

# INTRODUCTION AND OVERVIEW

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Since mid-year 2000, California's electricity problems have been a central concern in the state. Californians have faced blackouts, seen the state budgetary surplus decimated, watched as Northern California's largest natural gas and electric utility, Pacific Gas and Electric, filed for bankruptcy, wondered if and when Southern California Edison will follow the same route, listened to politicians debate how much to pay to purchase transmission lines from financially strapped utilities, and listened to state officials point fingers at myriad organizations and individuals for causing the crisis.

This book attempts to explain these events as an integrated saga that California has faced and is still facing. The saga began with an opportunity for California to restructure its electricity system to make it more flexible and responsive to changing economic conditions. Following the flawed implementation of this restructuring, California's political leadership failed in 2000 to respond effectively to the challenge of tight electricity markets, mismanaged the electricity crisis in 2001, and thereby saddled the state with heavy long-term, electricity-related financial obligations. As a result of the fundamental policy mistakes made by the state's governor and other political leaders, the saga continues, with California facing an electricity blight as it struggles to recover from its self-imposed wounds.

The electricity restructuring, often mischaracterized as “deregulation,” included provisions that put the state and especially the investor-owned utilities in a risky economic situation. With delays in new generating-plant approvals, a failure throughout the western United States to match the growth in the consumption of electricity with new capacity, and problems with the newly created California wholesale markets, the downside risks became reality and California faced a difficult challenge.

Difficult challenges require wise political leadership. Such challenges require strong, courageous political leaders willing to make difficult and potentially politically unpopular choices. But that type of leadership never emerged in California. Rather than solving the challenge by taking appropriate steps, California’s governor failed to act and then, once he started to act, overreacted. That failure of political leadership transformed the difficult challenge into California’s energy crisis.

The “energy crisis” was a dual crisis: an electricity crisis associated with an insufficient supply to meet the demands of the California economy and the rest of the West, coupled with soaring wholesale prices, plus a financial crisis facing California’s investor-owned electric utilities, the California state budget, and ultimately the taxpayers and electricity ratepayers of California.

During the height of the crisis and as the crisis subsided, the governor and the California legislature responded to the short-term crisis by enacting a group of long-term measures, which now threaten to create a continuing blight on the State of California. These measures collectively seem designed to turn California into a public power state rather than one characterized by a free market system for electricity.

The changes in California moved through four somewhat distinct, although overlapping, stages. The following four chapters of this book correspond to those four stages:

- California’s Restructuring: Turning Opportunity into Risk
- The Challenge
- Through Crisis
- From Crisis to Blight

Each stage, and in fact the whole process, should be seen not as a random set of disconnected events but rather as a continuing

sequence in which choices were made. At each juncture, there were problems to be solved, often because of earlier policy decisions. At each juncture, there were alternative actions that could have been taken. Given the political and economic forces at play at each juncture, logic underlay the decisions. The choices selected, however, often created new difficulties later. At each juncture, different choices could have led to very different outcomes, and perhaps different problems.

Although one group of events led to another in a causal chain, the results were far from preordained since very different choices were possible at almost all junctures. The totality of the system changes and the consequences for the State of California was the result of this sequence of public policy decisions. Unfortunately, the outcomes are now evolving in directions greatly different from the goals expressed by those instrumental in the initial restructuring.

The focus of this book is this series of policy decisions, the alternatives, and the consequences of the decisions, within the context of the process as a whole.

Figure 1.1 diagrams the chain of causation, linking one decision to the next. The various boxes represent issues, actions, or important system characteristics. The various colors of the boxes represent the four stages of development plus prior conditions. The arrows represent causal links, in the sense that the conditions associated with each action created forces or motivations that encouraged the next decision or constrained the next set of actions.

In green are issues underlying the restructuring decisions that culminated in Assembly Bill 1890 (AB 1890), passed by the legislature in August, signed by the governor in September 1996, and implemented in March 1998. In yellow are some of the important legal provisions of AB 1890 that created a high risk. In addition to these actions are factors or changes that created a challenge to the State of California; the most important ones are shown in orange boxes.

The red boxes represent the key factors or actions that represented the dual crisis: the electricity crisis and the financial crisis, including a group of these factors with a circular set of causation arrows. These factors mutually interacted, causing the system to spiral into a crisis. Indicated above the red boxes and shaping this whole process was the failure of political leadership.

