



Electric Utility Deregulation and the Myths of the Energy Crisis

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If the purpose of electricity deregulation is really to improve the quality of people's lives by lowering the cost of a critical commodity, it has obviously failed, as demonstrated in every state which has chosen to deregulate. Power companies, free from the oversight of state regulators, have quadrupled prices for Montana industrial consumers, doubled prices in many Northeast and New England states, and driven one of California's utilities to bankruptcy. Whereas consumers have been left to pay higher prices, energy corporations in deregulated markets have made record profits.

It is clear that deregulation's design was intended to benefit the energy industry far more than consumers. Characteristics inherent to the electric utility industry effectively prohibit competition from occurring. These attributes, well-known to engineers and economists for decades, were glossed over by the energy industry as they orchestrated a national push to deregulate markets. Their intention was to break free of the cost-based regulations which restricted their profits but guaranteed low prices and reliable service to consumers.

In deregulation's wake, blame has been foisted upon everyone from environmentalists to NIMBYism (not in my backyard). But, it is clear that these and other myths are promoted to obscure the fact that fault lies with deregulation and its inability to provide electricity affordably or reliably. To fully understand how deregulation failed so miserably, we must examine the past.

Federal Role

Prior to deregulation, electricity was supplied by regional monopolies that owned both the power plants and the transmission lines for the distribution of power. The California Assembly, like their legislative counterparts in every other state, set the rate of return of profit for the utilities, and the state public utilities commission, like their peers across the country, planned for future power needs and helped ensure that rates were fair and based on the cost of service. Although this system was often abused because of the enormous political power of the electric utilities and their ability to influence policymakers, it did keep in check the profiteering tendencies recently displayed in the deregulated markets of California and Montana.

Whereas states controlled electricity, the federal government played an early, unintended role in encouraging deregulation. In response to the energy crisis of the 1970s, Congress passed the Public Utility Regulatory Policy Act (PURPA) in 1978. PURPA's purpose was to wean America off foreign oil by encouraging

alternative fuels for generating electricity. PURPA requires utilities to buy power from independent power producers (mostly small generators, or ones using renewable energy sources) at a price approved by regulators. To achieve PURPA's objective of encouraging alternative energy supplies, regulators in many states approved high prices for long-term PURPA contracts, which were passed on to consumers in the form of higher rates.¹

At the same time, many utilities were building or just bringing on-line nuclear power plants. These reactors experienced tremendous cost overruns due to significant construction costs, expensive compliance with safety regulations, and significant waste disposal costs.

The Energy Policy Act of 1992 (EPACT) started to chip away at utilities' monopolies by expanding the Federal Energy Regulatory Commission's (FERC) authority to order utilities to allow independent power producers equal access to the utilities' transmission grid. Together, PURPA and EPACT provided the first cracks in the utilities' monopoly.²

By the mid-1990s, large industrial consumers sought to escape the high costs of power in some parts of the country, such as California, that came as a result of building expensive nuclear power plants. At the same time, independent power producers such as Enron were actively lobbying to be able to sell power to these big consumers. Political pressure for deregulation mounted because the breakup of the \$300 billion dollar utility industry meant huge amounts of money could be made. No doubt, too, the meteoric rise of the dot.com industry in the early- and mid-1990s put pressure on the energy industry to increase their rates of return. Enron, an important campaign contributor to the Republican Party and to President Bush, lobbied for deregulation not only in California but at state legislatures across the nation and in Congress.

Despite warnings from Public Citizen and other consumer groups, deregulation was heartily embraced by both political parties. Under the Clinton administration, the U.S. Department of Energy (DOE) even wrote its own federal deregulation bill that it promoted unsuccessfully.

