasize our strong support for the Legislature to hold the PUC's feet to the fire in complying with ACR 143. After listening to the dialogue between you, Mr. Chairman, and Mr. Arth this morning, it would seem that the Bluebook has lost much of its color. There doesn't seem to be anybody who's now willing to take responsibility for it. Perhaps at the next hearing the PUC will tell us that it was a file clerk who developed the Bluebook. In any case let me turn at this point to Mr. Joseph who will speak to a couple of key points.

CHAIRMAN SHER: Thank you.

MARK JOSEPH: The electric utility system which has grown up over the last hundred years in this state is one of the best and most reliable systems in the world. We should be very, very careful before we do irreparable damage to that system. When we make these changes and if we do make changes we have to be sure that they are really going to benefit all the people in California. We think that carefully thought out and carefully designed changes can be made which will benefit everyone. We believe that the Poolco concept and PBR could be ways of improving the system if they're done carefully and properly. However, with respect to direct access as PG&E proposes it, we think that ordinary residential and small business consumers would never be able to make the kind of special deals that a large consumer can make. There is no way that either you or I or anybody representing our neighborhoods can make a deal which will get us electricity and be competitive with a large industrial user which has a large steady load which doesn't fluctuate very much. We are inherently a less desirable customer no matter how clever we are and no matter how clever anyone representing us as a group is. We will always be less desirable. We can never compete. Direct access can never be equal access. In contrast with the Poolco concept where you have an independent dispatcher dispatching the generation resources has a lot to say for it. And I think there are really two important overriding features of a pool which are attributes. First, the generators would compete to sell their power based on their price. Cheaper generators, as you pointed out earlier, would sell to the pool before more expensive generators would. And the important factor here is really that these benefits would flow to all customers, not just to the people who can make deals. All customers get the benefit of this competition. We are in the Poolco column.

Now with respect to PBR, PBR could work if it's properly designed and you asked several witnesses, "What are these benchmarks, what's really going on?" I'm going to take a small stab at answering your question and tell you what the important features are of PBR.

Let's start out with the price cap. The price cap is determined and I'll use Edison as an example because that's the case that is currently going on where

there's really the most data. Edison would start with a base rate of revenues for the transmission and distribution part of the company which we set based on 1995 general rate case revenues. That's the starting point. Each year after that it goes up by inflation but not quite full inflation. It goes down from that by a productivity factor. That's the total revenue. Everything else is left to Edison's discretion. Any amount they can spend less than that benchmark each year under Edison's proposal goes first 100% to the shareholders. Then, if there are really large savings below that, they get split between the shareholders and the customers. That's the price side of PBR.

The other side of PBR, which everyone recognizes as important, is the service side of PBR. And this is the side which most concerns us. It's critical that strict service performance targets be established for the utilities because if these targets are not properly designed it will simply provide the utility with a strong economic incentive to take short-term profits at the expense of the reliability of the system. The company will get financial rewards for degrading the human and physical infrastructure of the company. So, in considering the appropriate approaches to utility reform...

CHAIRMAN SHER: Don't you say that starting point are the 19, what rates, what year?

MARK JOSEPH: 1995 would be the starting point for Edison.

CHAIRMAN SHER: The rates that are now permitted for transmission and distribution, is that what you said?

MARK JOSEPH: Yes. The nongeneration side...

CHAIRMAN SHER: And there's no... Those rates don't assume a certain level of service?

MARK JOSEPH: Those rates assume serving all of the customers the utility.

CHAIRMAN SHER: As the utility sees fit or, you know, certain response time when your power is off?

MARK JOSEPH: Because everyone recognizes that the utility will have a financial incentive to cut back on things like maintenance and repair, part of Edison's proposal and part of all the proposals so far has been to establish service quality standards which have to be maintained at the risk of a penalty if they're not maintained. And so that's the service half of PBR. And we think that that's the half that people who are looking out for the interests of the customers have to be very careful to see that it gets implemented properly.

CHAIRMAN SHER: Okay. But it's possible to do it but you shouldn't lose sight of it. That should be part of the deal.

MARK JOSEPH: That's right. We think it's possible to do it. We have made specific proposals in the Edison case and those...

CHAIRMAN SHER: And in their application they made their own proposals, is that right?

