California's Crisis Threatens the Nation

by Marsha Freeman

In mid-March it became increasingly clear that the sixth-largest economy in the world, that of the state of California, is headed for a literal new Dark Age. Rolling blackouts hit the state on March 19 and 20, *although electricity demand was lower by one-third, than it was on the peak days of the last two Summers, and will be this Summer*. The state's power capacity is already crippled by deregulation, and March was only a small prelude to what the hot weather will bring.

Regardless of what you read every day, this crisis was not caused by a shortage of capacity, or power-hungry consumers, or environmental regulations, but by the "greatest train robbery" in American history. Deregulation allowed a handful of wholesale electricity suppliers, most from out of the state, and most from George W. Bush's Texas, to take actions, including keeping generating capacity off-line, in order to create the appearance of a shortage. This cover story was used to charge whatever ransom for power they could get away with, while they try to convince the gullible that demand has outstripped supply. This profiteering has created a "power market" which threatens the entire nation with ruin. Here is the wave of disaster already breaking over close to 20% of America's national production, including its aerospace, aircraft, and high-tech centers:

- California's total costs for electric power, which were $6-7 billion a year until last year, soared to $27 billion in 2000; they could reach *$70 billion* during 2001.
- The state's $10 billion bond issue, planned to stabilize electric purchases for ten years, may run out *this September,* and isn't even fully committed yet.
- The California state budget, which had the nation's largest surplus reserve fund, is blowing out; 65% of that accumulated surplus has vaporized in the last three months.
- The state's power-grid operator charges that Texas "robber baron" companies looted California of $6.2 billion in hyperinflationary overcharges, just from last May to this February.
- Smaller, in-state power-generating companies are disappearing. Not having been paid for months by the state's big utilities for power, these companies are taking their power off the market or going bankrupt outright.
- Hundreds of large and small companies, from Silicon Valley to the smelter belts of the aluminum and copper industries, are shutting plants or going bankrupt, and were hit in late March with another 40% rate increase.

Inflation Is Spreading

Any citizen, legislator, or Federal lawmaker who thinks that this is "California's problem," should think again.

On March 26, economist Steve Cochrane reminded the readers of the *San Francisco Chronicle* that "everything we produce or consume requires power." Cochrane predicted that the price tag for goods produced in California, and consumed all over the country, will rise 2-4%. This is very conservative. According to the Bureau of Labor Statistics, the consumer price index for the Bay Area of Northern California has already risen 6.5% from February 2000 to February 2001, 3% higher than the national figure.

Considering how much of the food you eat and the high-technology products you depend upon for your daily standard of living comes from California, consumers and industries around the nation will now feel the effects of this run-away speculation in energy.

The tentacles of California's financial disaster have already reached your state. Pension funds, municipalities, and school districts across the nation that hold California utility debt are seeing their investments become worthless. Payments in the tens of millions of dollars have already been missed by the utilities to the State Teachers Retirement System of Ohio, the Tennessee Consolidated Retirement Fund, and dozens of others.

And if the richest state in the union is heading for dissolution, thanks to its deregulation policies, how far behind can others be?

Plenty of Supply, But Not For Sale

If the demand for electricity in California was less than 30,000 Megawatt on March 19, when the state had to institute rolling blackouts to protect the grid, why weren't there blackouts last August, when demand was nearly 45,000 MW, or 50% higher?

While the Winter season is when scheduled maintenance for power plants generally takes place, state agencies say that *this* Winter, there was suddenly a 50% increase in the number of power plants off line, making more than 11,000 MW of capacity unavailable. When State Public Utilities Commission officials tried to investigate whether the plants were taken down to create an artificial shortage and drive up the price ("gaming" the market), they were physically stopped at some of the plant gates.

For nearly a year, state officials have appealed to the Federal Energy Regulatory Commission (FERC), currently headed by free-market ideologue and Trent Lott protégé Curtis Hebert, to investigate and punish instances of market gaming. Under intense political pressure, FERC's Hebert released a report on March 15 naming Williams Energy Marketing & Trading, based in Tulsa, and AES Southland of Virginia, as having taken power plants out of service in April and May of last year, for the sole purpose of driving up the price.

Another factor leading to the rolling blackouts stemmed from the financial distress of Southern California Edison and Pacific Gas & Electric, which have been failing to pay small producers for electricity since November. About 3,000 MW—10% of total demand—were off-line during the two days of blackouts, as non-utility producers, which sell relatively small amounts of power to the utilities, shut down their plants for lack of funds. "Creditors committees" of these smaller producers, facing bankruptcy themselves, have been formed to try to force the two utilities into bankruptcy.

