

# Rich Ferguson, Energy Matter

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## Blame Game

It seems like yesterday when AB 1890 became law. Folks should have known that the electricity industry changes very slowly and experiments with rapid and drastic changes are doomed to failure.

Enron, a convenient scapegoat, has got most of the blame for the AB 1890 fiasco. But in truth, there is plenty of blame to go around. After all, the legislation was written by California's three investor-owned utilities. They got what they asked for—they just didn't realize what they were asking. One key piece of the bill was to establish a new market—

known as the California Power Exchange—where the utilities and other “load-serving entities” would buy electricity for every hour of every day. I served on CalPX's board of governors, where I had a good view of the train wreck as it unfolded, as if in slow motion.

Market prices were initially what folks had expected—low off-peak and rising as demand

increased. But normality did not last long. Prices began rising even when loads were light, and peak prices became terrifyingly high. Still, the high-priced consultants hired by CalPX to monitor the markets could prove no hanky-panky.

AB 1890 tried to fix a problem that didn't exist. And it didn't fix the problem that did exist and still does. The notion (it doesn't deserve to be called a theory) behind AB 1890 was that “competition in the marketplace” would somehow magically lower electricity prices.

However, the prices paid to electric generators must, on average, cover the cost of fuel and operations. The utilities had been doing a good job of making decisions about which power plants were the cheapest to operate. Utility power plant dispatch decisions were not a problem, and selling power in the CalPX market was not going to lower operational costs.

The problem that prompted AB 1890 was that California couldn't agree on which new power plants to build and who should build them. The utilities, the California Energy Commission, the California Public Utilities Commission, the Legislature, and just about

everyone else spent the decade before AB 1890 arguing about what new plants to build. My organization, the Center for Energy Efficiency and Renewable Technologies (CEERT), was founded in 1990 in order to join the debate.

Oddly enough, electricity rates were going to decline without AB 1890. But then there was that very expensive Diablo Canyon nuclear plant being built by Pacific Gas & Electric. Competitive power plant prices were based on “avoided costs,”

and with Diablo Canyon as the bogey, prices were quite attractive for an initial period of 10 years. But by 1996, many of these projects were “falling off the cliff,” coming to the end of their 10-year bonanza.

I recall a frantic afternoon dashing through the terminals at LAX in order to meet with CPUC member Greg Conlon, to explain that electricity prices were scheduled to come down without AB 1890. I’m not sure whether he understood, and I missed the last plane back to Sacramento. The utilities understood, however. They touted the rate freeze that AB 1890 included as a guarantee that customers would not be harmed by the deregulation experiment. However, they knew perfectly well that freezing rates meant that they would not have to pass the coming savings from lower PURPA prices on to consumers. Keeping the many billions of dollars involved was justified on the basis of purported “stranded costs” that the utilities were going to incur as a result of deregulation.

To this day I fail to understand what it was that justified allowing the utilities to keep this dough. What happened to all this money? The utility parent companies took it from the utilities and squandered it, buying money-losing power plants in other states, among other investments. When electricity prices blew up, the money was gone and the utilities had nothing to fall back on.

When the utilities lost their creditworthiness, the state was forced to declare an emergency and hired the venerable Texan S. David Freeman to round up power contracts that were guaranteed by the Department of Water Resources. Much of the power Californians use today was purchased through these contracts.

So what have we learned from the AB 1890 experiment? The lesson is that the number-one contentious issue in the electricity industry is who is going to be allowed to invest the capital to build new power plants and reap the very handsome rates of return with a virtual ironclad guarantee from the CPUC. That’s the question with which California is still grappling 10 years later. Some say the utilities should regain their complete monopoly dominance over the industry. My own view is that relieving the utilities of all vestiges of competition would result in high prices and poor performance. If other companies can do the job better, more quickly, and more cheaply than the utilities, we should let them.

California continues to struggle with this concept. The real question is how to deal with the political power that the utilities have amassed. Edison and PG&E are two of the largest utilities in the world, and their clout in Sacramento is enormous.

As I predicted to Kip Lipper—one of the smartest legislative staffers in the Capitol—so long as utilities retain their political power, the stalemate will continue. My solution is unrealistic, of course: break utilities into two separate

monopoly companies to manage the transmission system and to sell power to customers and let the parent company compete for long-term generation contracts. If folks had only listened 10 years ago.

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