PUBLIC UTILITIES COMMISSION
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October 2, 2002

The Honorable Bill Morrow
Vice-Chair, Select Committee to Investigate Price
Manipulation of the Wholesale Energy Market
California State Senate
State Capitol
Sacramento, CA 95814

Dear Senator Morrow:

Thank you for your letter of September 20, 2002. This letter provides an initial response to your communication.

Your letter poses 27 separate questions, some of them multi-part, concerning the Commission staff Wholesale Generation Report. The Commission staff is preparing responses to your specific questions, and will send along those responses as they are developed.

As a preliminary matter, I want to provide you with some context for the report in order to frame the issues that are suggested by your first question: "Is this report the final and only version?"

Since the enactment of Assembly Bill 1890 in 1996, the Commission has been required, by Public Utilities Code Section 362, to assure the availability of divested power plants for purposes of system reliability and to prevent an over-concentration of market power. Senate Bill X2 39, enacted in 2002, amended this code section to direct the Commission specifically to assure that divested power plants are operated in a manner to maintain system reliability.

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The Wholesale Generation Report finds strong evidence that the divested power plants were not operated so as to avoid blackouts and interruptions. The data analyzed in the report suggests that those divested power plants were operated during system critical hours in ways that contributed to blackouts and service curtailments and interruptions. Although the report says that generators contributed to blackouts through their bidding behavior, it also explicitly states that there may be other factors that explain the operation patterns of these plants. The report specifically notes that grid operation methods or decisions could also be responsible for power not generated. The next step for the Commission will be to examine the root causes of the consistent repeated system failures that California experienced, as they relate to the roughly 17,000 megawatts of divested plants. That examination includes a number of the other potential factors you have raised in your letter. Put simply, this report is one step that the Commission will take in meeting its statutory mandate, but it is not the last or only step.

The work of the Senate Select Committee to Investigate Price Manipulation is very important in this regard. For example, we have known for some time that in November 1997 Reliant Industries was boasting of the ability to raise prices under conditions of electric system stress.[1] We did not know until the Committee's publication of the Perot Systems memos, however, that Reliant was relying not only on general knowledge of power operations, but also on specific strategies derived from specialized information about the design of the ISO to exploit weaknesses in the system by withholding power. Similarly, the Select Committee's effectiveness in moving the Enron memos into the public domain facilitates our analysis of some of the other strategies and rationales for California's blackouts that your letter suggests. This information enables us to pursue root causes of system failure and withholding with more focus than would otherwise be the case.

I look forward to continued collaboration with the Select Committee in advancing the interest of the people of the State of California in assuring the continued reliable operation of the electric grid. With your help, we can prevent a repetition of the prolonged experience of blackout and service curtailments that California families and businesses experienced in the spring of 2001.

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[1] "We have a lot of experience dealing with summer peaks and dispatching plants. When you operate on a merchant basis, and sell into a power exchange, you can watch the price climb during the day. We might decide to hold our plant off the market at 12 noon, even if the price looks favorable, because we can get a better price at 4 p.m. We think we know a little bit about what will happen if we hold our plant out a few hours. We can play on that expertise." (Public Utilities Fortnightly, November 15, 1997, page 5, quoting Houston Industries [Reliant's predecessor] Executive Charles Oglesby. Mr. Oglesby is now President of Reliant's marketing subsidiary.)

If you have any information that can assist PUC staff in this inquiry, please contact Rich Clark, Director of the PUC's Consumer Protection & Safety Division, at (415) 703-2349. Again, thank you for the cogent questions you have posed and for the opportunity to clarify the context for this study. PUC staff will provide you with updated information as it is assembled.

Sincerely yours,

Loretta M. Lynch

Cc: The Honorable Joe Dunn
Chair, Select Committee to Investigate Price
Manipulation of the Wholesale Energy Market