Remarks to LAPA/LACC Joint Meeting

November 17, 2006

- Good morning. Thank you for inviting me to speak today.
- I appreciate this opportunity to share with you recent developments and upcoming policies affecting California's electric and gas industries, and what they mean for Southern California.
- This is an industry in which it is imperative that we take the long view.
- The assets are costly, capital-intensive and long-lived. The environmental impacts are great and, particularly with respect to CO2 emissions, even longer lasting than the infrastructure itself.
- And the news on climate change just gets more alarming every day. It has become clear that human-caused emissions, not natural cycles, are driving global warming, and mounting evidence indicates that the pace of climate change and the probability of sudden, catastrophic effects is greater than previously thought.
- The implication is clear: We must begin making significant emissions reductions <u>now</u> if we are to avoid dire outcomes.
- That's why I was dismayed to hear that several Southern California cities were moving to extend their contracts with the Intermountain Power Project (IPP), a pulverized coal plant located in Utah.
  The contracts currently expire in 2027; but the cities are looking to extend them to 2044. Burbank and Riverside have already voted in favor of extending the contracts and Glendale and Anaheim are

weighing the offer. Pasadena, apparently, is not going for this. And I was especially pleased to see that Los Angeles, which buys 66% of IPP's output, declined this offer

The contract extensions are an undisguised attempt to evade the clear intent of the Legislature and the Governor. SB1368, which will become law in January, prohibits new long-term investments in power plants with emissions exceeding those combined-cycle gas turbines we are building throughout the state today.

The cities are trying to get in under the wire. They say that they are just looking after the long-term interests of their ratepayers. And yes, it's true that taken at face value these contracts offer bargain-basement prices.

But we all know there's more to it than that. In fact, I think that this is short-sighted policy.

For starters, another bill from this year's legislative session – AB32 - will also become law on January 1. That bill establishes a statewide greenhouse gas (GHG) emissions cap that includes emissions from imported electricity. It requires California to pare our GHG emissions back to 1990 levels by 2020, and it recognizes that further cuts will follow.

Indeed, the governor has set a target of cutting emissions 80 percent below 1990 levels by mid-century. A large portion of these cuts will come from the electricity sector. The California Air Resources Board (CARB) is charged with developing a plan in which the necessary cuts will be allocated across sectors and energy providers.

Presumably the cities expect their power purchases from IPP to grand-fathered when CARB sets their emissions allocations. I wouldn't be so certain of that, given the magnitude of the necessary cuts and the circumstances of the contracts' renewal.

Moreover, I think it is inevitable we'll see serious action by our federal government well before 2027.

Indeed, the cities may come to rue the day they extended these contracts. Pulverized coal plants like IPP will inevitably become obsolete in an increasingly carbon-constrained world.

So in the name of protecting ratepayers' pocketbooks the cities are really imposing on them a new and potentially large financial risk.

We are following a very different path at the CPUC.

I would like to given you an overview of the policies that we are undertaking to reduce the carbon footprint resulting from serving the loads of companies we regulate, and to shelter their customers as much as possible from the financial risks inherent in the inevitable shift to a carbon-constrained world.

I will then turn to another topic that I know is of great interest to you - how we intend to assure adequate electric and gas infrastructure is in place, both in the very near term and over the long-run.

The CPUC is already working closely with the Air Resources Board and the California Environmental Protection Agency to implement AB32.

As I noted earlier, the bill sets an overall GHG reduction target for the state.

The first step toward meeting that target is to set up emissions reporting requirements so that we know where we are starting from; and we can gauge our progress. Then the required cuts must be allocated across sectors and sources, including imported electricity.

At the CPUC, our focus will be on how these cuts are allocated to the electricity and gas sectors as a whole, and the companies under our jurisdiction.

Intertwined with the question of allocation is another question: What options will be available to companies as they strive to meet their targets?

I was very pleased to see that AB32 contains language allowing CARB to implement the cap using a market based approach and that the governor, by executive order, has signaled that trading must be part of CARB's plan.

I expect that this cap and trade system will encompass California's electrical sector, along with several others. Creating a cap and trade system for greenhouse gas emissions will be a critical step in the right direction.

For the first time we will put a price on greenhouse gas emissions, providing meaningful economic signals to businesses and consumers alike.

