"Free Lunch" - David R. Johnston

Chapter 17

TROJAN HORSE

A HEAVY MORNING MIST BLANKETED AUSTIN AS THE MEMBERS OF the House of Representatives made their way to the capitol, a Texas-size building made of a kind of granite called sunset red. They came to end a century of state government regulating the price of electricity and to create the dawn of what they told the voters would be a glorious new day. They promised that competitive markets would provide electricity cheaper and more efficiently than utilities regulated by the state government regulators had or possibly could.

Just outside the massive chamber doors, which stood like the gates of ancient Troy, each solon met a legion of lobbyists. All had played a role in shaping Senate Bill 7, making deals over this clause and that comma. All the corporate lobbyists embraced the final deal, but not two others, who stood out that morning.

One was Janee Briesemeister, a policy analyst for Consumers Union, publisher of *Consumer Reports* magazine. Lithe, free of makeup, and on the verge of middle age, she looked much younger and could have passed for one of the executives but for her plain suit, which even she felt was out of place among the fine raiment of the finance, legal, and utility crowd.

The other was Tom Smith, the executive director of Ralph Nader's Public Citizen in the Lone Star state. Smitty was a living icon of a consumer advocate. Short and trim, with wire-frame glasses, he walked and talked like a sociology professor with a bit of the scold in him. He wore a straw fedora, with wispy gray bumpers springing beneath the hatband and sprouting wild all the way down to his chin, symbols of his fiercely independent thinking about politics and power.

On this spring day in 1999 Briesemeister and Smith played the roles of truth tellers destined to be ignored and ridiculed, just like Cassandra and Laocoön in ancient Troy when the Greeks left their giant wooden steed outside the city gates.

Cassandra was cursed to always tell the truth, yet never be believed. Virgil recounted in the *Aeneid* that warnings came from within the wooden colossus the Greeks left before seeming to sail away:

> *Oft the clashing sound*
> *of arms was heard, and inward groans rebound*
> *yet, mad with zeal, and blinded with our fate*
> *we haul along the horse in solemn state*
> *then place the dire portent within the tower.*
> *Cassandra cried, and cursed this unhappy hour*
> *foretold our fate, but, by the god's decree*
> *all heard, and none believed the prophecy*

The priest Laocoön thrust a spear into what seemed like a marvelous gift to expose "a deadly fraud," only to be mocked (and later killed).

In Austin, a modern chorus of lobbyists drowned out Briesemeister's and Smith's warnings that Senate Bill 7 was not as it seemed. Smith was handing out flyers. One of the legislators could not resist a verbal jab at the man warning of economic disaster hidden in the bill. "Right, Smitty," the lawmaker said mockingly, "you're going to take on Steve."

The reference was to Steve Wolens, Democrat of Dallas, who was in charge of Senate Bill 7, which had passed the upper chamber two months earlier. Wolens had a reputation for devising creative ways to get impossible bills through the House, just as Odysseus came up with the idea of the Trojan horse to slyly enter Troy. *Texas Monthly* magazine once described Wolens this way: "Mesmerizing in debate, indefatigable in preparation, incisive in analysis, he is the House's most dreaded foe and most welcome ally."

By fiat, Wolens was about to transform electricity into a competitive business, or at least transform part of the electricity industry into what appeared to be a competitive business. This moment did not arrive by popular demand or by accident. The debate under the capitol dome in Austin, like those in half of the other state capitals, was the product of years of buying political influence by one man and the company he created: Ken Lay and Enron.

Lay sent teams of executives to meet privately with politicians and with executives of large companies that consumed electricity by the power plant. Its publicists beguiled journalists and stock analysts with equal fervor. Enron supported seemingly scholarly studies that advanced its cause. Enron's message excited the big industrial users, who had complained for years that they were charged too much. They said the prices set by state utility boards forced them to subsidize residential customers and small businesses. They had a point. In some states big customers not only were denied discounts for buying in volume, they were hit with premium prices.

The Enron executives promised that if they got their way, electricity would flow plentifully, and with lower prices, to these big buyers. How? The magic of markets. At the same time, Enron said, profits for the makers and sellers of electric power would rise, drawing new investment to build more power plants. It was a message that big business wanted to hear. It was a promise that, ever since *downsizing* entered the lexicon, had become all the rage in corporate America: more from less.

The problem was how to make politicians care. Voters did not care much. No candidates were whipping up voter rage over electricity prices, which had been falling for decades until they started to creep back up in the seventies. Hardly anyone cared about the arcane issue of how costs were split among industrial, commercial, and residential customers. Among the voters, no one was clamoring for competitive electric markets.

Enron offered a solution. It paid politicians to listen. Remember, as every politician says, his or her vote is not for sale. All that donations buy is access to officeholders: time to make a pitch and to get the donor's concerns in the forefront of the politicians. There is so much demand for contributions, and so little time to listen, that hardly anyone gets heard for free.

To make sure its voice was heard, Enron and its executives poured $5.4 million into campaigns for Congress and the White House in the last half of the nineties and the 2000 races, three-fourths of it to Republicans. Enron money flowed freely to state officials, too, especially in Texas, where Enron was confident that it could remake the rules by which electricity is sold. After all, Governor George W. Bush counted among his loyal friends the Enron leader he called Kenny Boy.

Donations also flowed from those paid by Enron, as well as companies currying favor with it. This made Enron's support even more valuable than the numbers about its own giving suggested. From his first run for governor of Texas in 1994 until he reached the White House, Enron was the single largest supporter of George W. Bush, donating $736,800. Of the next six biggest contributors to Bush, four were connected to Enron. Among them was Vinson & Elkins, the Houston law firm on which Enron relied most. Another was the parent of the Arthur Anderson accounting firm, which during the Depression rose to national prominence through diligent examination of an electricity industry scandal. In a few years the firm would come to its end because of its work for Enron in a remarkably similar scandal.

Lay also sent teams to meet with utility executives and leaders. Enron hoped to win them over. If they resisted, it tried to scare them into retreat.

One who heard their pitch was Jan Schori, general manager of the Sacramento Municipal Utility District. The burghers and farmers who prospered in the rich and flat lands around Sacramento, long after the gold rush had panned out, created the power district in the 1920s. They wanted an electric utility that would be responsive to their needs, focusing on reliable service at the lowest cost so their businesses would prosper. The utility district's prices typically ran a third lower than Pacific Gas and Electric Company, the corporate-owned utility with a monopoly in most areas of Northern California. As part of the utility district's tradition of service, Schori takes meetings with almost anyone seeking to do business with the agency, which collects about $6 billion from customers each year. One day, about the time of the Texas vote, Enron came calling.

Thinking the Texans wanted to sell some new financial service, Schori invited Jim Tracy, the utility district's chief financial officer, to join them. They gathered around a long table with metal legs painted black in an office that looks down on a grove of flowering cherry, ginkgo, and other trees, a sample of the thousands of shade trees that the district has given away over the years to help cool the area in summer and thus reduce demand for electricity.

The Enronites entered as if they owned the place. Years later Schori remembered thinking that they were so incredibly well dressed and so young; so very young and yet so confident, it was arresting. They said

times had changed, that the smart move was to switch to Enron management.

Schori explained that the utility district was not a soulless business that could be bought, but a local government agency with directors elected by the people. The Enronites shifted their approach. They presented themselves as corporate Cassiuses inviting their hosts to join in a conspiracy to overthrow the dictates of regulation. A market revolution was necessary, the Enronites whispered behind the closed doors, for the good of the people.

