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

From the Front Pages to the Back Burner?

Even before this week's tragedy pushed all other considerations off the front pages of America's newspapers, California's energy crisis had been receding from the headlines and news broadcasts.

One of the last telephone calls I received from a reporter working on the story was on Monday before the disaster, from an ABC-TV network correspondent who was beginning to put together a piece on why California escaped major blackouts this summer. Somehow, I doubt that piece will ever get finished and broadcast.

Many of us have become accustomed to starting our daily news search on the Internet but in recent weeks the crisis has been frequently supplanted by the Gary Condit/Chandra Levy imbroglio, the possible BART strike and now, of course, the multiple threads related to the aftermath of the World Trade Center/Pentagon destruction.

The energy crisis is not over; far from it. Despite the becalmed marketplace for power and gas, I don't think anyone really believes that the underlying problems have been solved, that the flood of emergency orders and legislation have done much long-term good, or that we are on track toward restoring a healthy power market. We still don't even know how much this is going to cost or exactly how we are going to pay for it all.

For reporters, it's just harder and harder to find fresh angles to the story. Even the best recent front-pagers, such as a *San Jose Mercury News* team report from September 9, "Power Deals Under Fire," break little new ground. Though offering a valuable update on the Department of Water Resources' contract obligations in light of the changed market, the article might seem a little stale to casual readers who have heard that line already.

In recent conversations with my journalist colleagues, more than a few have talked about "reader burnout" and the dreaded "editor's burnout." Patience wears thin when your daily headline reads: "Lawmakers Still at Impasse on (fill in the blank)."

That may be inevitable after a solid year of front-page headlines. But it would be a shame to see the attention of news professionals wander from energy even before the immediate situation has resolved. One of the biggest self-criticisms I heard from my professional colleagues has been that too few were paying attention when restructuring policies were being put into place, "when it really mattered." Many of these reporters have been pursuing a year-long graduate course in energy policy, and now that they are finally understanding all the nuances and have developed a sense of context, they realize that "the big story" is now something else.

What I want to do today is to identify which of the still-unfinished news stories emanating from California's energy crisis will be worth watching closely and to suggest some of the story lines that will have long-term consequences for local, state and national energy policies.

The Edison Bailout--Even if the Senate miraculously gets out a measure sometime later today and finds elusive concurrence with the Assembly by the session deadline, a legislated solution to the utility financial morass appears doomed. What Governor Gray Davis had hoped back in April would be a statewide template for utility "rescue" has splintered into three incompatible strategies. There is a hole in the Edison package big enough for unsatisfied creditors, possibly power generators, to drive an armored car through on their way to bankruptcy court. Unlike Pacific Gas & Electric's fairly contained and well-managed Chapter 11 case, an Edison filing (forced or voluntary) will prove nasty and could drag its parent corporation into reorganization as well. Edison International is weak throughout, and despite the attempted "ring-fencing" around Mission Energy assets, there is little else of value left in the corporation except its public housing investments. The house that Bryson built could well collapse.

The California Power Authority--Few know what exactly to make of this new agency, except that it was structured in the image of Dave Freeman. Even though there is a 2007 sunset date built into the legislation that created this entity, there is a strong motivation to make it a permanent part of the energy agency firmament. Statutorily appointed board member Phil Angelides is not secretive about his desires to see this entity become a lasting model for public power and state intervention in energy markets.

Though the agency's initial strategies of securing reserve margins and boosting investments in renewable resources and efficiency are worthy goals, the Power Authority has been established in ways that create direct conflicts with existing market structures and other regulatory agencies.

The Department of Water Resources--The surface indications are that DWR has done its task and will increasingly back away from power buying. Key staff are already returning to their main jobs with the state water agency. However, many of the contracts signed by DWR last for a decade or more, and the continuing obligation to meet "net short" energy needs has not disappeared, despite a current surplus. Something is going to have to be done about the ongoing need to derive a "revenue requirement," and given challenges from PG&E, the courts may decide the department must create a special accounting staff just to make sure the job is done to the same standards as a traditional regulatory review.

Money--The media are pretty well attuned to the financing issues, and you can expect more twists and turns as California attempts to issue as much as $20 billion in bonds to cover DWR expenses, utility bailout schemes and the activities of the Power Authority. The entire financial landscape has changed dramatically following this week's events.

The California Public Utilities Commission--Speaking of regulatory review, it should come as no surprise to close observers that the CPUC has been skating on thin legal ice for months now. Its choice to enact policies and issue orders on the fly has thrown the concept of process out the window. I'm told that concern about the defensibility of some orders is "an everyday conversation" within the agency.

Soon there will be a full five-member panel of Davis appointees. That is going to change things--whether for good or ill depends on whether you think the current administration is doing a good or horrendous job.

New power plants--For all of the executive orders to expedite power plant siting, the fact is that most units that reached operation this summer were in the queue well before the emergency began. The power supply crisis may have been a rationale for temporarily suspending air-quality rules and truncating the public siting process (it certainly was the thing that pushed Calpine's controversial Metcalf project across the line), but even CEC members are openly questioning the continuing need. Public opposition is already stirring at some sites.

The emergency peakers may never get built, nor may a good number of larger plants. There will be a number of reasons, but one of the key factors is the absence of a market. California has already destroyed the concept of "merchant plant," and it is inevitable that developers are going to refigure the balance of risk and reward under the limited options presented when the state appears to be the only buyer.

Market Settlements--Everyone to date has focused almost exclusively on the Federal Energy Regulatory Commission "refund" hearings [EL00-95 et al.], and it is guaranteed that California officials will be dissatisfied with the outcome. Increasingly, market participants are getting anxious about all of the other financial flow issues, particularly the settlements of cost liability between Cal-ISO and DWR. This issue poses a distinct threat to market stability that if left unresolved will haunt us in the not-too-distant future.

Regional Interface Issues--In the long run, this could be the most important policy consideration of all. The greatest weakness of California's response to the crisis is its inherent belief that the state is the most important player and its needs and demands should be met before and above all others'. The key components of this will be formation of a regional transmission operator that fits the specifications of federal policy guidelines and how California will fit into a West-wide RTO.

And that is just a partial list. While I do not expect much of anything to come from the various "market manipulation" investigations except more rhetoric, there will be headlines galore about allegations and accusations. Whether they lead to anything substantive remains to be seen **[Arthur O'Donnell].**