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Deregulation and Hydroelectric Power: Opening the Floodgates to Disaster

Executive Summary

Electricity is an inherently local and interconnected structure—generation, transmission and distribution are all linked in real-time—so irregularities in one sector can have catastrophic consequences in others. And because electricity is essential to our everyday activities, be they commercial or personal, the industry is invested with the public interest. Hydroelectric power is doubly weighted with the common good in that it involves both electricity and rivers, which are environmentally fragile resources.

The failure of electric deregulation has decimated the industry, as utilities have lost over \$2 trillion in value since the collapse of Enron and dozens of other energy corporations. Some of these same corporations involved in the west coast energy crisis have bought hydroelectric resources in other states. The resulting financial turmoil threatens local control of dams purchased by out-of-state corporations.

The inability of restructuring to foster competitive markets in those 15 states continuing to pursue deregulation and to prevent utilities, independent power producers and energy traders from defrauding consumers during the west coast energy crisis provide overwhelming arguments against the deregulation of the hydropower sector. The importance is heightened for states like Montana and Vermont that rely heavily on hydropower. This paper examines the dangers of giving corporations too much sway over river systems, and highlights the benefits of publicly and locally controlled resources.

The Hydropowers that Be

The restructuring of the electricity industry in the 1990s dismantled one of Vermont's utilities, New England Electric System (NEES), resulting in new corporate owners located a continent away from the state's dams. NEES sold its 41 Vermont hydropower units on the Connecticut and Deerfield rivers in September 1998 to California-based PG&E as part of a \$1.6 billion sale of its assets. Some of the facilities had been in commercial service for as long as 1909, altogether producing 570 megawatts of electricity—more than enough power for half a million homes.¹ By March 2000, the dismemberment of NEES was complete when the company was swallowed up by the British conglomerate National Grid.

PG&E operated the largest utility in California, and was heavily impacted by the energy crisis. The company overexpanded outside the California market, using its National Energy Group subsidiary to purchase and run far-flung energy systems in places like Indiana, Mississippi, Vermont and Wisconsin. When PG&E filed for Chapter 11 bankruptcy in April 2001, it demanded that California taxpayers pay \$8

¹ PG&E 10-k filed with the Securities and Exchange Commission on March 9, 1999.

billion to cover the utility's costs from being price-gouged by wholesale participants like Enron, Dynegy, Reliant and Duke.

But at the same time that PG&E was exposing its California utility to financial abuse by the likes of Enron, the company's National Energy Group subsidiary was spearheading a \$9 billion out-of-state buying spree.² Spending that kind of money on PG&E's non-core California business was dangerous to National Energy Group's solvency, and the financial overextension hurt not only California consumers but Vermont ratepayers as well. National Energy Group defaulted on loans and threatened bankruptcy after credit rating agencies downgraded the company's debt in July 2002. That led to the cancellation of a planned \$750 million revolving line of credit the company had expected to receive in November 2002. In December 2002, National Energy Group defaulted on a \$431 million loan. In total, National Energy Group defaulted on \$2.9 billion in debt and other obligations as of January 17, 2003.

PG&E's sudden reversal of financial fortune had huge impacts on Vermont. As a condition of the December \$431 million loan default, National Energy Group has agreed to sell most of the facilities the company bought from NEES in 1998. The prospective buyer remains unknown. But with a majority of energy companies tainted by fraudulent fallout from the west coast crisis and with the entire industry afflicted by continued volatility and uncertainty of the future of deregulation, the new buyer could end up having the same financial problems plaguing PG&E.

This deregulation fiasco means that there is no way for Vermonters to know who will be controlling their state's natural resources and how those resources will be used. Furthermore, the economic ramifications of the sale are great if plant employees are laid off or lose their pensions, as 700 NEES employees were when the company's assets were sold to out-of-state corporations.³

Competitive Hydropower—An Oxymoron?

Local ownership is required to ensure that the dams are operated in the best interest of citizens and its environment. The hydroelectric power industry promotes dams as "green" electricity, marketing it as a renewable, low-impact energy. The construction and operation of dams, however, causes major environmental upheaval in river ecosystems, often resulting in a total loss of habitat for many plant and animal species.⁴ Unnatural patterns of water flow can cause damage for hundreds of miles above and below a dam.⁵ Dam construction and operation has serious effects on water quality and quantity, and therefore on the area residents who use the water.

Since hydroelectric power plants present significant environmental concerns, it is essential that these externalities are taken into account. Under deregulation, however, utilities like NEES have been forced to sell generating assets and abandon integrated resource planning, turning these unique public resources over to a market with no interest in producing low-cost power to its native customers while balancing environmental concerns. Instead, distant new corporate owners of hydroelectric facilities have exploited the lack of transparency inherent in deregulation to sell dam power out-of-state at high prices.

² *Claiming Poverty in a Sea of Riches: New Investments by Parent Companies Belie California Utilities' Claims of Bankruptcy*, Public Citizen, January 16, 2001, www.citizen.org/cmep.

