**Minority Staff**
**Committee on Government Reform**
**U.S. House of Representatives**
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FACT SHEET

# The California Energy Crisis: Myths and Facts

Republican leaders and Administration officials blamed California's electricity and natural gas crisis on factors other than market manipulation. They blamed rising demand for power, clean air regulations, power plant siting problems, and retail price caps. They consistently went out of their way to avoid the most obvious answer: market manipulation.

This factsheet examines these claims and compares them to the facts as they are now known a year after the crisis.

***Claim: The energy crisis in California was caused by demand for power that outstripped supply. Vice President Cheney's energy task force declared that "the California electricity crisis is at heart a supply crisis."[1] According to House Commerce Committee Chairman Billy Tauzin, "in California, electric generating capacity dropped 2 percent in the last 10 years. Demand went up 14 percent. . . . When consumers need energy in this economy, this nation needs to respond by making it available."[2] The Washington Times claimed in Insight Magazine that "demand has outpaced supply by a 5-to-1 ratio."[3]***

The Facts: Energy supply within California kept pace with demand. The total amount of electrical energy generated in California increased over 36% from 1991 to 2000, from 186 million MWh to 254 million MWh.[4] The increase in generation has far exceeded the state's 13% population increase and 19% consumption increase over the same period.[5] However due to drought and other factors, the availability of out-of-state energy supplies in 2000 was reduced.

In 2000 and 2001, when the state began experiencing blackouts, increased demand was not the problem. The key factor in determining whether outages occur is peak demand. In California, peak demand did not increase. In fact, peak demand was lower in 2000 than it was in 1998 or 1999.[6] See Figure 1.

***Claim: Clean air regulations were to blame. Shortly before his inauguration, President Bush told CNN that "if there's any environmental regulations that's preventing California from having a 100 percent max output at their plants -- as I understand there may be -- then we need to relax those regulations."[7] House Energy and Air Quality Subcommittee Chairman Joe Barton stated that "some of the (national clean air health) standards may be too tight."[8]***

The Facts: Numerous experts have stated that the Clean Air Act did not interfere with electricity production in California. These experts include Christine Todd Whitman, the Administrator of EPA;[9] Michael Kenny, the Executive Director of the California Air Resources Board;[10] and Carl

Wood, a Commissioner on the California Public Utilities Commission.[11]

The Clean Air Act provided sufficient flexibility to allow power plants to run full time when needed to supply California. When generators in California faced limits on their hours of operation, California acted to expand the number of hours the generators could operate. And in Los Angeles, the South Coast Air Quality Management District exempted power generators from the RECLAIM program,[12] which required the generators to buy costly emission allowances. California used innovative approaches, such as requiring mitigation fees, to ensure that these actions did not harm air quality. The mitigation fees were used to fund cleanup efforts relating to pollution sources.

***Claim: California's restrictions on siting power plants were to blame. Vice President Cheney said that "a big part of the problem in California is the process, especially for siting plants."[13] "The answer to why California doesn't have enough generation is fairly simple," said Sen. Frank Murkowski. "They have gone out of their way to discourage construction of new power plants. The permitting of new power plants has taken forever. They have a severe case of 'not in my backyard' when it comes to new electric power plants and transmission lines."[14]***

The Facts: Environmental restrictions have not prevented the construction of new power plants. Since 1999, seventeen major power plants with a total generation capacity of over 11,000 MW have received siting approval.[15] Fourteen of these power plants are currently under construction, and three are operational.[16]

It is true that no major power plants were built in California from 1986 to 1998. But this was the result of the investment decisions of California's utilities and independent power generators, not environmental restrictions. The Chairman of the California Energy Commission testified that the failure to build major power plants was attributable to "overreliance on the market to determine additional need, as well as regulatory uncertainty associated with restructuring and deregulation."[17]

***Claim: The California energy crisis was a state problem and there was little the federal government could do to help. According to White House spokesman Ari Fleischer, "I think all experts agree -- and we concur -- this is predominantly [a state problem] and the solution will be found in California."[18]***

The Facts: The root cause of the California energy crisis was the huge increase in wholesale rates for electricity, attributable in significant part to market manipulation. The spot market price of electricity in California increased from $30 per MWh in 1999 to $300 in 2001. The spot price even went as high as $1,900 per MWh. See Figure 3. California has no authority over wholesale electricity prices. It is the Federal Energy Regulatory Commission (FERC) that has the statutory obligation under the Federal Power Act to ensure that wholesale electricity prices are just and reasonable.