When Schori made clear that there was no interest in joining this cabal, the Enronites turned to threats. "They told us that we had better turn our business over to them or in a few years they would come back and take us over," she recalled.

Tracy, the district's finance guy, marveled at the hubris. "They sat there and told us they could run our utility better than we could because they knew more than we did or ever could about electricity and markets."

Schori and Tracy felt neither intimidated nor angry, just bemused at the arrogance of the young plotters in their Dolce & Gabbana suits. They thought that these pups without a wrinkle among them had not a clue about the steady, solid work it took to actually provide reliable electricity at all hours in all kinds of weather no matter how much demand surged and fell from one minute to the next. And they were certain their guests, the ink barely dry on their masters of business administration diplomas, gave little thought to how much planning and judgment went into making juice flow every time a switch is flipped not just today, but a decade or two in the future.

While the Enronites had failed to intimidate the public servants in Sacramento, they struck fear deep in the hearts of Texas utility executives. By the time the Texas lawmakers gathered to vote on Senate Bill 7 it had become apparent that Lay and Enron had vast political capital to spend, especially with Governor Bush. Utility executives understood this sooner than most because their careers depended on winning the cooperation of government to set prices as profitably high as was politically possible.

Floyd LeBlanc, the chief spokesman for Centerpoint Energy, the utility once known as Houston Lighting & Power, put it best: The utilities fought Enron until they realized that Enron would win. Then they cut the best deal they could. It was a story repeated in state after s from Maryland to Maine to Illinois and out on the West Coast.

Within a few years 26 states embraced the Enron way, passing that switched electricity to a competitive business, or at least creating appearance of a competitive business. The specifics varied widely, ex for one common element known as *stranded costs*. The utilities were g anteed that power plants built under the old monopoly laws, but no fully written off on their books, would be paid off, typically by allo the utilities to borrow the money and then add the cost plus intere monthly electric bills for years to come.

Guaranteeing payments was a strange way to initiate competi which by definition means winners and losers. It was as if the landlo the only apartment building in town, confronted with new apartm under construction, persuaded the city council to force his tenants tc off his mortgage even if they decided to move into newer quarters.

As Briesemeister and Smith saw it the utilities wanted to eat cake and have it too. The utilities wanted the potential benefits competitive market, but with the guaranteed payments that came fr regulated monopoly. To the modern Cassandra and Laocoön this not competition, but sheltered capitalism with guaranteed profits.

As events would unfold it would turn out that their predictions derstated the economic damage that would soon be done not ju Texas utility customers, but also to millions of people and busin from Chesapeake Bay to Puget Sound. There would also be a lucky who made enormous fortunes.

It was stranded costs that Smith and Briesemeister warned most a that day in Austin. Just days earlier a House committee had take Senate Bill 7, the Enron bill, and more than 100 amendments were forth, including some dealing with that guarantee the utilities wante

Representative Kevin Bailey, a Houston Democrat, voiced the l est concern. "We've increased stranded costs considerably in this from the previous bill," Bailey told Wolens, doubling the figure t billion. That was the equivalent of about $1,200 for each household the state.

At one point Bailey suggested that Wolens, his fellow Democrat, looking out for the bosses, not for the working people who are the ty's base.

"The big boys have been backing up the truck and loading it

this bill," Bailey said, while "the little guys aren't able. They don't even have a car to back up, and they don't have a trunk or the car to get anything in it."

The hearing room audience erupted in laughter.

Wolens was annoyed. "Mr. Bailey, you want to start discussing what the big boys have done on this bill? Because I will spend the next two hours—"

"No, no," Bailey quickly interjected, again drawing a laugh from onlookers as he tried to defuse the situation.

"Mr. Bailey, no, no, no, no, no, no, no," Wolens persisted, trying to talk over his counterpart. "Mr. Bailey, I'll let you complete, but I'll let you know I ain't taking that sittin' down or standing up. I have spent an enormous amount of time on this bill. I have spent more time than I ever thought I was going to be spending on it. And for you to suggest what the big boys have been doing on my time rubs me a certain way."

Bailey raised the question of whether there was any need to change the system for setting electricity prices at all. He cited a report by the Texas Office of Public Utility Counsel, the state's consumer advocate in electric rate cases. It predicted that sticking with the existing system of regulating electric utilities would produce lower prices, a drop of as much as 16 percent by the end of 2003.

It was unfair, Bailey argued, for residential and small business customers to pay almost all of the stranded costs while the big industrial customers paid little. After all, everyone had agreed that the big industrial customers would be the major winners in a competitive market for electricity because as sophisticated volume buyers they could negotiate lower prices for themselves. Bailey pointed to a chart showing a large purple area that designated how much residential ratepayers would pay in stranded costs. Then, he called everyone's attention to a little red bar, the tiny share that was to be paid by the biggest industrial customers.

"I'm not against paying the stranded costs," Bailey announced. It was how the burden was spread that mattered to Bailey. His words set off a flurry of activity by lobbyists. Terral Smith, Governor Bush's legislative liaison, immediately began twisting arms to kill the Bailey proposal. The industrial lobbyists joined in applying pressure to shove the costs onto consumers and small business.

What Bailey never did was take on Enron. Eight years earlier Bail had learned how dangerous that could be for a Texas politician. Back 1991, when he was a freshman in the legislature, Bailey would not along with a bill that Enron, then a natural gas pipeline company, wante Soon Bailey's campaign manager was working for his opponent and E ton contributions were financing the opposition. Bailey eked out a n row victory in the primary, but two years later Enron and its allies w again financing his opponent.

By 1999 no one in Texas politics with a lick of sense got into a fi with Lay or Enron. The company's coordinated drive to create a st government to its liking had put the candidates it backed into ev statewide office, Republicans all. Thanks to Enron's money, Repub cans controlled the Texas state senate for the first time since Reconstru tion. Enron was not all-powerful, but it was not a force to mess w unless, like Smith and Briesemeister, no one paid attention to your p dictions.

As the final debate on the bill took place in the House chamber Austin, Briesemeister joined the other lobbyists in the gallery far abo the floor. The stranded costs issue had gone through several perm tations, but in the end residential customers were stuck with the b gest share of the costs at 40 percent and the commercial and sm business customers had to pick up 30 percent. Still, the remain 30 percent share placed on the industrial customers was better th their original hopes as shown by the little red bar on Bailey's chart. Briesemeister listened to that final debate, she thought how it was really a debate at all, just posturing. *How stage-managed this all see* she thought.

Late that day Wolens received a standing ovation from his peers the corporate lobbyists in the gallery. The bill had not even passed, everyone was on their feet, congratulating Wolens, and themselves, overthrowing a system that was not broken in favor of what Enron Governor Bush said was the better way of letting the market determ the price of electricity.

When the vote was called, Senate Bill 7 passed by a tally of 142 t Briesemeister felt sick. She was certain that the promises of lower pr would prove to be illusory, that for all of its flaws the existing system less costly to consumers.

Sure enough, by 2006, Texas electric rates were more than 50 per

higher than four years earlier. Painful as that was, it was not the worst of it. For what the lawmakers in Texas and other states had created was not a market that Adam Smith would recognize, but a system to manipulate prices. And while the lawmakers mad with zeal remained deaf to the warnings, Enron knew it had enacted into law an economic Trojan horse. So did Wall Street. The soldiers of Mammon were poised to emerge and take their spoils.