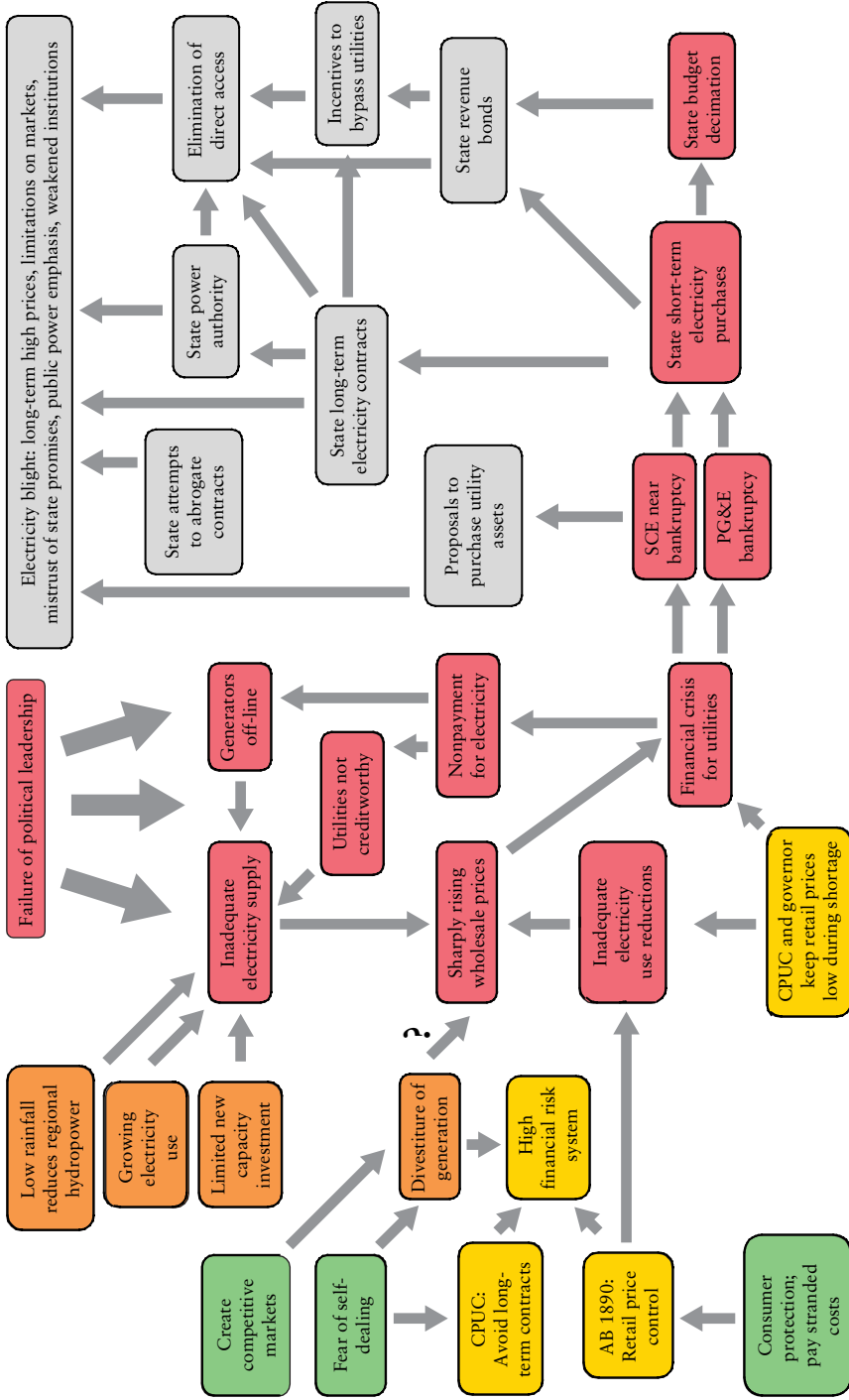


FIGURE 1.1: The Chain of Causation in California

Finally, actions in gray boxes are described here as the growing long-term blight on the state. Taken together, these actions are changing California into a public power state, limiting market operation, and maintaining long-term high electricity prices. The process can be stopped. Future political leadership can determine how far down this road California will proceed.

The ultimate end state of California's energy system remains unknown. Will California continue down the path toward public power? Will it return to the market-oriented goals of the original restructuring? Or will California move to some fundamentally different electricity system? Any of these paths remain open to the state. Which path is chosen depends on a combination of private sector actions, California legislative and regulatory decisions, and federal governmental decisions. These then remain as collective choices for California.

What follows is an attempt to explain and make sense of the changes implemented at each stage of the process. This discussion will comprise Chapters 2 through 5. The final two chapters look to the future. Chapter 6 examines some of the policy issues that California should face that could help move it out of its present difficulty. Chapter 7 offers reflections based on this sequence of events. These reflections, it is hoped, will help other states contemplating restructuring their electricity systems. And perhaps some will be applicable to other major policy initiatives.