***Claim: The Administration did all it could do to help California. The Vice President said in***

***May 2001 that "we have done virtually everything the Governor has asked us to do since we came to office."[19]***

The Facts: The Administration consistently opposed the one measure that was crucial to bringing down wholesale prices in California -- a price cap. President Bush dismissed limits on wholesale power prices, saying "that's not a fix" and "price controls would be a short-term delay of a needed solution."[20] And Vice President Cheney said "price controls do not do anything but hurt when you deal with those kinds of questions" and "price caps don't work."[21]

The Administration also overlooked evidence of market manipulation. FERC was warned in August 2000 about some of the trading strategies used by Enron to boost its profits in California.[22] FERC failed to investigate the allegation adequately and to take measures to reduce market manipulation.

After much delay, FERC finally agreed in June 2001 to strengthen the weak price mitigation plan it had previously put in place in California. Even then the White House expressed opposition: The Vice President said, "If I had been at FERC, I would never have voted for short-term price caps."[23]

***Claim: California's retail price caps were responsible for the state's problems. A representative of power company Dynegy testified that "California made a critical error by deregulating only the wholesale market, while maintaining rate caps on retail purchases."[24]***

The Facts: California's retail price caps prevented California's two biggest utilities, SoCal Edison and PG&E, from passing on the high wholesale electricity costs to consumers. The caps did contribute significantly to PG&E's bankruptcy. However, the retail price caps did not cause wholesale prices to skyrocket, and removing the caps would have done little to discourage exorbitant wholesale prices.

The main benefit of higher retail rates is to increase conservation. Ultimately, California recognized this and used retail rates to increase conservation. Under the state's voluntary 20/20 Energy Rebate plan, residential, commercial, and industrial customers received a 20% rebate on their 2001 summer electric bill if they cut back their electricity use by 20% over the previous summer's level.

***Claim: Market manipulation was not responsible for California's energy crisis. Energy Secretary Spencer Abraham dismissed claims that energy producers were conspiring to drive up prices in California and elsewhere as a "myth."[25]***

The Facts: Market manipulation, combined with a flawed deregulatory scheme, was the real cause of the energy crisis. According to the head of Cal-ISO, which operates California's electricity grid, "the exercise of market power by suppliers . . . has cost California consumers billions of dollars since the summer of 2000."[26] The most serious manipulation involved energy generators exercising market power by selling electricity at exorbitant prices or by holding supply off of the market to drive up prices. In March and April 2001, the outage rates at power generators averaged 14,000 to 15,000 MW, over four times higher than the normal rate. See

Figure 2. Power plants operated by five companies ran at just 50% of capacity between May 2000 and June 2001.[27]

Power marketers also engaged in various trading strategies that increased costs -- and the likelihood of rolling blackouts -- for California. These strategies are discussed in internal Enron memos. They include submitting phony power schedules; deliberately overstating load (demand) so as to create the appearance of congestion on transmission lines, which would result in the state paying Enron to cut back on its load; and "megawatt laundering," or exporting power out of state and then immediately importing it back, in order to evade price caps. The Enron memos gave these ploys names like "Fat Boy," "Death Star," and "Get Shorty."[28]

Perhaps the most cynical ploy was the simplest -- buying price-capped power in California and exporting it to other regions without a price cap. According to one memo, written in December 2000, the latter strategy "appears not to present any problems, other than a public relations risk arising from the fact that such exports may have contributed to California's declaration of a Stage 2 Emergency yesterday."[29]

Recent admissions by at least seven major energy traders that they participated in fake "round-trip" trades have further underscored the extent to which energy markets are subject to manipulation.[30] Those companies, several of which conducted business in California, all conducted trades in which they exchanged the same amount of power at the same price with another company. The trades were apparently intended to exaggerate the companies' revenues and make it appear that markets were more active than they really were. They may also have contributed to higher energy prices. One energy analyst described the trades as having "enormous potential significance."[31]

## Endnotes


1. *National Energy Policy: Report of the National Energy Policy Development Group* (May 2001).

2. House Committee on Energy and Commerce, Subcommittee on Energy and Air Quality, *Hearing on Congressional Perspectives on Electricity Markets In California and the West and National Energy Policy*, 107th Cong. (Mar. 6, 2001).

3. *Californians Enter 'In-the-Dark' Age*, Insight Magazine (Jun. 11, 2001).

4. *See* California Energy Commission, *California Electrical Energy Generation, 1991 to 2001* (online at www.energy.ca.gov/electricity/ electricity_generation.html).

5. *See* California Energy Commission, *California Electricity Consumption by Sector (1990-2000)* (online at www.energy.ca.gov/electricity/ consumption_by_sector.html).

