EIR Economics

California Energy Disaster: A Failed Economic Policy

by Marsha Freeman

With the Jan. 17 beginning of rolling electricity blackouts in California, the debt crisis gripping that state's deregulated utilities began to threaten banks and investors worldwide, and its extreme energy crisis was already spreading to other parts of the western United States.

The crisis in California is no different than the more general financial crisis infecting nearly every nation in the world, where speculation, in the form of derivatives, junk bonds, exorbitant interest rates, and energy price inflation, is destroying the physical economy.

There is no time left for half-way or "politically palatable" measures to solve either the international or local crises. The only policy that will produce results is the one put forward by economist Lyndon LaRouche: Fully re-regulate vital infrastructure, such as electricity; cancel the disreputable debt that has accrued through hyperinflationary speculation; proceed with an orderly bankruptcy reorganization that allows critical service to continue; and create large volumes of credit to promote investments in public infrastructure.

For California, this may well require invoking the full powers of the national and state governments, repealing national and state deregulation laws, dictating fair and reasonable terms to disarm speculators, and perhaps asserting *eminent domain* to seize generating facilities. No matter what particular actions are required, the bottom line is to reinstitute government oversight to ensure reliable, reasonably priced electricity, and a crash program to build new capacity as quickly as possible.

There are physical contraints in producing and transporting adequate amounts of power in California, thanks to a decade of underinvestment. Periodic shortages of electric generating capacity have existed in the past, in different parts of the country. But, in the past, the reliability of the system, and service to customers as a whole, was maintained through cooperation on a regional and national basis. This has now disappeared in the dog-eat-dog world of deregulation.

It is the policy of deregulation that has made solving the physical lack of generating capacity in California impossible, as power suppliers see how high they can drive the price of electricity, and their profit. This has led to the financial ruin of the electric utilities. It has created a situation where there is a day-to-day crisis just to provide reliable electric power to 25 million people in California.

Every administration since that of Jimmy Carter in the 1970s, has supported the policy of deregulation, lying to the American public that more "competition" would benefit them through lower rates. In fact, deregulation was promoted by large industrial consumers, looking for a way to reduce their costs. The biggest promotion and sales job was done by oil and gas companies, many of them confederates of, and contributors to, the Bush family in Texas, who stood to make a killing through speculation and manipulation of a market freed from government control.

Now, even in the face of California's clear and worsening public emergency, the outgoing Clinton Administration has not acted, and the incoming President Bush has threatened to undo what action might have been taken. California officials say that Federal Reserve Chairman Alan Greenspan, in meetings in December, told them to "just let the market work."

Policymakers, from the White House to the State House, must sober up, junk the "billionaire every minute" propaganda of the "new economy," and end a deregulation policy which is based on satisfying greed, rather than the public good.

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Reaching the End Game

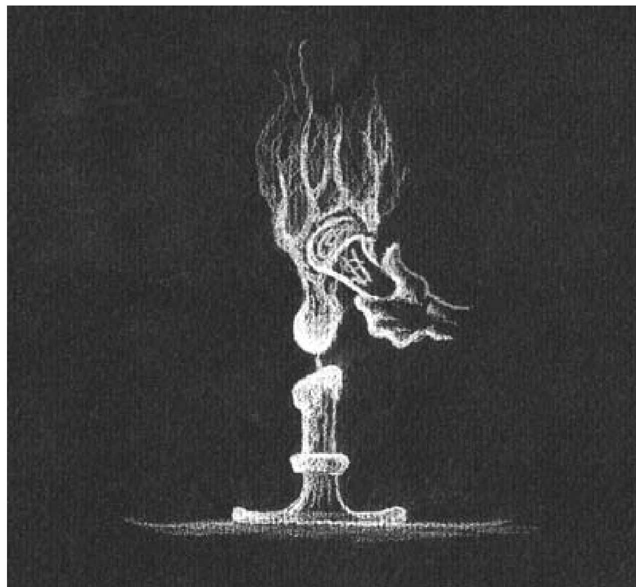
After eight months of borrowing to pay exorbitant prices for electricity supplies, Southern California Edison finally told the Securities and Exchange Commission (SEC) on Jan. 16 that it was "temporarily suspending" payments of nearly $600 million. Edison and Pacific Gas & Electric (PG&E) together have amassed more than $11 billion in new debt since last June. Southern California Edison missed payments that included $230 million of principal and interest on its notes. A payment of $215 million due to the state Power Exchange was not made. The Exchange stated the next day, that because it depends upon fees paid by the utilities for arranging the sale of electricity, there could be a "domino effect," and it could "go into default," along with the utility. Similarly, the Independent System Operator, which manages the state grid system, stated that since it depends upon fees from utilities for use of the transmission system, it, too, could face financial ruin. And, $151 million owed to "qualifying facilities" in the state—small generators that produce expensive power using "renewable" energy, such as windmills—was not paid. This led Moody's Investors Service to downgrade the credit rating of five operators of such facilities.

Immediately, rating agencies Moody's and Standard & Poor's downgraded Southern California Edison's credit rating to "junk," eliminating the possibility that it could continue to borrow to keep its operations running. Despite pleas from the utilities, the Governor, and Federal regulators that the suppliers delay scheduled payments, a Houston-based Dynegy, Inc. spokesman coolly declared, "We just aren't going to do that," and began action instead to push the utilities into involuntary bankruptcy.

One day later, PG&E informed the SEC that it would default on $33 million in commerical paper, and that its parent company would default on $43 million in payments. A spokesman for the utility stated that this first default may not be the last, because the utility has a $583 million power bill due on Feb. 1, and $431 million in other payments due on Feb. 15. In response to the default, the state Power Exchange said that it would suspend the utility's trading rights at the end of the week, leaving it without the ability to buy power!

