Senator Feinstein Urges Governor Schwarzenegger to Sign Energy Re-regulation Bill

September 10, 2004

Washington, DC – Citing the consequences of California's attempt at energy deregulation in 1996, Senator Dianne Feinstein (D-Calif.) called on Governor Arnold Schwarzenegger to sign the Reliable Electric Service Act, a measure to re-regulate the State's energy markets.

Senator Feinstein sent the following letter urging Governor Schwarzenegger "to prevent another energy crisis" in California:

September 9, 2004

The Honorable Arnold Schwarzenegger
Governor
State of California
State Capitol, First Floor
Sacramento, CA 95814

Dear Governor Schwarzenegger:

You have on your desk a bill that would revoke the failed energy policy embodied in AB 1890 enacted in 1996 and restore the necessary oversight and regulation to protect California's customers from price volatility and market manipulation. With the passage of AB 1890, California became one of the first states to experiment with electricity deregulation. Unfortunately, AB 1890, and its implementation by the California Public Utilities Commission (CPUC), turned out to be an abysmal failure. As a result, I believe that re-regulation is the only way to ensure that Californians receive reliable electric service at a reasonable cost.

As you know, AB 1890 attempted to deregulate both the wholesale electricity market (the electricity sold from energy generators to the utilities) as well as the retail electricity market (the electricity sold directly to customers). However, retail electricity rates for consumers were kept regulated until after the utilities fully recovered their stranded costs from selling off their generating assets.

The CPUC required utilities to sell their non-nuclear and non-hydro generation assets to out-of-state energy companies, and then the CPUC forced these same utilities to purchase back the electricity from the new owners of these plants in the day-ahead and spot market. Since the utilities no longer owned significant generation of their own and since they were forced to procure all the necessary power to keep the lights on, the utilities had no choice but to purchase electricity at whatever price the market dictated.

The CPUC also did not allow utilities to hedge their positions by entering into long-term contracts for electricity as these contracts were thought to diminish the benefit of the less expensive electricity prices that could be realized on the unregulated spot market. As a result, California's utilities were almost entirely dependent upon the spot or day-ahead market.

Unfortunately, the theory behind AB 1890, that competition would drive electricity costs down, was proven to be mistaken. The utilities, which before AB 1890 was implemented, were able to generate electricity for an average of about $30 per megawatt hour, were forced to buy back electricity from the exact same power plants at $300 or $600 or even $1000 per megawatt hour.

Not too long after, Southern California Edison and PG&E (which actually declared bankruptcy) were no longer creditworthy and were unable to purchase the power necessary to keep the lights on. When this happened, the State stepped in and used its budget surplus to procure the needed power. The state was then forced to sign $43 billion dollars in long term contracts with these same out-of-state generators.

The end result was that the State's electricity bill practically quadrupled from about $7 billion in 1999 to more than $27 billion in 2000 and $26.7 billion in 2001. Since the State had given up its regulatory authority when the utilities sold their assets to out of state companies, any oversight authority was left up to the Federal Energy Regulatory Commission (FERC), an agency that has since proven itself to be incapable and unwilling to fulfill its duties to protect consumers.

You now have the opportunity to prevent another energy crisis from occurring in California. AB 2006, the Reliable Electric Service Act, was written to ensure that California never again faces a recurrence of the 2000-2001 energy crisis.

The bill requires:

- **Regulatory Oversight**
  The CPUC would have regulatory oversight of the California electricity market. Electricity customers would pay cost-of-service rates (as approved by the CPUC) based on the utilities cost of producing or contracting out for power.

- **Resource Adequacy Requirements**
  investor-owned utilities and non-utility electricity service providers to meet stringent reliability requirements to ensure that adequate physical generating capacity is located where and when it is needed to provide local area and system-wide reliability.

- **Utility Resource Planning**
  AB 2006 requires that utilities' long-term integrated resource plans identify all cost-effective energy efficiency and load management options, ensures renewable requirements are met, and ensures that overall resource adequacy requirements are met.

  AB 2006 requires utilities to manage a diversified portfolio of both utility and non-utility owned generation, combining the potential benefits of a competitive market with the stability of cost-based regulated generation, to achieve best value to customers.

- **Building Generation**
  AB 2006 provides that, prior to approving a certificate for a utility-built power plant, the CPUC must consider competitive alternatives to utility-built power plants from third parties.

  If any of those alternatives meets the same or better reliability and environmental requirements at lower costs, the CPUC must reject the utility certificate.

- **Attracting Investment**
  AB 2006 encourages investment in much-needed power plants by ensuring that costs to bring power on-line are recoverable in rates, but only if those costs are found reasonable by the CPUC.

  This rule applies both to direct investments by utilities as well as the costs of contracting for power with third parties.

- **Protecting Against Market Manipulation**
  AB 2006 requires utilities to have on hand a significant reserve margin, as determined by the CPUC. The reserve margin will ensure that Californians are not dependent on market prices for power that, as the energy crisis proved, can too easily be manipulated.

I urge you to sign AB 2006 into law in order to prevent another energy crisis from occurring. By signing AB 2006, you will be providing certainty to California's energy markets. Without such certainty, needed financing for new generation is not likely to materialize. The result may very well be a return to volatile energy prices and blackouts.

As you know, in my January 7th letter I suggested that California adopt a hybrid system where the vast majority of consumers would be served at cost-of-service based rates regulated by the California Public Utility Commission, while very large consumers (500 kilowatts or greater) would have the option to choose between this regulated system and the open market. I recognize that AB 2006 no longer includes language allowing large customers to opt out of the regulated system. However, if you do sign AB 2006, I would like to work with you to evaluate the need for additional legislation allowing large customers to procure energy on the open market.

Thank you for your attention to my request. I hope that we can work together to prevent another energy crisis in California.

Sincerely,

Dianne Feinstein
United States Senator

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