FERC's duty is clear: Order energy refunds for California

(San Jose Mercury News, March 28, 2003)

By Frank A. Wolak

The staff of the agency that regulates wholesale electricity markets in California and the rest of the United States issued a comprehensive analysis Wednesday of the natural gas and electricity markets during the California energy crisis. They finally got it right.

The quality of the economic analysis in this report from the Federal Energy Regulatory Commission far exceeds that in all previous staff reports. It appears that FERC finally understands its statutory mandate to set ``just and reasonable'' wholesale energy prices.

FERC's job is far from over. It has not yet dealt with the most difficult part of its job. It must now order natural gas and electricity suppliers to pay all of the refunds California consumers are legally entitled to, regardless of the current financial condition of these industries.

If FERC fails to order the appropriate refunds, it will not only shortchange California consumers, it will defeat its own long-term goal of making energy markets more efficient.

The FERC staff report confirms the findings of a number of independent investigations of the California electricity and natural gas markets over the past two years. They have produced overwhelming evidence that suppliers in these markets took actions that raised wholesale electricity prices far above the ``just and reasonable'' prices required by the Federal Power Act of 1935. In such instances, the act requires FERC to determine what ``just and reasonable'' prices are and to order refunds of any excess payments by consumers.

Over the past two years, independent academic experts and market monitoring entities have come to a consensus on a method for determining ``just and reasonable'' prices. The method has been largely adopted, at least in concept, by the FERC staff report.

Following this methodology would require FERC to order substantial refunds, which it may shy away from. Or it might reduce the refund by restricting, improperly, the time period or types of transactions the method is applied to.

The Federal Power Act clearly states that electricity consumers should be protected from unjust and unreasonable prices on all wholesale market purchases. There are no exemptions for purchases made under long-term contracts, or for purchases by state agencies on behalf of California consumers.

California consumers should be most concerned with FERC ordering refunds only from firms that it finds ``manipulated prices.'' The Federal Power Act refund obligation does not distinguish between causes of unjust and unreasonable prices. If a supplier charged California consumers a price that FERC finds is too high to be just and reasonable, then it must pay refunds, even if did nothing more than sell at the prevailing market price.

What seems to be a difficult decision is in fact quite easy. What is at stake for FERC is its vision of ``dependable, affordable energy through sustained competitive markets.''

FERC is currently promoting a standard wholesale market design throughout the United States. The top priority of any state government considering adoption of this market design is whether FERC will provide the same level of protection for consumers against excessive prices as the state's own regulator currently does.

If FERC orders lower refunds for California consumers than they are legally due, those states that have not yet restructured will resist FERC's plans even more vigorously than they already are. This will perpetuate the current patchwork of poorly integrated wholesale electricity markets that has prevented consumers from realizing the full benefits of wholesale electricity markets.

Although Wall Street analysts and the management and shareholders of the firms subject to refund obligations argue that paying substantial refunds will push them into financial insolvency, this conclusion is unwarranted. FERC can structure these refund obligations to be paid out over long periods of time, or through long-term contracts at substantially discounted prices.

FERC should adopt this forward-looking perspective and order all of the refunds that California consumers are due under the Federal Power Act. Although this outcome may not be in FERC's short-term interest, it is clearly the least-cost path to FERC's long-term goals.

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