Utilities commission charges energy companies with fraud in California crisis

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Details of the fraudulent schemes used by energy companies to manipulate California's deregulated power market have been exposed in a report issued September 17 by the California Public Utilities Commission (CPUC). At a time when the impact of a severe budget crisis has led to extensive cutbacks in social services, this account, along with other exposures, reveals some of the means by which California's treasury was drained of over $11 billion in the course of an energy crisis that lasted over a year.

According to the analysis made by the CPUC, of the 38 days of blackouts and service interruptions in the state from November 2000 to May of the following year, all of the blackouts that occurred in the south and 65 percent of those in the north could have been avoided. Some 81 percent and 51 percent of the service interruptions in northern and southern California, respectively, would not have occurred if the energy generators—Duke, Dynegy, Mirant, Reliant, and AES/Williams—had not withheld power from the state's energy grid in order to drive up prices.

Basing itself on data drawn from the companies' own records, the CPUC report states that these calculations are conservative estimates, because they accept as valid every instance in which the generators claimed that they could not supply power due to "unplanned" plant shutdowns. The number of facilities that went off-line reached historic highs in the course of the energy crisis. (The CPUC is currently conducting a separate investigation into this matter).

Even with these assumptions, on all but two of the 38 days of power disruptions, the five suppliers had between 37 percent and 46 percent more electricity available for generation. For example, on May 8, 2001, when a 400 megawatt-hour deficit caused the Independent Systems Operator (ISO), the concern that oversees the state energy grid, to blacken the lights in northern California for two hours, Duke alone had the capacity to generate an additional 2,000 megawatt-hours of power.

The companies, collectively responsible for supplying 38 percent of California's power, failed to generate the needed energy in part because they refused to bid power into the state's energy markets.

Under California's deregulated system, there are five separate exchanges through which prices are set for electricity. The Power Exchange (PX) runs "day-ahead" and "day-of" markets to schedule purchases for power needs in advance. The ISO operates its own "day-ahead" market, as well an "hour-ahead" market and a "real-time," or spot-market. The latter is intended to make last minute, unanticipated adjustments to the energy supply. The ISO also makes "out-of-market" (OOM) deals with suppliers. These are often used in an effort to secure needed electricity at the eleventh-hour.

The multi-tiered exchange system is rife with possibilities for manipulation. According to the CPUC report, by either failing to bid at all or by withholding bids from the day-ahead market and then offering them at the last minute in the spot market or as OOM deals, the energy companies created artificial shortages, causing prices to skyrocket.

Before May 2000, a megawatt-hour typically cost between $25 and $40. In December of 2000, it went as high as $1,500—an increase of over 3,700 percent. In part this leap was due to the fact that in early December the ISO was forced to abandon the $250 megawatt-hour price cap that the state had instituted because the agency could not find suppliers willing to sell at that level.

In addition to the "gaming" of the system that occurred through bidding, the energy companies failed to respond to ISO requests for power or ignored commands from the ISO's Automatic Dispatch Instructions (ADI) system to produce energy that the companies had previously agreed on through the bidding system. In some instances, the

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generating firms asserted that "economic considerations" prevented them from supplying the power. In addition to under-staffing and under-fueling power plants so as to undercut their performance, the CPUC found that the five suppliers intentionally delayed the restart times of facilities taken off-line for repairs or maintenance. This further contributed to unexpected power deficits that had to be met with purchases of energy at much higher prices.

ISO records indicate that generators argued with ISO system operators at critical times—impeding efforts to keep the energy flowing in emergencies. During periods in which the power grid's functional integrity is at stake (such as when reserves are below 3 percent) ISO operators have the right to order any generating unit under its authority to produce power without the price being set beforehand. However, on numerous occasions, generators simply refused.

The CPUC report states: "According to ISO logs, in two conversations beginning at 9:21 PM on December 6, 2000, the ISO ordered generator H to start three units with a total capacity of 580 megawatts for system reliability. Generator H refused to start the units up unless the ISO operators guaranteed a price; the ISO insisted that the plants were needed for system reliability. Generator H called back minutes later to report that the plants were simply unavailable due to air quality restrictions."

The response of the energy companies to the CPUC report has been to echo the assertions of Duke spokesman Patrick Mullen, who claimed the accusations were "blatantly false." Mullen insisted that on the dates under scrutiny, the ISO was in control of his company's generating capacity. A spokesman for the ISO, however, stated that while there were instances in which the ISO told suppliers to withhold power, there were "times that the generators simply weren't offering power that was available."

As a front-page article published on September 16 in the *Wall Street Journal* reviewing the evolution of the California energy crisis documents, Duke, Dynegy, Mirant, Reliant and AES/Williams were by no means the only players in the defrauding of California's energy markets. Nor, for that matter, did the price gouging begin only in May of 2000.

The various schemes used by the biggest single player in the California energy crisis—Enron—to inflate prices were symptomatic of earlier efforts by the energy companies. [*See*: Enron defrauded California out of billions during energy crisis] Prior to the onset of the full-blown crisis in late spring 2000, the power suppliers were probing the deregulated market to find weaknesses that they could exploit.

For example, in July 1998, a little over three months after the initial creation of the PX and ISO exchanges, Dynegy began using its position to muscle exorbitantly high prices for its supplies out of the ISO. Dynegy put in a bid to the ISO to provide last-minute reserve power for $9,999 a megawatt-hour. Ordinarily, the price was around $10. According to the *Wall Street Journal*, within five hours Dynegy and three other generators bled the state of $8 million because the ISO had no other sources to turn to at a time when they were scrambling to meet an unanticipated surge in demand.

On one day in May 1999, wholesale electricity prices leapt by 70 percent due to a last-minute shortage caused when Enron proposed to move 2,900 megawatts of needed electricity along a power line that could hold only 15 megawatts. The *Journal* article reported that the maneuver cost the ISO an additional $7 million in last-minute purchases. Enron subsequently paid the PX $25,000 in order to settle an objection raised about the incident.

Immediate power suppliers to the energy market were not the only players involved in swindling California. On September 23, the chief administrative law judge at the Federal Energy Regulatory Commission ruled that El Paso Corporation intentionally withheld natural gas from southern California in order to artificially raise prices on a commodity crucial for energy production. In contravention of CPUC regulations and through illegal collusion with its subsidiary, El Paso deliberately restricted pipeline capacity by 10 percent at the height of California's energy crisis.

According to the CPUC, this raised natural gas prices in southern California by $3.7 billion. The CPUC is demanding a refund of $200 million, an amount equivalent to the profits that El Paso reaped from the deal. Despite the ruling, the company denies wrongdoing and says it will request that the FERC reject the CPUC's demand.

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