



PUBLIC UTILITY DISTRICT NO. 1 of CHELAN COUNTY

P.O. Box 1231, Wenatchee, WA 98807-1231 • 327 N. Wenatchee Ave., Wenatchee, WA 98801

(509) 663-8121 • Toll free 1-888-663-8121 • www.chelanpud.org

February 21, 2020

Submitted via email to: initiativecomments@caiso.com

Dear Governance Review Committee:

Chelan PUD is a member of the Public Generating Pool, and Chelan supports PGP's comments on the Governance Review Committee's Scoping Paper. Chelan submits these additional comments, emphasizing the need to implement independent governance for the CAISO's extra-territorial markets.

The region's history shows the importance of independent governance for expanding CAISO markets

In Chelan's view, the best societal outcome is for centralized electricity-market trading to be expanded. As the west increasingly relies on variable electricity resources, market expansion is the best way to continue integrating those resources from a reliability and economic efficiency perspective. It is easy to see why people who focus on reliability, economics, and power/transmission operations would urge the adoption of unified, west-wide system operations. Moving in this direction is the right thing to do for west coast consumers, if structured fairly. A fair structure, though, requires independent governance.

Some market proponents suggest that reservations about CAISO governance are a front for an unwillingness to recognize the role of centralized markets in meeting carbon reduction objectives. Suggesting that markets need to be appropriately structured to assure impartiality is not the same as being opposed to markets. Chelan's goal in these comments is to outline the importance of governance principles and how they are essential to the successful expansion of markets.

Governance—and the associated politics—are fundamental concerns of any market enterprise. Market rules create reliability and efficiency but also allocate costs and benefits. Even small changes in market rules can reallocate substantial sums, benefiting or harming anything from small groups to entire geographic regions. Those who control the market's rules have tremendous power. And, absent independence, that power can be exerted for the benefit of their constituents. This is particularly a risk when there is substantial price volatility or reliability risk as occurred during the 2001 west coast energy crisis.

For more than 50 years, the Northwest and California have benefited from a synergistic electric power relationship, based on mutually beneficial sharing while not giving up control or leverage. Like most trading relationships, more trade increases the overall benefit, and the exchanges have created enough value to be rational for both sides. When there have been consequential policy differences between the two regions, however, the core

of the issue has almost always been around distribution of net benefits. Those differences have been significant and difficult to resolve. Yet most have been resolved over time due to a balance of power that has been roughly equal.

There was a very difficult dispute in the late 1980s over what became BPA's intertie access policy for the Pacific Northwest-Pacific Southwest Intertie. At that time, California parties were pursuing actions based on their belief that the pricing of Pacific Northwest hydropower was too high. From the Northwest perspective, California entities were collectively attempting to use their monopsony power on the southern portion of the intertie to reduce import prices. BPA adopted its intertie access policy as a direct response to Californian attempts to extract value at the expense of the Pacific Northwest. Ultimately, the policy was adopted and sustained, but the debate also led to large expansions of the AC and DC interties, which increased benefits for both regions.

Then there was the 2000-2001 west coast energy crisis. The energy crisis was the result of many factors, including a failed deregulation experiment in the California electricity markets, and it significantly affected California consumers. But the Pacific Northwest also suffered from the fallout. Electricity prices in the region rose 36 percent between 1999 and 2002, leading to the loss of around \$10 billion from the Northwest's regional economy. To make matters worse, the state of California spent the next 15 years litigating against numerous power suppliers, including BPA. This was particularly vexing to the Northwest as California politicians at the highest levels had requested BPA to sell electricity to offset shortages in California and then sanctioned the resulting transactions. Any sizeable imbalance in control or leverage between the regions during the energy crisis would have greatly exacerbated these detrimental outcomes.

There have also been remarkable examples of interregional cooperation. The original development and then expansion of the AC and DC interties were tremendously difficult undertakings that could only have been accomplished through the concerted efforts of Pacific Northwest and California individuals and organizations committed to creating a greater good. In addition, many short-term and long-term commercial arrangements have been put in place that have saved consumers billions of dollars while also substantially reducing air emissions.

Over the decades there have been attempts to turn to the Congress to resolve these inter-regional disputes to the benefit of one region or the other. For the most part, the structure of the Congress has dampened these interregional disputes and induced collaboration. A policy that is unduly detrimental to California would fail in the House, where California has a large number of representatives. Conversely, a policy that overwhelmingly favors California would fail in the Senate, which has a larger delegation from the Pacific Northwest (eight members to two).

