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

Myths Exposed, Myths Expounded

Ever since the summer of 2000 began revealing the seams and structural flaws in Western power markets, California's restructuring program has got more attention from media and the public than at any time previously. Perhaps only the delay in opening markets in January 1998 gained so much initial attention, but this year's season of discontent offered a sustained chance for reporters to turn stories of greed, human misery, political opportunism and regulatory backtracking into daily headlines.

One of the problems in news coverage is that reporters unfamiliar with the industry make assumptions that are offered as facts, exaggerated into headlines and repeated by others in a continuous, echoing loop.

I call these myths, something like the urban legends about Mexican hairless dogs that turn out to be really big rats, or the vanishing hitchhiker who haunts the world decades after her death. These stories sound good, grow with the telling and embed themselves into our way of looking at the world, even if they may not be completely true.

There are other types of myths, stories and beliefs that reflect basic understandings of ourselves and our culture. What we are seeing as a result of the recent crisis is that certain myths we have come to believe--oh, for instance, that a competitive market will bring only lower electricity prices--may be replaced by other myths and beliefs as a result of changed circumstance or disillusionment.

My concern is that we do not confuse one type of myth with the other and end up reformulating the industry on the basis of half-truths and urban legends.

Admittedly, some of our prior conceptions need to be altered by the new realities of the market we're still in the process of understanding. Some things we thought were true have turned out to be not so true.

So, as a public service, I'd like to offer some examples of prior myths that have been exposed as false and several new myths being promoted in the marketplace of ideas.

Majority rules at the CPUC. The majority does not rule; it sits in an uneasy balance between incumbency and irrelevance. Three times this summer, policy directions endorsed and approved by the commission have been overturned--or undermined--by the new Democratic administration. These overrides took the form of direct assertion of a new paradigm, backhanded legislative lobbying and direct action to overturn decisions not favored by the new incumbents.

Independent means independent. The political pressures and serial votes on price caps at the California Independent System Operator's board of governors led to harassment, threats and the public resignation of one board member, plus the replacement of another who was reluctant to toe the new party line. The accusation was that the board had been hijacked by special interests, but the truth is that the stakeholder board was purposefully designed to reach disagreement on anything controversial.

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

Ending the rate freeze early was a good idea. This previously held idea proved false in the instance of San Diego Gas & Electric, and it could prove disastrous for Pacific Gas & Electric and Southern California Edison, as well as their ratepayers.

The corollary proposition--Selling all the power plants at a premium price is a great way to end the freeze early--is also coming under a reality review. No one seemed to think that the new buyers would ever be able to make up their purchase costs in the market; now we've discovered some have already paid off their investments.

In media reports and analyses of the California market, certain "facts" have been repeated so often that people start to believe them.

Utilities were forced to sell their generation. Let's just say they were strongly encouraged by the prospects of reduced rates of return and heightened regulatory scrutiny, but the utilities' proposals to sell all fossil-fueled projects (and others by PG&E) were at their own initiative.

No new generation has been built in California in 20 years. This statement completely negates the history of the independent power industry, which built and continues to operate more than 5,000 MW of diverse generation from 1981 to the present, including virtually all of the state's wind, geothermal and solar resources, plus its most efficient, modern, gas-fired baseload facilities.

California experienced repeated rolling blackouts. What occurred on June 14 was a well-controlled "rotating outage" effected by PG&E and local municipal utilities to compensate for voltage instability in the San Francisco area. The extent of the outages was about three hours, affecting fewer than 100,000 people. Cal-ISO executives have called the June 14 incident "the most flawless load shedding" they ever saw. Within minutes, the action stabilized the problem, and the system was able to ride out a record-setting day with no further problems except all the media attention. Other curtailments of power that happened during the summer (14 instances) were all done under contractual arrangements with the affected customers who voluntarily entered interruptible programs.

Of course, the CPUC is now changing the nature of the interruptible program from one of voluntary participation to something like a mandatory sentence.

Cal-ISO caused the emergencies to drive prices higher to favor generators. This allegation has actually been made by an activist group to the Federal Energy Regulatory Commission. There is a related charge: Cal-ISO prematurely called most of its Stage One emergencies even though there was more than adequate reserve capacity.

The reality here appears to be that the accuser, a Northwest energy consultant, is basing his charge on forecast resource availability from the Western System Coordinating Council while Cal-ISO had to work with what was actually available on those days in question.

When asked whether Cal-ISO had made such a terrible, costly mistake, CEO Terry Winter responded, "This summer I've paid $1 million in penalties to the WSCC for operating the system under reserve requirements."

There are several other mythical statements that have been repeated so often in news reports and regulatory filings that they are on the verge of becoming legends. Unfortunately, we do not have time or space to go into them further this week.

I'll mention a few of the most prominent, and readers can decide for themselves how much truth they might contain:

- The market is not workably competitive.
- Out-of-state generators illegally gamed the system by withholding power.
- Utilities gamed the system by underscheduling load.
- Los Angeles bought Northwest power and sold it at 20 times what it paid.
- SDG&E failed to hedge its purchases.
- Hedging is a guarantee of cost savings.
- Rate caps solve the problem.
- FERC will order refunds of windfall profits.

Because we are still in the midst of six or seven separate investigations of the market, we will have to wait to see whether evidence is brought forth to prove or disprove these new myths **[Arthur O'Donnell].**

This article originally appeared in California Energy Markets, October 20, 2000.