The federal government got more involved in 1996. Seeking to further compromise the utilities' monopoly, FERC issued Order 888, which was even more aggressive in its requirement that utilities open their transmission to independent producers. FERC's intent was to introduce competition at the wholesale level and to keep utilities from using their control of the transmission system to limit the entry of lower priced generation. But the primary result was to force states to deregulate, or else their regulated monopolies would get priced out by utilities operating in other states who had access to the transmission lines. Order 888 led to increased independent power generators, which overwhelmed most states' ability to manage supply. This inability to plan for and manage supply prompted many states, including California, to fully deregulate their wholesale markets.³

In December 1999, FERC issued Order 2000 calling for the creation of regional transmission organizations (RTOs), independent entities to replace state control and operation of the transmission grid. If the establishment of RTOs is allowed to proceed, states will lose the ability to control electricity prices and

reliability for their citizens, and corporations will have more free reign over the nation's energy markets.

The California Debacle

California's utilities were initially skeptical of deregulation because of the high cost of power from their nuclear plants. But, the rise of technology stocks placed enormous pressure on the energy industry to achieve higher rates of return, as Wall Street threatened to move its capital elsewhere unless energy companies found a way around their tightly controlled profit margins. Utilities ended up lobbying heavily for deregulation because they knew that their enormous political clout in the state legislature could shape deregulation's outcome.

In response to federal policies and industry pressure, 24 states and the District of Columbia passed legislation and regulations to deregulate their electricity markets between 1996 and 2000 (at the end of 1999, 12 had passed deregulation legislation).⁴ California was one of the first to jump in. The state's extremely complex legislation, written primarily by California's utilities, created a vast program for a vast market. It was wrangled over in a series of rapid-fire hearings, and rammed through the legislature in a process that took only 3 weeks. It was unanimously passed and signed into law by Governor Pete Wilson in the fall of 1996.

The legislation, written and supported by utilities, privatized their profit and socialized their risks. The most glaring example of this was the \$28 billion dollar consumer-funded bailout for the utilities=so-called stranded costs.⁵ Stranded costs are essentially mortgage payments that the utilities make to cover their purchase of expensive boondoggle nuclear power plants. The utilities argued that the bailout was necessary because they would now be assuming marketplace risk, and the uncertainty of their future profits made the paying off of debts they incurred under regulation too burdensome. To accomplish this bailout, rates were artificially frozen for 4 years, at what was then 50% above the national average cost of electricity.⁶ To date, ratepayers paid approximately \$28 billion through added costs to their electric bills to bail out the utilities.

In 1998, a coalition of consumer groups called Californians Against Utility Taxes sponsored a ballot initiative, Proposition 9, which would have invalidated portions of the 1996 deregulation bill and prevented the utility bailout. The proposition would have required the utilities and their shareholders, not ratepayers, to bear the burden of the \$28 billion bailout.⁷ According to energy analysts at the California Energy Commission, if Proposition 9 had passed, residential power customers would have seen their energy costs fall between 18 to 32 percent.⁸ California's utilities spent more than \$30 million defeating Proposition 9, compared to the \$1 million spent by consumer advocates (a similar grassroots ballot effort in Massachusetts met an equivalent fate).⁹

The state's deregulation legislation not only provided utilities with a bailout, but financed an international spending spree by the utilities using non-California subsidiaries. They purchased power plants and propped up the value of their stock through share buybacks. The stranded cost bailout provided them with capital, which they used to invest in other industries that they had been prohibited from entering under the regulated

monopoly system. California's utilities invested in telecommunications and other types of high-growth services that they planned to sell in conjunction with their sale of electricity.