But if market participants surrender the governance of western energy markets—yielding the ability to decide future disputes into the hands of officials representing only California constituents—this delicate balance will be upset and collaboration will be jeopardized.

The absence of full representation will become painfully obvious in moments of crisis (an especially vivid image for those who were in leadership positions during the west coast energy crisis). Those who are accountable to California constituents will feel great pressure to act. The CAISO board (statutorily directed to operate for the benefit of California's consumers), the Governor (who appoints those board members and directs the state's energy policy),

the Attorney General (who can sue to recover from out-of-state utilities or refuse to defend a policy that might protect out-of-state market participants), and potentially others will have strong incentive to shield California's interests at the expense of others. If an expanded CAISO under California political leadership would have been in charge in 2001, the direction from California political leadership almost certainly would have been to protect California consumers at any cost. A former Governor was recalled as a result of the energy crisis. His incentive would have been to take any actions available to protect California consumers, no matter the consequences for other states. It is easy to conceive that the options to promote California-centric policies would have included orders to make changes to market rules, dismantling or defunding governing structures that did not align with California-centric policies, delaying or increasing the difficulty of withdrawal, or providing less than fully objective market information. No group that has a structural bias toward a particular market segment or region should control governance.

This is not meant to disparage the CAISO's ability to operate an efficient and just market. The CAISO management team are top-notch, strategic and operational decision-makers as well as problem solvers. The issue is not a lack of trust in their competence or integrity. The problem is that an inherent bias exists in any system where final accountability rests with elected representatives who reflect only a portion of the market's consumers. Elected representatives are accountable to their constituents—as they should be. But in an expanded CAISO market without independent governance, those accountable represent just a fraction of those whom the decision affects.

Mechanisms to assess or manage the political risk

There are three types of propositions for assessing or managing the political risk as the CAISO responsibilities expand: keeping market changes modest or incremental such as by only expanding the energy market rather than the full RTO, using intermediary governance structures underneath the CAISO that have independent governance, and withdrawal provisions that are minimal and easy to exercise. All three deserve further consideration.

There has been substantial discussion about the market rules necessary at start-up to ameliorate concerns of a geographic preference bias. But, no matter the rules established initially, change will come rapidly to energy markets, and hence market rules will evolve. Certainly, it is important to address the rules governing pricing mechanisms—issues like default energy bids, capacity payments, transmission congestion payments, and resource adequacy—up front. Nevertheless, rules established at initiation can be altered over time by the governing entity. It will be difficult to establish permanence in the start-up market rules that are designed to provide balance between regional interests. Hence, while balanced market rules are necessary at start-up, they are not sufficient to address the governance concerns. Independent governance and/or requirements for an independent third party to resolve concerns of extra-regional California parties can help to ameliorate these concerns.

As to incremental change, the question is where in the CAISO's continued expansion has the progress down the slippery slope become so great that it will not be possible to climb back up before substantial economic harm has been incurred. Increased reliance on the CAISO is occurring in four steps: the Energy Imbalance Market, RC West (the newly initiated reliability coordinator services), the Extended Day-Ahead Market (the instant proposal), and full RTO expansion. Each step provides greater benefits but also greater political risk. From Chelan's perspective, the threshold is likely crossed after the implementation of the EIM and RC West but before EDAM. While the RC and EIM

can lead to reallocating benefits, that risk is not significant enough to avoid moving forward. Moving from EIM to EDAM, however, means expanding the market from covering roughly 5 percent to 40 percent of trading—that is a fair way down the slope and more than a modest or incremental change. Hence the need to address governance issues in a more thorough and permanent manner than was necessary for the EIM.

Regarding intermediary governance structures, the fundamental question is how much decision-making can be statutorily devolved to a subordinate governing board (like the EIM Governing Body). There may well be arguments that the CAISO Board must be accountable for ultimate decisions due to fiduciary and legal reasons. That means, though, when the dollar implications get big enough to impact the politics, California elected officials will be in charge.

While strong exit provisions do provide risk mitigation, the sunk costs, market implications, and politics will make withdrawal problematic, particularly in a short timeframe. Yet, the energy crisis displayed that a great flow of dollars in electricity trade can occur in short timeframes. Withdrawing parties may still incur damage before the withdrawal is effective. And a mass exodus that threatened to extend or exacerbate the crisis would certainly invite political intervention, particularly if it appears the exercise of withdrawal provisions will create sub-regional winners and losers. Consider for example the role the Department of Energy could be asked to play in a withdrawal decision, if California perceived it to be contrary to their interests. Electricity policy and market mechanisms are arcane. Just the explanation as to what is driving a withdrawal decision would take substantial time—resolution would take much longer. Additionally, at that moment, DOE may base its resolution not on what is equitable, but rather what it perceives to be in the political interest of the party in the White House. Finally, all of this may be occurring in a moment when lots of dollars are moving across the regional borders.