Chapter 18

SIGHTLESS SHERIFFS

JAY INSLEE WALKED AS FAST AS DECORUM WOULD ALLOW. THIS the Capitol of the United States, after all. The Washington C gressman was anxiously navigating the unfamiliar basement hall located on the other side, deep below the Senate chamber. Inslee sear for a room where he was to join the five Republicans and the d other Democrats who comprised the Oregon and Washington de tions to Congress.

In his right hand, Inslee clutched a fax, its late arrival from the Coast this March morning in 2001 the reason for his rush. When h nally found the right door, the meeting had already been underway minute or two. Inslee, an inveterate basketball player, quickly spotte only open seat and slid his athletic frame into it. Directly across the at a man he had never met before, the new vice president of the U States.

The bipartisan gathering was to seek relief from the worst econ crisis to hit the West Coast in decades. Electricity prices had skyrock A kilowatt of power that a year earlier cost $30 was now priced at $ The old price reflected the cost of generating power plus a profit. S the costs of generating electricity had changed little, the new price no such connection to costs. And strangely, even when the populac back on its use of electricity after opening eye-popping bills, prices st high, defying the bedrock economic principle of supply and demanc

California consumers and businesses saw their statewide electri tab from an annual expense of about $6 billion to more than $60 bil It was the economic equivalent of the state raising taxes on a fami four by $7,000 a year. Electric bills were out of control in Oregon

Washington, too. But no one was there from the California delegation Cheney insisted on that.

Everyone in the room knew that electricity was an industry in transition, from prices set by state utility boards to a competitive market, even if they had no grasp of how the new price mechanism worked. The cause of the skyrocketing prices was a mystery to everyone but the few who understood what laws like the one passed in Texas, as well as the one California enacted, meant for making the few rich at the expense of the many.

Wasn't competition supposed to mean lower prices? And why would prices soar when the amount of power people were buying had grown at normal, predictable rates? And why did prices stay high, even rise, when people flipped switches off? To anyone with a basic understanding of economics it made no sense.

Some of the lawmakers worried that this was something far more ominous than an economic glitch that would pass in a few weeks. Constituents were calling on the phone, demanding that somebody do something. The volume of calls grew with each month's electric bills. And there was fear that the current March prices would soon look like bargains. Summer was coming and, with it, increased demand for power to run air conditioning equipment. But what to do?

This deep sense of unease prompted unpleasant thoughts, a few lawmakers in both parties would say privately many months later. They realized how easily this economic crisis could boil over into something much worse. California was riven by rolling blackouts, as well as brownouts, in which power flows at reduced voltage. People had been stuck for hours in elevators. Others could not get cash out of automated teller machines or even retrieve their debit cards. There had been accidents when traffic lights failed, some of which led to nasty disputes. Thousands of poor families, the electric bill suddenly burning up half their meager income, had their power shut off for nonpayment. It did not take much thought to realize that people would use candles for light and this would, inevitably, cause fires that would kill small children.

In the Capitol basement, the more senior delegates spoke first. They told Cheney about widows on fixed incomes who had to choose between going hungry or going without their medications because the electricity bill ate all their money. Someone mentioned a family whose electric bill was suddenly larger than their mortgage.

As one of the more junior lawmakers, Inslee waited his turn. He watched Cheney. The vice president's movements and words indicated that stories about little old ladies did not penetrate his steely resolve. What Inslee could not discern was whether the vice president did not believe the stories or—and to Inslee this would be worse—that Cheney did not care.

Representative Norm Dicks, a Democrat who represented Washington State's Olympic Peninsula, called electricity prices "the most serious financial crisis facing Washington State since Boeing laid off 60,000 workers in 1970." Back then things got embarrassingly bad for Americans. People in Japan sent baskets of food to help families of laid-off workers in Renton, Seattle, and Tacoma. Americans depending on charity when they were third world peasants after an earthquake was a Cold War propaganda story that the Soviets and their friends played big for its propaganda value.

The talk in that Senate basement turned to small business. Grocers and ice-skating rink owners had complained that the cost of electricity to run their refrigeration units was ruinous. Some electricity-intensive businesses simply shut down. Many employers who used power for nothing more than lights and computers had stopped hiring. Some had laid off workers. Job losses in Washington State alone could reach 40,000, someone said.

Cheney did not express any concern about rising electricity prices hurting small business. Some in the room heard Cheney say "this is how markets work" and something about "froth in any market." Inslee had expected that the troubles of Main Street business owners would stir the vice president to action. *Old ladies going hungry don't move him. Okay. But how can he not care about small businesses?* Inslee thought.

What the legislators had asked for, at least some of them, was the imposition of price caps so that the price of electricity would be related to the cost of producing it. That was how the traditional regulation system worked. Utility rates were set based on the cost of producing power, including a generous amount of surplus capacity for peak demand times like hot summer days, plus a profit. The Federal Energy Regulatory Commission had the power to impose such caps if prices in any market, competitive or regulated, were not "just and reasonable." Nothing had happened to make it cost more than $30 a kilowatt or so to produce power, even if no one understood just why. Cheney said no to price caps. Period.

When Inslee's turn came he focused on the fax, whose late ar

had made him the last person to enter the room. The fax had come from Robert McCullough, a utility economist who rose to become a vice president of Portland General Electric in Oregon before he set out on his own. McCullough made his living as an expert witness in electric utility litigation, an area requiring knowledge of arcane economic and legal details and an ability to translate them into plain English. To many in the power business these skills made him a hated man. Overnight McCullough had gathered complicated official data from California and then reduced it to a single fact so revealing that when the fax finally printed out in Washington, Inslee had a *Eureka!* moment.

McCullough had analyzed the status of every electricity-generating plant in California the day before. Which ones were running, which were down for scheduled maintenance, and which were offline due to an unexpected breakdown or other reasons. What he found was not what one would expect based on textbook economic theory. Even though record prices were to be had for anyone with power to sell, the owners of generating plants were not cranking up every boiler and diesel motor they owned. Instead, a third of the electric power–generating capacity in California was offline.

To Inslee, a former small-town prosecutor, this cried out for investigation. Normally a small percentage of power plants would be down for maintenance or offline because of unexpected breakdowns. But a third? And when prices were running 10 to 20 times what they had been just a year earlier?

Some of those in the room would say later that what happened next was unlike any political negotiating session they had ever attended.

Inslee quickly made his points as he slid the fax across the table. Cheney, without reading it, slid the fax back, saying, "You know what? You just don't understand economics."

Inside, Inslee began turning white hot with fury, but said nothing. He did not even tell the vice president that his degree from the University of Washington was in economics, not that that would have changed anything. But while Inslee held his tongue, the questions in his mind gelled. *It's clear we are wasting our time. He has a closed mind. I understand economics; what I don't understand is letting people get screwed.*

When the meeting ended after 45 minutes, Cheney left via a side door. The lawmakers went out to talk to the few reporters present, including a Seattle television news crew. Representative Jennifer Dunn, a Washington State Republican whom the party often relied on to deliver

scripted messages, said, "We shouldn't look for a trendy and superfi answer and give an artificial response like price caps." And she said administration was doing all that it could. Inslee could hold his ton no more. That is just not true, Inslee said—the administration plans to exactly nothing.

Less than a month later the vice president met with Ken Lay, wh Enron had spent all those years, and millions in campaign donatio buying access to politicians so it could shape the new laws on comp tion to its liking. Cheney had many meetings with energy-industry ecutives and he fought to keep them all as secret as he could. He arg that to even reveal with whom he had met would somehow compron the quality and independence of the advice he received.

