High California Energy Prices Resulted in Significant Profit Increases for Out-of-State Generators

Prepared for Rep. Henry A. Waxman

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EXECUTIVE SUMMARY

At the request of Rep. Henry A. Waxman, this report analyzes financial data from California's six largest nonutility energy generators to assess their financial performance in 2000. The six companies, all based outside the state, are Duke Energy, Dynegy, Mirant, NRG Energy, Reliant Energy, and Williams Energy. Together, they own or market roughly 17,000 megawatts of capacity in California. While previous press accounts have discussed some of these companies' earnings, this report is the first to examine the companies' annual reports, filed recently with the Securities and Exchange Commission, to obtain full and complete information for all of 2000.

The report's findings indicate that the companies profited immensely from California's high electricity prices last year. On average, profits more than doubled for all six companies from 1999 to 2000. At both Dynegy and NRG Energy, profits more than tripled.

The companies have a wide variety of operations and they typically do not report their earnings by state. Where data is available, the report analyzes the companies' subsidiaries or operating units doing business in California. These subsidiaries or units posted even larger gains than their parent companies. For example, at Williams Energy Marketing & Trading Co., a subsidiary of Williams Energy Services which sells energy from California facilities, profits increased nearly tenfold, from $104 million in 1999 to over $1 billion in 2000. And at Reliant's wholesale energy business segment, which supplies electricity to California and other competitive markets, operating income rose over 17 times, from $27 million in 1999 to $482 million in 2000.

I. BACKGROUND

The year 2000 was a difficult one for California. In May, residential customers of San Diego Gas & Electric saw their bills double on average, and by mid-summer those customers' bills had tripled. In June, rolling blackouts in San Francisco affected hundreds of thousands of people. The same month, the California Independent System Operator (Cal-ISO) declared the first of many Stage 2 alerts, as power reserves dropped below 5% in the state. In December, for the first time, Cal-ISO declared a Stage 3 emergency as power reserves fell below 1.5%. Stage 3 emergencies were subsequently declared every day for over a month.

While Californians suffered electricity shortfalls and blackouts, higher electricity prices meant higher revenues for power generators and wholesalers based outside the state. Wholesale prices on December 15, 2000, for example, ranged from $429 per megawatt hour (MWh) to $565 per MWh, compared to prices that ranged from $12 per MWh to $29 per MWh one year earlier. According to Federal Energy Regulatory Commission (FERC) Commissioner William L. Massey, "[t]hese high prices serve only to continue a massive wealth transfer out of the region."[1]

Rep. Henry A. Waxman, the ranking member of the Committee on Government Reform, requested that the Special Investigations Division of the minority staff of the Committee on Government Reform investigate the extent to which out-of-state energy generators have profited from California's energy problems. This report presents the results of this investigation.

II. METHODOLOGY

The report is based on publicly available information filed by California's six largest nonutility energy generators with the SEC. These companies are Duke Energy, Dynegy, Mirant, NRG Energy, Reliant Energy, and Williams Energy. All of the companies generate power in California, with the

[1]Remarks of Commissioner William L. Massey to the Fourth Annual Midwest Energy Conference of the Energy Bar Association (Feb. 8, 2001).

exception of Williams, which has an exclusive agreement to market power from California facilities owned and operated by AES Southland, Inc.

The report uses figures for operating revenues, operating income (operating revenues minus operating expenses), and net income (profits) reported by the companies for 1999 and 2000. In two cases, these numbers were not available in the companies' annual reports: the Williams Companies, Inc., did not report net income for their wholly owned subsidiary, Williams Energy Services, and Reliant reported only net income attributable to common stockholders.

In general, the publicly available data on the six companies does not reveal the extent to which the companies' operations in California contributed to their financial results in 1999 and 2000. All six companies have a wide variety of operations and they typically do not report their earnings by state. For this reason, the report also analyzes any publicly available data on the companies' subsidiaries or operating units doing business in California.

III. FINDINGS

The key findings for all six companies are summarized in Table 1.

The key findings for the companies' subsidiaries or operating units doing business in California are summarized in Table 2.