The problems described above seem particularly relevant given the state of the California market. All indications are that California is on the verge of a serious supply-demand imbalance. CAISO has projected resource shortfalls of over 4,000 MWs just within the next two to three years.¹ Additionally, California needs continued imports to mitigate its shortfalls, even as other regions in the west face potential deficits of their own.² The projected supply/demand picture, particularly for California, does not provide confidence that another electricity crisis is outside the realm of possibility. Under those circumstances, any number of events can cause significant and extended price volatility or outages, either of which creates a tipping point for political involvement where politicians believe their careers are at stake.

So where does this lead us? There are substantial operational and reliability benefits from regionalizing markets. There are also considerable overall economic efficiency benefits. But the Pacific Northwest should have serious reservations about reordering a political/governance structure that has led—albeit tenuously—to a

¹ *Reply Comments of the California Independent System Operator*, 11 (Cal. Pub. Utils. Comm'n Rulemaking 16-02-007) (Aug. 12, 2019), available at <http://www.caiso.com/Documents/Aug12-2019-ReplyComments-PotentialReliabilityIssues-IRP-R16-02-007.pdf>.

² *E.g.*, *Exploring a Resource Adequacy Program for the Pacific Northwest*, Figure 4 (depicting projections from multiple studies all predicting capacity deficits in the Northwest), available at https://www.nwpp.org/private-media/documents/2019.11.12_NWPP_RA_Assessment_Review_Final_10-23.2019.pdf.

reasonably fair sharing of benefits over the decades. The Pacific Northwest needs assurance that the issues and interests identified in PGP's comments are addressed in a thorough and fully satisfactory manner, or the risk is too great to proceed.

Specific governance interests and approaches that may achieve them

Consumer-owned utilities in the Pacific Northwest have developed a set of governance interests to be addressed in the market expansion initiatives.³ Chelan fully endorses these interests and believes the supporting proposals identified by Northwest Public Power could provide a governance structure that would be agreeable to Northwest stakeholders.

- Independent Board with an Independent Selection Process
- Decision Making Authority over Market Rules that Impact EDAM Footprint
- Durability of EDAM Governing Body
- Enhanced Formal Input to EDAM Governing Body
- Third Party Dispute Resolution
- Exit Provisions and Financial Protections
- EDAM Governing Body Input into CAISO Resource Allocation
- Transparent Process and Review

A central theme of these elements is independent functioning. This is also a core requirement of RTOs and ISOs. In Order No. 2000 FERC established that "[a]n RTO needs to be independent in both reality and perception."⁴ The independence requirement for RTOs is a continuation of the independence requirement established for ISOs in Order No. 888. "[A]n ISO should be independent of any individual market participant or any one class of participants (e.g., transmission owners or end-users). . . . The ISO's rules of governance, however, should prevent control, and appearance of control, of decision-making by any class of participants."⁵ In Order No. 888-A, FERC reemphasized the importance of independent governance:

We reaffirm our view that ISO Principle[] 1 (independence with respect to governance) . . . [is] fundamental to ensuring that an ISO is truly independent and would not favor any class of transmission users. As the Commission stated in its recent order on the proposed PJM ISO: 'The principle of independence is the bedrock upon which the ISO must be built if stakeholders are to have confidence that it will function in a manner consistent with this Commission's pro-competitive goals.' . . . We remain concerned that ISO proposals that do not include governance by a fair representation of all system users may not be independent[.]⁶

³ See *Public Generating Pool Comments* (Feb. 21, 2020).

⁴ *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 810, 850 (1999).

⁵ *Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21540, 21596 (1996) (emphasis added).