At their April 17 meeting Lay gave the vice president a three-p memo that stated that "events in California and in other parts of country demonstrated that the benefits of competition have yet to realized and have not yet reached consumers." Lay's memo urged Bush administration to reject any limits on what Enron and others co charge for power. "Price caps, even if imposed on a temporary basis, be detrimental to power markets and will discourage private investm by raising significant political risk," the memo said, without specify what political risk or to whom. The memo then made what would t out to be a revealing observation about just how the rules on comp tion had been written. "Similarly, a return to cost-based wholesale r will be extremely difficult," Lay's memo said, as consumers would le years later.

Throughout this time both President Bush and Vice Presid Cheney and their aides blamed the crisis on California officials, wh they said had not allowed the construction of enough power plants had mismanaged. They also blamed Governor Gray Davis, a Democ even though he was not the cause of the problem. However, his hap responses, and his panicked decision to spend tens of billions of dol locking in prices at what turned out to be the peak of the crisis, w major reasons that voters later recalled him. The voters replaced h with one of the richest men in the country, Arnold Schwarzenegger, actor of such vast wealth that he is the only individual American to o a Boeing 747 jumbo jet (which he leases to Singapore Airlines).

In the months that followed, the Northwest delegation, and es cially Inslee, pressed for an investigation. At every opportunity Ins denounced the administration and attacked its integrity. The Fed

Energy Regulatory Commission did little at first, which was not surprising. Its chairman was Pat Wood. When Bush was governor of Texas he had named Wood to the Texas utility commission at Lay's urging. When Bush became president, he named Wood chairman of the Federal Energy Regulatory Commission, acting again at Lay's urging.

A few months later, Wood announced that the commission would impose price caps. That action, he emphasized, was exactly what Enron did not want. In most places the news was played like Wood really was his own man. But the price caps were modest and would allow prices to remain much higher than they had been, just not so high as to run a political risk of voter revolt.

The following February, in 2002, almost a year after the basement meeting and just weeks after Enron collapsed, Wood announced that the commission would investigate whether Enron had manipulated the energy markets. Ultimately this supposed investigation would produce a brief report concluding that "in perspective, the crisis remains an aberration from the competitive markets that have benefited customers both before and since."

Wood was a sightless sheriff, standing in the middle of a busy brothel while observing only the piano player, whose every missed note he claimed credit for pointing out. That Wood closed his eyes came to light only because someone else was unwilling to ignore it. The Snohomish County Public Utility District, which provides electricity in that Washington State county, was on the hook to pay $120 million to Enron for power it would never get. Its leaders suspected that Enron had manipulated power prices. The district lacked proof because, under Wood, anything that might show criminality was ignored.

One day the Snohomish officials learned that the government had tapes of every call placed by Enron traders. They asked for the tapes and were denied. They fought to get the tapes until they won. Then they spent $800,000 transcribing them. What they showed was worse than even Inslee imagined.

Traders talked about money they "stole from those poor grandmothers in California." They shouted with joy when a brushfire let off so much heat that the volume of electricity on a major transmission line had to be reduced, allowing Enron traders to jack up prices. "The magical word of the day is 'Burn Baby Burn,'" one trader exulted.

Other traders talked openly about how, when Wood imposed the minimal price caps, they got around them by selling electricity made in California to Arizona or Nevada and then selling it back into the state to evade the caps. They talked about how the new president from Texas would be good for Enron.

When the Snohomish district made its transcripts public, the responses were revealing. Enron, gasping its last in bankruptcy, said it was cooperating with investigators. Wood's spokesman stuck to the Bush administration line that the crisis was a tale of California politicians failing to do their job without quite making the accusation. Ignoring the guilty pleas already made by several Enron traders accused of fraud and other felonies, Wood's spokesman, Bryan Lee, said: "The bottom line is, was this crisis all manipulation? Or was there an actual shortage that resulted in the supply and demand already being tight?"

Once the evidence of Enron's systematic criminal behavior became overwhelming, the Federal Energy Regulatory Commission appeared to finally act with regard for some interest other than Enron's. It ruled that Enron could be required to give up all of the profits it earned since 1997. The operative word turned out to be "could."

Wood's successor as commission chairman, Joseph T. Kelliher, said that any firm that extracted profit through market manipulations on his watch would be forced to disgorge all profits. That turned out to be more hollow than promise.

What seemed like a routine settlement came before the commission for approval in June 2006, two years after the transcripts showing Enron's trading desk was a vast criminal conspiracy. It involved Enron's claim that it was owed about $160 million by two small nonprofit utilities. To end the dispute, Silicon Valley Power, an agency of the City of Santa Clara, California, paid Enron $36.5 million for power it had agreed to buy but that Enron never delivered. Valley Electric Association, a cooperative in the rural desert west of Las Vegas, paid $14 million. Both payments settled issues from the period when Enron was engaged in criminal fraud.

What about Chairman Kelliher's vow that on his watch any profits from manipulations would be disgorged? Lee, his spokesman, said that policy remained in force. But, he explained, the settlement involved not profits, but a dispute over termination fees. Whether "the termination fee is an unjust profit," Lee said, "is something the commission has not weighed."

Congressman Inslee was incensed. "It's the equivalent of Bonnie and Clyde, having been arrested, demanding that the banks refund the money

they stole and the government making the banks give them the money." Senator Maria Cantwell, a Washington Democrat, said the commission "has abdicated its responsibility" to protect consumers and taken the side of Enron and its creditors, "instead of looking out for the public interest."

The settlement also drew complaints from a cement company that has been billed $4.2 million for electricity that Enron will never deliver to its Montana kiln operation. Jack Ross, general counsel for Ash Grove Cement Company, said he was at a loss to understand why the commission staff agreed to the settlement. "We thought FERC would be an advocate for the consumer and we are an energy consumer," Ross said. "We felt the staff decision was more aligning itself on the Enron side and we were very surprised that they were so cozy on the Enron side."

The settlement with the two small municipal electric systems contained a provision that showed just how cozy Kelliher's commission was on the Enron side. It removed from the public record all of the notes, letters, e-mails, and audiotapes that documented Enron's crimes. Paragraph 12 of the settlement said that the commission staff agreed "to release the Enron Parties from all existing and future claims under any legal theory or cause of action that: (1) Enron charged, collected, or paid unlawful rates, terms or conditions for electric energy, ancillary services, or transmission congestion or natural gas in the western markets; (2) Enron manipulated the western electricity or natural gas or associated markets in any fashion, or otherwise violated any applicable tariff, regulation, law, rule, or order relating to the western markets; (3) Enron was unjustly enriched."

So there it was, five years after Cheney had told Inslee he did not understand economics. What the Bush administration did understand was that it could help its friends get rich, even if they were too clever by half and lost it all. First Cheney could deny a problem existed, and decline to inquire. Then the administration could create the appearance of an investigation while taking care to make sure nothing untoward would be found. And finally, when the evidence of wrongdoing came out anyway, it could just seal the record, promising to never ask a question or speak of these unpleasant matters again.

But wait. There's more.

Among the documents withdrawn from the public records under the settlement were notes taken by an Enron lawyer named Mary C. Hain. She worked at the hub of Enron's electricity trading operation. That was in Portland, Oregon, where Enron owned its only operating company, Portland General Electric. While far from conclusive, the notes indicate that Hain knew about wrongdoing or, at a minimum, considered a strategy to counter any serious investigation. Hain wrote:

> no one can prove, given the complexity of our portfolio
>
> look like we're forthcoming
>
> answer questions, say nothing—answer questions, finger others

What makes these notes interesting is that the Federal Energy Regulatory Commission never questioned Hain under oath about her notes. Instead, it hired Hain as a lawyer in its office of administrative litigation. When word of Hain's hiring got around, Senators Dianne Feinstein, a California Democrat, Cantwell, and others asked questions.

