



Federal Energy Regulatory Commission

California Manufacturers & Technology Association

**“California Dreamin’ versus Reality:
Lessons Learned”**

**William L. Massey, Commissioner
U.S. Federal Energy Regulatory Commission
South Lake Tahoe, Nevada
August 3, 2001**



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LESSONS FROM THE CALIFORNIA EXPERIENCE

- **Regulators must insist on good market design**
- **Grid operation and planning must be done by Regional Transmission Organizations**
- **Regulators must have sharp market intervention tools and use them quickly and decisively**

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MARKET DESIGN ELEMENT: Appropriate Hedging Instruments

- **Do not rely too much on spot markets**
- **Must have balanced portfolio of supply instruments – futures and forward contracts**



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MARKET DESIGN ELEMENT: Assurance of Adequate Generating Capacity

- **Avoid significant fluctuations of price and availability**
- **Ex ante reserve requirements on load serving entities**
- **Allow adequate new generation to be sited**



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MARKET DESIGN ELEMENT: Uniform Interconnection Standards

- **Location decisions should be based on economics**



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MARKET DESIGN ELEMENT: Congestion Management

- **Promote efficient use and location decisions**
- **Locational marginal pricing works well**



MARKET DESIGN ELEMENT: Demand Responsiveness

- **Mitigates price increases and market power**
- **Customers must:**
 - **See prices before making consumption decisions**
 - **Have reasonable means to adjust consumption in response to prices**
- **Demand side bidding (“negawatts”)**



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MARKET DESIGN ELEMENT: Ex Ante Price Mitigation

- **A circuit breaker on extreme price increases**
- **Example: bid mitigation under certain conditions**



GRID MANAGEMENT PROBLEMS IN THE UNITED STATES

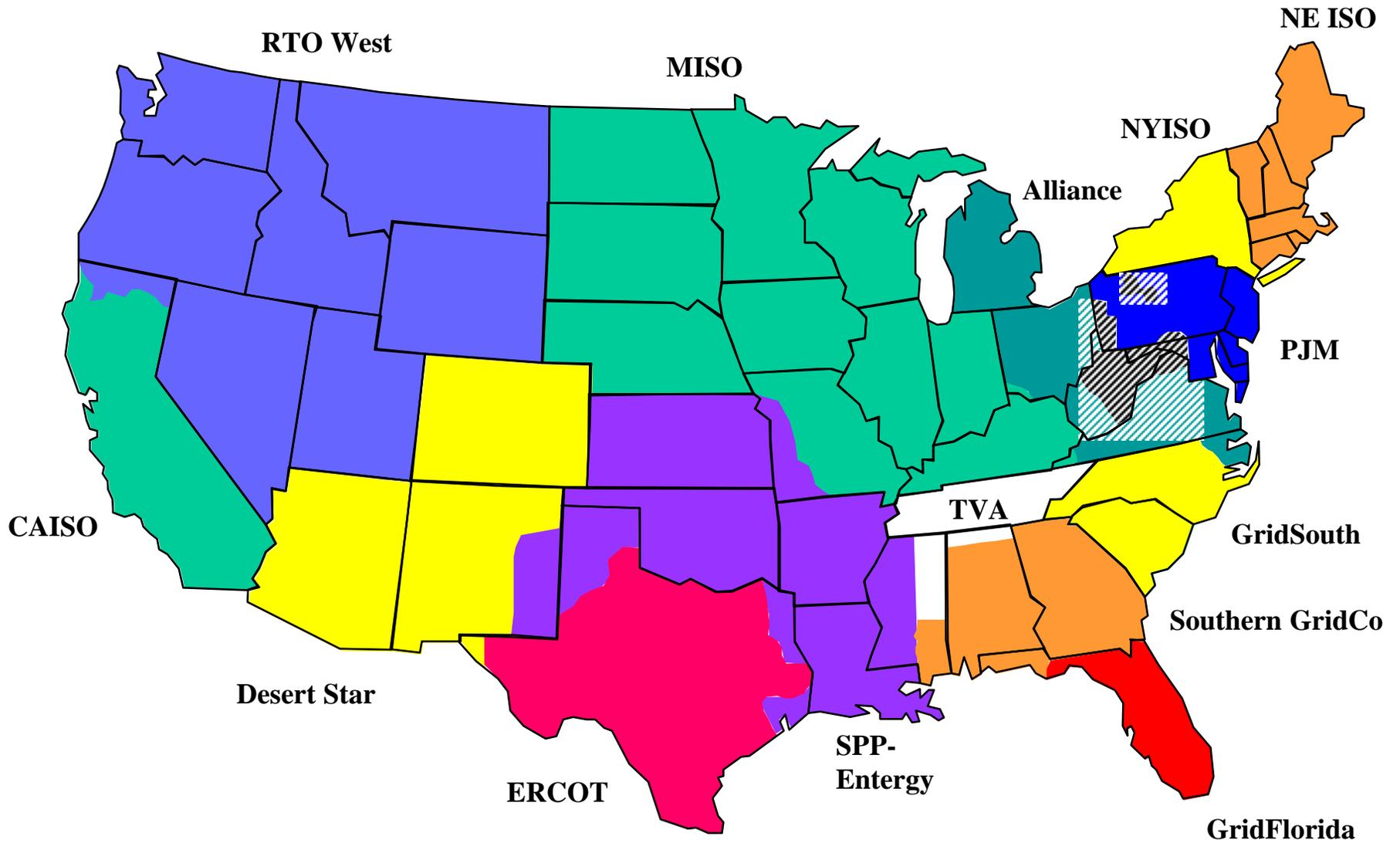
- **Vertically integrated grid operators**
 - **Conflict of interest in providing access; discrimination**
- **Grid management is fractured among more than 100 operators**
 - **Markets are regional but grid management is sub-regional**
 - **Multiple transmission rates keep markets too small**