A. Duke Energy Corporation

Based in Charlotte, North Carolina, Duke Energy Corporation delivers both electricity and natural gas to customers throughout the United States and abroad. Duke purchased three electric generating stations from Pacific Gas & Electric Co. for $501 million in 1998, and currently owns four fossil-fired generating units in California with a combined capacity of 3,300 megawatts.

Duke's operating revenues more than doubled from $21.766 billion in 1999 to $49.318 billion in 2000 (an increase of 127%), while operating income also more than doubled from $1.819 billion in 1999 to $3.813 billion in 2000 (an increase of 110%). Net income rose 18% from $1.507 billion in 1999 to $1.776 billion in 2000. Moreover, the 1999 net income figure was inflated by an extraordinary gain of $660 million after tax relating to the sale of certain pipeline companies in 1999. If this extraordinary gain is removed, the increase in net income from 1999 to 2000 becomes 110%. Duke rose from 69 to 17 on the Fortune 500 ranking of the country's largest companies.

The 2000 figures for Duke's North American Wholesale Energy unit, which has operations in California, showed even greater gains. The unit's operating revenues increased from $11.801 billion in 1999 to $33.874 billion in 2000, an increase of 187%. The unit's operating income rose from $210 million in 1999 to $488 million in 2000, an increase of 132%.

B. Dynegy Inc./NRG Energy, Inc.

Based in Houston, Texas, Dynegy Inc. provides energy products and services in North America and Europe through its subsidiaries. NRG Energy is an independent global power producer headquartered in Minneapolis, Minnesota. Dynegy and NRG jointly own 2,768 megawatts of generating capacity in California.

Dynegy's operating revenues increased 91%, from $15.430 billion in 1999 to $29.445 billion in 2000, while operating income grew 168%, from $544 million in 1999 to $1.459 billion in 2000. Net income (profits) more than tripled from $152 million to $501 million. The company jumped from 112 to 54 on the Fortune 500.

Dynegy Marketing and Trade, the company's power generation and marketing subsidiary with operations in California, reported operating income of $770 million in 2000, an

Table 1: Increase in Operating Revenues, Operating Income, and Profits of Electricity Generators (% change from 1999 to 2000)

Company	Operating Revenues	Operating Income	Net Income (Profit)
Duke	127%	110%	18%
Dynegy	91%	168%	230%
NRG	332%	421%	221%
Mirant	488%	50%	-3%
Reliant	93%	49%	N/A
Williams	64%	195%	N/A

increase of 171% over its 1999 operating income of $284 million. The subsidiary's net income (profits) were $440 million in 2000, a 311% increase over its 1999 profits of $107 million.

NRG Energy's total operating revenues more than quadrupled from $500 million in 1999 to $2.158 billion in 2000, while operating income rose more than fivefold from $110 million in 1999 to $573 million in 2000. Net income more than tripled from $57 million in 1999 to $183 million in 2000. Net income from NRG Energy's California assets represented approximately 33% of its net income in 2000.

C. Mirant Corporation

Mirant, formerly Southern Energy, is a global energy company with principal offices in Atlanta, Georgia. Mirant's wholly owned subsidiary, Mirant California, LLC, through its wholly owned subsidiaries, owns generating assets in California with a total capacity of 2,938 megawatts.

Mirant's operating revenues were $13.315 billion in 2000, an increase of $11.050 billion from its 1999 operating revenues of $2.265 billion. Operating income rose 50% from $444 million in 1999 to $664 million in 2000. While Mirant's net

Table 2: Increase in Operating Revenues, Operating Income, and Profits of Electricity Generators' Subsidiaries/Operating Units (% change from 1999 to 2000)

Subsidiary/ Operating Unit	Operating Revenues	Operating Income	Net Income (Profit)
Duke's North American Wholesale Energy Unit	187%	132%	N/A
Dynegy Marketing and Trade	N/A	171%	311%
Mirant Generation and Energy Marketing Products	1079%	N/A	N/A
Reliant Wholesale Energy Segment	143%	1685%	N/A
Williams Energy Marketing & Trading Company	138%	N/A	869%

income dropped from $372 million in 1999 to $359 million in 2000 (-4%), this was in part attributable to a $313 million gain on the sales of assets in 1999 and to higher interest expenses in 2000. Earnings from operations were $366 million in 2000, a 36% increase over 1999.

