

Our Fake Energy Crisis What *Really* Happened in California

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Hiding behind the rhetoric of free enterprise, major campaign donors to George W. Bush have reaped billions of dollars from the president's refusal to cap wholesale electricity prices during California's deregulation crisis. They stand to make billions more at the expense of consumers and the environment if the crisis is used as a pretext to pass upcoming federal legislation promoting fossil and nuclear fuels.

Indeed, based on fears generated by the power crisis in California, energy bills now barreling toward Congress would drill the Alaska National Wildlife Refuge, lift environmental regulations on burning fossil fuels, promote new nuclear power plants and hand still more consumer and taxpayer billions to the producers of electricity.

But there's something dreadfully wrong with this picture.

Namely: the electricity crisis in California has been a contrived, corporate-driven epic that has socked ratepayers and taxpayers with a staggering double-whammy, destabilizing a huge energy delivery system that had functioned reliably for nearly a century.

The disaster's primary driving force was a botched 1996 deregulatory scheme that forced ratepayers to hand more than \$20 billion in "stranded cost" bailouts to the very utilities now crying uncle. Those companies have still not fully accounted for what happened to that money.

Once that deregulatory scheme was enacted, beginning in 1998, critical miscalculations caught those utilities in a vice of their own making that allowed billions more to flow to a select few power generators, many of them key Bush supporters. Those energy barons are, in turn, are using the crisis as a pretext to demand pro-fossil/nuclear legislation that will yield them still more billions, again at the expense of the public and the environment.

At both the state and national level, corporate campaign donations have helped fuel the disaster. And now an increasingly angry California populace is demanding both answers and solutions.

As early as 1996, this catastrophic, immensely complex failure was predicted by consumer and environmental activists who vehemently protested the flawed deregulatory scheme that made it happen. Among other things, they now point out the crisis has nothing to do with the available supply of electricity, which is more than ample to meet California's current needs.

In other words, California's deregulatory disaster has been a predictable political event -- a "failure by design" as one critic calls it -- not one prompted by a real shortage.

The solutions, both for California and the nation, are to be found not in misguided producer-driven legislation, but in proper enforcement of existing federal regulations -- especially in enforcing caps on wholesale electricity prices.

And in the example of municipal-owned utilities in Sacramento, Los Angeles and other California communities that wisely chose to forgo deregulation are models gaining critical new mainstream support as the state moves to dig itself out.

There was much joy and hardly a sign of dissent in Sacramento's official halls of power on the day in 1996 California's deregulation bill was signed by Governor Pete Wilson, who at the time had presidential ambitions.

The legislature had unanimously voted for the bill. The utilities and their lobbyists were gushing, as had their campaign coffers in the months leading up to the vote. This is "a great day for us," cheered John Bryson, president of Southern California Edison, the bill's chief architect. "We believe this plan is the best way to facilitate a smooth, timely transition to a competitive electricity market and maximize value for our shareholders and customers." It was "a large achievement and a sound achievement for the state in terms of giving customers choice."

With abundant infusions of utility cash, AB1890 was promoted by the state's major utilities as a way to save customer money through the magic of marketplace. In 1995, Bryson trumpeted deregulation as "the best, soundest way to move to a desirable competitive market that will benefit all customers, large and small." SoCalEd, he said, was "committed to a 25% rate reduction effective January 1, 2000. As near as we're able to tell, this is consistent with our goal." The utilities spent more than \$3.6 million lobbying to win the bill in 1996, and another \$4.1 million to promote it in 1997.

But Bryson -- who at the time was paid over a million dollars a year to head the utility giant -- could hardly have been more wildly wrong, as he recently admitted. SoCalEd and its counterpart PG&E are billions in debt to their suppliers. Blackouts and threats of blackouts have rolled across the California landscape. The state is hemorrhaging \$50 million per day for a service that, before Bryson's big plan, was cheap and reliable. Politicians are committing Golden State residents to \$10 billion and more in bailout costs, with no end in sight. And the worst has yet to come: annual energy demand peaks not during the winter but during California's sultry summer, when the air conditioners run at full blast.