MARK JOSEPH: They did. And we thought it...

CHAIRMAN SHER: That's what I want to look at, you know, to see what they are and to see what the response is.

MARK JOSEPH: We'll be happy to provide you as much or little detail on that as you want.

CHAIRMAN SHER: No more than six pages.

MARK JOSEPH: We'll do.

CHAIRMAN SHER: Okay. All right.

MARK JOSEPH: We think that California's high quality reliable electric service is an asset of this state. It's an asset to businesses and it's an asset to the consumers, and I would sort of pose a series of questions that anyone should consider before they jump too hard on the PBR band wagon. I would ask whether anyone really thinks the economy will be better off if a storm keeps businesses in the dark for half a day instead of half an hour. I would ask whether new businesses will really locate in California, if their computer systems periodically lose power for a few seconds because transformers are not replaced until they fail. And I would ask, is it worth deferring maintenance of the electrical system so consumers can save a nickel a month if they have to reset their VCR's all the time.

And what about the people who put the wires back up after a storm and who replace the transformers before they fail? Or answer the phone when you have a question about your bill? PG&E has already announced, as Art said, that thousands of people are going to lose their jobs. Is it really in the public interest for thousands more at PG&E and several thousand at the other utilities to lose their jobs just to save a few cents per month. I think several witnesses have said, "That's not where the money is. The money is in generation." And so we should be very careful with these PBR proposals that we don't really damage the system that we need to save, particularly to really achieve very small savings. That's all I have to say for you.

CHAIRMAN SHER: Well, just so I'm clear, are you saying that PBR can have benefits if it's done right or are you saying you don't see where the savings can ever justify taking these risks about what the utilities will do in order to achieve the savings.

MARK JOSEPH: I'm saying that PBR can save some money, though it's not going to be very much and it's not going to be anything...

CHAIRMAN SHER: Is it worth doing from your point-of-view?

MARK JOSEPH: I think it's probably not worth doing but I think it's going to happen.

CHAIRMAN SHER: Okay. I like that. That's clear so you always want to have a backup. It's shouldn't be done. It's not worth doing but if they do it then it ought to have certain things built into it.

MARK JOSEPH: That's right. I think anybody who looks at the numbers will see that there isn't really very much...

CHAIRMAN SHER: When we have our hearing on PBR I hope you'll come back and talk to us about that. Thank you very much for your testimony. It was very clear. Okay. We're nearing the end. We've got two more witnesses under item eight on the agenda, the Municipal Utility Perspectives. Welcome Gerry Jordan, who is the Executive Director of California Municipal Utilities Association and Jan Schori who is the General Manager of SMUD so Gerry, are you going to start?

GERALD JORDAN: Thank you. And thanks for sticking around, you and Senator Leonard both.

In our view, restructuring is fundamentally a Legislative policy issue and to the extent that you are going to have dramatic policy changes which go beyond letting markets evolve on a step-by-step basis, we think that decision ought to be made through legislative action and not through regulatory action. I think you've already identified that the most important aspects, I think, from a Legislative standpoint and from the standpoint of policies adopted by local elected officials are how we're going to handle such things as externalities, fuel diversity and renewables, DSM and efficiency issues and social goals. And to be very clear, our message for you today is transmission first. We have tried with a lot of our utilities who don't own transmission for approximately the last hundred years to get wholesale transmission access. We don't have wholesale transmission access yet. We think we're very close. We spent the last four years negotiating a regional transmission group and are happy to report that two days ago FERC approved the first two regional transmission groups and the one that we're involved in, the Western Regional Transmission Association, which includes most of the major utilities in the western United States and the Western Area Power Administration and the Bonneville Administration and we think that is probably the single most optimistic prospect for lowering rates for everybody in California.

Everyone of the proposals that have been talked about today, whether they're either version of Poolco or retail wheeling are dependent on transmission access. It is simply naive to believe that if we can't perfect wholesale transmission access that there's going to be any possibility of perfecting either a transmission pool or a retail wheeling. Having said that I will say that we would rank the existing proposals of the proposals we think that the retail wheeling proposal has clearly the most problems related to it. There are technical issues we think that are not easily solved. In addition, there are significant jurisdictional issues. We do not believe that the PUC has the authority to order retail wheeling. We think that's pre-empted by the federal government and by FERC and going down that road we've created a number of jurisdictional problems. We think that the Poolco idea has a lot more potential. There are still a lot of unanswered questions particularly as to

how transmission and transmission pricing is going to be handled but it is a next better step.

