

**Testimony of Karen A. Tomcala
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Before the Subcommittee on Energy Policy,
Natural Resources and Regulatory Affairs
Committee on Government Reform
U.S. House of Representatives**

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Good afternoon Mr. Chairman and members of the Subcommittee. I am Karen Tomcala, Vice President of Regulatory Relations for Pacific Gas and Electric Company. PG&E is the northern and central California utility that delivers natural gas and electric service to one in every 20 Americans. I appreciate the opportunity to testify before you today regarding the California Independent System Operator's (ISO) efforts to reform California's wholesale energy market, a critical endeavor for ensuring reliable electric service for California consumers.

We all know by now that the California energy crisis of 2000-2001 resulted from a combination of factors, inadequate resources and a flawed market design being primary among them. Under mitigation measures ordered by the Federal Energy Regulatory Commission in June 2001, the California energy market is currently functioning with a must-offer requirement, bidding and price mitigation measures, and adequate resources. Nevertheless, much work remains to ensure a stable, reliable wholesale market for the long-term. FERC has recognized this fact and ordered a redesign of the California market to correct the potential for dysfunction and inefficiency inherent in the current design, and the California ISO has responded by initiating a proceeding known as Market Design 2002 (MD02).

PG&E supports the ISO's efforts because a well-functioning wholesale power market is a necessary component for utilities like PG&E to provide the reliable service our customers require.

We must all recognize that the MD02-related tasks before the ISO are both technically complex and politically sensitive, and the ISO must move forward respecting both of these facts. With this in mind, I would like to emphasize the processes necessary for the ISO to achieve a successful MD02 program.

First, the ISO must coordinate its market redesign activities with state efforts. Fixing California's energy market requires both federal and state regulatory attention. The California Public Utilities Commission, under new leadership and in coordination with the California Energy Commission and the California Power Authority, is beginning to construct a coherent model for the state's energy future. The ISO's activities must proceed in synchronization with these efforts so that its ultimate MD02 product supports the emerging model.

Second, the ISO must provide an effective process for stakeholder participation and input in developing MD02. The experience of the utilities and others who were on the front lines of the crisis is too valuable a resource to be ignored.

Moreover, the crisis has shaken the confidence of everyone involved.

Redoubled efforts to ensure that stakeholders' concerns are heard and addressed in the MD02 process are necessary to re-establish confidence that

California will have a fair and stable market design on which participants and consumers can rely. Creating such stakeholder buy-in can provide the additional benefit of minimizing costly and time-consuming litigation, both during the design process and down the road. Our collective resources are better dedicated to fixing California's market and bolstering the state economy.

Third, the ISO must develop as necessary and engage in regional coordination processes that recognize the regional nature of the Western market. As has often been discussed, the electric power system in the West is interconnected by an extensive transmission system that has been used to optimize the region's resources for many years. For example, during the fall and winter months, mild temperatures in California create surplus generation in the state, which can be used to help meet high heating demands in the Pacific Northwest. Conversely, during the late spring and summer months when demand in the Northwest is generally moderate due to milder temperatures, surplus hydroelectric power is transmitted to California where it is needed to meet high cooling demands.

To retain these synergies that have greatly benefited consumers all across the West, the ISO must work cooperatively with the region to provide appropriate mechanisms for addressing seams issues between the Pacific Northwest, California, and the Desert Southwest. Such a regional approach does not require that the market designs in Western states be identical – only that they be consistent enough to permit the regional cooperation and coordination that have

been the hallmarks of the Western market for years. Examples of issues that should be coordinated across seams at the regional level include:

- Operational and commercial rules: Such rules must be sufficiently compatible so as not to preclude market participants from conducting business across state boundaries, for instance providing consistent timing for submitting energy schedules prior to the close of a market.
- Market mitigation: Because the energy marketplace in the Western United States traverses state boundaries, market mitigation measures should be coordinated across the same geographic footprint.
- Resource adequacy: Market rules addressing resource adequacy should be coordinated on a regional basis to recognize the interconnected nature of the energy market in the West and the benefits available from the seasonal sharing of resources.

Finally, by engaging in the processes I've just described, the ISO can do much to create a well-functioning wholesale power market in California. The ISO, through its role as the non-discriminatory grid manager, is positioned to provide a range of transmission-related benefits to the regional electric power market, including more efficient and reliable operations, transmission pricing that eliminates so-called rate pancaking, improved congestion management, improved reliability through application of its open access transmission tariff, and more coordinated planning of transmission investment. All of these activities will result in a robust transmission system for the benefit of consumers.

In tandem with transmission benefits, getting essential market rules right will ensure that MD02 provides the most reliable service and the greatest protections available for consumers. One example of getting it right would be using MD02 to craft mitigation rules targeted to address specific market problems. The crisis demonstrated that inappropriate or uncoordinated mitigation is a potential source of gaming -- when price caps in California were low relative to neighboring states, some suppliers were motivated to export power from California thereby making the supply situation in California worse. Another way in which the ISO can use MD02 to get it right is to implement stable, transparent market rules, an essential precursor to investment in new infrastructure. The upheaval associated with the California crisis, not yet fully resolved, has chilled investment in the state leading to projections of supply shortage recurrence in the 2007-2008 timeframe. Implementing stable rules on which investors can rely can reverse this trend and ensure fully adequate resources.

The fact of the matter is that doing all these things may take some time. But doing them right is the most important objective. Taking the extra effort to coordinate, strive for consensus, plan, and implement MD02 properly is the only way to provide customers with the stable, reliable service that they deserve.

Thank you Mr. Chairman. I would be pleased to answer any questions.