

# Politics and Markets: The Latest in California

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## Some History

- California ISO and PX began operations 4/1/1998.
  - CAISO ran the grid and ran real-time balancing market.
  - PX ran day-ahead and hour-ahead (later day-of) markets.
- On same date, retail competition began for all IOU customers.
- Utilities were strongly encouraged to sell fossil generation and told to sell all output of their generation and contracted purchases into PX and to purchase all power for their bundled customers from the PX.

# More History

- Wholesale market worked well for first two years; prices were low; supplies were adequate.
- Retail competition also worked well for large customers and for small renewable purchasers
  - Most contracts involved small discounts from IOU tariffs or PX price.

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# More History

- Supplies grew tight in 2000 due to
  - Rapid increase in demand due to hot economy and hot weather
  - Minimal new supply coming on line (generators had waited until new market rules in place)
  - Decline in imports due to growing load in neighboring states
  - Major increase in natural gas prices
  - Some plant unavailability due to high demand on old plants and some apparent withholding of supply

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# More History

- Prices increased sharply beginning in May 2000
- Nonfirm and firm load were shed
  - First rolling blackouts
  - Many hours of interruptible load shedding
- Utilities had to buy even more power in the spot market as they had sold most of their fossil plants under CPUC direction
  - CPUC had deemed spot prices reasonable and utilities were at risk for longer-term purchases

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# More History

- ISO instituted lower price caps, eventually going down to \$250/MWh;
  - Prices hit caps in many hours
  - Price cap issue became very political
  - FERC had to approve changing price caps
- IOUs asked for CPUC permission to buy term power at 5-6 cents/kWh to reduce risk of spot prices; CPUC reacted slowly and was only willing to find “reasonable” prices no longer available in the market; thus IOUs stayed short

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# More History

- Under many prior CPUC orders and under state restructuring legislation, IOUs were at risk for power costs in excess of frozen retail rates
  - IOUs disputed this since spot purchases were under filed rate doctrine and sued the CPUC
- By end of 2000/January 2001, PG&E and SCE were in financial trouble
  - PG&E filed for bankruptcy in April 2001
  - PG&E and SCE credit ratings dropped below investment grade

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# Response to Crisis

- In January 2001 state passed emergency legislation:
  - Directing the Department of Water Resources to buy power to meet IOUs' net short
  - To create California Power Authority to build new plants if necessary
  - To change ISO board to one appointed by Governor, raising jurisdictional issues
  - To stop further sale of IOU generating plants and return them to cost-of-service regulation

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# Response to Crisis

- CDWR signed many 10-year contracts for power in exchange for limited supplies in 2001-2002
  - Contracts were for 6x16 or 7x24 power and did not match peaky load shapes, resulting in need to sell surplus
- Prices for state-purchased power were high; contracts had take-or-pay provisions and high termination costs; state took on much risk; generators little
- Contracts and prices not made public until June 2001, driven by litigation

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# Response to Crisis

- Despite legislated rate freeze, CPUC raised rates twice to pay for DWR purchase costs, targeting large customers, exempting small residential users, and sparing agriculture
  - Called increases “surcharges”, outside of rate freeze
  - Resulted in more than doubling some large customer rates
- Alternate retail suppliers dumped customers back on IOU procurement when prices rose in late 2000 and early 2001, increasing IOU load

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# Response to Crisis

- FERC issued order in December with soft price caps, hard ones in June
- DWR bought power covering much of net short, albeit at very high prices
- Weather was cooler, state began conservation programs and economy faltered
- Spot market shrank and DWR sales of surplus drove down spot market prices

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## Market & Customer Response

- Market prices moderated with DWR purchases, FERC price caps, conservation, and load moderation
- High prices drove many large customers back to direct access (retail competition)
- Direct access (DA) increased from 2% of IOU load in July 2001 to 14% at present
- Increase in DA led to more sales of surplus by CDWR at low prices

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# Regulatory Response

- CPUC decided to impose exit fees on DA customers to have them share the burden of high CDWR prices and sales of surplus at low prices; also to share cost of above-market QF contracts
- CPUC suspended new DA contracts after of 9/20/2001
- CPUC reached settlement with SCE on filed rate doctrine case that largely made ratepayers pay for utility undercollection
- CPUC entered PG&E bankruptcy case to do same

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## Fallout

- State entry at time of high prices locked in high prices for 10 years
  - Contract renegotiations have had only minor impact in reducing costs
  - Price increases in response to rate increases to pay for CDWR power drove large customers to seek alternate suppliers
  - Exit fees may render these agreements uneconomic (exit fee decision expected over a year after customers signed contracts)

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# Fallout

- Now effort to have IOUs take back procurement, once they are creditworthy
  - However, they do not want to take over the high-priced CDWR contracts, although state wants to
  - IOUs want approval by CPUC of medium-term contract purchases going forward to eliminate regulatory risk and spot market risk
  - Customers are stuck with all of the DWR costs and the utility historical undercollection costs

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# Policy Issues

- Could earlier, favorable, CPUC response to utility requests to buy term power in mid 2000 have alleviated problems?
- How much did CPUC focus on spot purchases and divestiture as part of restructuring aggravate the problem?
- Did the state make things worse with its massive procurement at the worst time in the market?
- Could earlier FERC action have helped stabilize market?
- Should retail competition (now suspended) be restarted?
  - New legislation has passed to allow community aggregation, as long as exit fees are paid

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# Policy Issues

- Will redesign of ISO market (i.e. more like PJM) help?
- What role did market power play in price increase, regardless of market design?
  - How can it be controlled?
  - Will FERC-ordered market redesign work in this area?
- What is role of demand response?
  - When excess power resulted from policies, CPUC reduced focus on demand response. Fall in prices has discouraged new generation, which could lead to shortages in as few as 2 years. Will more long-term contracts be needed to assure it is built? Will current state contract linkage to building new generation work?

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# Policy Issues

- Review of all such questions and search for answers is critical to putting the state on a sound power footing. Participants are split between those pro-market and those who claim restructuring was a disaster. Who is right?
- New policy decisions are being made without the analysis. Will they solve the problems?

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