Of the current proposals The Western Regional Transmission Association we think is the most likely to succeed and we're not suggesting that efforts to evolve towards a pool cease but we should certainly deal with transmission access first while we're working on those other things. If it took us four years to negotiate Worda, it's going to take considerable time to negotiate a pool or a retail wheeling environment which takes care of all the things we've previously mentioned.

As I said before, I think we'd like to emphasize that we believe there ought to be a step-by-step process here and it ought to be evolutionary, not regulatory in nature.

CHAIRMAN SHER: Okay. Thank you.

JAN SCHORI: Last but not least.

CHAIRMAN SHER: Well, we've got a couple...

JAN SCHORI: You've got a few other people.

CHAIRMAN SHER: On the end here.

JAN SCHORI: My name is Jan Schori. I'm the General Manager of the Sacramento Municipal Utility District which I assume all of you know serves Sacramento. I imagine most of you, if not all of you, are customers of ours. I do have a written statement that I would like to have be made part of the record. Since we're sort of running out of time I'll keep it real short. I do have a few comments I wanted to make.

First, I think SMUD has been hailed by some as a model utility of the future and one of my concerns in watching this entire restructuring debate is whether or not we're going to become a utility of the past. Unfortunately, it seems to me that some of the parties have lost sight of a very critical objective that SMUD has sought to pursue in all of its ratemaking decisions and that is a careful balancing of maintaining cost-effective rates with important public policy measures that we have made major commitments to, especially in Sacramento, a commitment to doing something about cleaning up the air. We're concerned that we're about to become a member of the Lonely Hearts Club when we look at what's happening to renewables and DSM programs. And we encourage this committee to take a strong stance to encourage not just the PUC but all of the parties that are coming before you to make a commitment to come up with some real solutions. What are we going to do to ensure that the state continues to maintain the steady progress that we've shown in promoting renewables.

More than 30 people, 30 companies and entities signed a DSM joint statement that was submitted to the CPUC with a list of questions indicating that there are critical issues that have to be resolved to push forward with the gains that we've made in the energy efficiency front. At this point, that's where it's ended. That group has not yet met and I admit, SMUD is one of the members

and we need to get on the dime. We need to come up with some concrete solution.

I wanted to respond to the advantage of being last, obviously, as I can respond to a few of the comments that were made by people ahead of me. First, I wanted to comment briefly on Assemblyman Baca's questions about PBR and its applicability to municipals. It's really a meaningless concept from municipalities because obviously our rates are basically cost based. We don't have any stockholders. We only have ratepayers. The ratepayers are the customers, they're the owners. There is no conflict of interest and the bottom line is when we make a decision, if it's a good one the ratepayers benefit, if it stinks, they have to pay for it. And unfortunately at SMUD, we have examples of both and we're dealing with them in our rates right now.

CHAIRMAN SHER: And they vote the rascals out, right?

JAN SCHORI: Yes. Well, they voted something else out of our rate base. Into the rate base but out of service, I guess would be an accurate way of putting it. We're very concerned about the direct access proposal because when you look at it from a municipal perspective it really does look to us like it is simply a mechanism for cost shifting and bypass, so at this point we are not aligned with that column. We are not at this point endorsing the Poolco concept either, primarily because there are so many questions that remain unanswered and we want to be sure that our customers will end up to be better off if we engage in this kind of a proposal. We do, however, strongly support the idea that we have to do something about solving transmission. We think maybe a transmission pool is the first idea we should look at.

And last, I wanted to comment briefly on the CERT proposal. SMUD has not yet met with CERT to work through the proposal and it's applicability to SMUD but I think there's some fundamental issues that need to be understood. Generally speaking, that proposal is going to work for utilities that own a lot of old transmissions that can be written up to market value. If you look at most municipalities, if they own any transmission at all, it's pretty darn new and it's pretty close to market value right now. Witness the California-Oregon Transmission Project. When you have a utility like SMUD that has a huge stranded investment problem in dealing with Rancho Seco, it's very clear to me, at least with the level of analysis we've done to date, that proposal is a loser for us. We may be the biggest losers, but it's not clear to me how any transmission dependent utility really is going to come out better off. Their customers come out better off under that proposal. Thank you very much.

