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

From "Soul of the Grid": The Electric Coup d'État

The November ruling from the Federal Energy Regulatory Commission called for dismantling the boards of the California ISO and the PX by January 29. Although the stakeholder representatives were supposed to be replaced by industry experts with no direct ties to market participants, and policy control would pass on to ISO management, Governor Davis and the Legislature had other ideas.

They quickly enacted ABx1-5, another measure authored by Assembly member Keeley, which allowed Davis to name the new ISO board members.[6]

On January 24, a new panel composed of five Davis appointees took its place in the Folsom meeting rooms. Much to his surprise, Electricity Oversight Board chair Michael Kahn was named the new ISO board chair. "I was head of the EOB, and it never occurred to me in a million years that I would be asked to head the ISO," Kahn said. "And the next thing I knew, I got a phone call from somebody saying, 'They want to check the press release with you.'"

The rest of the group: Tal Finney, the governor's energy adviser; Maria Contreras-Sweet, secretary of the Business, Transportation and Housing Agency; Carl Guardino, president of the Silicon Valley Manufacturing Group; and Mike Florio, senior attorney for The Utility Reform Network and the only holdover from the stakeholder board.

In another surprise move, each of the members of the existing board had been served a letter by Attorney General Bill Lockyer, demanding they resign within 24 hours or face criminal penalties of $5,000 each. Most were dumbfounded.

John Fielder, senior vice president of Southern California Edison, said the AG's letter based its demand not on California law but on English common law. "It's an old order that kings used to issue to get rid of princes that might be challenging the throne," Fielder explained.

"It was just mind-boggling," said Barbara Barkovich. "As far as I was concerned, if that law had gone through the courts, it would have been unconstitutional. The FERC had approved the original board; it had approved the tariff. The state had no ability to change the tariff through a state law." She joked that she and the other governors might have been "arrested for impersonating a board member."

But the legal issues were serious ones, said ex-chair Jan Smutny-Jones.

The last formal meeting of the stakeholder board occurred January 25. Governance and transition issues were already on the agenda, noted Smutny-Jones. Everyone agreed that the stakeholder board had become too dysfunctional, but the intention was that a more independent board would be selected to take control, as FERC had required.

"We'd retained outside counsel to advise the board on how to make this transition, and I wanted it to be smooth. There were real legal issues. It wasn't at all clear that what the state did was legal. It was awkward because the ISO is a state corporation, founded under state law, and it's a nonprofit, so that gives the AG a significant amount of authority over nonprofits. But it's also a FERC-regulated utility. We were caught between a rock and a hard place."

The legal procedure, Smutny-Jones was told by attorneys, was that as outgoing chair he should write a letter to Kahn, figuratively turning over the keys. "Then I get a call from the *Los Angeles Times* one night about eight o'clock: 'What do you think about the lawsuit that Lockyer just filed against you guys?'"

He was angered by the apparent public relations ploy. "The reality was there wasn't any drama being set up here, there really wasn't. It was very important to us that we transition smoothly, quietly, and let the system operate. We were very concerned about morale at the ISO; we were very concerned about how all the market participants would view this."

Rather than raising a fight, "We all resigned at the same time in the face of this threat from the attorney general," Fielder said.

FERC was not pleased with the action, but it was undergoing a significant change of its own. James Hoecker announced that he was departing from the commission in late-January, leaving the new Republican administration to appoint a new chair.

Although Democrat William Massey spent one day in the chair's seat, President Bush on January 25 appointed Curtis Hèbert to the job. Hèbert was fervent in support of free enterprise in power markets. "I believe it is part of the solution rather than part of the problem for the malfunctioning markets on the West Coast," he said.

In his last statement on California matters, Hoecker predicted a confrontation with Governor Davis over the ISO board. "While stacking the board of a FERC-jurisdictional public utility with state political appointees may not raise ire in California," Hoecker wrote, "it is an unacceptable intrusion into federally regulated power markets."

The change in leadership at state and federal levels left many people expecting one of two things to happen: Either FERC would immediately declare the new California ISO board structure illegal and take over the organization, or the Davis-appointed board would fire Terry Winter and other executives of the ISO at once.

Amazingly, neither occurred. But that didn't mean either Kahn or Davis was pleased with the grid operator's management.

"It was a very hostile beginning," Kahn reflected. "When I became the chair of the ISO, I went and saw Winter and [general counsel Charlie] Robinson. I basically said, 'Look, I think you did a terrible thing that harmed the state of California. You weren't working for me then. You might not have told the old board what was going on, and they didn't discipline you for it. It doesn't seem appropriate to me to come and change the rules, but here's the deal. If you ever do anything, if you ever lie to me, you're fired. If I don't have the votes to fire you, I'll quit.'"

Kahn said he was "very, very explicit" with Winter and Robinson. "I viewed it as a matter of my duty and responsibility to give them one chance . . . and Winter never told me anything that didn't turn out to be true," he said. "I believe now in retrospect that

Charlie and Terry sincerely thought what they were doing was right. I believe that they showed a lack of judgment" about the effects of the soft price cap.

From the vantage point of two years, Kahn explained why the California ISO team was still in their jobs. "They have earned my trust, all of them."

There was, however, no trust between the Davis administration and the federal government. On February 7, the emergency orders from the Department of Energy lapsed for the last time. **[Arthur O'Donnell].**