Edison International's largest unregulated subsidiary is Mission Energy, created in 1990. Mission's revenues and profits did not take off until 1999, when Edison International transferred billions in consumer-funded stranded cost funds out of California. A Public Citizen analysis shows that Mission Energy, along with a few other smaller Edison International subsidiaries, spent more than \$10 billion on non-California investments since December 1998. In addition, Edison International spent \$2.35 billion on stock buyback programs since deregulation began.¹⁰

PG&E's high-growth subsidiary, National Energy Group, has not been as forthcoming, electing not to disclose the purchase price of many of its recent acquisitions. Information gleaned from several news reports reveals that since 1999, PG&E's purchases outside California and the Pacific Northwest total at least \$9 billion. PG&E spent over \$1 billion on its own stock buyback plans since the onset of deregulation. The consumer-funded bailout and the forays into new industries increased the utilities' earning potential and were strongly applauded by Wall Street.¹¹

Deregulation provided incentives for California's utilities to sell their power plants to unregulated companies. They sold most of their fossil fuel plants at above the book value, making a significant profit. They retained their nuclear and hydro-power generation due to the extraordinary regulatory demands on these two generation sources.

The deregulation legislation also transferred control over pricing of electricity generation to FERC. FERC ended cost-based pricing, and certified that each of the participants was now allowed to charge market prices—whatever price the market would bear.

Most of the corporations that bought the California utilities' power plants were from out of state and included Virginia-based AES, North Carolina-based Duke, Minneapolis-based Xcel, and Houston-based Dynegy and Reliant. Eleven major companies, some of which simply buy and sell power without actually owning a single power plant, were selling electricity into the state's auction, where electricity is bought and sold several times (in paper transactions) before it is actually delivered to consumers.

Why Deregulation Failed

America has painfully learned what happens when deregulation is applied to an industry with inelastic supply and demand, high capital costs and prohibitively expensive transaction costs. With state government regulators no longer officiating wholesale electricity markets, the inherent characteristics of electric generation leads to excessive market power concentrated in a handful of energy companies.

Unlike other industries in the American economy, it is very difficult to foster competition in the electricity industry. Electricity's high overhead costs limit the number of players, since it requires hundreds of millions

to build or buy a power plant. And building one is not easy, as construction can take years. Constraints on siting power plants also inhibit competition because plants must be near power lines and meet minimum public health standards, since those using natural gas, oil or coal (as 70% of U.S. plants do¹²) produce harmful emissions.

These constraints on power plant construction not only limit competition, but also the flexibility of supply to respond to changes in demand. Unlike other products, electricity cannot be stored after it is produced; it must be immediately consumed. The capital constraints that restrict the entry of new generators into the market, therefore, limit the ability of supply to match demand. Unless orderly advance planning is conducted to match supply with demand, shortages occur that drive up the price of electricity. And when the few corporations who control the power plants are left unregulated, there is tremendous incentive to withhold supply to create artificial shortages to drive up prices and profits.

High transaction costs spent on household consumers for billing, repair and other customer services force electricity providers to operate on very narrow profit margins for each household consumer. Large industrial customers, with their economies of scale, have lower transaction costs and pay far lower rates. In 2000, for example, the average American household paid 8.22 cents per kilowatt hour for electricity, 84% higher than what the average industrial consumer paid (4.46 cents). Households also paid 14% more than the average commercial consumer (7.22 cents)¹³. Although price discrimination exists under a regulated scenario, it becomes more severe under deregulation, forcing household consumers to incur higher costs by subsidizing commercial and industrial consumers even more.

Although these structural impediments to competition in electricity markets have been well known to economists for decades, policy makers at FERC and state lawmakers naïvely assumed that competition would magically appear once the wand of deregulation was waved. But they forgot, or ignored, the fact that the energy corporations who spent millions lobbying for deregulation were intent on exploiting these well-known problems.

Problems in California arose almost immediately once the state deregulated the wholesale market because the energy companies were now unaccountable to consumers. No longer forced to sell electricity for a set price to a geographically defined consumer base, energy companies used the inherent limitations in the electricity industry to leverage their market power to manipulate prices and supply. And, state regulators were powerless to stop them.

The problem was that as soon as utilities break up their monopolies by selling their power plants, states cede regulatory authority over the electricity produced by those plants. Under standard interpretations of the 1935 Federal Power Act, states can regulate only the retail sale of electricity to *end consumers* (courts have ruled that wholesale sales of power are too fluid for individual states to handle, therefore classifying it as interstate sales subject to federal jurisdiction).¹⁴ Under regulation, the utilities generated electricity at their own plants, delivered that electricity over their own wires, and sold the product to end consumers. Regulating the retail price meant that states were, by extension, regulating the wholesale market, too,

because the same company controlled both the wholesale and retail markets.

