

# CITIZENS ECONOMY AND EFFICIENCY



## COMMISSION

OF LOS ANGELES COUNTY

August 21, 1997

TO: Michael D. Antonovich  
Supervisor, Fifth District

FROM: David Abel   
Chairman, Economy and Efficiency Commission

SUBJECT: Wheeling Power for Energy Cost Savings

### Chairman

David A. Abel

### Vice-Chairman

David W. Farrar

### Commissioners

Fred Balderrama

Richards D. Barger

Gunther W. Buerk

John Crowley

Louise Frankel

Jonathan S. Fuhrman

Christopher Hammond

Jaelyn Tilley Hill

Michael A. Jimenez

Chun Y. Lee

Carole Ojeda-Kimbrough

Roman Padilla

William J. Petak

Robert H. Philibosian

Marc A. Seidner

H. Randall Stoke

Julia E. Sylva

Tony Tortorice

### Executive Director

Bruce J. Staniforth

The Commission has received your August 4<sup>th</sup> request to investigate the matter of an employee suggestion made by Mr. Bruce Schneider concerning "Wheeling Power for Energy Cost Savings". During the initial phases of our investigation into this procedural matter, we became acutely aware of the potential magnitude of the fiscal and budgetary impacts that this issue raises. As a result of the magnitude of the potential impacts to the County, the Commission wanted to take this opportunity to recommend that your Board direct the Economy and Efficiency Commission to conduct an independent review of the options available to the County and define the strategies to pursue to best capitalize upon this emerging market.

### BACKGROUND ON THE WHEELING POWER ISSUE

As I am sure you are aware, on January 1, 1998 the deregulation of retail electrical energy in California begins. The most important feature of California's electricity deregulation legislation, A.B. 1890, is direct access provision, or in other words, the ability of a customer to select its provider of electricity and negotiate the terms of the purchase. This restructuring to the way that power is purchased replaces the traditional utility model where state government's granted monopolies to utility companies in exchange for state regulated utility rates. This deregulation legislation within California, the first state to deregulate electricity at the retail level, was supported by all of the major stakeholders including the California Public Utilities Commission, the Legislature, the Governor, utilities, large customers, small customers, and potential new power providers. In short, almost everyone involved in the process supported A.B. 1890.

There has already been a move toward deregulation of electricity at the wholesale level (wheeling). Deregulation of retail electricity (retail wheeling) advances this concept

Supervisor Michael Antonovich  
August 21, 1997  
page 2

in a radical new way of doing business that has significant potential impacts to users of electricity. Under this deregulation a Power Exchange (PX) will be created. The role of the Power Exchange, which will be located in Alhambra, is to provide a competitive auction to meet the electricity needs of Exchange customers. The Power Exchange will function much like a stock exchange. This wholesale power pool will be the market into which power plant owners sell their electricity, with prices being set on an hourly basis.

The Independent System Operator (ISO), which will be based in Folsom, will take over and operate the State's transmission system as a neutral and separate entity from the Power Exchange. However, like the Power Exchange, the ISO will be regulated by the Federal Energy Regulatory Commission (FERC), and will be overseen by a five member Oversight Board. The ISO's function is similar to that of an air traffic controller. It manages the transmission system, coordinates transactions, and keeps the power flowing. Under the Federal Energy Regulatory Commission regulations, the ISO must meet regional and national reliability standards. Local distribution companies will continue to provide transmission and distribution (T&D) services to end-use customers. However, customers will be able to choose the energy services company they wish, and will not be limited in their choice due to their location. It appears that in response to deregulation, the utilities are leaving the generation business and moving into direct competition in the provision of electrical service.

## **MARKET IMPACTS OF DEREGULATION**

As previously noted, the most important feature of the new deregulated system is "direct access." Under direct access, utility retail customers will be able to choose their energy supplier. Customers can also choose to remain traditional utility customer with options for hourly metering (virtual direct access) or price guarantees by hedging contracts. **Large customers, like the County will be able to negotiate a lower rate.** Large electric utility customers will have the option of receiving a traditional electric bill and remaining a full service customer, or selecting "direct access" by choosing their energy supplier and negotiating their own contract terms. Customers will be able to choose between guaranteed/fixed electric prices or variable prices determined by fluctuations in Power Exchange rates. The option of direct access holds the promise of significant cost savings for large and medium size business, **since these customers will be able to negotiate custom contracts.** Electricity services, such as emergency response, will be tailored to meet special customers' needs.