6. *See* California Energy Commission, *Previous Energy Commission Peak Electricity Demand Forecasts* (online at www.energy.ca.gov/electricity/ commission_demand_forecast.html).

7. *Bush Suggests Easing Curbs on Pollution*, Los Angeles Times (Jan. 19, 2001).

8. *Showdown Likely over Clean Air Act*, Fort Worth Star-Telegram (Jan. 26, 2001).

9. *Crossfire*, CNN (Feb. 26, 2001).

10. Letter from Michael P. Kenny to Rep. Henry A. Waxman (Feb. 14, 2001).

11. Testimony of Carl Wood, House Committee on Energy and Commerce, Subcommittee on Energy and Air Quality, *Hearing on Electricity Markets: Lessons Learned from California*, 107th Cong. (Feb. 15, 2001).

12. South Coast Air Quality Management District, *Proposal to Adopt Proposed Changes to RECLAIM* (agenda no. 35 at May 11, 2001 board meeting) (online at www.aqmd.gov/hb/ 010535a.html).

13. *Fox News Sunday*, Fox (Jan. 28, 2001).

14. Congressional Record, S508 (Jan. 24, 2001).

15. California Energy Commission, *Update on Energy Commission's Review of California Power Projects* (online at www.energy.ca.gov/sitingcases/backgrounder.html).

16. California Energy Commission, *Update on Energy Commission's Review of California Power Projects* (online at www.energy.ca.gov/sitingcases/backgrounder.html).

17. Testimony of William Keese, House Committee on Energy and Commerce, Subcommittee on Energy and Air Quality, *Hearing on Electricity Markets: California*, 107th Cong. (Mar. 22, 2001).

18. *New D.C. Team Not Likely To Play a Major Role in State's Power Woes: Bush Aide Calls It a California Problem*, San Diego Union-Tribune (Jan. 18, 2001).

19. *Meet the Press*, NBC (May 20, 2001).

20. *Bush Won't Intervene in Calif. Crisis*, Associated Press (Jan. 18, 2001).

21. *Meet the Press*, NBC (May 20, 2001).

22. *FERC Told by Edison of Market Rigging by Enron*, Los Angeles Times (May 21, 2002).

23. *Cheney Rejects Price Caps, Aid for Calif. Power Crisis*, Los Angeles Times (May 5, 2001).

24. Peter G. Esposito, Vice-President and Regulatory Counsel, Dynegy Inc., House Committee on Energy and Commerce, Subcommittee on Energy and Air Quality, *Hearing on Electricity Markets: Lessons Learned from California*, 107th Cong. (Feb. 15, 2001).

25. *California Chided on Power-Plant Stand*, San Diego Union-Tribune (March 20, 2001).

26. Statement of Terry Winter, President and Chief Executive Officer, California Independent System Operator Corporation, Senate Committee on Energy and Natural Resources (May 15, 2002).

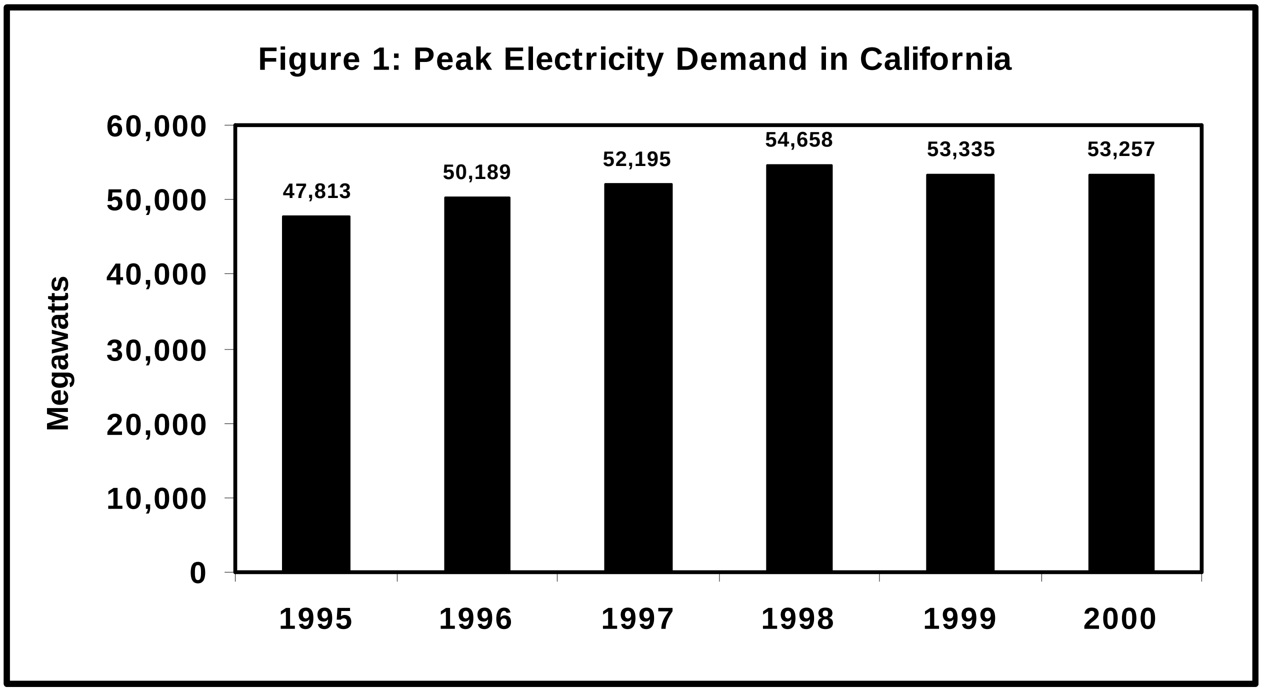
27. Holman W. Jenkins, Jr., *Business World: Memos on a Meltdown*, Wall Street Journal (May 15, 2002).