Fortunately for Bryson and the legion of MBAs that helped him make those predictions, an army of mainstream pundits and corporate think tankers have joined forces exonerate him by

selling the false notion that the crisis couldn't have been predicted. It was instead, they say, due to the unfortunate convergence of increasing demand, bad weather, random power plant outages, grid problems and, most of all, "not enough deregulation." Even now, The Wall Street Journal and a battalion of pro-business heavyweights blame the crisis not on the utilities who drafted the legislation, but on a public that barely knew of its passage, and is now being forced to foot the bill.

Totally ignored is the fact that a broad coalition of consumer and environmental groups saw this coming, right from the start. They bitterly opposed the original AB1890 deregulation bill. In 1998, as deregulation was taking effect, they gathered 700,000 signatures to put on a fall ballot initiative that would have nipped the crisis in the bud.

But they ran into a hugely funded utility attack that would not be denied. Still intoxicated by the promises of deregulation, William Hauck, Chairman of Concerned Stockholders of California, a SoCalEd lobby group, spoke for the industry when he warned that returning to public regulation would dismantle "the competitive electricity market and customer choice, and will actually result in higher electric rates." Big energy steam-rolled the campaign with a \$40 million counteroffensive. The advocates had only \$1 million. Repeal was buried, 73-27. (A parallel Massachusetts campaign was crushed on the same day, by a similar margin, with similar expenditures.)

It was a grim day for consumer advocates like Eugene Coyle, one of the state's most respected energy analysts; Nancy Rader of Public Citizen; Herbert Chao Gunther of the San Francisco-based Public Media Center; Harvey Rosenfield of the Foundation for Taxpayer and Consumer Rights; Ed Maschke of the California Public Interest Research Group; Paul Fenn of the Oakland-based American Local Power Project, and a host of other green activists who had fought hard to avoid what's now happened. They had never trusted the deregulation gamble. They argued that the electric power industry was a natural monopoly that could never sustain true competition and demanded public control. They predicted disaster all along.

One such prophet was Dan Berman, an energy expert working to win public utility ownership for his hometown of Davis, California. With Boston-based activist John O'Connor, Berman wrote in their 1976 book *Who Owns the Sun*:

Today deregulation, cheap electricity, and natural gas are all the rage. But few people are paying attention to what will happen when the price of natural gas and oil go up, as they most surely will, after falling by 75 percent in the last decade. What will happen when the new, unrelated 'independent power producers' of cheap electric power fired by combined-cycle gas turbines pass on whopping rate increases to the public as the price of natural gas soars? Will big industry come weeping to the public, hat in hand, as the savings-and-loan investors did? Are the energy corporations crippling American industry by reinforcing an addiction to cheap fossil fuels and electricity. Will there be a massive ratepayers' revolt when utilities try to stick consumers with doubled and even quadrupled utility bills?

AB1890 did include measures that appeared to benefit ratepayers. A 10 percent rate cut was frozen for as many as four years. But the cut was financed by an elaborate bonding scheme that would force consumers to pay huge sums of long-term interest. "In effect, the small customers are borrowing to give themselves this rate cut, which is like borrowing money to give yourself a raise," said Coyle at the time. This is a "hidden tax that Californians will have

to pay to private utility owners." "Beyond 2002," added Ed Maschke of California PIRG. AB1890 "adds hurdles that customers just jump before leaving the monopoly, making it likely that only a few will benefit even then."

Through the early 1990s, Southern California Edison had stymied the construction of new generating facilities, which they feared would compete with ones they already owned. Now AB1890 made it still harder for startups to lure new customers away from the established giants. And harder still for cities, towns and counties to "aggregate" their demand and buy power as a unit, a measure consumer groups wanted as a counter-balance to utility domination.