Chairman Kelliher insisted there was no issue because Hain would not work on any Enron matters. Hain told the *Los Angeles Times*, which asked about her hiring, "I'm an extremely ethical person. I've felt that I've been that way my entire career, including the time I was at Enron." The value of the statement can be weighed in the context of the mob boss Joseph Bonanno, who in his autobiography boasted about what a moral and ethical man he was, at least in his own eyes. Hain said her notes were the product of two meetings in which she hardly knew what was being talked about because she was a regulatory lawyer and the others were traders.

Robert McCullough, whose fax showed that a third of power plants were offline when prices soared, said her hiring should raise a question about why the commission could not find someone else among all the legions of regulatory lawyers in America who was at least as good, if not better. "Apparent indifference to corruption," he said, "seems like a very poor qualification as a regulator."

Today Enron is gone. So is Lay, dead in July 2006. His fatal heart attack came after his fraud conviction, but before his sentencing. That means the record in his case, like the record before the energy regulatory commission, will be changed. His conviction will not stand. As for the market manipulations that cost energy customers tens of billions o

dollars in electricity charges alone, and left California with debt it will take two decades to pay off, officially whatever did happen will never be spoken of again by regulators under the settlement.

Despite this, the story is not over. The damage Lay and Enron caused was not limited to criminal acts. Enron had laws written to suit its schemes. Those laws remain on the books. They continue to enrich the wealthy few at the expense of the many through auctions that are called markets but, as we shall see, act instead like bid-rigging systems approved by government.

Chapter 19

PAYING TWICE

AT THE CORE OF THE ARGUMENT THAT MARKETS ARE BEST LIES ADAM Smith's observation that, in a free market, prices will fall to the lowest level at which proprietors can stay in business. Professor Sarosh Talukdar of Carnegie Mellon University decided to look into how this applies to the auction markets for electricity.

Talukdar created an ideal market. His simulated market had ten electricity generating companies, each of equal size, selling power; and ten utilities, also of equal size, buying power. The sellers seek the highest prices, while the buyers want to pay the lowest prices possible. There was more than enough capacity to supply the market.

In this idealized market, prices would be expected to fall as buyers took only the lowest bids. Instead, prices rose. And as time passed and more trades were made, the prices the buyers had to pay rose higher and higher. The results astonished Talukdar, so he ran four variations of the market experiment to test the findings. The results were always the same. Prices rose.

This pattern of rising prices suggests strongly that the sellers were colluding. The classic way to raise prices is for sellers to meet in secret and agree to fix prices at higher levels than the market would set.

But in Talukdar's experiment, collusion was impossible. The sellers could not have met in secret to fix prices because they were not people, but simple computer programs called learning algorithms. The programs were so simple that high school students with a knack for software could have written them.

What the experiments showed was that sellers could jack up prices in this market because the buyers are forced to buy. If the price of a share of

stock or a piece of land is too high, buyers can walk away. Not so electricity, where the utilities that distribute the power are required to supply it. In this auction, the sellers all paid attention to the prices offered by other electricity sellers, then raised their own prices to higher and higher levels. So long as no one broke ranks and undercut the market, the sellers overall got higher prices and fatter profits than they would in a competitive market.

This unstated coordination gave the producers of electricity what economists call *market power,* which means the ability to set prices higher than a competitive market would allow. Within less than a hundred rounds of bidding, Talukdar's experimental auctions resembled not so much a competitive market as a cartel, in which many sellers obtain monopoly power by coordinating their actions to artifically inflate prices. That is what OPEC, the Organization of Petroleum Exporting Countries, does openly when members collude on setting the price of oil by limiting production.

"Collusion is a crime," Talukdar noted, "but learning is not. My studies show it is easy to learn from the signals given by others how to get the benefits of colluding without breaking the law."

Professor Talukdar is a computer scientist, not an economist. He thinks as an engineer thinks. "In building complex systems, whether it is a manufacturing process or a jetliner," he said, "you have to have rigorous verification to see if what you designed actually works the way you intended. But that is not the practice with economists, who do not verify the design of trading markets. Economists have this faith in markets, that markets are always a good thing."

Defenders of the electricity auction system, especially the owners of power plants, insist that the system has produced lower prices than the old regulated system, whose rates covered costs and provided a virtually guaranteed profit to the utilities. But the figures they point to show that prices fell, not because of market forces, but due to the rate caps and freezes that government imposed. Numerous studies found no benefit to consumers. One Cornell University study concluded, "There is no evidence to support the general expectation that deregulation would result in lower electricity prices." Instead, the evidence points to competition resulting in the higher prices that Talukdar's experiment found.

Talukdar said that his experiments show that "the design of markets matters a great deal and the design must be verified to see if it really works as a free market." Frank Wolak, a Stanford University economist who favors competitive markets for electricity, said Talukdar is right. The design of markets matters a great deal, Wolak said, because "even small flaws in the design of markets can cause enormous harm to consumers in very little time."

The damage was, and is, huge. Marilyn Showalter, an advocate for publicly owned power systems, analyzed Department of Energy data. The data showed that in the 12 months ending in May 2007, electricity in states that adopted Enron-style laws cost $48 billion more than the average cost in states that retained traditional regulation, which ties prices to the costs of production. That is $132 million per day in excess costs that act like a tax on the customers paying the bill.

In adopting Enron's recommendations to create electricity markets, state legislators did not take into account many unique aspects of electricity that affect its suitability for market auctions.

In markets for stocks, pork bellies, airline tickets, and houses, potential buyers have the option to walk away if the prices are too high. A stock can be bought on another day. Bacon is not required for breakfast. A trip can be deferred, and so can plans for a new house. But utilities in California, Connecticut, Illinois, Maryland, Texas, and a dozen other states must buy power every day. Many corporate-owned utilities, under laws Enron drafted, were required to sell their own generating plants. They are forced to buy power in the electricity markets since they no longer produce electricity themselves, but are still required to supply all that customers want.

Unlike the stock market, where vast numbers of strangers buy and sell, the electricity markets involve a relative handful of buyers and sellers. In New Jersey, for example, just 10 generators won bids in 2006 to supply a third of the state's base load of power for the next three years.

In many markets, the buyers and sellers are related companies under a single corporate umbrella. When regulated utilities sold their power plants, the buyers were often unregulated sister companies owned by the same corporate parent. In such arrangements, if the unregulated company that owns an electric power plant gouges the utility, the result is big profits for the parent company, creating a perverse incentive to raise prices.

Finally, electricity trades repeat each day. Power is sold for specific time periods, often an hour or quarter hour, a day or two before it is needed. The short periods allow prices to be affected by changing demand from customers as they turn on air conditioners on hot afternoons

or flip off lights at bedtime. Because auctions occur so often, those who generate power for sale can get an idea of what the market will bear by studying the weather report and historic patterns of demand. This is where the analysis of trading patterns that drove up prices in Talukdar's experiment comes into play.

Moreover, electricity markets operate in government-imposed secrecy. Individual stock investors can make sure they got a fair price by checking the prices paid just before and after their trade. But the Federal Energy Regulatory Commission and the electricity exchanges it authorizes stamp many trading records confidential, though some records are made public months or years later. Many times even this knowledge is misleading, however, as the markets include not just the owners of power plants, but brokers who act as fronts.

