

# L A's

## The Saga of

# Municipal

# Utility

By Al Senia

### CHARTING THE FUTURE OF PUBLIC POWER

Detractors view the Los Angeles Department of Water and Power (LADWP) as a giant behemoth, impervious to criticism and mired in bureaucracy. Supporters see LADWP, the largest municipal utility in the nation, as an efficient guarantor to the sprawling city of power, water and low rates with an operational model that should be emulated by municipal utilities around the country.

No matter on which side of the perception divide you stand, however, this much is clear: LADWP is huge, and its practices and policies impact public power throughout the United States. In many ways, the California utility's fortunes—as well as its political and operational shortcomings—mirror those of public utilities across the United States.



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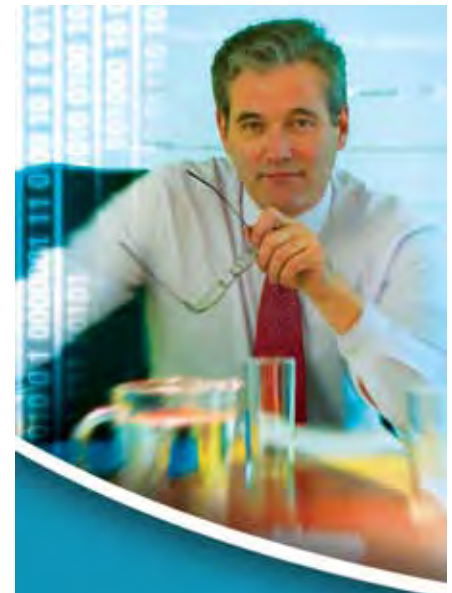
# L.A.'s The Saga of Municipal Utility

*They are a  
bellwether utility company  
in a bellwether state  
in energy matters.*

"In a lot of ways, they represent public power," says Alan H. Richardson, president and CEO of the American Public Power Association. "They are a bellwether utility company in a bellwether state in energy matters." Noting that LADWP serves 3.9 million city residents and has an annual budget of \$3.16 billion (of which electric comprises \$2.5 billion), Richardson views the utility as a "behemoth" compared to other APPA members. "It is certainly not your average publicly owned electric utility simply because of its size," he says.

Much like any dominant player in any industry, LADWP has come to personify the industry itself. Richardson notes that the utility, which played a significant role in founding APPA, has helped validate the ongoing need and significance of public power during an era when energy privatization and deregulation have moved to the forefront. When the issue of deregulating private and public utilities emerged several years ago in state and national legislatures, "LADWP was a leader in providing a vigorous defense to that challenge," Richardson notes. The utility contributed time and money to fight the threat.

However, that activist role comes at a price. LADWP's political activities have come back to haunt it on the home front. The utility, which is governed by a five-member board of commissioners appointed by the mayor and confirmed by the City Council for a five-year term, recently drew fire from some board members for spending \$2.2 million for lobbying in Sacramento and Washington. Ron Deaton, DWP general manager, reported to the board that the agency has a \$1.3 million, three-year contract for federal lobbying with an outside firm. It also spends nearly \$900,000 annually for other contracts with law firms and strategy groups involved in state lobbying. It's unclear what the board will do, if anything, about such expenditures.



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# L.A.'s The Saga of Municipal Utility



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## VICTIM OF SUCCESS

The utility was established in 1902 to deliver water to the city of Los Angeles. It began distributing electricity fourteen years later. Today, it provides 23 million megawatt-hours of electricity and 201 billion gallons of water annually. It generates its own electricity with a total capacity of 7,200 megawatts. Peak demand in Los Angeles recently hit 7,200 megawatts. This means LADWP often has extra electricity to sell to the state and regional power markets. In fact, during the California energy crisis in 2001, the utility did exactly that — and was roundly criticized in some political circles for profiteering during a period of tight energy supplies.