When deregulation came, a small number of Californians did leave their established utilities for competitors promising cheaper or "green" renewable-based power. But those competitors could never get a foothold against the entrenched utilities. As the idea of a free market in electricity rapidly collapsed, so did the competition. As Fenn predicted, with unfortunate accuracy: "Unless residents and small businesses can buy power in aggregate through their local governments, 'consumer choice' will mean little more than paying higher rates to a middleman or to your current utility."

There were also some incentives for conservation and renewables written into AB1890. But the utilities have long fought mandated programs for increased efficiency and conservation, many of which have proven highly effective. With deregulation, the utilities are once more in the business of selling as much electricity as they can, and programs demanding the opposite have become marginal at best.

At the root of the problem -- and of the critics' opposition -- were "stranded cost" arrangements that the mainstream media continues to all but ignore. AB1890's driving force was an elaborate compensation program to deliver up to \$28.5 billion to the utilities as an off-set for investments in nuclear power once billed as "too cheap to meter," but in 1996 branded by them as "uncompetitive."

Taken as a whole, warned Coyle at an August, 1996 press conference, deregulation and the torrent of cash it would generate for the utilities "will not build infrastructure in California. PG&E and Edison will likely invest it overseas, in places like Indonesia and Australia where both companies are already active. In fact, the entire [bailout] is a liquidation of California assets, with almost all of this ratepayer and taxpayer money likely to flow to foreign investments."

Today, those same critics are more livid than satisfied that they were right. In their view, the state's once reliable power grid has been sacrificed for a risky attempt at financial alchemy. Service has plummeted and chaos emerged throughout the grid. But in fact, they say, the crisis itself is not real: it's been fabricated by out of state power generators, the "profiteers" that Gray Davis excoriated in his state of the state address, who are withholding energy to drive prices up.

Unfortunately, Davis himself has been compromised by large campaign donations he has taken from SoCalEd and the other in-state utilities. He has helped spread the widely held myth that California simply doesn't have access to adequate power. In fact, it has more than

45,000 megawatts, while peak demand during the blackouts this winter hovered below 30,000, according to the state. In part because SoCalEd fought so successfully against building new power plants inside the state, the stability of the grid now rests on little more than private companies' willingness to sell on the daily spot market. The blackouts, consumer advocates contend, merely show that unregulated companies find it more lucrative to sell less power at a higher price than to sell more power at a lower price.

Moreover, the activists -- and a growing segment of the public -- now suspect the utilities of exaggerating their losses by as much as \$6 billion, through an elaborate shell game: one branch of the company profits lavishly from high prices for energy that it sells to the other branch, while that second branch clamors for a government bailout. Since 1997, for example, the PG&E utility has shifted at least \$4.69 billion to its parent corporation. While the utility was hiring bankruptcy lawyers last summer, its top executives were dumping shares of the parent corporation's stock.

Looming behind it all is the \$20 billion in stranded cost payouts consumer and environmental advocates so bitterly opposed in 1996. "What happened to all that money?" asks Fenn.

Watchdogs like TURN contend the utilities continue to collect billions more than they actually owe on those investments. This windfall, a TURN report says, has been transferred to parent companies, where it's been dispersed as stockholder dividends and shielded by complex accounting firewalls. Thus in the years since deregulation, as Coyle and others predicted, billions have been transferred from the public to the electric utilities to the parent corporations, where it has not been accounted for.

The Public Media Center's Gunther says the companies have spent much of this "rogue cash" as if they were "drunken sailors." Pacific Gas & Electric's parent company, the National Energy Group, has made huge investments in power supply networks in New England and New York, and is actively trying to build a string of natural gas generators along the Hudson. SoCalEd's parent, Mission Energy, has been deeply immersed in controversial speculations in Indonesia during the regime of the deposed dictator Suharto, a shady involvement exposed in depth by the Wall Street Journal. "The money has not gone to help things in California, that's for sure," says Gunther. "But where is it?"

Bush's Backers Cash In -- Big Time

In the name of "free market competition," California's AB1890 electric deregulation bill of 1996 suggested that the utilities divest their power plants. There was a widespread belief that they would become pure distribution companies that would allegedly battle one another for the business of small customers.