These price signals will make investments in energy efficiency and low-carbon products even more attractive than they are today.

However, this new market will take time to design and become operational. Especially in the near term, additional policies must be deployed to assure timely progress.

Our loading order policy, which is laid out in Energy Action Plan II, assures that we will stay on track. Under the loading order, our priorities are energy efficiency and demand-side investment, renewable energy, and conventional transmission and generation investment.

Last fall, the Commission approved an unprecedented energy efficiency program, authorizing $2 billion in funding for energy efficiency programs for 2006-08. These investments will reduce global warming emissions by an estimated 3.4 million tons of carbon dioxide by 2008, which is equivalent to taking about 650,000 cars off the road.

Our two main policy thrusts in the area of renewable energy are the Renewable Portfolio Standard (RPS) and the California Solar Initiative.

Under the RPS, we aim to obtain 20 percent of our energy from renewable sources by 2010 and 33 percent from renewable sources by 2020.

Meanwhile, the California Solar Initiative - now mandated by SB1 - has a goal of installing 3000MW of new distributed solar generating capacity by 2016.

Fundamentally, we see the CSI as an investment in the maturation of the solar energy industry, which I believe will play an increasingly important role over the long term in meeting the electricity sector's GHG emissions reduction goals. Over the next decade, we aim to make the industry self-sustaining and eliminate the need for subsidies.

So far I have stressed the need for taking a long-term perspective - indeed a very long-term perspective - when it comes to the problem of climate change. I've also emphasized the importance of market-based measures in achieving the necessary reductions in greenhouse gas emissions.

When it comes to assuring reliable energy supply at reasonable rates, you will see that taking the long-view and relying on markets are again at the heart of our approach.

I would like to start on this topic by taking you back to last summer. Last July we experienced an extended statewide heat wave - the longest period of sustained high temperatures in both Northern and Southern California in more than half a century. Of course, we all know that the extraordinary weather also brought exceptionally high energy demand. All-time system peak records were shattered and then shattered again within a matter of days.

Some people were ready to call this Energy Crisis II, but that's far from the truth. There were no rolling blackouts. We only saw scattered outages as local distribution equipment failed, largely due to the sustained heat itself. Only on the record-tying ninth day of the heat wave did the ISO go to Stage 2 and call upon interruptible customers to shed load.

In my view, such highly unusual circumstances are what interruptible programs are for. This was a far cry from the hours upon hours of interruptions that some of you endured in 2000 and 2001.

So what we saw last summer was not the onset of a new energy crisis, but rather just how far California has come since the events of 2000-01. All of us should recognize the great work of the California ISO in keeping our system running.

I think my agency can claim some of the credit as well: Over the last few years we have led the effort to develop a resource adequacy program, working in close coordination with the ISO and our sister agency, the Energy Commission. We definitely enjoyed some good luck during the heat storm. There were no major unplanned outages of power plants or transmission links.

But it's also clear that we had the right system of carrots and sticks in place to ensure that power plants delivered energy to the grid when and where it was needed.

I can assure you, however, that we are not resting on our laurels!

We promptly launched a collaborative effort with the other energy agencies to take another look at how we determine the need for new resources, and we immediately initiated efforts to beef-up reserve margins throughout the state, and especially in Southern California. We have asked all of our utilities to do more on both the supply and demand side, and to do it as fast as they can.

Specifically, we have asked them to move forward with any extra demand response measures they can implement for next summer, and to fast track any new generation projects that can come on line in 2007, especially peakers.

The response so far has been gratifying. In the case of SCE, I also issued a ruling in which I directed them to bring us 300 MW of additional air conditioner cycling for next summer, and build 250 MW of new peaking capacity. They are on track in both of these endeavors.

On top of these efforts, SCE has also just filed an application with us for a power purchase agreement that will result in additional new capacity for next summer. Under the deal, the Long Beach plant would be retrofit so as to provide another 260 MW of peaking power in Southern California. It would come on-line by August 1, 2007. We will process this application as fast as humanly possible, and get a decision out shortly after New Years.

These urgent, near term measures complement our continuing efforts to assure reliable and affordable service over the long run.