The fact that utilities in deregulated states routinely sold their power plants for two or three times their book value should have been an indication that the purchasers of these plants clearly expected huge rates of return from their new investments. As prices in California's wholesale market skyrocketed, the profits enjoyed by the unregulated power companies followed suit.

Price Caps Problem?

Deregulation proponents attempt to justify these failings by arguing that full deregulation removing all retail price controls to force consumers to pay the full wholesale price is the solution to America's ills. They argue that price controls discourage adequate investment because power companies had no incentive to build new plants, as their rate of return was limited by the retail price caps.

Every state which has pursued deregulation has included retail price caps as part of their plan, to account for the utilities' so-called *stranded costs*, or debts the utilities accumulated building expensive nuclear power plants in the 1970s and 1980s. Utilities in deregulated states argued that unless they were relieved of these debt burdens, they would be unable to compete in a deregulated market. State lawmakers agreed to a compromise, where consumers paid off the utilities' stranded costs in exchange for a rate freeze on consumers electric bills. Once consumers were finished paying off the stranded costs, the rate freeze would end.

If retail price caps are removed at a time of very high wholesale prices, the conservation by force would prove to be not only politically unacceptable but would incorrectly assume that high prices are the result of a competitive market and should rightfully be passed on. Prices in a deregulated wholesale market are high because the inelasticity of supply has led to excessive scarcity rents,

Deregulation's Price Gougers: Profits by the Eight Major Energy Corporations In California's Wholesale Electricity Market						
Company (HQ Location)	'99 Profit (\$ mil)	'00 Profit, \$ mil (year dereg failed)	% Change	Profit 1 st Half '00 (\$ mil)	Profit 1 st Half '01 (\$ mil)	% Change
West Coast Power (joint-venture between Minneapolis-based Xcel and Houston-based Dynegy)	\$29	\$245	+745%	\$52 *	\$84 *	+61%
Dynegy (Houston)	\$152	\$501	+230%	\$160	\$285	+78%
AES (Virginia)	\$228	\$641	+181%	\$407	\$218	-46%
Williams (Oklahoma)	\$221	\$524	+137%	\$452	\$539	+19%

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Duke (North Carolina)	\$847	\$1,776	+110%	\$722	\$877	+21%
Reliant (Houston)	\$508	\$838	+65%	\$357	\$536	+50%
Enron (Houston)	\$893	\$979	+10%	\$627	\$829	+32%
Mirant (subsidiary of Atlanta-based Southern Co.)	\$361	\$319	- 12%	\$194	\$304	+57%
TOTAL	\$3,239	\$5,823	+80%	\$2,971	\$3,672	+24%

* 1st Half 2000 and 2001 figures are for NRG, parent company of West Coast Power, and a subsidiary of Xcel.
 SOURCE: Data compiled by Public Citizen from company 10-K and 10-Q reports filed with the SEC.

helping energy companies dictate prices. For example, West Coast Power, the NRG subsidiary that owns California power plants for the parent company Xcel, had after-tax profits of over \$245 million in the year prices for California electricity skyrocketed—745 percent higher than a year earlier in 1999.¹⁵

A Public Citizen analysis of the eight major power companies controlling California's market show that from 1999 to 2000—the latter being the year that California's deregulation scheme collapsed—their after tax profit jumped by \$2.6 billion, from \$3.2 billion in 1999 to \$5.8 billion in 2000. The trend continued in 2001, with profits of nearly \$3.7 billion in just the first six months, an increase of 24% over the record profits of the first six months of the 2000 year.