Henry Martinez, LADWP's chief operating officer, says such criticism highlights how the role of the municipal utility can be misunderstood. "We didn't go out with power at that time to influence the market or take advantage of the market," Martinez explained. "We constantly offload extra transmission to the market." Neither state nor federal energy regulators ever charged the utility with wrongdoing.

Such power sales help keep LADWP's electric rates below that of neighboring IOUs, approximately 30 to 40 percent lower for residential users and about 25 percent lower for industrial and commercial users, Martinez estimates. The utility sells about 58 percent of its power to commercial users, 10 percent to industrial users and 31 percent to residential customers. Its operations are financed solely through power and water sales; in fact, the city uses its profit to subsidize some operations. Approximately 7 percent of its operating income (or \$190 million in fiscal year 2004-2005) was transferred to the city general fund, up from \$177.8 million the previous year. That's one reason the utility has managed to survive the political arrows lobbed at it.

In an age of widespread deregulation, LADWP is comfortably and fully integrated. "We have our own generation, our own transmission and our own delivery system," noted Martinez. "We have our own natural gas and coal assets. We are a full-service organization that controls all aspects of operation."

That's a far cry from the state's private utilities, which were deregulated a few years ago, forced to shed their generation and transmission capacity and shoved out into the "free market" for energy supplies. The resultant debacle created shortages, higher prices and much consumer skepticism, although state voters last November handily defeated a ballot initiative to restore utility regulation in the private sector.



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# L.A.'s The Saga of Municipal Utility

## News Flash>>

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### EMBARRASSING GLITCH

Blame an inaccurate work order. Or blame the complexity of running the largest municipal power utility in the land.

In September, power snapped off across Los Angeles, affecting 2 million people. Henry Martinez, assistant general manager of the Los Angeles Department of Water and Power, said a work crew mistakenly cut several power lines, triggering the crisis.

"It was a case of miscommunication," he told the *New York Times*.

### RENEWABLE INVESTMENT

The Los Angeles Department of Water and power intends to use renewable energy sources to generate 20 percent of the energy it sells to retail customers by 2017.

The utility has set an interim goal of 13 percent by 2010.



Henry Martinez

## TRANSMISSION DEBATE

Martinez says LADWP strives to be fully integrated and maintain "a very robust model that has withstood a wide variety of market pressures. We've been able to take out some of the volatility from the energy supply market." Some of the smaller neighboring utilities in cities such as Pasadena, Anaheim and Riverside opted to turn over their transmission capacity to the California Independent System Operator, a public-benefit corporation created to operate the majority of California high-voltage wholesale power grid. Martinez says LADWP opted not to do that; it views transmission as an integral part of its integrated operation.

Transmission capacity is an issue that bedevils the California market; last June the Federal Energy Regulatory Commission chairman warned that the region had the worst electrical supply situation in the nation. Martinez says the large utility has taken an active role in trying to improve the area's power grid by working closely with private utilities in California, Arizona and Nevada. "We operate transmission in our controlled area, but we interoperate with the other utilities and the California ISO," he says.

LADWP still derives 52 percent of its power from coal, a fact that nearly bankrupted it 10 years ago. It derives 26 percent of its power from natural gas, 11 percent from nuclear, 6 percent from hydroelectric and 5 percent from renewables. The use of renewable energy rose from 3 percent to 5 percent during the past year and will reach 20 percent by the decade's end. The state recently launched a massive solar energy subsidy program; LADWP launched its own \$150 million subsidy effort back in 1998 which involves both residential and commercial users. There are additional incentives if the systems are purchased from local manufacturers.