The transmission wires that delivered the power would remain as regulated monopolies.

And then the generating facilities would, in theory, be bought by dozens of small, entrepreneurial power companies. With the three key functions of the electric power industry thus separated, the "magic of the marketplace" would drive prices down and service up.

While blaming the public for this crisis, the pundits continue to overlook that the key to the utilities' deregulation scheme was the assumption wholesale electric prices would stay low. SoCalEd and PG&E had devised the cap on consumer prices based on the idea that they could dominate supply.

In fact, according to Fenn, the utilities divested themselves only of about half their power plants. But a substantial percentage of the state's power supply -- about 30% by some estimates -- remains in the hands of independent producers, many of them based out of state.

In the midst of the transition, the big utilities failed to negotiate long-term supply contracts. They now blame that failure on consumer advocates. But the failure instead was a complex, nuanced matter. As Paul Krugman of the *New York Times* has pointed out, the independent producers were opposed, as they stood to profit immensely by keeping the state dependent on short-term markets they could dominate. Consumer groups were in fact supportive. In general, so were regulators. As Gene Coyle puts it, "when the utilities petitioned to be able to sign long-term contracts the CPUC approved that but didn't give a blanket 'prudency' approval ahead of time. In other words the CPUC said -- in effect -- go ahead, but we'll look at them to make sure you aren't doing sweetheart deals. Without that approval, the utilities did NOT take advantage of the new rules."

However it happened, the utilities were left dependent on a spot market where short-term prices could soar without notice. That, in turn, left the public at the mercy of a handful of out-of-state energy speculators, most notably Duke Power of North Carolina, and Dynergy, Reliant and Enron, all of Texas. These are very big players, who more closely resemble the OPEC cartel than feisty Silicon Valley-type competitors that free marketeers envisioned.

Based in Houston, Enron is the nation's largest natural gas supplier -- and one of George W. Bush's key supporters and closest advisors. Its president, Kenneth Lay, gave him \$500,000, his largest single contribution for the 2000 election. James Baker III, George Bush Senior's former Secretary of State, is a principal at Reliant. According to Public Citizen, Enron, Dynergy and Reliant gave in excess of \$1.5 million to Bush's campaign and inauguration committee, and to the Republican National Committee. In all, Public Citizen says nine power companies and a trade association with substantial interests in the California energy market gave more than \$4 million to Republican candidates and party committees in the 2000 campaign. Bush's new Secretary of Energy, Spencer Abraham, was the energy industry's

largest single campaign recipient during his failed US Senate re-election bid in Michigan.

When added to the big contributions the California utilities gave Governor Gray Davis and much of the state legislature, one wonders if the public ever really had a chance. "A handful of people who were really smart figured out how to make a ton of money by selling the same product in essentially the same market conditions as before at ten times the price," says Michael Kahn, co-author of a state-sponsored study on the crisis.

By and large those "people who were very smart" were vastly rewarded by the Federal Energy Regulatory Commission's refusal to cap the prices at which they were selling power to California during a crisis many now believe they created for just that purpose. Wholesale electric prices were deregulated in the early 1990s. But the FERC retained the power to step in and cap those prices when they ceased being "reasonable." It recently did just that during a recent power crunch in the northeast.

But in California, FERC just stood by, helping foster the widespread belief that the power producers withheld supply at key moments to help escalate the price -- and got away with it. That has not yet been officially confirmed by any governmental study. But Public Citizen reports that Enron showed a 42 percent increase in profits last year, Reliant a 55 percent jump and Dynergy at 210 percent rise, all thanks to the feds' refusal to cap wholesale prices. As energy analyst Eugene Coyle puts it: "We've been FERCCed."

Indeed, during the hot summer of 2000, with Bill Clinton still in the White House, FERC did not intervene while wholesale prices soared. When San Diego Gas & Electric (having collected its final stranded cost money) was allowed by the Public Utilities Commission to unfreeze its consumer prices, the first shockwave of the dereg disaster hit southern California consumers. SDG&E doubled and tripled their bills.