Finally, the very nature of electricity means that it must be produced, transmitted, and consumed in an instant. Automakers can cut production when vehicles do not sell. Investors who hold too much of a particular stock can sell it in blocks over time to get the best price. But electricity cannot be held in inventory.

There is one other crucial difference between electricity and stock markets. In electricity markets, every seller gets the highest price—*even when it is higher than the price at which they were willing to sell.* That is the rule in the electricity auction market: the highest winning bid sets the price for all.

Contrast this to the stock market. Someone who wants shares of a company buys them at different prices, perhaps $10 a share to start, and then, as word gets around that someone is accumulating shares, paying $20. The average of these prices may be $15. Not so with electricity. In electricity markets, everyone gets the highest price that is accepted. It is as if the stock market buyer had to pay $20 for every share, even the ones offered for sale at half that price.

Giving every seller the high price for the day, hour, or other time period creates a huge incentive to hold generating stations offline to restrict supply and thus drive up prices. This was exactly what was shown in the fax that Vice President Cheney refused to examine when he told Representative Jay Inslee, "You just don't understand economics." This system also creates incentives to apply what is learned, as Professor Talukdar showed, to rig prices.

Consider what happened on March 2, 2003, in the Texas electricity market. Power was being auctioned off in quarter-hour segments for the next day. Some power was offered for free, presumably by nuclear power plants, which must run at the same rate around the clock. Several dozen bidders then offered power at various prices.

The average of the bids required to supply all the power that was needed came to $83 per megawatt hour. But the bid that cleared the market, the bid that provided the last megawatt of power needed to meet demand, was more than $200. Under the rules for electricity markets, every generating company was paid the high bid of more than $200 per megawatt hour. The difference between the individual prices that the sellers offered and the price actually paid was $150,000. That money was extra profit for all but the top bidder.

In the auction for the next quarter-hour period, the bidding pattern changed. There were still generators offering power for free. But the high bid for the last few megawatts of power needed by customers was $990. Every owner of a generating plant got that price, even those offering power for free. The extra profit? More than $800,000 in just fifteen minutes.

The industry calls these inflated prices "hockey stick" bids because, when plotted on a chart, the prices show a long handle that rises slowly with a spike at the end like the blade on a hockey stick.

Official state reports identified only as "Company C" the bidder who set the price at nearly $1,000. Years later it was identified as TXU, which owns both the regulated Dallas electric utility and, through a sister company, a host of power plants. Although historically stocks of utilities were reliable but slow to appreciate, TXU has been one of the best-performing large company stocks between 2002 and 2007, showing just how valuable the pricing manipulations of "Company C" were to its bottom line.

The system was a perfect arrangement to get, not the lowest possible prices, but a free lunch through inflated prices, served up by government rules. Any one of the many TXU generating plants could make a high bid that produced windfall profits for the others. Because the power was sold to regulated utilities, which by law must provide whatever power customers demand, the price was just passed on. But customers had no idea that in some quarter-hour segments they were paying exorbitant prices. Why? Because all customers get is a monthly statement that adds up the prices paid for every fifteen-minute period into a single total.

Technology allowing residential and small-business customers to know what price they pay each moment for electricity has been available

for decades. In the seventies, utility regulators in California and some other states said they would make it widely available to encourage people to reduce their use of power during periods of peak demand. Somehow, though, it just never happened. And without that knowledge of prices at each instant, customers cannot know when their pockets are being gouged.

The supposed markets for power enable price gouging in still other ways. California has 1,400 power plants, which ought to be more than enough for a vibrant market and, as Adam Smith observed, should drive prices down to the lowest level at which the businesses can afford to continue operating. But ownership of those California plants is so concentrated that just six generating companies can set an artificially high price for electricity virtually all the time, research by Carnegie Mellon University shows.

New Jersey and Illinois are among the states that conduct annual electricity auctions. In New Jersey, just 10 generators won contracts to supply a third of the state's base load of power through 2009. The price? It was 55 percent higher than the previous year's three-year bid.

In Illinois, prices also soared. Among the winning bidders to supply power? An unregulated sister company of Commonwealth Edison, the Chicago utility, both of which are owned by Exelon. In essence, this is a system in which an unregulated company earns outsized profits from a regulated company, which in turn earns virtually guaranteed profits and, by law, can pass on the prices it pays for electricity to its customers. Think of this as the anti–Adam Smith policy.

That electricity is sold in what are called markets, but are really mechanisms to rig prices and cheat customers, has become obvious even to the large industrial and commercial customers who initially bought into Enron's campaign to make generating electricity a competitive business. They have seen their own prices rise, not fall. Robert A. Weishaar Jr., a lawyer for many big industrial customers, told the Federal Energy Regulatory Commission that his clients were being taken for a ride and damaged by commission policies that allow price gouging. "The 'markets' that are rolling off the commission's production line are not fit for their public purpose," he wrote.

The Federal Energy Regulatory Commission, however, rejected all such complaints out of hand. Under its circular logic, once it declares that a market for electricity has been created, whatever prices markets produce must by definition be fair and just, because markets produce fair and just prices.

Faux markets are not the only way that customers are having their pockets picked under current policies originally promoted by Enron. When competition began, most states that adopted the Enron proposals required utilities to sell their power plants. They not only allowed them to be sold to sister companies that were unregulated, they allowed them to be sold at bargain-basement prices.

Most plants were sold for the cost of construction minus the amount that had been depreciated, that is, the amount written off on the company's books. This was allowed even when the plant had actually risen in value. Said Lynn Hargis, who was a longtime federal government energy lawyer before joining Ralph Nader's Public Citizen: "Selling a power plant for its depreciated value is the equivalent of selling my grandmother's house for what she paid for it decades ago, less depreciation, while ignoring its real value. Nobody would do that."

For electricity customers it was even worse than that. The utilities demanded that they be paid in full for the value of the plants that they had not yet written off. These were the "stranded costs" in the Trojan Horse bill that the Texas legislature, and the legislatures of many other states, passed to mollify the utilities.

Across the nation, state utility regulators let the utilities sell bonds so they could immediately pocket in cash the value of the plants that they transferred to their unregulated sister companies. Then the cost of these bonds, plus interest, was added to electric bills. For residential customers of Centerpoint, the old Houston Lighting & Power, this will add an average of almost five dollars to their bills every month for 14 years.

Some of these plants were then resold at huge profits. Centerpoint sold 60 power plants that generate most of the power for the Houston area to a joint venture of four investment firms—the Blackstone Group, Hellman & Friedman, Kohlberg Kravis Roberts, and Texas Pacific Group. The price was less than $1 billion. Just eighteen months later, the four investment firms resold the plants for a profit of almost $5 billion. It was a deal that even by the standards of Texans produced awe, though no shock.

Sempra Energy, parent of the utility in San Diego, and two investment partners bought nine Texas power plants in 2004 for $430 million. Less than two years later, it sold just two of the nine plants for $1.6 bil-

lion. A group led by Goldman Sachs, the investment bank, bought power plants in upstate New York, Pennsylvania, and Ohio starting in 1998. It sold them in 2001 for a profit of more than $1 billion.