⁶ *Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, on reh'g*, Order No. 888-A, 62 Fed. Reg. 12274, 12317-18 (1997)

FERC was focused on fairness in transmission access when it articulated these principles. Admittedly, EDAM will not require the CAISO to operate or directly control any transmission facilities beyond its current footprint. FERC previously recognized, however, that it is appropriate to consider how an RTO's or ISO's market service proposal affects its ability to meet its underlying obligations. "[W]e must consider a proposal by the RTO that concerns a service provided by the RTO. If, as we find below, the proposal has the potential to adversely impact [the] ISO's ability to satisfy [its] obligations as an RTO under Order No. 2000, we cannot ignore that potential simply because [the] ISO has already achieved RTO status."⁷

Chelan believes that an EDAM governance structure should meet the FERC independence threshold. In order to accomplish this the CAISO Board of Governors will need to delegate sufficient authority to an EDAM governing body to independently craft and sustain market rules. The EDAM governing body must also have primary authority over those rules; that is, the CAISO Board should not be able, unilaterally, to propose new rules or act on proposals. The EDAM governing body will need adequate access to financial and human resources, and independent market expertise, to be sufficiently durable and effective. Moreover, the CAISO Board must be precluded from unilaterally shrinking its purview. If the CAISO Board needs to retain final approval to control or modify any or all of these activities without some form of independent third party review, then the confidence in fair decision-making, particularly when the system is stressed, will be compromised.

While the CAISO board is nominally independent, the board does not meet the spirit of the principle when it serves an expanded market. California market participants are largely subject to political oversight, like the CAISO, either through the governor-appointed California Public Utilities Commission or locally elected boards. While not directly engaged in decision making, this class of market participants directly serves and collects revenue from the constituents of these elected officials.

Additionally, the CAISO is statutorily required to take California's consumers into consideration. Section 345.5 of the California Public Utilities Code stands out in particular. It requires the CAISO to manage its markets in a manner that "reduc[es], to the extent possible, overall economic cost to the state's consumers" and "maximize[s] availability of existing electric generation resources necessary to meet the needs of the state's electricity consumers."⁸ The CAISO's bylaws internalize these requirements. And there may be other statutory provisions that undermine any non-legislative attempts to improve governance. For a market that encompasses most of the Western Interconnection, this framework is not "independent in . . . perception" nor does it guarantee "fair representation of all system users" as required of RTOs and ISOs.

(emphasis added). See also Order No. 2000 65 Fed. Reg. at 850 (reiterating the principle of independence and reaffirming that it "must apply to all RTOs").

⁷ *Midwest Indep. Sys. Operator, Inc.*, 126 FERC ¶61,139 P 62 (2009).

⁸ Cal. Pub. Util. Code § 345.5 (emphasis added).

The risk of carefully crafted governance compromises being overturned needs to be addressed

The existing California statutory framework appears problematic for meeting the identified governance interests in terms of achieving sufficient independence. This is important because the risk is not just what agreements can be reached with the CAISO, but also what can be sustained in case of legal challenge.

What protections are possible—and legally sustainable—to ensure that CAISO’s mandate to reduce costs and maximize availability for California consumers is not realized through increased costs or reduced availability to consumers in other states? The CAISO may adopt an EDAM governance structure that satisfactorily incorporates the protections PGP and Chelan have proposed. But what preserves that structure when exigent circumstances arise, particularly if there is significant risk to California consumers absent CAISO intervention?

The CAISO’s bylaws require the establishment of the EIM Governing Body through a charter, and a similar approach may be taken for an EDAM governing body. Amending the EIM Governing Body article of the bylaws requires a two-thirds vote of the CAISO Board of Governors and the EIM Governing Body. However, substantive changes to the charter only require CAISO Board of Governors’ approval. This would allow it to remove decision-making authority, overruling dispute resolution mechanisms, disregard independent expert or stakeholder input to the EDAM governing body, erect onerous and costly exit criteria, or replace the EDAM governing body with hand-selected members. The CAISO Board of Governors could, conceivably, circumvent the EDAM governing body entirely. To prevent this, EDAM governance should contain protections against the CAISO Board of Governors’ ability to nullify the EDAM governing body charter.

Beyond the CAISO Board’s ability to undermine EDAM governance, there is the risk that litigation could unravel compromise solutions. Would the framework be resilient enough to survive litigation by California parties asserting that governance must give priority attention to the protection of California consumers? Under that circumstance, what assures that the California officials charged with upholding the state’s laws (and representing the CAISO) will support the independence agreements if there is a perceived conflict with protecting California consumers? These questions need to be answered even if our recommendations are adopted in order to assure a sustainable solution over the long-term.

