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

The Economics of Restructuring in California: How Will We Know When We Get There?

After I pay this month's Pacific Gas & Electric bill, I'll have deposited $123.94 into California's stranded-cost retirement fund. That's $124 down and only $20 billion to go.

Not that I mind being so deep in debt. Big numbers don't scare me; I have a mortgage in San Francisco. Two, in fact.

Besides, since the start of California's restructured and almost-competitive electric marketplace in 1998, I've saved $141.61 off my power bills thanks to the 10 percent rate reduction mandated by AB 1890 and SB 477, the landmark laws that made it all possible. And, so far, that discount has cost me only $182.61.

Such are the economics of restructuring in California. I'll be enjoying that 10 percent discount for four years--financed through bonds over ten years at about 6 percent interest. In the long run, I've been assured by the California Public Utilities Commission, I and everyone else in the state will come out ahead by $1 billion or more. Even though we'll end up paying more than $9 billion to retire $6 billion in rate-reduction bonds, the state has decided that the immediate benefit of that discount will be more valuable than the money it will cost to repay the bonds in the future.

That's good because I'll need the money. I still owe $20 billion dollars.

The total amount of California utilities' stranded costs has never been determined. The most commonly heard estimate, from $28 billion to $30 billion, was derived from utility testimony before the CPUC and the state Legislature in 1994-95 but was never formally adopted in any regulatory decision or law.

Instead, one of the grand compromises embodied in AB 1890 was that the utilities would be given a four-year transition period during which they could collect into a special account the difference between their revenues from retail power sales (at rates frozen to 1996 levels) and expenses. This difference--or "headroom" as it is called--comprises the competition transition charge, or CTC, that is being tracked monthly for accrual into a "transition cost balancing account." One of the many financial devices created since restructuring began, the TCBA is the best measure of the total tab for stranded costs--but it is not the only cost-recovery mechanism for the utilities.

By my count, there are at least a half-dozen ways that the investor-owned utilities will be capturing funds to pay off the state's massive stranded-cost IOUs. (Note: One of the notable rhetorical changes brought by restructuring is that we no longer refer to utilities as IOUs but as UDCs, utility distribution companies. The ratepayers are now responsible for paying off the IOUs in the form of stranded costs.)

Besides the TCBA collections and the rate-bond repayment (which is called the Transition Trust Amount, TTA, on your monthly bills), utilities may keep collecting certain restructuring costs even after the transition period is over. For instance, the costs of implementing the new Power Exchange and Independent System Operator market structures are such expenses allowed by Section 376 of AB 1890. In addition, the law allows utilities to collect their labor severance and retraining costs over an additional five years beyond the end of the transition.

Other sections of the law endorse continued collection of the cost of energy purchased through long-term contracts with independent power producers (known as qualifying facilities, or QFs). In some cases, these contracts will last through the year 2025. The energy portion of the QF payments will eventually be set by the Power Exchange clearing price; the capacity portion of the pacts falls into the category of stranded costs.

Nuclear costs are recovered through the incentive ratemaking deals crafted for San Onofre and Diablo Canyon. The SONGS arrangement will extend for two years beyond the transition period, according to law.

Finally, there are the proceeds from the auction of power plants. California has been fortunate in that nearly all of the utilities' fossil-fuel plants that have been sold earned premiums over their book values, except for San Diego Gas & Electric's South Bay plant, which was transferred at cost to the Port of San Diego in a special deal. PG&E's Hunters Point plant will not be sold but retired and written off. Arguably, this increased the value of other Bay Area facilities, which also fetched a premium above their book value when bought by Southern Company.

Under the assumptions built into AB 1890, the proceeds from power plant sales should be used to decrease the total stranded-cost tab, and any premiums collected above book value should reduce ratepayer liabilities. With enough of a premium from sales, the transition period may be able to end early--as it did in SDG&E territory as of July 1.

But when there is no set stranded-cost figure to subtract from, the calculation of cost liabilities gets very fuzzy. In fact, one of the great unanswered questions of California's restructuring program is this: When will we know when we've paid off the stranded-cost debt? Even though SDG&E has said it has collected enough CTC to end the rate freeze, it's difficult to determine exactly how much is enough.

As best as we can determine, California's utilities have already taken in $10.637 billion to pay for their stranded costs. Now, if the original estimates prove true, we only have $20 billion more to go. That's the easy part of the calculation. Sometime soon, we're going to have to make sure that these costs are allocated properly to each customer class based on their fair share of the debt **[Arthur O'Donnell].**

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