These income figures, however, significantly underestimate the actual profits these companies made from their California operations. Other than West Coast Power, which only owns power plants in California, the balance sheets of the other companies include results from all of their activities. Because these corporations are not required to reveal the income they made in California, their profit numbers are dragged down by other sectors which lost money.

State investigators, sifting through confidential wholesale price information, have calculated that these top energy corporations overcharged California's utilities and ratepayers more than \$9 billion.¹⁶ FERC has acknowledged that billions in refunds are to be collected from these profiteers, and is overseeing ongoing settlement talks between the state and the corporations. As is the norm for the slow-footed FERC, a decision on the refund order is not expected until at least March 2002.¹⁷

Although it was clear that prices in California and the entire western market were wildly out of control in 2001, President Bush remained firm in his opposition to temporary price controls. The federal government had lone jurisdiction over California's dysfunctional wholesale market. In a tense meeting with California Governor Gray Davis in Los Angeles on May 29, Bush failed to grasp the irony of his proclamation that electricity price controls would lead to "more serious shortages and even higher prices" made while sitting

in a building wired to one of the only regions in the state immune from the power crisis: the socialistic, city-owned power of Los Angeles.¹⁸

While Bush and FERC continued to play their “free market” ideological fiddle while California burned, the state’s utilities mounted huge losses as prices for the electricity they had to purchase on the wholesale market vastly exceeded the amount the state permitted them to charge consumers. The utilities’ recent out-of-state shopping splurge had left them with insufficient cash on hand to cover their bills. And Wall Street was unwilling to provide reasonable bond financing for companies with few prospects for recovery.

As a result, the taxpayers of California used the state’s impeccable credit to assume responsibility for purchasing electricity on behalf of the beleaguered utilities. The failure of the federal government to control wholesale prices forced California to spend \$60 million per day to purchase overpriced electricity from a handful of greedy companies.¹⁹

In light of the state spending tens of billions of dollars on electricity, even fellow Republicans hopped on board the price control train. Eight western state governors – half of whom are Republicans – called on Bush to enact price controls, and two GOP members of the House of Representatives with ratings at mid-90 percent from the American Conservative Union sponsored federal legislation to force Bush to enact price controls. Faced with the reality that their inflexible free-market ideology was a failure, Bush and the federal government relented.²⁰

Since the federal government imposed round-the-clock wholesale price controls for the entire western electricity market in June 2001, prices have dropped significantly, and California has experienced not one single rolling blackout. Spot prices fell more than 80 percent immediately after the price controls took effect.²¹

Rising Demand, Environmentalists and NIMBYism to Blame?

Deregulation proponents have argued that California’s commitment to strong air quality standards prevented the development of adequate power plant construction. Environmentalists blocked or slowed the construction of power plants, the argument goes, and NIMBYism ensured that people’s unwillingness to live next to a power plant prevailed over the energy needs of the greater good. Deregulation defenders claim that not a single power plant was constructed in California in the 1990s.

This claim, however, is false. California Energy Commission data clearly shows that 11 new power plants, with the capability to generate 1,200 megawatts of electricity, or enough power for more than a million homes, came on line during the 1990s.²²

California has installed generation capacity of 55,000 megawatts – 20 percent more than the 2000 summer peak demand of around 45,000 megawatts.²³ The state’s problem was that about 30,000 megawatts of that capacity cannot be regulated by the state, thanks to deregulation. So the owners of the unregulated

plants have incentive to intentionally shut down plants in order to artificially constrict supply to drive the price of electricity higher at their other, operational, plants.

At the height of California's electricity crisis, as much as 13,000 megawatts was offline for undisclosed reasons. According to the *Wall Street Journal*, 461% more capacity was offline for undisclosed reasons in August 2000 compared to a year earlier.²⁴ In deregulated markets, undisclosed power plant shutdowns are a new phenomena: under state-regulated markets, power plant owners must continually disclose any problems which force a plant shutdown.

