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Statement of Jan Schori, General Manager, Sacramento Municipal Utility District,
On behalf of the Large Public Power Council

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Good afternoon Commissioners and fellow panelists. I am Jan Schori, General Manager of the Sacramento Municipal Utility District ("SMUD"), and I am speaking today on behalf of the Large Public Power Council ("LPPC"). Thank you for allowing me to participate. We appreciate the Commission's willingness to engage in an open discussion with all sectors of our industry on key policy issues affecting wholesale electricity markets.

LPPC represents 25 of the largest municipally owned utilities in the nation, and together our members control nearly 90% of the public agency owned, but non-federal, transmission investment in the nation. We are members of the American Public Power Association ("APPA") and support the message that APPA is delivering in the context of today's discussion.

LPPC's perspective on the issues before the Commission today is somewhat unique. We have members that are within RTOs, those that border RTOs and do business with them, and those outside RTO markets. Despite these varying geographic circumstances, in all cases we look at the performance of electricity markets from the standpoint of the consumers we serve. As publicly-owned entities, LPPC members have no profit incentive. Our interest is in providing reliable service to our customers at reasonable rates. To the extent markets are consistent with or advance that goal, we support them. To the extent markets fail in that endeavor we will work to improve them. We strongly support the Commission's thoughtful and incremental approach to solving problems as evidenced in Order No. 890.

The purpose of this afternoon's panel is to address non-RTO bilateral markets. Of course, the Commission has only just considered the open access framework upon which such markets are premised in Order No. 890, revisiting the Order No. 888 framework. In LPPC's view, Order No. 890 gets things right in emphasizing further clarity and openness with respect to ATC calculation and system planning. The Commission has directed meaningful improvement to the open access approach, while avoiding radical, experimental mandates that have caused so much uncertainty and price volatility in electric markets over the past several years.

So what is next in looking at non-RTO bilateral markets? I'd like to address three points:

1. First, bilateral markets are the result of regional choice: We have two alternative world views of the electric industry held by those who endorse organized markets and those who find that non-RTO bilateral markets suit their needs. The decision embedded in the Energy Policy Act, and your new Order 890 is that we are not going to force parties to choose one of these models or another. So, our work now is how to make them work smoothly for the benefit of consumers.

2. Bilateral markets work. In the West, the market with which I am most familiar, we have made good progress with new tools promoting transparency and broad trading opportunities to maximize competition and efficiency within the existing Western Systems Power Pool framework, but without a centrally administered apparatus. It is in this context that I want to address the question you posed in the agenda for today's panel on whether rate-based investments pose a risk to customers. My answer is that preserving the option of rate-based investment, whether in transmission or generation, is an important tool in benchmarking market offerings and should remain a viable strategy to ensure consumers are getting affordable, reliable power when they need it.

3. Certainty is what drives much utility decision making, especially for load serving entities with the obligation to serve. This is the principal reason why my utility and many LPPC members gravitate to bilateral markets. Uncertainty regarding the expense of transmitting power across RTO/ISO systems (in part, resulting from volatile congestion and marginal loss charges) is the principal challenge confronting most if not all organized markets and this uncertainty remains the significant concern to LPPC members doing business within and through organized ISO and RTO markets. This is a particular concern of mine as I think about how to deliver to my load renewable resources that are remote from our system, as most are. This discussion relates to your question on what can be done to improve the integration of remote resources that we would like to procure on the competitive market.

Respect for Regional Choices

The Commission has appropriately recognized that the best solutions are often developed locally to match the underlying infrastructure of the electricity industry in that area. Where RTOs have not taken root, LPPC believes it would be poor policy to press for their development absent regional consensus. Where Day-2 markets have not been developed (Southwestern Power Pool), LPPC similarly believes there is no case for their imposition. Where regions do make the decision to proceed with Day-2 RTOs, but abut traditional bilateral markets, the Commission must ensure that the market choices and reliability of the individual utilities bordering an ISO or RTO are neither directly nor indirectly undermined.

Short of RTO development, where a region has determined that there are certain organized functions that may be performed effectively on a regional basis, but that are meaningfully less complex and centralized than an RTO structure, LPPC believes the Commission should be supportive. The ColumbiaGrid and WestConnect organizations, in the Pacific Northwest and Southwest, are cases in point. These organizations have undertaken a number of cost-effective wholesale market enhancements including, importantly, regional planning and they are actively investigating additional upgrades. As the work of these organizations proceeds, the Commission should remain flexible as to its ultimate role and responsibility in promoting these regional improvements.

The State of Bilateral Markets

Bilateral markets are thriving in the West and Southeastern regions of the country, providing load-serving entities with deep, liquid trading platforms within which buyers and sellers can transact. I will address the West, the market with which I am most familiar. The vast majority of such trading for day-ahead power in the West occurs on the Intercontinental Exchange (Ice) platform. "Ice" is an internet-based trading platform providing a marketplace, similar to the stock market, where participants can post bids and offers and complete transactions. Specific entities posting the bids and offers are not disclosed to the traders on the electronic platform. Virtually 100% of the bilateral electronic trading done in the Western Interconnection is completed through the Ice platform, with over 300 entities participating as buyers and sellers. In 2006, nearly 161,000 trades were completed over Ice at western hubs. All participants have visibility of bids and offers at each trading hub. This price transparency creates market liquidity, resulting in an active and competitive market. Ice deals are formalized under the WSPP agreement.[1] Ice users can purchase physical firm transmission from the WestTrans.net OASIS, where 26 providers post surplus transmission from Canada to Mexico, at fixed prices that are known up front.

