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

California's Energy Plan Jigsaw Puzzle

Sometimes, all the pieces are right there on the table and you still cannot make out the complete picture. And sometimes, you get down to the end of the game only to discover that you've still got holes right in the middle of the frame and the last, essential pieces are nowhere to be found.

Over the course of the past month, Governor Gray Davis has been piecing together a new energy plan for the state of California to replace the crippled and costly power market created by AB 1890. The components of the plan are four: 1) stabilize power costs through long-term contracts and relieve utilities of spot-market purchases, 2) increase generation supply before next summer, 3) revitalize energy-efficiency and demand-side programs, and 4) provide some form of financial assistance to utilities to prevent them from going bankrupt. He says he wants to do it all with no further utility rate increases.

Details of the new plan have emerged from a flush of emergency orders, news conferences and hasty legislation. So much news has been flying out of Sacramento that it is difficult to absorb it all before the next wave hits, and we never quite get to pin down the details or assess the credibility of proposals before we're on to the newest series of ideas.

Having tried to add up the numbers and test the reality of the governor's ad hoc energy policies, I'm left with a great concern that he is overselling the solutions. That could leave the state in an even more precarious position if we come up short this summer, even though we believe we've solved all the problems.

1) Power procurement--Appointing the Department of Water Resources as the state's procurement arm to fill in the difference between what utilities generate or control through contracts and what they need to deliver each day was a last-resort measure that threatens to create an institution. The $10 billion funding mechanism, supposedly devoted to long-term contracts, is quickly evaporating in daily purchases, although we are being kept in the dark about the real costs and projections. The latest estimate is $60 million per day now that San Diego's energy is covered. What we've been told is that DWR and its negotiators hoped to obtain about one-third of the utilities' peak demand--between 10,000 MW and 15,000 MW--through contracts and to reduce spot purchases to just 5 percent of load by this week. What we know is that only one contract has been publicly revealed; at the outside, it provides one-tenth of the goal at nearly half the set-aside.

The state has decided it need not reveal any further information about bids. A second procurement attempt has closed, and we know even less about it than we knew about the first. When politicians say they are "very pleased" with the results, but refuse to divulge details, you should worry.

The best that can be said about the procurement effort to date is that it repackages existing resources into an unknown future liability, and the money set aside so far is nowhere near enough.

2) New Generation--The goal announced last week is to add 5,000 MW of new power by this summer, another 5,000 MW by next summer, 5,000 MW by 2003 and another

5,000 MW by 2004: 20,000 MW in four years, given expedited permitting without compromising environmental standards. The biggest questions about this ambitious schedule have not been answered. Will affected communities simply acquiesce as they are denied the full process for reviewing developments? Will there be enough natural gas to fuel these projects? Will there be enough turbine parts? Even if enough emergency peaking units can be solicited to fill a 1,000 MW gap this summer, where will they go and how much will they cost?

Last October, these resources were deemed too expensive by the governor's advisers. What will we pay now?

The men charged with carrying out this order, including Larry Hamlin of Southern California Edison and Winston Hickox, head of the state Environmental Protection Agency, have varying degrees of optimism, but none of them can answer the questions at this point. What reporters heard during a news conference this week was hemming and hawing about gas strategies, vague assurances about equipment availability and nothing at all about how to make this work.

Also, meeting the supply side of the equation depends on assumptions about hydroelectricity and availability of existing units that are beyond the control of the state.

3) Conservation--Pat Dorinson of the California Independent System Operator this week told a reporter, "Conservation is no longer an option. It's a way of life." This month, the governor announced a spending package of $800 million to achieve 3,700 MW of peak-demand reduction by this summer. Half of that money already is allocated for programs through the California Public Utilities Commission and the California Energy Commission.

The figures bear scrutiny. Existing DSM and efficiency programs administered by utilities and approved by the CPUC cost $325 million per year for approximately 120 MW of new load reduction, on top of an equivalent level of ongoing savings. That includes the $73 million Summer Initiative program recently approved. Under last year's law, AB 970, the CEC has allocated $50 million to obtain 161 MW to 200 MW of conservation. Pilot programs proposed by the CPUC's Energy Division envision 100 MW of savings for $138 million, although the Office of Ratepayer Advocates thinks more could be gained by giving customers the tools to leave the system.

Even a back-of-the-envelope calculation shows that we are spending $500 million to get the most readily available 600 MW of conservation. The other 3,100 MW is going to come from where? For only $400 million? At the very least, we have a lot of work to do; at worst, we are deluding ourselves.

4) Utility Stability--The details of this strategy will be revealed later today by the governor, but the outline is known: state purchase of utility assets, including transmission and possibly land, for several billions of dollars. Utilities still must write off billions in losses and drop legal claims to higher rates.

Financed through issuance of bonds (on top of the $10 billion for power contracts), and supposedly with no extra rate increases, this strategy puts California in the electricity business for a long time to come. The costs associated with transmission have not really been worked out. Sure, it's a revenue source, but it requires a minimum $1 billion investment in upgrades to solve all the pent-up problems.

By becoming a player in the game, the state thinks it is winning back autonomy, but it subjects itself to federal jurisdiction over transmission and interstate commerce. In the looming battles with the Federal Energy Regulatory Commission, California will earn no special deference regarding how it operates the transmission system.

Though the governor has called this a "consensus" plan, it is obvious even at this point that it is a one-sided offer. We'll have to wait to see how the utilities, consumer advocates, financial institutions, creditors and courts respond.

So, we still lack crucial pieces of the puzzle. If this should all work out and Davis can prevent the collapse of California's electricity system, it will be a major political miracle--but only the beginning of a difficult transition into an entirely new form of state involvement in the utility business, unprecedented in America. The closest corollaries are federal marketing agencies, or perhaps the New York Power Authority, but those were created in a different historical and economic era and are subject to very different pressures from without and within.

California has a way of creating novel solutions to its perceived problems. The danger is that if they don't work, as our restructured market has not worked, we are left with unprecedented problems to solve. Now we begin phase two of the cycle **[Arthur O'Donnell].**

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