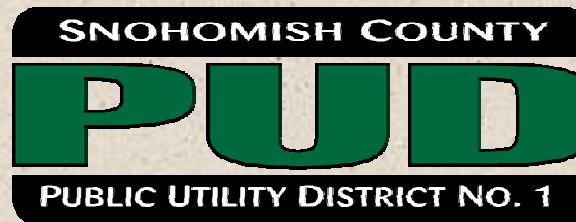


THE 2000-01 WESTERN POWER CRISIS: CONSUMER EXPLOITATION AND REGULATORY INDIFFERENCE

Presented to:

**United States Senate
Democratic Policy Study Committee
May 8, 2006**

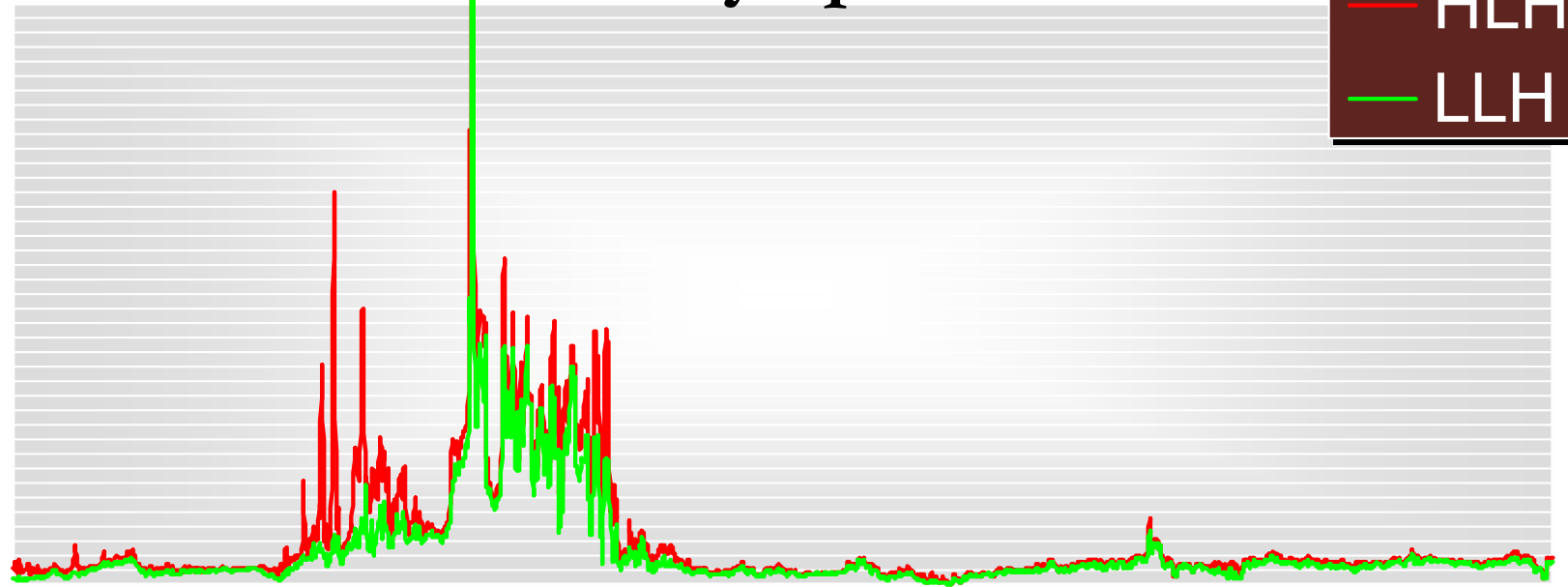


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2000-01 Western Power Crisis

Mid C Daily Spot Price



A Disaster for Consumers

- Snohomish PUD Rates Increase ~ 60%
- Economic Devastation Across County
- Huge Impacts on Public Agencies
- 50% Increase In Disconnects
- Heating Assistance Office Overwhelmed

Cumulative Consumer Impacts

- Washington State: Loss of 43,000 jobs, \$1.3 billion in disposable income
- Huge Impacts Across the West
 - 589,000 lost jobs
 - \$35 billion in lost productivity (1.5% of regional GDP)
 - Helps tip region into deep recession
 - Recurring blackouts in California

Enron Knew Consumers Were Vulnerable

Which States Are Most Susceptible to California Crisis?

- Washington
- Oregon
- Idaho
- Montana
- Wyoming
- Nevada
- Utah
- Arizona
- Colorado
- New Mexico

FERC Greases the Skids

- “Market-Based Rate Authority” granted nearly without question
 1. Outdated market-power screen
 2. No one ever turned down
 3. Data filing requirements unenforced
- Electricity Markets Lack Basic Protections Common to Other Commodity Markets
 1. Transparent Pricing
 2. Regulatory Oversight
 3. “Circuit Breakers”
 4. Rapid and effective penalties for violators

The Rush to Commoditize

- Electricity Traditionally Treated as a Necessity, Not a Commodity
- Back-Door Commoditization
- Electricity Uniquely Vulnerable to Market Abuse
 1. Can't be stored
 2. System must be balanced instantaneously
 3. No substitutes
 4. Loss of service is devastating
 5. Buyers can't say "no"

FERC Ineffective Response to the Crisis

- Response to Crisis Slowed By Near-Religious Devotion to Deregulation Ideology
- Enforced Contracts Tainted by Market Dysfunction
- Staff Inadequately Trained
- Dropped the Ball on EnronOnline

Lessons from Lay-Skilling Trial: Enron profits from the chaos

“...chaos in California created chaos in the entire western market...The chaos drove high prices; and the high prices drove our profits, yes.”

Testimony of Timothy Belden, Feb. 28, 2006, Lay/Skilling Trial

Lessons from Lay-Skilling Trial: Enron Profits Exceeded \$1 billion

- Former Enron Executive David Delainey (2/28/06):
“We were---we were making tons of money. We were knocking the cover off the ball, essentially. . . 50 to 60 percent of the profits that we made gross margin were driven from our trade activities, particularly our speculative trading activities.”
- According to Delainey and Belden, during the crisis Enron made:
 - \$229 million in first three quarters of 2000
 - \$104.4 million in Q4 2000
 - \$445.3 million in Q1 2001
 - \$333.5 million in Q2 2001

TOTAL: \$1,172,000,000

Lessons from Lay-Skilling Trial: Traders Love Chaos

DOJ: Is volatility a good thing for a speculative trader?

Delaine: Yes.

DOJ: Why?

Delaine: The higher the volatility that you have, the better—the higher the potential profit you can make...

--February 28, 2006

Chaos Helps Traders But Hurts Consumers

“I agree that price volatility in the power markets was the key contributor to increased profits...”

--Tim Belden, March 1, 2006

Electricity Markets Reward Perverse Behavior

- LV Cogen is a 52 MW generator located in Nevada
- Enron Orders “Forced Outage” on January 17, 2001, beginning at 11:00 am
- California Experiences Rolling Blackouts 11:00 am to 2:00 pm
- Violation of Secretary of Energy Order

FERC & CFTC Lack Necessary Tools

- FERC Using a 1935 Statute in a 2001 World
 1. Not intended to regulated commodities
 2. “Filed Rate” Doctrine
 3. “Mobile-Sierra” Doctrine
- CFTC Lacks Authority Over Enron-like Trading Platforms

Recommendations

- If electricity is to be treated as a commodity, it must be regulated as a commodity
 - Comprehensive regulation of all related markets
 - Strong mechanisms to stop abuses
 - Strong consumer remedies
 - Legal doctrines arising from cost-based regulation must be treated as anachronisms