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JUICE: Overseer's Undercurrent What If Restructuring Worked?

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During his final State of the State speech last night, Governor Gray Davis outlined an aggressive spending package for water, transportation, and housing projects, pledging to promote \$50 billion for new infrastructure over the next decade. After several years of fiscal constraint following the post-9/11 economic downturn, Davis said he is pleased to report that state tax revenues increased by \$5 billion last year, allowing a "fresh start" for California's budget.

Challenging critics who claim he will be a lame-duck executive during his last year in office, Davis called for bipartisan support of his "21st Century Express" spending package. It's the state's most ambitious public works program since the administration of Governor Pat Brown. "If there is one thing we've learned from the energy supply squeeze of 2000-2001, it's that timely investments in necessary infrastructure combined with strong oversight of competitive markets can prevent a difficult situation from turning into a full-blown crisis. We can now afford to take the lessons learned from energy and apply them to other areas of critical public need."

Even as he spoke, Democratic hopefuls to succeed Davis began their campaigns for the spring primary. Meanwhile, Republican leaders are said to be in continuing talks with movie actor Arnold Schwarzenegger, trying to convince him to be their standard-bearer in the coming election. Schwarzenegger had previously considered running as an alternative to Davis, but he dropped out when the nascent recall movement fell apart in the summer of 2003.

Historians are rarely given to confabulation. Unlike novelists, columnists, and certain stem-cell researchers who create entire lines of existence from whole cloth, historians prefer to couch any speculations about the past within a solid context of events, documents, and artifacts.

Nonetheless, there is an increasingly popular undercurrent of "What If?" history that investigates how a course of events that, in retrospect, seems inevitable might have unfolded very differently.

Frequently called allohistory or uchronia, these studies of what-might-have-been can be found in dozens of books and scholarly articles, such as the counterfactual classic *HitlerWins* (www.uchronia.com).

This being the month in which we commemorate, but not celebrate, the fifth anniversary of California's January 17, 2001, energy emergency, I thought it worthwhile to forgo the standard postmortems for a restructured energy industry, and instead visit the land of Uchronia.

Here, despite some problems and a lot of controversy, California's competitive electric marketplace survived the troubled summer of 2000 and problematic winter of 2001 without falling into a \$40 billion sinkhole or the snake pit of political missteps, recriminations, investigations, and litigation that we've endured during the past half-decade.

Admittedly, this is an exercise in imagination and hopefully not simply what one German academic terms *geschichtswissenschaft* (unhistorical crap).

In the opening sequence, I posit not only that Gray Davis survived the crisis to fill out his second term as governor but that, unlikely as it seems now, he emerged as something of an admired leader with intact aspirations for national office.

Allohistorians try to identify what they call the "point of divergence" in history. That's the moment when imagination takes over from reality and establishes a different path for the future.

Over the years, many pundits and politicians have speculated that the energy crisis might have been alleviated or prevented altogether by stronger federal actions. For instance, if the Federal Energy Regulatory Commission had more forcefully addressed the problems of cost refunds, market manipulation, and natural gas delivery problems in its December 2000 order declaring California's electric marketplace to be dysfunctional, the outcome would have been different.

Others point to a crucial period the previous August—a period of calm between two perfect storms. At the time, it was possible for utilities to negotiate interim or long-term power supply contracts with generators to reduce reliance on spot power markets and stabilize the increasingly unbalanced allocation of load between the Power Exchange (PX) and the California Independent System Operator.

In my view, however, the crucible of policy choices occurred several months earlier, say January 2000, when it became apparent that Northwest hydropower was not going to be as abundantly available for California consumption. That's when system operators and market participants began pointing out potential trouble spots in San Diego and San Francisco, transmission constraints on Path 15, and something very suspicious about the way Southwestern natural gas was being scheduled for delivery into Southern California.

In fact, all of these things were known, or knowable, well in advance of the summer heat wave that triggered brownouts in San Francisco, price spikes in San Diego, and the first political backlash against power markets. The CPUC had sponsored hearings in San Diego that offered clear warnings of bad things to come. The Legislature held hearings on potential power supply squeezes, and utilities and power marketers were already adjusting their strategies to prepare for (or cause) severe price swings on the PX.

What's different in my scenario is how the people in power responded to these early warnings.

Imagine if instead of ignoring the potential problems, the Davis administration had stepped up early enough to support the grid operator's call for a strong commitment to conservation programs beginning in spring 2000 (rather than delaying its response for a year).

