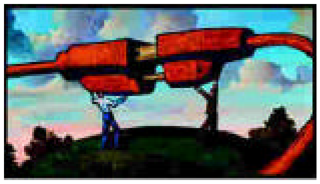

CALIFORNIA Energy Circuit

An independent weekly www.californiaenergycircuit.net

JUICE, September 10, 2004

Overseer's Undercurrent

That Was Then, This Is Now . . . um, Now!

By Arthur O'Donnell

This is how fast things can change on the power system. By noon on Tuesday, the California Independent System Operator (CAISO) was pretty certain that there would be a new peak-demand record set later in the afternoon. But there was confidence about meeting the load without difficulties, as the charts of available resources appeared to indicate more than adequate reserves.

By 1 p.m., the trend of energy consumption began diverging upward from projections at just about the same time that the reserves chart plummeted by 1,000 MW. CAISO managers never confirm specific power plant outages, but it appears from the daily listings of nonoperational units that sometime between 11 a.m. and 3 p.m., two fairly significant generators fell off line: the 775 MW Ormond Beach unit 2 and the 227 MW Huntington Beach unit 4.

What had been a comfortable cushion of reserves thinned precariously as the supply and demand curves rapidly approached convergence.

Over the next three hours, the charts wobbled and dynamic equilibrium shifted. Several small hydroelectric units in Northern California were pressed into service, as were generators previously on maintenance waivers. All the while, Pacific Gas & Electric was trying to reenergize transmission lines near The Geysers region that had been out of service because of nearby fires. Once ash and fire retardant were cleaned away, the lines were able to restore power flows for about 400 MW of geothermal units that had been shut in. CAISO's supply and demand curves moved briefly in tandem, and then diverged as energy use crested and more reserves became available.

Just in time, too. By 4 p.m., the grid operator established another record peak of 45,165 MW, almost 600 MW above the morning's projections. This was the sixth new "all-time" peak set in the past two months on the CAISO system—but it would stand less than 24 hours, as demand reached 45,597 MW on Wednesday (though not in as dramatic a fashion).

The prior demand record, 43,609 MW (adjusted for the more recent loss of Sacramento load), had stood for five years. Now, it appears that 45,000 MW is the target benchmark of power use for a moderately hot day in California.

This is how fast things can change in Sacramento. By midsummer, the outlines of the session's major piece of energy legislation, AB 2006, appeared to be set. There seemed to be an acceptable trade-off between assurances of cost recovery for electric utilities and the ability of certain classes of energy users to enter direct-access markets. A core-noncore market regime was prescribed as the compromise vehicle for restoring some semblance of electric competition while ensuring that anyone wishing to take advantage of the market would have to pay.

Then, a rapid series of amendments to AB 2006 altered the bill radically. Not only was the core-noncore structure deleted; so was existing statutory permission for most of the major elements of the AB 1890 restructuring program—retail direct access, CAISO authorization, stranded-cost recovery for utilities, and all other elements of Section 330 of the Public Utilities Code. Amendments eliminated but did not replace or update those elements.

By the time it was finalized, AB 2006 read more like an agency reform measure. It directs the California Public Utilities Commission to adopt more stringent conflict-of-interest rules; delineates a whole list of new requirements that would redefine the regulated utilities' "obligation to serve"; opens up all significant litigation and/or rate-case settlements to extensive challenges by "any affected party"; and all but requires the CPUC to allow "any creditworthy entity" to trump utility proposals for new power construction. But the ability of investor-owned utilities to recover their costs remained (although the language was refined and the right somewhat limited), as did the rhetorical legislative intent to "restore stability in markets."

These substantive but inexplicable changes to AB 2006 left me wondering exactly what problems legislators were trying to fix, and they pretty much ensure that the governor will veto the bill as soon as he gets around to it.

This is how fast things change in the industry. Only five years ago (about the time California had set its previous record peak), the future seemed clear: Competitive power markets at retail and wholesale were proceeding apace in California and several other states; independent system operators would give way to regional transmission organizations; and merchant generators—possibly merchant transmission operators—and nonutility power marketers and energy service providers of many kinds would lead the way to an unbundled, lower-cost, and more efficient marketplace for electric services.

Three years ago, it was a completely different story as California's power markets were dazed and shell-shocked from toxic exposure to volatile energy costs, market manipulations, and rampant regulatory reversals. Enron was silently collapsing from the inside, and the confidence in markets was evaporating throughout the industry and among policy makers. A return to traditional ratemaking appeared to be the only course of action that made sense to those who had taken over the CPUC.

One year ago, the shock remained, and prevailing consensus was that wholesale markets were moribund and the merchant power model was as bankrupt as Enron, NRG, and Mirant. Traditional utilities were more risk averse than ever, and no energy executive would be caught dead hinting of overseas diversification, construction without contract or rate-base guarantees, or any other chancy ventures.

Then, natural gas and petroleum prices took to the skies while financial houses, including Goldman Sachs, Barclays, Merrill Lynch, and others, jumped into wholesale energy markets and various competitive niches in asset management and trading. Investor-owned utilities' stocks (at least those in the Dow Jones utilities index) began outperforming nearly all other market segments, compared to their dismal, deathbed state a year or two ago.

Things change quickly, making it ever so important for energy professionals to stay on top of it all. As an energy news reporter, I know how difficult it is to stay current, and how much harder it is to adapt to circumstances that change with such velocity. It's not easy to wake up every day and see things in a different light, especially if some of the changes are subtle or partly hidden from clear view.

I've made it my career to fashion some of the tools that people in this business can use to understand and survive these constant changes. I encourage people to subscribe to newsletters like *Energy Circuit*, to follow the daily news flow via Energy Central's Web site and e-mail alerts, and to attend conferences that update all the latest developments and provide the pulse of the industry in those areas of greatest concern to the individual.

The editors of *Energy Circuit* have allowed me this brief commercial message to point out some upcoming events: the Law Seminars International California conference on regulation and markets next week, Energy Central's upcoming audio conference "Bringing Financial Muscle to Power Markets" on September 23, and the Northern California Power Agency's annual meeting in Monterey that same week. I'm also contributing a cover feature on the aging utility workforce for a new *EnergyBiz* magazine that will appear next month, and I have a weekly column called "The Business Electric" found exclusively on Energy Central's Pulse.

I invite you to join me for one or more of these ventures, so that together we can develop a better understanding of what changes to expect next.

—Arthur O'Donnell is national editorial director, newsletters, for Energy Central. He can be reached at energyoverseer@comcast.net *or* www.energyoverseer.com.

California Energy Circuit
editorial@californiaenergycircuit.net
Phone: (510) 883-9827, (510) 534-9109
P.O. Box 2174
Berkeley, CA 94702
www.californiaenergycircuit.net