Customers could be reimbursed for electricity which is taken over the price guarantee and the guarantor may keep any premium for electricity taken at prices below the price guarantee. To assist customers in making informed decisions regarding the selection of services, electrical corporations will be required to itemize their bills to disclose the charges associated with transmission and distribution separately from generation charges. Utility distribution companies will be competing for market share with regard to electricity sales, and sales of value added services, including conservation expertise, arbitrage between the price of electricity and gas, power quality services, billing, metering, usage analysis, energy retrofits, and electric infrastructure design and construction.

## **IMPACTS TO THE COUNTY**

What should Los Angeles County do to be ready for the January 1, 1998 deadline? First, the County should undertake a detailed independent energy review of its requirements or validate any studies that have been accomplished to date. Consideration should be given to deciding between the various energy marketers who are rapidly moving into the state. It will become increasingly important for the County to be aware of and understand what options each marketer is providing. It is also important to consider the price and the systemic impacts of a selection.

Electric energy marketers are mostly multi-billion dollar companies with staffs of lawyers and engineers assigned to drafting sophisticated contracts dealing with issues such as power scheduling; transmission scheduling and capacity trading; long term, short term or seasonal sales or swaps; fixed or market based pricing; power reliability or quality; and availability of emergency response. These contracts contain technical jargon and concepts peculiar to the energy industry. Moreover, they are dealing with their core business. To take advantage of this emerging free market, Los Angeles County will need to retain an knowledgeable energy consultant, and possibly legal counsel, to assist it in understanding its options and, potentially, in finding and negotiating its best deal.

In addition to the requirements placed upon the County in finding the best deal for purchase of power, it will be important to conduct an analysis of the power market to enable making an informed decision as to the expenditures and maintenance on its own power generating capability. In such a radically restructured market it will be important for the County to fully understand its options to avoid potential unnecessary cost exposure in the production of power at its existing sites.

## **RECOMMENDATION**

Los Angeles County needs to prepare now for the major change in how they purchase power. By preparing now the new era of deregulated electricity the County will be better positioned to reap major savings. It is self evident that only those customers with an adequate knowledge and understanding of their own power needs will be able to maximize the potential savings. To provide this understanding and to best position the County to meet this radically new market structure it is recommended that the Board of Supervisors direct the Economy and Efficiency Commission to:

1. Work with a recognized authority in the field of electric utility deregulation in the development of an independent study to finding the best deal for purchase of power. It will also be important to conduct an analysis of the power market to make an informed decision as to the expenditures and maintenance of the County's own power generating capability. This study will accomplish the following:

- a. An understanding the impacts of this new structure of the deregulated electric industry on the County

- b. The conduct of a detailed energy review of County requirements and power generating capabilities in order to determine whether direct access is advantageous, and if so, on what terms.
- c. Provide direction on developing an in-house expertise in electricity purchasing.
- d. Make recommendations as to the appropriate strategies to adopt and the specific courses of action necessary to pursue in the newly deregulated power generating environment.

2. In order to accomplish this recommendation the Commission will require approximately \$105,000 to engage a recognized authority in the field of electric utility deregulation.

## **CONCLUSION**

The Commission feels that the emerging market structure brought about by the deregulation of the electric power industry, and as was noted in the employee suggestion by Mr. Schneider, will create a power marketplace full of opportunity on one hand and fraught with risk on the other. To respond effectively to the conditions created by this "unbundled" of the market will require the County to make critical and cost effective decisions in areas such as arranging for transmission and delivery or hedging against price fluctuations. These sophisticated strategies could result in significant savings only if the County takes competent, directed and forceful action in response to this market restructuring.

C: Each Commissioner