With the full weight of the CPUC behind them, utilities could have implemented a 20/20-like program of incentives for consumers to use less power during the summer. Rather than experiencing 17 Stage Two alerts that summer as loads routinely surpassed 40,000 MW, the sequential peaks were substantially flattened by a broad base of energy conservers, rather than by sole reliance on industrial interruptible customers.

Some emergencies would still have occurred as hot weather led to new record loads for PG&E and many other utilities that year. But the system would have met these challenges without the severe disruptions that took place.

Or perhaps when SDG&E executives first sounded the alarm in April that the other utilities were engaging in massive load shifting away from the day-ahead market and into CAISO spot markets, the regulators and market operators had quickly quashed the price-reducing strategy?not through price caps, but by enforcing market protocols and punishing underscheduling practices with the threat of heavy fines.

Certainly, retail prices would have spiked, and there would have been just as much pressure from consumer advocates and local politicians to reintroduce cost regulation. But suppose the CPUC had actually adopted the philosophy it had been considering in restructuring proceedings, articulated by administrative law judge Angie Minkin in her draft ruling on post-freeze policies: "We did not initiate electrical restructuring to shield consumers from the market. We prefer that customers understand the impact of the market and accompanying price signals."

What if, instead of suspending further restructuring efforts and launching a pointless investigation of what investor-owned utilities did with all that stranded-cost money, the CPUC and legislators had allowed each utility to terminate the retail rate freeze that summer, while establishing balancing accounts to offset windfall profits on nuclear energy sales and plow the money back into transmission upgrades and time-of-use metering?

Might this have set the stage for long-lasting demand-response programs? Utilities would have been set to sign long-term contracts that resulted in massive new power plant construction. Direct access could have really taken off, as independent marketers offered truly competitive pricing and green power products to consumers.

I think it's entirely possible.

Rather than pretending California had caused its own problems and that the market would prevail, FERC might have adopted a policy that "Strong competitive markets require firm oversight, just as in stock markets and other kinds of commodities trading."

The Enron memos would remain unchanged, though, providing insights into the kinds of manipulation possible. But here's the difference, as recently stated in FERC's report on the California crisis: "If the express prohibition of market manipulations had been in place then, it is possible that it would have deterred market participants because they would have known the serious consequences of their actions."

There you have it-though you might come up with your own version of alternative events that might have stemmed the tides of energy history in the state, leading us to a more preferable (or perhaps even worse) situation.

Make Up Your Own Allohistory

Let's imagine some of the other features of our current-day energy Uchronia-the alternate universe to the energy crisis:

- While taking a big economic hit, California's utilities did not fall into insolvency. PG&E never entered Chapter 11?although the Enron debacle did disrupt wholesale markets enough to push the utility into selling its National Energy Generation affiliate and trading operations.
- The Power Exchange eventually faded from the scene, after it was no longer needed to set the price of stranded-cost reimbursements and utilities resumed competitive procurement for long-term contracts. The PX's small market for electric futures contracts was subsumed by NYMEX.
- Unhindered by political adversaries, the California Independent System Operator became the cornerstone of a Westwide regional transmission organization, covering the Southwest but not the Pacific Northwest?which still harbors suspicion of federal regulators? ambitions. Transmission construction booms, despite opposition, and regional markets have become more cohesive and less constrained.
- Retail direct access in California continues at strong levels for industrials and large commercial users, but it never really achieved deep household penetration. Still, dozens of marketers actively try to get consumers to switch from utility service by offering modest price savings and green-power products.

--Renewable energy penetration rises to record levels via consumer choice, rather than portfolio mandates.

--Wholesale energy markets, in contrast, limped through the Enron debacle. The merchant generation model, once assumed to be the future of the industry, has become a hybrid, with companies largely relying on firm contracts but devoting about a third of their supplies to spot transactions. A few early prosecutions of traders for price-reporting practices and other manipulations chastened the wholesale market but did not kill it off.

--The majority of new power plant construction has been for natural gas-fired plants-but they are currently experiencing adverse consequences of price volatility, post-Hurricane Katrina. The newest plants remain profitable because of their efficiency, while many older plants have been forced into retirement or refurbishment.

--A unit at San Onofre Nuclear Generating Station is slated for mothballing, while owners SoCal Edison and SDG&E have decided to invest in a life-extending steam generator replacement for the other--as has PG&E at Diablo Canyon--using shareholder funding as nuclear plants are no longer in the rate base and have been spun off into nonregulated affiliates.

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