## LADWP – ENERGY SERVICES

>> OPERATING REVENUES	\$2.5 BILLION [6/30/06]
>> CAPITAL EXPENDITURES	\$628 MILLION [6/30/06]
>> ASSETS	\$9 BILLION [6/30/05]
>> EMPLOYEES	5,773 [5/06]
>> CUSTOMERS [6/30/04]	
RESIDENTIAL	1.2 MILLION
COMMERCIAL	180,000
INDUSTRIAL	15,000
>> SERVICE AREA	465 SQUARE MILES
>> POWER SALES [6/30/04]	
TO CUSTOMERS	23.6 BILLION KILOWATT HOURS
TO OTHER UTILITIES	1.4 BILLION KILOWATT HOURS



***Our workforce is aging much quicker than that of other utilities.***

#### EMBARRASSING MISSTEPS

Despite its best efforts, LADWP has suffered its share of public embarrassments. Last September, for example, General Manager Ron Deaton apologized for two power blackouts that affected 2 million city residents; cost the utility more than \$600,000 in damaged equipment and lost revenue; and pointed up weaknesses in the city's power system. "It was an unfortunate event," said Deaton, adding the incidents provided "a humbling insight into the procedures that must be improved and help us better prepare for a major disaster." The blackouts lasted less than two hours in most areas of the city.

DWP officials said the second, larger blackout was caused by workers mistakenly cutting power while performing a modernization upgrade. Their actions caused a short circuit, which triggered a shutdown of city power plants. In their report, officials also recommended that training programs be reviewed, engineering designs receive closer scrutiny, workers get more precise instructions and a better breaker system be developed to keep power lines separate. Another city probe is still pending.

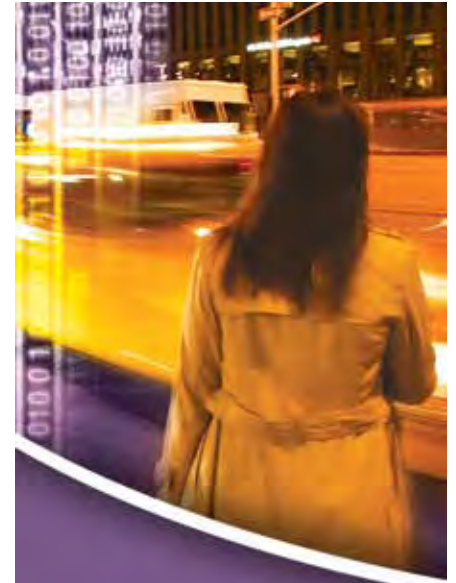
The incident underscored what Martinez identifies as one of his largest challenges. "Our workforce is aging much quicker than that of other utilities," Martinez says. "Successor planning is becoming a challenge as the years go by."

Since LADWP operates under the city's civil service system, Martinez says there is a rigorous method of selection and promotion that contrasts with the more flexible private sector. "In five years, 50 percent of our workforce will be eligible for retirement," he says. In part, that's a result of the pain LADWP still feels from a series of earlier cutbacks to avoid financial disaster. In 1997, the utility struggled under a \$7 billion debt, much of it tied to its investment in the coal-driven Intermountain Power Project in Utah. Paying off the bonds used to build the facility accounted for 60 percent of the cost of producing power from there. This caused LADWP to spend twice the industry average to produce its electricity. To cope with its debt and a rapidly changing energy market, 20 percent of the workforce was let go through buyout or layoff.

As a result, a decade ago many of the most experienced workers took a package and younger, recently hired employees were jettisoned. Now the utility is paying the price. The mid-level experienced workers who stayed put are eligible for retirement. Martinez says the problem is exacerbated by a lack of technical training in high schools and colleges that makes finding qualified replacements difficult. He says the utility is getting more involved in working with city schools to emphasize such training in their academic programs. "Our success has come from building a long, steady legacy of success over the years. It's a challenge to continue to maintain the hiring of personnel," he says.

He believes another key challenge for the utility is maintaining its financial balance in a rapidly changing industry. "We are relying heavily on natural gas as an area of supply," he notes. "Thirty percent of our energy is produced with natural gas. If prices rise above our projections, we're stuck with being underfunded."

The utility is also operating under a mandate to enlarge its portfolio of renewable resources, relying on hydroelectric, wind and biomass projects. "It brings in a whole new level of complexity," Martinez says. ☒



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