Consumer rates for SoCalEd and PG&E, however, were still capped. As wholesale prices soared, they claim to have lost more than \$12 billion. Then, in the midst of the crisis, Jim Hoecker, the widely respected, Clinton-appointed FERC Chairman, resigned without explanation.

When the utilities -- and Governor Davis -- appealed to President Bush to take charge of the situation and re-cap wholesale rates, Bush refused, yielding spectacular profits for his benefactors at Enron and the other independent power producers, not to mention SoCalEd and PG&E's parent companies, Mission Energy and the National Energy Group. Meanwhile, on February 13, a federal court refused to lift the cap on consumer rates that the utilities themselves had devised for AB1890.

It is this vice that has prompted the huge wave of media spin that says the problem in California is not a failure of deregulation, but rather that there simply hasn't been enough. The utilities are desperate to end the rate freeze for consumers they themselves invented to, but whose existence they -- and the free market pundits -- falsely blame on the public.

In the breach, they want the state to buy power for them at huge cost to the taxpayer, thus circumventing the freeze on consumer rates that was the core of the original bargain that allowed them to collect more than \$20 billion in the stranded cost cash bailout.

While refusing to account for where that stranded cost money went, they simultaneously claim they're short of cash. And they've thus created doubt among independent producers like Enron about their willingness or ability to pay. The producers, in turn, want the taxpayers to guarantee the purchase of power at rates that appear to fluctuate wildly based not on supply, but on the willingness of the independent producers to sell it.

In the midst of this convoluted crisis, President Bush wants to further advance the agenda of his vastly enriched supporters on yet another front. He says environmental restrictions should be lifted so more power plants can be built. Alaska should be drilled. There's even a GOP bill afoot to promote the construction of more nuclear power plants.

Oil from Alaska won't make any difference, as the amount of electric power generated by oil in California is marginal. At the federal level, Senators Frank Murkowski and Trent Lott propose the most Sisyphean solution. Building more nukes would, of course, take years. And environmentalists will rightly point out that it was bailouts for atomic reactors the utilities themselves branded "uncompetitive" that led to this mess in the first place.

The proposal to lift environmental restrictions to promote the drilling and burning of natural gas will also create a host of problems. "It's not about supply," says Fenn. "There's plenty of capacity around. It's a problem of who *controls* the supply, and the money that pays for it."

Indeed, says Fenn, the state's electricity demand has peaked at 33,000 mgw, but there is 40,000 mgw of in-state capacity. "As in the oil crisis of the 1970s, this shortage is political, not physical. It is being caused not by a physical lack of energy supply, but by politically-conceived market structures written into AB1890 that prevent non-utility-controlled power from reaching consumers, much as the local telephone monopolies have prevented competition in spite of the law for years.

"That's why local control of electricity supply is critical to real solutions. And why the idea of gutting environmental laws under the auspices of energy relief is such a horribly impotent gesture."

Equally futile, say the critics, is bailing out the utilities that created this mess, and whose parent corporations are profiting from it as never before. "We're so afraid to let these companies go bankrupt," complains Fenn. "But when all is said and done, the public would be better off letting them go bankrupt and using eminent domain to buy their assets. At least then we'll have gotten something tangible out of the deal.

A trip to bankruptcy court, some argue, might also force the utilities to account for where all that stranded cost and other bailout money has gone.

Thus far, the cautious, utility-friendly Governor Davis has been unwilling to lead that charge. A bill now being hotly debated, sponsored by the powerful Senate Democrat, John Burton, would require the utilities to surrender ownership of the statewide transmission network as a price for staying solvent.

The utilities complain that they are not asking for a bailout, only for the high cost of wholesale power to be passed on to consumers.

But critics sense a shifting political climate. "People are angry," says Burton. Even the staid Governor Davis is calling for "a buyout" rather than "a bailout," though how far he is willing to go remains to be seen.