CHAIRMAN SHER: Thank you. Thank you for your testimony to both of you. All right. We have two other persons who have signed our list. I invite them to come forward now. Glynnis Jones, Appliance Recycling Centers of America, who's given us a video that we promise we'll read if you keep your remarks very short. Not read, but view, I should say.

GLYNNIS JONES: I will be very brief. Thank you for giving me an opportunity to let you know how, for a private company such as ARCA, providing DSM services to an electric utility, how frightening the Bluebook proposal process has been. We got into this very late in the game and discovered how

complex and how many barriers there are to understanding all of the procedures and the bureaucracy that's involved in this. But what we do have is 70 employees in the city of Compton working in our facility that started out as a win, win, win proposition a year ago and now looks like a lose, lose, lose come the first of the year. We've been told that it's likely that the funding will end for the program at the end of this year. This is something that we took a look at what the risks were involved in working with electric utilities and decided that given the state's position in support of DSM and environmental issues that it was a good risk for us to take. We have since re-evaluated that. However, we think that perhaps if the Public Utilities Commission receives its funding through the Legislature, perhaps one way to make it all more realistic to them is to start discussing their funding for 1995. Maybe this will bring a little more sanity to this discussion and bring people to the table looking at real solutions, not theoretical situations and we have peoples' jobs on the line so I...

CHAIRMAN SHER: Maybe you'll become a stranded cost and you'll be bought out.

GLYNNIS JONES: Well, that's what I have is a stranded investment in Compton. The building was for sale for three and a half years before we invested in it. We've made a five million dollar investment and we have no other customers that currently today can replace the electric utility business...

CHAIRMAN SHER: So you heard all these witnesses today say they wanted to share in paying for these stranded investments so it looks good for you.

GLYNNIS JONES: What's good for the goose is good for the gander, okay? So thank you very much for listening to us and we hope that we'll be able to be a participant in the future in the discussions of the DSM and the electric utility industry in California. We hope that things will happen that will allow us to stay in place.

CHAIRMAN SHER: Thank you.

GLYNNIS JONES: Thank you.

CHAIRMAN SHER: Final witness, Carolyn Kehrein, is that how you pronounce that? I'm sure I botched that. I can pronounce your employers name though, Proctor and Gamble.

CAROLYN KEHREIN: It's Kehrein. I'm Carolyn Kehrein. I'm with Proctor and Gamble. Proctor and Gamble is both an industrial customer and a cogenerator. Cogeneration has allowed business to be more viable in this state. There's been lots of talk today about the minority of QF contracts - the interim standard offer 4. I wanted to provide some data on the majority of the QF contracts. The majority of the QF contracts currently are making between less than three cents and five cents. This is for very reliable fuel efficient power generated ... near load centers. Bob Foster earlier today said that there was a problem, going to be a problem even after the fixed price problems disappeared. I don't think that less than three to five cents is a

problem. For instance, facilities that operate under Pacific Gas and Electric SO1 right now would be making an annual average of about three cents this year. I'm not saying that that three cents is reasonable but that's what they're getting paid. So the last point that I'd like to make is that this last decade has been very hard on business. Stock prices have been impacted, there's been downsizing, i.e. layoffs, job loss, and this has occurred at a lot of different companies that you've heard of. For industry to survive all of our suppliers, including our utilities, need to go through some of the leanness that industry has gone through. They need to become as lean and effective as we've had to become if we're going to survive the whole chain, it has to be lean and effective. Thank you.

CHAIRMAN SHER: You mean you like retail wheeling as a consumer and that you can be competitive to supply as a generator?

CAROLYN KEHREIN: Personally, I am in support of direct access, yes.

CHAIRMAN SHER: Thank you. Personally and for Proctor and Gamble?

CAROLYN KEHREIN: From what I know I think Proctor and Gamble is in support of direct access.

CHAIRMAN SHER: Okay, thank you. I think we've reached the end of our witness list. I want to thank you all for attending and staying to the bitter end as Senator Leonard and I did. I've learned a lot. You'll be hearing more from us but that concludes our business for today. Thank you.

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