Again, we are working collaboratively with our fellow energy agencies on several closely linked initiatives:

- Developing a workable, durable wholesale energy market structure that harnesses the power of competition;
- Expanding and modernizing our electric and gas infrastructure, and
- Increasing the price-responsiveness of electricity demand.

I'd like to now briefly review highlights of ongoing CPUC policies and recent actions in each of these areas. I will begin by discussing our efforts in the area of **market design**.

Last July we voted out a major policy decision in our ongoing long term procurement planning proceeding. It paved the way for development of new generation. Indeed, shortly after the vote, SCE launched a fast track RFO for 2000 MW in new capacity. The Long Beach project that I mentioned earlier was pulled out of the bids submitted in response to that RFO for expedited treatment.

Last summer's decision also laid out our vision for the structure of California's electricity industry. It clearly signals our commitment to pursue policies that will promote a viable and workably competitive wholesale generation sector, and increased customer choice.

We are also continuing to refine our resource adequacy program to ensure that energy is available when and where it is needed, and we are coordinating closely with the California ISO on the redesign of wholesale electricity markets.

Once these policies are in place we will be able to consider reopening direct access, perhaps as soon as 2008-09.

Let me turn now to what we are doing to assure adequate infrastructure over the long term. We have directed the utilities to bring us comprehensive 10-year energy procurement plans before the end of this year. We will review these and issue a decision by mid-2007. This will set the stage for the next round of procurement.

California also needs to promote infrastructure enhancements to ensure adequate supplies of natural gas - additional pipeline and storage capacity, diversify supply sources, and the ability to import liquefied natural gas (LNG).

Opponents to LNG have put forth persuasive but incomplete arguments regarding the need for LNG. I've long said that LNG will help to increase supply and thereby moderate, natural gas price impacts for California. To argue that we don't need LNG terminals given our energy efficiency and renewable goals is a risk I'm not willing to take.

For LNG, we have required the California natural gas utilities to file open access tariffs, which provide firms access to natural gas supplies from LNG terminals or from pipelines. We also recently approved stricter natural gas quality standards. By establishing natural gas quality rules now, we provide LNG providers the certainty they need in order to begin procuring new supplies.

The first LNG receipt point has been established in southern California at Otay Mesa, with deliveries expected in 2008 from Sempra's Baja project. While several LNG terminals are in the planning / permitting stage, I expect ultimately that California will be served by at least two terminals - the one in Baja and another, probably offshore of Southern California.

The third and final policy are on which we have made considerable progress and will continue to forge ahead is making electricity demand more responsive to wholesale market prices.

To achieve this goal we need new infrastructure as well as new pricing programs.

We are making progress on both fronts. Over the last few years we have been pushing the California utility industry to install advanced metering infrastructure throughout their service territories. This will make it possible to put dynamic pricing tariffs in place for all customer classes. This year we signaled our intention to do that in each of the IOU's general rate cases, as the new meters are installed.

More efficient dynamic tariffs, such as Critical Peak Pricing and Real Time Pricing, reflect the true value of delivering energy to customers at peak times and provide consistent and meaningful signals to conserve.

Over the last couple of years, all three of our IOUs have developed business plans for installation of advanced metering infrastructure and are in varying stages of implementation. PG&E's roll-out began yesterday in Bakersfield. SDG&E is slated for next summer, and SCE will follow soon thereafter.

So what does all of this mean for your rates in the coming years?

I cannot provide you an exact number, but what I can say is that by harnessing the power of competition in several key areas, we will be able to keep your rates as low as possible.

I started off by telling you that we simply cannot turn our backs on the formidable problem of climate change. But I also stressed that the lowest cost and most effective way to confront that challenge is by using market forces to provide encourage business to find new and creative solutions.

All of you need to be part of that process, by engaging constructively in the design of the system and by looking closely at how you operate your businesses to ferret out opportunities to realize efficiencies and reduce your GHG emissions.

We're doing our part too. In the arena of climate change, my agency will be front and center in the effort to design sensible, market-based policies for the electricity and gas industries. We will protect ratepayer interests by assuring that what we ask our energy providers to do is within their grasp, and by giving them the flexibility to find low-cost and effective ways to meet their targets.

In the area of reliability and resource procurement we are also taking the long view and looking to markets everywhere we can to stimulate private investment and provide customer choice.

So, that's on overview of where we are. Thank you.