Within 24 hours, the ripples of a possible bankruptcy began to hit new shores. Banks, insurance companies, and mutual funds, in the United States and abroad, began issuing unconvincing press releases, denying that they had any serious exposure, should the utilities go belly up. However, Lynn LoPucki, law professor at the University of California at Los Angeles, stated on Jan. 18, in regard to the two California utilities, that "either of these would be a huge case by itself. Together, they surpass anything we've ever seen. This is putting more creditor dollars at risk than any other bankruptcy in history."

Consumer groups shrieked that the companies should "eat" the losses, rather than have customer rates raised to "bail them out." But the utility stock- and bondholders, who can be left holding the bag in a bankruptcy, aren't Silicon Valley Internet billionaires. The day after the PG&E default, Fitch's rating agency downgraded the Orange County, California's shool investment fund, because it holds about $40 million of Edison debt securities. This fund supports local school operations. (Readers may recall that this is the same Orange Country that went into bankruptcy itself a few years ago, when its "investments" in highly speculative derivatives went sour.) Orange County Treasurer John Moorlach, stunned by what has happened, described utility investments as so secure "you would sell them to widows." Not anymore.



"The California Effect."

Too Little, Too Late

On a Federal level, since December, Energy Secretary Bill Richardson has issued, and reissued, orders to force energy suppliers with generating capacity in the western part of the nation, to sell power to California's utilities, whether they think they are creditworthy, or not. But Richardson has done nothing to enforce this order, and power suppliers, some with the backing of the Governor of Idaho, have publicly defied it. During a speech in California on Jan. 18, only miles away from neighborhoods being subjected to power blackouts, Richardson, days from leaving office, "warned" power suppliers that he will take them to court, using his "enforcement power." California and nearby public officials had pleaded for months with Federal authorities to set a cap for wholesale electricity prices throughout the region, so that Houston-based, and other out-of-state bandits, could not charge whatever they felt they could get away with, for power. Washington refused to act.

By the beginning of January, PG&E was warning California Gov. Gray Davis that the utility would soon face a differ-

Part of the 5,000 megawatts of nuclear power capacity, partly built and then abandoned and never put on line, which could have been providing power to the West Coast states from Bonneville Power Authority and Washington Public Power.

ent crisis, inability to buy natural gas for its customers; and that some of the companies refusing to sell it gas because of its credit problems, were the same companies that had driven it to the edge of bankruptcy with electricity prices. PG&E also explained that a natural gas shortage would make the electricity crisis worse, since gas, which is used to produce 31% of California's electricity, would have to be diverted to homes and other priority customers.

On Jan. 10, PG&E warned that if the Governor did not invoke emergency powers, it would run out of gas by Feb. 1. Governor Davis wrote a personal letter to President Clinton, asking him to use his mandate under the Federal Power Act to force companies to sell California natural gas. Richardson was still "considering" this on Jan. 18!

State Won't Say, 'Re-Regulation'

Although both the Governor and state legislators have been well aware for months that billions of dollars shelled out to what the Governor has termed "highway robbers," were putting 25 million Californians at risk, a leisurely pace of entertaining legislative proposals produced nothing by the time of the defaults.

Starting on Jan. 9, high-level meetings began in Washington, involving the Governor, utility executives, state regulators, some of the power suppliers, Energy Secretary Richardson, and Treasury Secretary Larry Summers. The Federal officials said they were just "honest brokers," who would take no Federal action.

Only after the lights were out did Governor Davis declare a state of emergency on Jan. 17, allowing the state Department of Water Resources to use money already in its budget to "enter into contracts and arrangements" with power suppliers to buy electricity to "mitigate the effects of this emergency"—i.e., use the good name and credit of the state to bypass the utilities. To prevent the state from going into the kind of debt plaguing the utilities because of over-charged prices, Governor Davis asked a firm price of 5.5¢ per kilowatt-hour. The electricity barons said no; further blackouts ensued.

Davis also announced that he was asking the legislature to pass a bill appropriating additional funds to the Department of Water Resources, to allow it to continue to buy wholesale power until a longer-term solution, through long-term contracts, could be successfully negotiated. Nothing has yet been passed. State legislators, wary of radically increasing rates to consumers to pay for the wholesale power, are not anxious to jump into the fire.

It is clear that these half-way measures will not reverse the crisis. If the utilities have to swallow the billions of dollars of losses, they will never be creditworthy again. If the state bails out the utilities, it will have a taxpayers' revolt on its hands, as consumers are asked to subsidize outrageous, triple-digit profit rates for George Bush's friends. If the utilities are simply left in bankruptcy court, their physical assets could be lost, and billions in new cross-defaults occur.

Whatever specific steps are necessary, and however the debt is cancelled or reorganized, the utilities must be able to continue to perform their vital service. The state must regain its oversight, taking responsibility for the construction of new power plants, transmission lines, and other infrastructure. The Federal government must reassert its role as the protector of the public from profiteers and speculators, and foster the expansion of required infrastructure. Before the "deregulation age," laws were put on the books to ensure this.

This was the legacy of President Franklin Roosevelt. He used the power of the Federal government, through the Rural Electrification Administration, to bring electric power to isolated areas where utilities said that it was unprofitable to build; used the good credit of the United States to build dams and power plants along the Tennessee and tributory rivers, to create new businesses, scientific agriculture, and industry; formulated laws to prevent Wall Street financiers and speculators from "fleecing" Americans for basic needs, such as electricity; and enabled the largest boom in infrastructure investment since the building of the Transcontinental Railroad.

This is the scope of what is necessary to solve the economic crisis, and California's energy crisis, today.