The prices of these and many other plants rose because of the easily rigged markets for electricity that make it possible for owners to inflate prices. Robert McCullough, the utility economist whose fax on price manipulations Vice President Cheney dismissed without reading it, said that from Maryland to Texas to California, the sale of power plants by utilities to sister companies had no benefit for customers. "The same energy is generated by the same plants, owned by the same owners, and sold to the same customers, simply at a vastly higher price," he said.

Ralph Nader said regulators should have required price protection to shield consumers from a "double-header corporate gouge, where the defenseless customer is paying twice for the same power plants."

But wait. There's more.

Paying twice for the power plants is not the only way that electricity customers are forced to double up their costs. Across the country, electricity customers pay taxes that are embedded in the rates they pay. Because utilities are legal monopolies, they must recover all of their costs from customers, ranging from the price of fuel and the chief executive's expense-account lunches to income taxes on profits.

These taxes do not always make it to government, however. When state utility boards set electric rates, they assume that the utility will file its own tax return. But often when the utility has a corporate parent, the parent files the tax return and the parent may not pay any taxes. When that happens, the utility and its parent company eat a free lunch at the expense of their customers.

The system that allows the corporate parents of utilities to pocket taxes has many defenders. Paul Joskow, a Massachusetts Institute of Technology utility economist, said, "For the customer, the result is the same." He meant that if utilities filed their own tax returns and paid the taxes, their rates would be the same as when they pass the taxes on to their corporate parents.

Mike Hatch, when he was Minnesota attorney general, said Joskow's argument is hollow. "Essentially, utility ratepayers pay the tax twice," Hatch said, "once through the utility bill and again through the lost revenue to government that means either higher taxes for them or fewer government services."

Hatch provided help to Myer Shark, a Minnesota lawyer who spent

the last years of his life trying to recover $300 million in taxes, embedded in the rates paid by that state's electric customers, that never reached government. The taxes benefited Xcel Energy, which operates in ten states, though Shark sought recovery just in Minnesota. To Shark, who was in his nineties when he took on Xcel, pocketing taxes violated laws prohibiting "unjust enrichment" by legal monopolies like utilities.

"The law says that utilities are entitled to a just and reasonable return, but when they keep the taxes, they are earning an unjust and unreasonable rate of return because those taxes add to their profits," he said. Just days before he died in 2007 at the age of 94, Shark filed the last legal papers intended to make sure a court would decide his case and reject any efforts to dismiss it because he would not be around to argue further.

The champion at pocketing taxes was Portland General Electric, during the years 1997 to 2004 when it was the only operating business owned by Enron. Each year Oregon residents and businesses paid about $92 million to cover Portland GE's income taxes. But Portland GE, like virtually all electric utilities with a corporate parent, did not file its own tax returns. Instead, Enron filed the tax returns. Enron did not pay taxes, thanks to its use of hundreds of shell companies in the Cayman Islands and other tax havens. That meant that Enron pocketed an extra $92 million a year from Portland GE customers, a total of nearly $1 billion dollars during the years it owned the utility.

News that Portland GE did not pay taxes caused an uproar in Oregon. The state was so hard-pressed for money that some counties could not afford sheriff's patrols. The Oregon legislature passed a law in 2005 to require that any taxes embedded in utility rates be turned over to government. Not only did Portland GE fight the law, so did Warren Buffett, who had just acquired Oregon's other big corporate-owned utility, PacifiCorp. Both wanted to profit off taxes.

Buffett is a master at delaying the payment of taxes not for a little while, but for a generation. His MidAmerican Energy Company owns electric and natural gas utilities, with operations from Oregon and Utah through Iowa and east to Britain. It paid just 4 percent of its American profits in federal corporate income taxes in 2006, far less than most Americans paid on their incomes. On its overseas profits, MidAmerican paid a 21 percent tax.

MidAmerican will have to pay the rest of his American taxes, but not for a long time. It deferred $666 million in taxes in 2007. In 2035 it will have paid just half of those taxes. A tax not paid today but in the distant

future is like getting an interest-free loan from the government, which is to say from the rest of the taxpayers. Imagine how rich you would be if you had bought a house 28 years ago, got an interest-free mortgage, and only now had to pay the price you agreed to so many years ago. Like Buffett you would be rich. When the government finally gets those taxes from Buffett's company it will get about 40 cents on the dollar. You will have to make up for those missing 60 or so cents through higher taxes, fewer services, or interest payments on more government debt.

This interest-free loan has not meant cheap electric rates. When it comes to charging high prices, Buffett plays hardball, extracting every dollar the regulators will allow his utilities to charge, as people in six Iowa cities discovered. For years Iowa had nine corporate-owned electric utilities plus a sprinkling of city-owned systems that sold power at lower prices. Then MidAmerican and another firm, Alliant Energy, consolidated the corporate-owned utilities into just two entities. Because consolidation lowers costs, people in Johnson City and five smaller towns tried, without success, to get lower rates, hoping this would both save them money and help local manufacturers create more jobs. Rebuffed, they organized to buy out MidAmerican and run municipal systems so they could get their power for less.

Buffett's agents immediately went to work to make sure electricity prices would not fall. His firm spent more than half a million dollars in Johnson City. It also filed a petition to lower rates, though more than four years later rates remain unchanged.

But Buffett's key move was getting legislation to thwart not just six towns but to punish the people in the nine cities with municipal power for giving advice on how to convert from corporate power to municipal power. MidAmerican drafted bills that would have made the existing city-owned systems pay taxes, prevented them from making changes as technology and the times always require, and blocked them from offering any new services, such as municipal Internet or cable television service. Buffett's lobbyists bluntly told the Iowa Association of Municipal Utilities that it would make the legislation go away on one condition: that the association stop giving advice to the six towns on how to switch to municipal power. Bob Haug, the association's executive director, told his members that the influence of Buffett's lobbyists showed how the state of Iowa had been transformed into "Iowa Inc." He said that given MidAmerican's grip on the legislature the association had no choice but to bow to MidAmerican's demand that it adopt a resolution promising to never help any Iowa citizens seek a municipal power system.

Carol Spaziani was a librarian in Johnson City before she retired. She became a leader of the municipal power campaigns. Spaziani said that she watched in amazement and horror both at how Buffett used government to enrich himself at the expense of others and at how eager state legislators and others were to bow to the will of his lobbyists. She said she was also struck by the inability of the news media to articulate the issues of a matter crucial to the local economy, and, when they were covered, how it was written up as a political dispute worthy of only a few words on the inside pages.

"On television I keep seeing this beneficent billionaire who is portrayed as someone we should all respect because he is so rich, and he has given so many billions to charity," Spaziani said. "What I don't see is coverage about how Warren Buffett is forcing people in Johnson City to pay more than we should for electricity, and how that means fewer jobs and hardship for people just so he can make more billions."

But wait. There's still more.

State regulators generally allow utilities to earn a profit of 10 percent or so. Yet despite this limit on profits, investors famed for earning much bigger returns, like Warren Buffett, are buying electric utilities. Kohlberg Kravis Roberts & Co. and the Texas Pacific Group, which teamed up to make those enormous profits buying Texas power plants, are in the game. The two firms worked jointly in 2007 to buy TXU, the big Dallas utility involved in the hockey stick bids. This joint venture came after KKR failed in its attempt to buy Tucson Electric Power in Arizona and Texas Pacific tried to buy Enron's Portland General Electric.

Why would investors famed for much bigger returns want electric utilities earning a solid, but modest, profit? The answer reveals how much government has become an ally of the rich in exploiting those with less.