Are there alternative governance structures that could be applicable under existing law

The California legislature considered updating the CAISO’s governance in response to PacifiCorp’s exploration of full membership in the CAISO. PacifiCorp serves customers in six states, including California. Stakeholders in the other five states had legitimate concerns about the utility transferring operational control of its transmission facilities to a politically-governed independent system operator. The regional governance exploration initiated under California SB 350 explicitly acknowledged this multi-state challenge:

A new RSO [Regional System Operator], combining the PacifiCorp operating companies with the California utilities now in the CAISO, will exhibit a wide variety of state energy policies and market conditions. California and Oregon have a 50% renewable portfolio standard, while Utah has no binding RPS and Wyoming and Idaho have none. Oregon has a very low compliance obligation under

the Clean Power Plan, while Wyoming has among the most severe obligations in the country. Three of the states are predominantly Democratic; three are Republican. Finally, retail rates vary widely among the six states. Any governance structure must respect and accommodate [sic] those wide differences so that the RSO can respond to the needs of its members.⁹

Section 359.5 of the California Public Utilities Code was passed to allow for transformation of CAISO governance. The reformed RSO would have been independent from market participants, regional preferences, and political impositions.

Ultimately, the expansion effort was unsuccessful, and section 359.5 was repealed by its own terms. The EDAM proposal does not require transfer of operational control of facilities, but concerns about the approach to varying state energy policies, market conditions, and environmental goals are still valid as they pertain to expansion of the CAISO's day-ahead markets.¹⁰

If revised legislation is not feasible, are there existing mechanisms to improve representation in a west-wide market? For example, Article 5 of the Public Utilities Code—Regional Compact—contemplates regional expansion of the CAISO. In section 359, the California legislature expresses its intent that the CAISO evolve into a regional organization. This section envisions a regional compact, or similar agreement among states served by the CAISO's markets, as a vehicle for transforming the CAISO's governance.¹¹ (This section was suspended while expanded RTO governance was explored under section 359.5, but it appears to be operative again now that section 359.5 is repealed.) Could the regional compact provisions be used to appropriately transform governance to accommodate the multistate market proposal? If so, is any additional enabling legislation required? If not, what are the barriers to its application?

Furthermore, it is not clear how other California statutory provisions—specifically, those related to the Electricity Oversight Board and the Power Exchange—could be used to influence the direction of the market in the future. The Electricity Oversight Board appears to be defunct, and the Power Exchange is finalizing its wind-down, but the statutes establishing and controlling those organizations are still effective. Could these bodies be reconstituted as additional political tools to dictate California-focused policies for expanded markets? How would that process take place, and would there be any opportunity for stakeholder input?

Alternatively, could a re-formed Power Exchange provide a vehicle for inclusive, west-wide governance of the expanded power markets? The sections of the California Code involving the Power Exchange do not appear to call out California consumers specifically. For example, section 355 states the Power Exchange's auction shall be "open on

⁹ *Considerations in Establishing a Western Regional System Operator*, 4 (figure citations omitted) (Cal. Energy Comm'n docket 16-RGO-01) (Apr. 29, 2016) available at <https://efiling.energy.ca.gov/GetDocument.aspx?tn=211041&DocumentContentId=25511>.

¹⁰ See various comments in Cal. Energy Comm'n docket 16-RGO-01 noting importance of independent governance to energy policy, energy markets, and environmental goals: *e.g.*, comments of Wyoming Office of Consumer Advocate (May 19, 2016); Industrial Customers of Northwest Utilities (May 20, 2016); Seattle City Light (July 6, 2016), all available at <https://efiling.energy.ca.gov/Lists/DocketLog.aspx?docketnumber=16-RGO-01>.

¹¹ Cal. Pub. Util. Code § 359.

a nondiscriminatory basis to all suppliers, that meets the loads of all exchange customers at efficient prices.”¹²

Section 338, describing the Electricity Oversight Board’s right to approve procedures and qualifications for the Power Exchange governing board, does not require a specific connection to California for Power Exchange governing board members. Instead, it simply requires board members to be electricity customers in the market footprint, and that a broad set of market stakeholders—including market participants and non-participants—be included.¹³ This section even contemplates multistate participation. Are there statutory impediments to transferring market responsibility from the CAISO to a new Power Exchange (leaving transmission system operation and planning with the CAISO)? Would any enabling legislation be required?

As the GRC develops its proposal, it would be helpful if the CAISO could answer the questions Chelan has posed throughout these comments, and provide its interpretation of its legal authority and limitations as well. These answers and information would assist stakeholders and the GRC in this process. Governance reform is of critical importance for market expansion, and Chelan looks forward to continued discussion of this topic.

Sincerely,



Stephen J. Wright
General Manager

¹² Cal. Pub. Util. Code § 355 (emphasis added).

¹³ Cal. Pub. Util. Code § 338.