REGIONAL TRANSMISSION ORGANIZATIONS (RTOs)

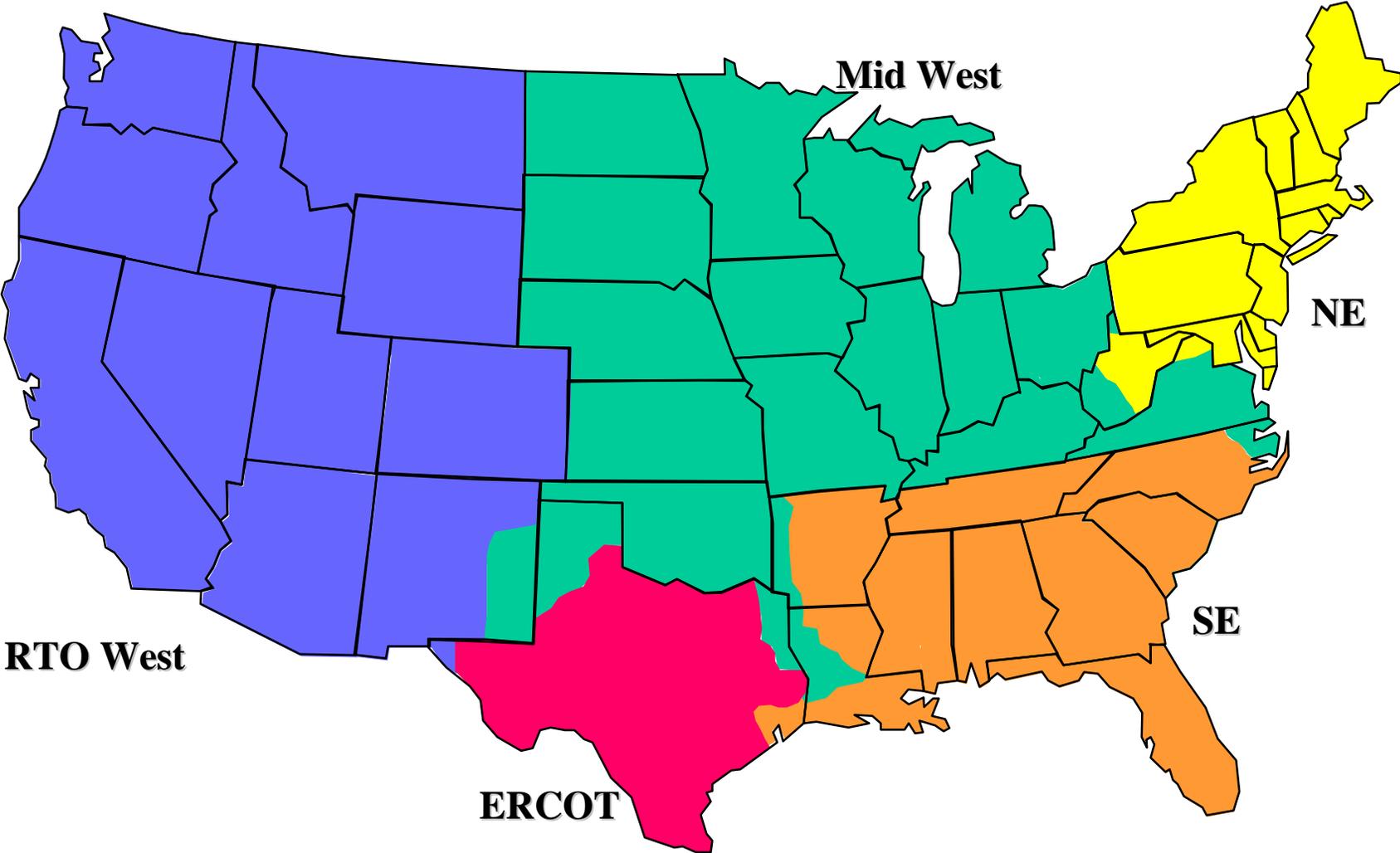
- **Grid manager for large region that is independent of merchant generation interests**
- **Benefits**
 - **Eliminate conflicting incentives**
 - **Streamline interconnection procedures**
 - **Enlarge markets through improved transmission pricing and congestion management**
- **Must be regional in scope – large and well-shaped**

Proposed RTOs



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Possible Consolidated RTOs



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REGULATORY INTERVENTION

- **Regulators must have sophisticated analytic tools**
- **Regulators must develop clear standards of acceptable behavior**
- **Regulators must intervene aggressively when markets are dysfunctional**



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REFUNDS

- **60-day evidentiary hearing**
- **Refund period – October 2, 2000 through June 20, 2001**
- **Non-jurisdictional sellers included**



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REFUNDS (Continued)

- **Formula:**
 - **variable cost of marginal unit**
 - **daily spot gas prices**
 - **10 percent creditworthiness adder**