Supply at a Price You Can't Afford

On March 22, California's Independent System Operator (ISO), charged with operating the state's electric grid system, filed documents with FERC in Washington, alleging and documenting that between May 2000 and February 2001, 26 electricity suppliers charged in excess of $6.2 billion over the competitive market price for power. The filing states, that "the current level of unjust and unreasonable wholesale electric prices cannot be sustained without threatening even further the economy of California and, indeed, of the nation."

The ISO studies show that "market power," or the ability to drive up prices beyond what they would be in a competitive environment, accounted for about 30% of the cost the now nearly bankrupt utilities were paying for electricity (**Figure 1**). This 30% monopoly markup was evident not just during emergencies, when a case could be made that supplies were tight, but during *all* times.

The ISO also addressed the problem of "megawatt laundering," or the practice of scheduling power produced in California for sale to out-of-state customers one day ahead of time, and then re-importing it for sale in the real-time or spot market at a substantial mark-up.

On March 15, Dr. Frank Wolak of the ISO's Market Surveillance Committee informed the Governing Board that based on an extrapolation of prices for the first two months of this year, California's electricity costs could total $70 billion for 2001, compared to less than $6 billion in 1998, and $7.43 billion in 1999. It has been projected that the $10-12 billion bond sale that the state is planning for June, may not be a ten-year stabilization plan, but may run out in September.

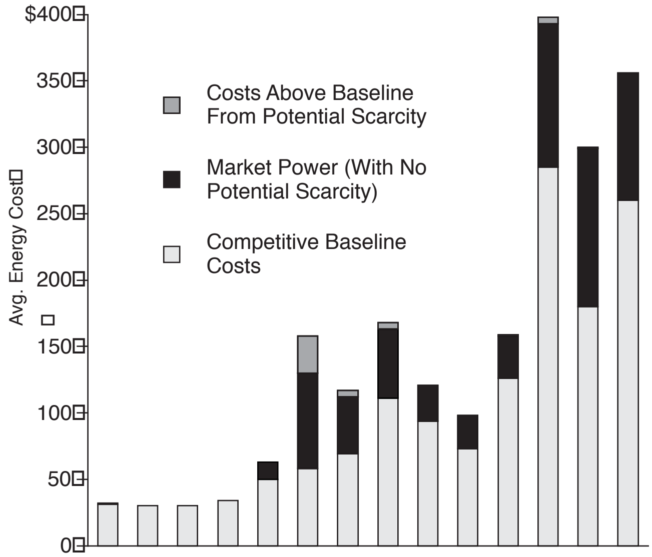
On March 21, the State Controller reported that the California surplus had fallen from $8.5 billion to $3.2 billion since January, when the state started purchasing electricity for the financially strapped utilities. Cuts have already been made in education, transportation, and other infrastructure programs because deregulation has allowed energy speculators to profiteer.

Officials in California are playing out an end-game scenario that could push the state, as well as the utilities, into bankruptcy. There is no solution through "conservation," or raising prices to "send a market signal" to consumers that they have to cut back to prevent blackouts. On March 27, the Public Utilities Commission announced an electricity rate increase that will raise the power generation rates for about half the

FIGURE 1

Impact of Market Power on Wholesale Energy Prices

($/Megawatt-Hr)



Source: Independent System Operator, March 22, 2001 Filing.

California's Independent System Operator finds $6.6 billion in overcharges by suppliers from May 2000, to February 2001. The vast majority of this robbery—the black bars—involved no scarcity, *no statewide power alert. FERC covers up this looting, by counting only overcharges during alerts—the tiny dark gray parts of the bars.*

state's residential consumers by over 40%. In addition to "proving" to Wall Street that the state is serious about paying for the power it has been spending the state's budget to buy, this increase is supposed to motivate people to "conserve," or voluntarily enforce cut-backs on their energy use.

During the Summer of 1997, more than 300 people died during a heatwave in the city of Chicago. Many of those who perished not only had fans in their homes, but also air conditioners. Many were elderly or otherwise on fixed incomes, and did not turn on their air conditioners, because they feared not being able to pay their electric bills. What kind of "market signal" is that?

California, New England, New York, and an increasing number of regions of the country are facing prices for electricity this summer that will put their economy, and life and limb, at risk. The hyperinflation, that is the result of a speculative frenzy by financial interests out to steal as much as they can from the $250 billion per year people pay for their electricity, is spreading through energy-intensive industries, such as mining and aluminum, and farming and manufacturing. Like the plague, no one is immune, and few will be spared.