

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

The Law of Unintended Consequences

In these unprecedented times, regulators and lawmakers need to be especially careful about adopting policies in the heat of the moment. While seeking to address one problem, they may inadvertently cause others more intractable.

In a way, you might consider the entire restructuring of California's electricity market an example of this dilemma. The attempt to introduce competition to utility service was initially intended as a way to restore life to a sluggish California economy, which in the early 1990s was in a recession tied to closure of military bases and other factors. One of the problems policymakers were trying to solve was a perception that California's electric rates were well above the national average and that local industries suffered a comparative cost disadvantage vis-à-vis competitors.

And now what do we have? A runaway power market that has already resulted in what many consider the largest rate hike in history--with the suspicion that it will be only the first down payment on a continuing series of bills to come.

When lawmakers enacted AB 1890, they thought they were providing a stable period for consumers under a rate freeze and creating a market mechanism that would ensure low prices for power. Just three years into that market, what has resulted can only be described as a dismal failure, with the constraints of the freeze contributing to the bankruptcy of Pacific Gas & Electric and the misconceptions about competitive prices driving the California Power Exchange. Whether the freeze actually afforded consumers much protection is a matter still to be determined, given the continuing battles over cost recovery.

There are many other examples, but today I'd like to focus on the California Public Utilities Commission's recent decision to impose a rate increase [D01-03-082]. The ruling was adopted with such haste that barely 24 hours had elapsed from issuance of both a proposed order and an alternate to a lightning round of "final oral arguments" to approval of the final order.

Given that it actually took two and a half years between the issue of the CPUC's Blue Book and passage of AB 1890--plus another year of planning, with a lot of discussion and consideration in between--and we still experienced so many unintended consequences, it might be safe to assume that this rate order might contain some surprises.

The manner in which the CPUC has addressed the utilities' power-procurement cost "undercollections" has already become a major issue even though it was somewhat lost in the glare of the rate hike and transfer of collected revenues to the Department of Water Resources, which were the primary aspects of the ruling.

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The commission rejected arguments from the utilities that they had met the conditions specified in law for ending the rate-freeze period. Instead, the CPUC kept the matter open and adopted an accounting proposal put forth by The Utility Reform Network that would balance the utilities' transition accounts to offset payments collected for native generation against the undercollections.

On the surface, that accounting makes sense, especially for the period beginning in May 2000, when the Power Exchange price began to exceed the "headroom" that restructuring law allowed for recovery of utility stranded costs. Rather than accumulating account balances and conducting a true-up each year, TURN favored a monthly transfer of liabilities into the collections account, which it believed better reflected the intent of AB 1890.

In applying this recalculation all the way back to January 1, 1998, the commission has actually put the utilities at risk for much of the transition costs they had collected prior to last summer. During the proceeding, the utilities argued strongly against the TURN accounting change, saying it would extend the rate freeze and cause them to absorb operational costs and write off billions of dollars in transition costs.

Even though the CPUC said it was holding off from making a final determination of the impacts of the policy, this was clearly a major victory for TURN and consumer interests. The utilities have responded harshly. "We do not accept the legality" of a retroactive accounting process, said Southern California Edison's general counsel Stephen Pickett. "Under the accounting change, we go back to 1/1/98, take all the transition costs and use them to pay for generation costs," Pickett testified during a congressional field hearing this week.

PG&E's vice president for regulatory affairs DeDe Hapner concurred. "This is rewriting history and makes it unlikely the rate freeze will ever end."

Under normal circumstances, the utilities would immediately challenge this provision through applications for rehearing of the rate order, then go to court. One of their strongest arguments would actually be on procedural grounds, that the commission was acting illegally by passing such a crucial order in such haste. Appellate judges do not like to interfere with policy decisions, but they frequently find fault with the process used to reach those rulings.

But these are different times, and entirely new tactics are being employed.

PG&E cited the ruling as one of the factors that drove it to seek Chapter 11 protection. This week, the utility asked bankruptcy judge Dennis Montali to enjoin the CPUC from carrying out its order and to postpone a restatement of accounts that the utilities were supposed to provide this week. The utility told the judge that TURN's proposal, as adopted by the CPUC, "was designed as an attempt to interfere with the Filed Rate Case" that the utility is pursuing against

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previous CPUC rulings that have prevented it from collecting wholesale procurement costs through rates [*PG&E v. Lynch; CV-01-1083-RSWL; Central District of California*].

PG&E argued that the ruling is illegal and "would threaten the assets of the estate and interfere with this court's jurisdiction." PG&E asked for a permanent injunction staying enforcement as necessary "to ensure PG&E's successful reorganization and preserve the court's jurisdiction over this matter."

Montali did not immediately put himself in the middle of the argument, but he has set it for hearings in the hopes that PG&E and the CPUC can work something out.

Edison is taking a different stance, arguing that its deal with Governor Gray Davis effectively moots the CPUC decision. How that works remains to be seen, but one of the lesser publicized provisions of the transmission-sale agreement would allow the utility to issue bonds to recover the uncollected costs of generation. Repayment of the bonds comes from ratepayers in the form of a "dedicated rate component" attached to utility bills, possibly over the next decade.

According to Pickett, the memorandum of understanding with the governor "provides that the undercollected amount will be securitized and utilities will be repaid." The effect of the order was to "restack" the accounts, he told CALIFORNIA ENERGY MARKETS. "The MOU makes restacking irrelevant."

This is obviously a position that is not conclusive, which as we know means more lawsuits on the horizon, as well as a hard sell to the state Legislature and the court of public opinion [**Arthur O'Donnell**].

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