Revenues from generation and energy marketing products were $12.816 billion in 2000, a tenfold increase over 1999 revenues of $1.087 billion. According to the company's annual report, this increase resulted primarily from Mirant's acquisition of a 40% interest in Mirant Americas Energy Marketing, effective on August 10, 2000, as well as from increased market demand in California, a full year of operations from the company's California and New York plants, and other factors.

D. Reliant Energy, Inc.

Reliant Energy, based in Houston, Texas, is an international energy services and energy delivery company. Reliant purchased five plants from Southern California Edison Co. in 1998 for $292 million. Reliant has approximately 3,800 megawatts of capacity in California.

Reliant's operating revenues increased 93% from $15.223 billion in 1999 to $29.339 billion in 2000, and operating income grew 49% from $1.258 billion to $1.879 billion. The company jumped from 114 to 55 on the Fortune 500.

Net income figures were not available from Reliant, but a related figure, net income attributable to common stockholders, fell 70% from $1.482 billion in 1999 to $447 million in 2000. The 1999 net income attributable to common stockholders was inflated by a gain on the company's Time Warner investment of $2.452 billion.

Reliant's wholesale energy business segment, which provides electricity and energy services in the competitive segments of the U.S. electric power industry, including California, posted substantial gains in 2000. The wholesale energy segment's operating revenues increased 143% for 2000 compared to 1999, from $7.912 billion in 1999 to $19.234 billion in 2000. Operating income rose $455 million in 2000, from $27 million to $482 million, an increase of 1685%. This increase occurred despite the fact that Reliant has not been paid for much of the power sold in November and December 2000 through the California Power Exchange and to Cal-ISO.

E. Williams Energy Services

Based in Tulsa, Oklahoma, Williams Energy Services, LLC, buys, sells and transports energy and energy-related commodities, including power. It is a wholly owned subsidiary of the Williams Companies, Inc.

Williams Energy Services' operating revenues increased 64% to $8.056 billion in 2000 from $4.901 billion in 1999. At the same time, operating income almost tripled, rising from $529 million to $1.558 billion. The Williams Companies moved up from 215 to 168 on the Fortune 500.

As of December 31, 2000, Williams Energy Marketing & Trading Company, a subsidiary of Williams Energy Services, had rights to market approximately 4,000 megawatts of electric generation capacity from facilities in California owned and operated by AES Southland, Inc. Energy Marketing & Trading's profits increased $904 million, from $104 million in 1999 to $1.008 billion in 2000, an increase of 869%. Revenues increased $912 million from $662 million in 1999 to $1.574 billion in 2000. According to Williams's annual report, the growth in revenues resulted from a $1.073 billion increase in trading revenues, which:

> is due primarily to higher natural gas and electric power services margins. The higher gas and electric power services margins reflect the benefit of price volatility and increased demand for ancillary services, primarily in the western region of the United States, expanded price risk management services including higher structured transactions margins, increased overall market demand and increased trading volumes.[2]

IV. CONCLUSION

On average, California's six largest nonutility energy generators posted profits that more than doubled in 2000. In some cases, their subsidiaries doing business in California reported that operating income or profits increased nearly tenfold or more. These numbers indicate that the companies profited immensely from the surge in electricity prices in California last year.

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[2]The Williams Companies, Inc., *Form 10-K for the Fiscal Year Ended December 31, 2000* (Mar. 12, 2001) (available at http://www.freeedgar. com).

V. SOURCES

The financial data used in this report came from the following sources:

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Dynegy Inc., *Form 10-K for the Fiscal Year Ended December 31, 2000* (Mar. 13, 2001) (available at http://www.freeedgar.com).

Mirant Corporation, *Form 10-K for the Fiscal Year Ended December 31, 2000* (Mar. 21, 2001) (available at http://www.freeedgar.com).

NRG Energy Inc., *Form 10-K for the Fiscal Year Ended December 31, 2000* (Mar. 29, 2001) (available at http://www.freeedgar.com).

Reliant Energy, Inc., *Form 10-K for the Fiscal Year Ended December 31, 2000* (Mar. 22, 2001) (available at http://www.freeedgar.com).

The Williams Companies, Inc., *Form 10-K for the Fiscal Year Ended December 31, 2000* (Mar. 12, 2001) (available at http://www.freeedgar. com).