Restructuring in the Rearview Mirror – a 10-Year Retrospective of California's Doomed Experiment with Electric Deregulation. By The Energy Overseer

How a $20 Sale Became a $150 Loss; Who Will Pay?

In the world of commodity brokering, it is not unusual for contracts to pass through multiple parties, or even for someone to buy the same contract more than once at different prices in order to meet a delivery obligation. After this past week's hectic bulk power market—made worse by widespread transmission and generation failures and record power demand in some territories—traders are exchanging tales of a 25 MW sale that changed hands more times than a rhinovirus.

Although 25 MW was ultimately delivered, at least one of the firms in the chain of delivery ended up buying the "same" power twice and paying as much as seven times the original price—$150/MWh—only to find that someone else had already delivered the energy. Meanwhile, about a half-dozen increasingly frantic power marketers were at a loss as to where to find energy at any price to fulfill their end of a chain deal that broke down.

Part of the problem, one veteran trader suggested, was that few of those linked in the chain knew what was happening, and some less-experienced traders accustomed to the relatively placid pace of long-term prescheduled sales were suddenly faced with the crisis of finding real-time power in a constrained market. So they walked away from their obligations. Sources indicate this was not the only instance of "contract failure" that plagued the bulk power market this week, but it might be the most complicated.

Without naming names, the story goes like this: At the two ends of the chain stood a large "national brand" power seller and a Southern California investor-owned utility which was the ultimate purchaser of the energy. In between were utilities and marketers, large and small, who were part of the delivery chain—each held a reciprocal set of contracts to buy and sell that 25 MW at the Palo Verde switchyard.

The original source of the power was the Northwest hydroelectric system, marketed by Bonneville Power Administration. But as far as the transaction chain is concerned, the generation source was irrelevant. What was important was that the initial buyer/seller also had made the wheeling arrangement from the California/Oregon Border to Palo Verde, via transmission lines that run through two utility control areas in California. Though billed as a "firm" sale, the contract was transmission contingent.

At Palo Verde, this same power was contracted to change hands no less than seven times—each time at a marginally higher price—until the last buyer/seller would deliver it to the ultimate utility purchaser.

The sale was for a single hour of duration during the mid-day peak period. Under normal circumstances, there would have been no problem tapping the huge Western power system for 25 MW and letting the accountants send the bills. However, this particular day presented a different challenge.

The weekend outage left behind a massive void in the supply system: the Pacific Intertie was limited to about 60 percent of capacity; nuclear units were off-line completely or still ramping back up to full power; several overworked Southwest steam generators were felled by tube leaks; and record heat was pushing many utilities to the verge of their historic demand, if not over the top.

Suddenly, a transmission-dominant utility in Southern California announced it was cutting non-firm transmission availability, severing the normal delivery path for the 25 MW to move from COB to Palo Verde. Any one of a number of technical reasons could explain the transmission curtailment, but skeptical observers noted that this same IOU issued news releases touting the fact that it was able to restore native service and sell more than 2500 MW to other power-strapped utilities. The fact that its out-of-state generation was now isolated by a transmission curtailment, one skeptical observer noted, certainly worked out well for the IOU selling into a desperate real-time marketplace.

At any rate—and the real-time energy rate was increasing to $75/MWh, $100/MWh, $125/MWh, even $150/MWh when it could be had—the initial "brand name" seller of the 25 MW was notified about the wheeling curtailment and declared the contract void because of lack of transmission. This seller told its buyer that it was being cut under force majeure provisions of its contract. That company (an independent power producer turned marketer) then cut the next fellow in line (an oil marketer turned power broker), who dumped the next (a Northwest utility). Each declared *force majeure*.

The Northwest IOU, however, rejected the *force majeure* claim and told the broker it was liable for damages under the contract. Because that seller had no energy to deliver, the IOU was forced into the market to find replacement power at $75/MWh to fulfill its next sale. The IOU even found another way to get the energy to the ultimate buyer, via underutilized transmission lines owned by small munis in California.

On paper, at least, the chain of delivery continued: from this IOU to an even bigger IOU, to an oil-pipeline affiliated marketer, to a utility-affiliated national energy marketer, to the biggest marketer of all—the Big Guy affiliate of a huge gas company—who was the final seller in the chain.

This Big Guy, however, did not know that delivery had been restored. It was told by the ultimate buyer, "Delivery has been cut and what are you going to do about it?" It was told by its seller, "Delivery has been cut and there's nothing we can do about it." The ultimate seller realized it had no energy and no easy way to deliver energy it didn't have.

To its credit, this seller accepted the responsibility, and paid a top price of $150/MWh to obtain power for the ultimate buyer, not knowing that the energy was already on its way to Southern California. The hour of delivery had come and the Big Guy was stuck with a high-priced commodity it could not unload.

Now the tracking of liability begins. Someone will have to pick up the tab for the premium real-time purchase that never got delivered. Someone will have to pay for the break in the chain. Each contract likely had a provision for "liquidated damages" that economically enforces the delivery obligation. Each buyer/seller will turn to the next guy higher up the chain for reimbursement. The question is whether the chain of liability will flow all the way to the initial "brand name" seller. One thing seems clear, one party that will bear no liability is the transmission-dominant IOU that cut the delivery path. *Force majeure*. Left behind are a lot of people grumbling about the nature of commitments in the new competitive power market **[Arthur O'Donnell]**

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