Addressing your request for comment on the question whether rate based investments pose a risk to consumers, I think the answer is no. I believe that consumers benefit from the availability of generation included in rate base under cost-based ratemaking, and amortized over a traditional term of 20 to 30 years. This is particularly true for well established generation technologies. I don't think I'm being too controversial in commenting that so-called competitive electric markets can operate dysfunctionally, and are susceptible to the exercise of market power and manipulation. When that happens, cost-of-service based supply serves as a check on market prices, keeping them more in line with what the results would be in a truly competitive market. The presence of cost of service sellers serves as an alternative source of power. Further, the availability of cost-based supply of power serves as a yardstick against which the competitiveness of prices in power markets can be judged. So, having integrated utilities charge cost-based rates in the wholesale marketplace seems anything but risky to me. Instead, it looks to me like an important check on market dysfunction.

[1] ICE website at www.theice.com/marketdata/naPower/naPowerHistory.jsp

Uncertainty and the Interplay Between Bilateral and Centralized Markets

Those of us operating in bilateral markets have faced challenges at interfaces with centralized market systems operated by RTOs and ISOs. Here, I would like to address three issues. First, changing market rules in organized markets can have an adverse impact on bordering non-RTO utilities operating in bilateral market. I do not think this has been given enough consideration It has been our experience that such entities have been established and modified without sufficient coordination with adjacent systems to ensure that inconsistent operating protocols do not harm reliability and commercial trade. Unlike changes in interconnected control areas, which in the WECC at least must undergo rigorous coordination, we have faced a variety of scheduling timelines and operating protocols that were wholly inconsistent with the surrounding control areas. This caused difficulties and unexpected new costs in the region as existing control areas had to modify their scheduling and operating protocols to accommodate this new system. Neighboring systems have had to add staff and train them in the much more complex operating protocols in order to maintain trades.

We all learned a valuable lesson from this early experience. The Commission should require more **meaningful** and effective **pre-filing coordination** of such changes with each affected neighboring control area. In that setting, the suggestions and recommendations of adjacent systems on proposed market design should be addressed. If those suggestions cannot be accommodated, the eventual filing must address the relevant issues and articulate a rationale for the approach taken. This would benefit all parties, as well as the Commission and Commission staff, by reducing the number of tariff disputes that land at FERC overburdening both FERC's and affected parties' resources.

Second, where remote resources must be engaged through bilateral agreements that require transmission across RTO regions, the Commission must help us secure firm, price certain transmission service. California has a longstanding policy supporting development of renewable energy, with fixed goals and timetables. Many states have adopted similar policies, so this issue is of importance to many if not most load serving entities. Much of what we need is found in the Pacific Northwest and Southwest, and transmission across the California ISO is necessary. I think you will find similar situations around the nation. New Section 217 of the Federal Power Act, added as part of EPAct 2005, requires ISOs, RTOs and other transmission organizations to provide firm transmission rights "or equivalent tradable or financial rights" to load-serving entities on a long term basis sufficient to meet their needs. These rights should be provided to entities seeking to wheel resources through RTO/ISO systems if they are to meet their load serving obligations. Many LPPC members are actively seeking to make long term investments in new renewable resources, but require stable, cost-certain, long-term transmission rights across RTO/ISO service areas in order to commit to the purchase of such resources. Volatile congestion-based LMP pricing and marginal priced losses is affecting the certainty regarding deliverability and cost as we endeavor to engage remote renewable resources, Renewable developers need our long-term commitment in order to build these new resources. The Commission should require RTO/ISOs to provide such

service in the interests of promoting interstate commerce and the development of renewable resources.

Third, natural gas-fired generation is now the marginal unit of supply in virtually all markets in the country. Sellers price their power in accordance with what they believe the buyer's alternative is, and in accordance with what they think they could get if their power were to be sold to the highest paying buyer in that market. While we are committed to development of renewable resources for their environmental benefit and fuel portfolio diversity, we had also expected price benefits and certainty. Our experience is that in obtaining bids and negotiating with developers, we have great difficulty in obtaining the price level and certainty one would expect when buying a renewable source of energy (the value of free fuel, so to speak, from a wind project, for example). From a consumer-oriented perspective, highest price bid markets appear to be adversely influencing pricing in non-RTO bilateral markets. The effect of this regime appears to be that it sets a floor for prices in bilateral markets above what cost plus a reasonable rate of return on investment would justify. High priced (gas index related) power suppliers set the market-clearing price at the margin in organized markets, and that price drives up the price for all suppliers, including those in adjacent bilateral markets. As a consequence, load serving entities with renewable commitments are placed in the position of constructing their own resources to avoid having all their generation costs linked to gas prices. I do not think our customers, or the market for renewable resources, benefit from this situation.

So, to conclude, if I were you, what would I put on my to-do list?

(1) I would call for RTOs/ISOs to meet with their neighbors when proposing market design changes that affect them. Where an accommodation cannot be made, I would call for those issues to be addressed in the filing;

(2) I would look for ways to stabilize transmission pricing through RTOs/ISO; and

(3) I would take a serious look at the adverse affect that highest priced bid markets have on the bilateral marketplace and consumer prices.

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