28. See Memorandum from Christian Yoder and Stephen Hall to Richard Sanders (Dec. 8, 2000) (online at www.ferc.gov/electric/bulkpower/pa02-2/Doc2.pdf).

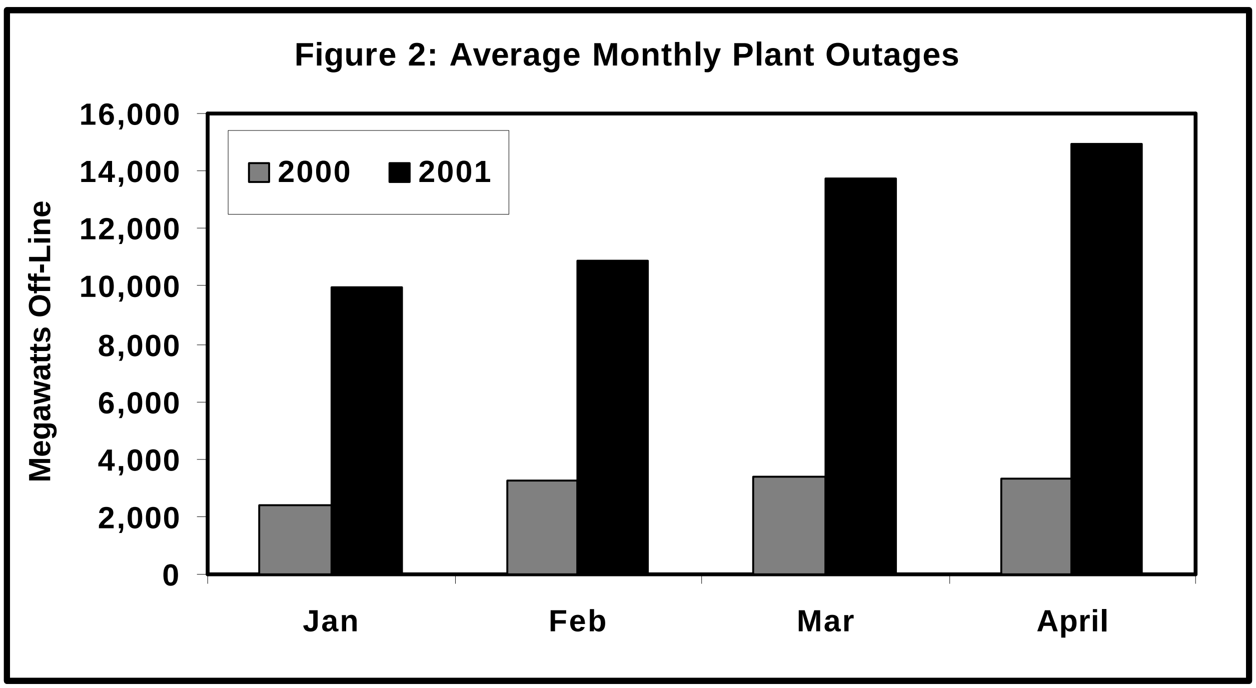
29. Memorandum from Christian Yoder and Stephen Hall to Richard Sanders re: "Traders' Strategies in the California Wholesale Power Markets/ISO Sanctions" (Dec. 8, 2000) (online at /www.ferc.gov/electric/bulkpower/pa02-2/Doc2.pdf).