After Enron bought Portland GE it raised rates, ending decades of cheap power. The revelation that it pocketed almost a billion dollars of taxes customers were forced to pay in their monthly electric bills turned many in Portland against both Enron and the local electric utility.

Then, in October 2003, the city's long Enron nightmare appeared to be coming to an end, thanks to Neil Goldschmidt, the most influential politician in the state. Goldschmidt was elected mayor in 1972 when he was just 32, the youngest mayor of a major American city. He went on

to become transportation secretary under President Carter and governor of Oregon. He was instrumental in making Portland a vibrant, livable city, with mass transit, bicycle lanes, and ways for minorities and others to have a voice in city affairs.

Goldschmidt announced that Texas Pacific proposed to buy Portland GE, and that he would shepherd the deal through Oregon's Public Utility Commission. At his side stood two business leaders, Gerald Grinstein, the chairman of Delta Airlines, and Tom Walsh, a prosperous developer. The promise was of local leadership of the utility, although the investment money was coming from far away. Things soon took many unexpected, even salacious, turns.

Texas Pacific instantly persuaded state officials to seal most of the documents about how it would finance the purchase. It claimed that the information would be of value to competitors, a curious argument, since Portland GE is a legal monopoly that has no competitors. But Oregon's Public Utility Commission, whose members were so lackadaisical that the chairman was known to nod off during official proceedings, went along. Lawyers representing big industrial customers, consumer groups, and others could see the financial records, but only if they promised not to reveal what was in them.

Ann Fisher, a veteran utility lawyer who represented downtown building owners, was vexed by what she saw. So Fisher wrote an essay for *The Oregonian*. She wrote that the sealed files told a very different story than the public announcements about the purchase. Fisher took care not to disclose any specifics that might be of value to Portland GE's mythical competitors, but she wrote that from the viewpoint of Texas Pacific, a 50 percent profit was not out of the question. Her words suddenly turned an issue that bores most people into the hottest topic in town.

Soon after that, someone slipped the sealed documents to an exceptionally savvy reporter named Nigel Jaquiss. He had made a fortune as a Wall Street oil trader and then decided his children would have a better life if their father had a job he really enjoyed. Jaquiss reported for the local alternative newspaper, *Willamette Week*.

Using skills he had learned at Goldman Sachs, Morgan Stanley, and Cargill, Jaquiss plowed through the documents and determined that Texas Pacific had found a way to earn more than three times the rate of return that was authorized for Portland General Electric. The key was a complicated ownership structure with a lot of debt and very little cash,

which meant that the real risk if anything went wrong would be borne not by the owners of the utilitiy, but by its customers. The public knew none of this, thanks to the official secrecy.

Such official secrecy in regulatory proceedings is becoming commonplace across the country. It fits the ideology that government is the problem, which it certainly is for some corporations when government acts as a guardian of the people against profiteers. It also has its attractive benefits for politicans, allowing them to do their work and even make subtle side deals to benefit friends without a spotlight on their actions. Keeping people in the dark also reduces the risk that the public will realize how much of its government has been twisted into a tool of the rich seeking to expand their riches at the expense of those with less.

The disclosures about the financial aspects of the deal followed an earlier story by Jaquiss that discredited Goldschmidt. It was the story of a secret that many of Oregon's business and political elite had known about, and many others had suspected or heard about, but that everyone had kept to themselves for more than three decades. Jaquiss showed how a few prominent Oregonians had even traded on the secret, getting official favors from Goldschmidt when he was in office.

The secret was that Goldschmidt, when he was mayor, repeatedly had sex with a 14-year-old girl, a neighbor whose mother was a close political ally. None of those who knew had stepped forward to protect the girl or to have Goldschmidt arrested for statutory rape. For years Goldschmidt paid the victim hush money. There was no indication that anyone among Oregon's elites ever shunned the child rapist, but plenty of evidence that some of those who knew turned to him when they needed to work the city, the county, or the state for official favors. Goldschmidt was, by all accounts, the man to see about getting government to help the rich and powerful, both fixer and kingmaker.

When Goldschmidt realized that the intrepid reporter Jaquiss had all the facts to break a story in the weekly newspaper, he went to *The Oregonian*, the largest daily paper in the state. He hoped that by giving the big daily newspaper a scoop he would get as friendly a story as possible, one that would not carry the sting that was certain to come from Jaquiss. It was a smart move. The next morning *The Oregonian* reported that when Goldschmidt was mayor he had "an affair" with a girl of 14.

The financial disclosures and the sex scandal eventually brought an end to the Texas Pacific bid. Jaquiss won an extraordinary honor for a

reporter at a weekly newspaper, a Pulitzer Prize. The city of Portland tried to buy the utility, promising to pay more than anyone else, and then to lower rates, because as a municipal utility it would not have to pay big executive salaries or dividends. The corporate lawyers and executives who by then controlled Enron declined to take this high bid. Instead they had Portland GE issue stock, and it became a freestanding company, one that immediately asked for a hefty rate hike and a change in rules that shifted the risk of rising fuel prices entirely onto customers. As with Warren Buffett's hardball moves in Iowa, corporate power worked to make sure customers paid the highest possible prices for electricity.

What is significant about the Portland deal is how it exposes the willingness, even eagerness, of government officials who are supposed to be acting on behalf of the public to use official secrecy to benefit private interests. And even when Texas Pacific's fixer was revealed to be a sexual predator whose victim was a 14-year-old girl, the local elite did not turn on him, did not demand an inquiry, and did not queston their own complicity. Instead, the state conducted a long, costly, and ultimately failed investigation to try to determine how Jaquiss got hold of the financial documents. The state tried to pin the blame on Ann Fisher, who had acted honorably, and who had not been the source of the documents.

Fisher paid a terrible price for being honest. She lost her business clients. She has had a tough time finding new ones, as the tightly knit Portland business elite closed ranks.

And Goldschmidt? After laying low for months he resumed working for clients seeking subtle favors from government. But unlike his public announcement in the utility deal, Goldschmidt adopted a lower profile, working the telephones and backrooms.

Advocating competition, and then using government as a way to make deals shrouded in secrecy that promise enormous profits and few risks for those getting richer, is a core strategy for those who have discovered how easily government can be turned into a source of personal enrichment. Next, let's examine the career of one of the biggest beneficiaries of this self-serve approach to government.

Chapter 20

RISING SNOW

THAT MARKETS ARE SUPERIOR TO GOVERNMENT REGULATION compelling on paper. Arranging symbols on pieces of paper w soned logic is, however, a much easier task than applying idea real world. Human beings must act out the policies, bringin strengths and shortcomings into play. They bring their own go ambitions and they must contend with external forces working different assumptions.

The career of John Snow, the CSX railroad chief executive w came Treasury secretary for more than three years beginning in 2 lustrates this dichotomy. The arc of Snow's career shows h movement to weaken government while strengthening corporate has enriched the few at the expense of the many.

John William Snow was born in 1939. He grew up comfort Toledo, where his father was a corporate litigator who enjoyed despite being nearly blind. Mealtime in the Snow household was a debating society with only one winner, which shaped Snow's rem skills at lobbying and flattery of those in a position to do him Snow once told an interviewer about a valuable lesson he learne the autocrat of the dinner table. "If you argued with my father, quite pleasant about it, but you would lose," Snow said. "Early o the tactical advantage of stating my views as hypotheses."

Snow graduated from college in 1962 and went to the Unive Virginia for graduate studies in economics. It was a heady tim professors there, James Buchanan and Ronald Coase, were dev ideas about markets and government, for which each would later Nobel Prize.