The advocates now argue that while a takeover of the transmission system might be a good first step, it is already regulated, and may need some very expensive upgrades. And it's worth far less than the \$13 billion or more the utilities are demanding. The taxpayers, they say, should get more for their money -- most specifically, ownership of the actual generating capacity, and thus control of the supply system that's now driving the crisis.

One corrective that has already emerged, and is being given a fair chance to become law, is a strong bill giving greater power for cities, towns and counties to aggregate their demand and buy in groups, a feature consumer advocates very much wanted in the original AB1890.

But the real crux of the debate now comes down one thing -- ownership of the actual generating capacity, and thus control of the supply system that's now driving the crisis. The people of the state, say the advocates, should get what they are paying for: permanent protection from private manipulations of their electricity supply.

A broad cross-section, including many of the original AB1890 opponents, are not eager to have the state run a single public-owned utility. "We want a more local-based solution," says Fenn, one embodied by California's two largest public-owned municipals, which have not only weathered the storm, they've thrived in it.

That radical point of view has just gotten powerful backing from James McClatchy, publisher of the powerful *Sacramento Bee*. Beyond the state's taking over the transmission lines, wrote McClatchy in a February 18 editorial, "the next step would be for the state to buy the associated generating facilities." Any final solution," said McClatchy, "would have to include public ownership of the generating plants that PG&E and Southern California Edison sold to speculators, as well as the facilities they still own."

The way to deliver the power, McClatchy added, would be through "existing locally owned and managed utility districts," as well as through ones newly organized to handle the job. "With public ownership of these systems," he said, "would come increased public transparency on all aspects of the operations -- where there is little now -- and thus less opportunity for sweetheart deals with friendly financiers or broker," leaving less room for "the rapaciousness of speculators and selfish political partisanship."

Among others, McClatchy points to the Los Angeles Department of Water and Power and the Sacramento Municipal Utility District have both kept rates stable for their customers while reaping substantial profits selling power into the grid. S. David Freeman now runs the LA utility, but guided Sacramento into its major transition to renewables and efficiency.

In June of 1989, Sacramento voted shut the district's one nuclear reactor, at Rancho Seco. Freeman, who previously ran the Tennessee Valley Authority, led SMUD into an era powered increasingly -- though modestly -- by wind and solar generating facilities, including enough rooftop panels for some 6,000 families. SMUD also inaugurated an unprecedented campaign for increased efficiency. It offered its customers \$100 rebates for retiring wasteful

old refrigerators (refrigerators account for 20% of the average household's electricity consumption). It distributed energy-efficient light bulbs. It promoted roof-top solar water heaters and photovoltaics, which convert sunlight to electricity. And it's planted thousands of shade trees to slash summer air conditioning demand.

Most advocates see municipal ownership as inseparable from a strong push away from fossil and nuclear fuels, which can be too easily manipulated, and toward renewables, most immediately wind. Since natural gas prices have skyrocketed, industrial-sized windmills have become the cheapest and quickest-to-build source of new generation. By December, a massive 450-megawatt wind farm now under construction along the Oregon-Washington border is expected to be pumping out juice at 3-5 cents/kwh, putting it at the cutting edge.

Such green developments, the advocates say, will remain marginal as long as the grid is dominated by a few huge corporations heavily invested in centralized technologies. Electricity is a service, not a commodity, says Gene Coyle. "It can never be subjected to true competition. It needs to be controlled by the public."

"Deregulation of the electricity monopoly is a failure," adds *Bee* Publisher McClatchy. "The monopoly should be returned to the tax-paying consumers who support it and depend on it."

But given the wall of "free market" media spin and the fossil-nuclear orientation of the Bush regime, such lessons will not come easily into the mainstream. The powerful fossil-nuclear interests close to the administration are about to push a federal energy bill headed exactly in the opposite direction, interpreting the California crisis from which they have profited so hugely as a mandate for precisely the technologies that helped create it.

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