30. *E.g.*, *Power Firms Told To List Bogus Trades*, Washington Post (May 22, 2002); *U.S. Orders Reports on Power Swaps*, Associated Press (May 21, 2002).

31. *E.g., Power Firms Told To List Bogus Trades*, Washington Post (May 22, 2002).

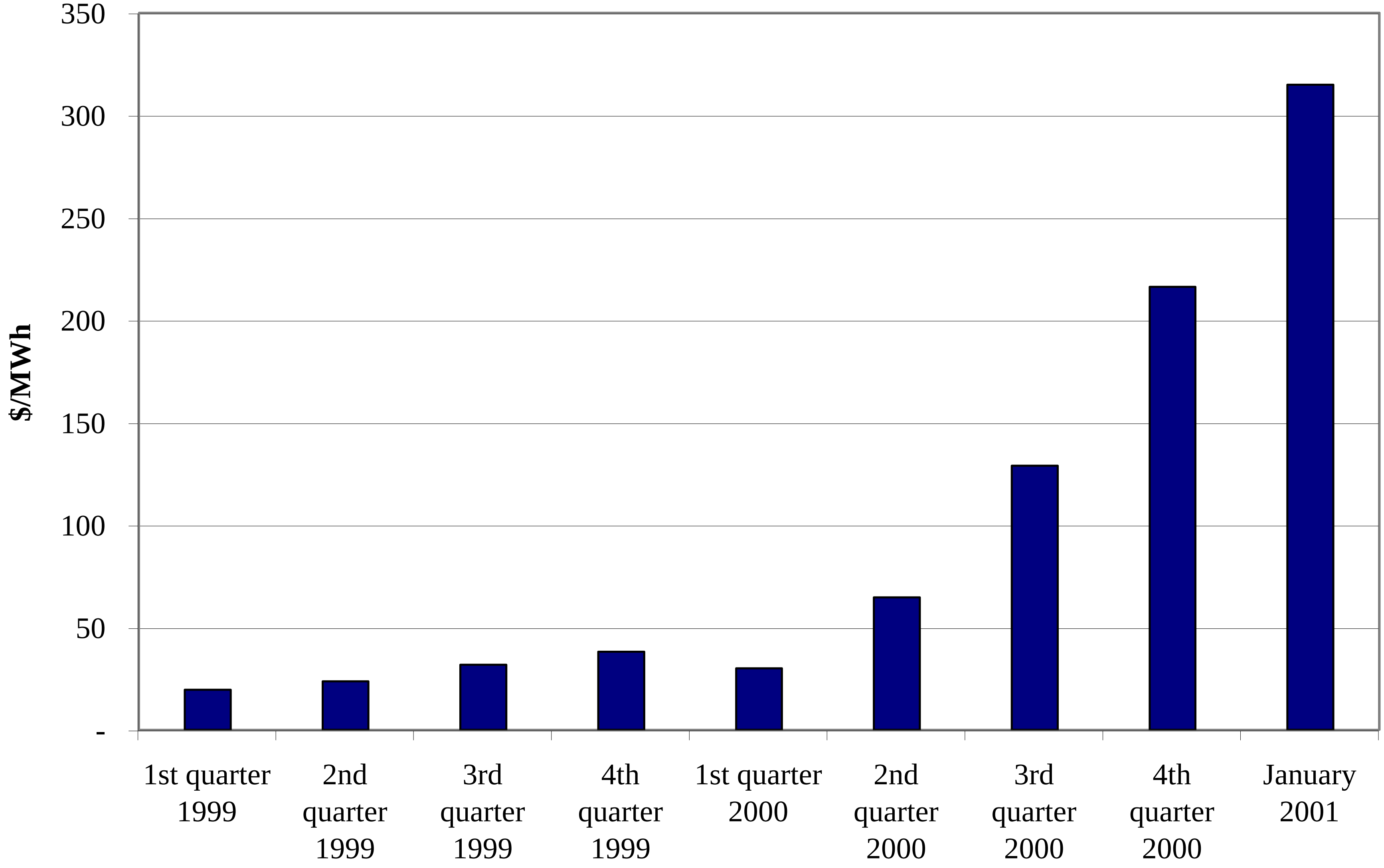



Source: California Electricity Commission




Source: California ISO

# Figure 3: Average Spot Prices
# 1999 - January 2001




Source: California Power Exchange