³ "PG&E Agrees to Acquire New England Power Plants," *The Wall Street Journal*, August 7, 1997.

⁴ Philip Raphals, *Restructured Rivers: Hydropower in the Era of Competitive Markets*, International Rivers Network, May 2001, page 36, www.irn.org.

⁵ *Dammed Deregulation: How Deregulation of the Electric Power Industry Could Affect the Nation's Rivers*, Public Citizen, June 1999, www.citizen.org/documents/damdereg.pdf.

The most startling example of this is in Montana. Like Vermont, Montana relies heavily upon hydropower to generate electricity. In 2000, 42 percent of the electricity generated in the state came from hydropower, compared to 19 percent in Vermont and just seven percent in the U.S. as a whole. As a result, Montana enjoyed the 8th lowest electric rates in the country.⁶ Montana passed deregulation legislation in 1997 and Montana Power, with roots dating to 1912, announced just eight months later that it would divest all of its power plants. By December 1999, Montana Power had sold all 11 dams and the company's four coal power plants—over 1,300 megawatts of its generating capacity—for \$767 million to Pennsylvania-based PPL.

PPL understood the importance of taking control of Montana's cheap hydropower when the company boasted that the acquisition was "expected to provide a significant impact on future results of operations."⁷ What an understatement. While the subsidiary PPL Montana represents only 5.2 percent of the total assets of PPL Corp, it produced 28 percent of the company's profit in 2000 and 2001, including 58 percent of PPL's 2001 profit.⁸ PPL Montana's two-year after-tax profit of \$189 million for 2000-01 means the company made a \$527 profit off every Montana household.⁹

PPL produced these impressive returns from its Montana investment by taking advantage of deregulation and low-cost dams. With Montana officials unable to regulate due to the state's deregulation law and because the Federal Energy Regulatory Commission (FERC) did not moderate the actions of wholesale power companies under its jurisdiction, PPL Montana was able to charge whatever price the market was willing to bear. And because PPL Montana had an unregulated monopoly, the market bore whatever price the company wished to charge. Montana prices increased by more than 1,000 percent from the beginning of 2000 (when PPL Montana took over) to June 2001,¹⁰ when FERC finally reregulated the entire western market by enacting price controls.

The actions of PPL Montana are a clear example of what happens when corporations are granted full control over America's power: their instinct to serve shareholders overrides the delivery of affordable, reliable electricity to consumers. Although there are cases, of course, where non-corporate power abused consumers (famously, when the City of Los Angeles Department of Water and Power price gouged California consumers outside the city by selling excess its power at exorbitant prices), there is no question that public power provides the greatest benefit to consumers because under municipal systems, shareholders and consumers are the same entity. Nationally, public power and rural co-ops provide electricity far more cheaply than power provided by corporations. City-owned power and rural electric co-operatives served 27% of American households in 2000, charging their customers 7.52 cents per kilowatt hour. Corporate-owned power, serving 73 percent of American households, charged their customers 8.53 cents per kilowatt hour—13 percent more than the price charged by publicly-owned power.¹¹

Corporations' lack of commitment to communities extends farther than just price-gouging consumers' energy bills. Since 1999, PPL Montana has paid \$8.6 million in property taxes on its 11 dams "under protest," which means that while the funds are collected they cannot be spent until the dispute is settled. PPL argues that its dams were overvalued and therefore the property taxes were too high. In the

⁶ U.S. Energy Information Administration, *Electric Power Annual 2000*, www.eia.doe.gov.

⁷ PPL 10-k filed with the Securities and Exchange Commission on March 2, 2000.

⁸ PPL 10-k filed with the Securities and Exchange Commission on March 1, 2002.

⁹ According to the U.S. Census Bureau www.census.gov, Montana had 358,667 households in 2000.

¹⁰ Jim Robbins, "As Power Prices Surge, Montana, Too, Asks Why," *The New York Times*, May 13, 2001.

¹¹ Compiled by Public Citizen from Energy Information Administration data www.eia.doe.gov.

meantime, school districts are suffering from lack of funds.¹² PG&E's National Energy Group recently lost a lawsuit against Vermont, in which it claimed that at least two towns' tax assessment laws were exorbitant and unconstitutional, and sought compensation for those taxes.¹³

Conclusion

River systems should be recognized as valuable natural resources belonging to the public trust. Under deregulation, however, companies have been allowed to control water flows and send electricity to distant consumers, forcing area residents to bear the environmental costs of hydropower production without enjoying the benefits. Indeed, beyond physical facilities, transnational corporations have little or no interest in the communities in which hydropower projects are located, often considering river systems as sources of cash rather than as part of an interconnected world of environmental and economic concerns. Regulated public ownership of dams protects consumers from the volatile energy market, provides a reliable product at a low, cost-based rate, and ensures reinvestment of revenues into local communities by limiting opportunities for corporate greed.

¹² John Stromnes, "PPL pays dam taxes 'under protest'," *The Missoulian*, January 7, 2003.

¹³ "Vt. Judge Rejects PG&E Claim." *Northeast Power Report*, July 30, 2001.