Williams, an Oklahoma power marketing firm with a significant presence in California, was fined tens of millions of dollars by FERC for intentionally shutting down some of its power plants. The federal investigation found that Williams intentionally withheld output at one of its plants so it could charge rates 12 times higher at its neighboring power plant. The lack of accountability in deregulated wholesale markets allows corporations to manipulate critical commodities like electricity.²⁵

These facts, that the state indeed had adequate capacity that was poorly managed by unaccountable corporations, forced the nation's leading libertarian think tank, the Cato Institute, to draw the same conclusion in a July 2001 report: "We find little evidence to support the argument that environmentalists are primarily to blame for the [California deregulation] crisis."²⁶

Of course, increased investments in energy efficiency and renewable energy technologies would have liberated California from the current centralized, integrated energy system that is based on polluting gas and dangerous nuclear energy. Whether a state deregulates or not, expediting the transition to a least-cost, environmentally sustainable energy system based on full exploitation of decentralized energy efficiency and renewable energy sources is the only path for a sustainable energy future.

Shared Misery: Montana and the Looming Crisis in Other States

A growing number of the 23 other states which passed some form of deregulation legislation have taken heed of the powers of re-regulation. Arizona, Nevada, New Mexico, Oklahoma and West Virginia have essentially repealed deregulation, others (Arkansas, Montana, New Hampshire, Oregon) are busy scaling it back, and most of those 26 states that were on the fence are running away as fast as they can.²⁷

Of these, Montana is the only state outside California that fully deregulated. In April 1997, the Governor signed Montana's deregulation law, which allowed the state's industrial consumers the right to negotiate long-term contracts with alternative electricity providers beginning July 1998. Residential and small business consumers were not scheduled to deregulate until July 2002.²⁸

It was unclear what advantage Montana lawmakers saw when they chose to deregulate. After all, Montana had the seventh cheapest residential electric rates in the nation—owing to the state's heavy reliance on the two cheapest forms of electricity generation, coal (56% reliance) and hydroelectric (42% reliance). Access

to abundant coal seams and rivers, combined with very low population density, allows for Montana to export between 40% and 60% of the electricity it produces—providing residents with ample surpluses of electricity.²⁹

Regardless, Montana Resources, a copper smelting firm which requires large amounts of electricity to run its operations, was one of many industrial consumers which sought alternative suppliers to the state's traditional monopoly, Montana Power. The mining company's president, Greg Stricker, was an early and eager advocate for deregulation. He had argued that if Montana failed to deregulate, companies like his would simply buy their electricity from power providers operating out of state. Montana's deregulation law left Stricker's company, along with other large industrials, free to negotiate long-term contracts with the provider of their choice.

Whereas the 1st year and a half was uneventful, in December 1999 Montana Power sold 100% of their generation assets to one company, Pennsylvania-based PPL. Just like in California, PPL operated as an unregulated monopoly as soon as the generation was split from the utility. PPL spun off a Montana subsidiary which operated the plants, and in the year and a half since they have presided over Montana's deregulated electricity market, they have enjoyed after-tax profits of \$186.7 million.

These profits have been fed from wholesale prices which jumped as high as 400% in a matter of weeks. Many industrial customers, forced to renegotiate their contracts during a time of high prices, could not afford to continue operating. Unable to afford their electric bill, dozens of industrial plants closed their doors, laying off more than 1,000 Montanans in the last year. Meanwhile, Stricker's copper smelting operation was also forced to close, laying off 320 employees. In March 2001, Stricker—one of the architects of Montana's deregulation law—announced to the Montana legislature that an immediate return to full regulation of Montana's electricity market is the only way to ensure that all Montanans receive reasonably priced electricity now and in the future.³⁰

In response, the legislature in June 2001 passed legislation delaying residential deregulation for 5 years, and allowed industrial consumers who were stuck with expensive PPL contracts to nullify them. But in order to appease PPL, the state of Montana has guaranteed the contract for five years at \$770 million, necessitating a minimum 50% rate increase for the state's consumers.

Agitated by the size of this bailout—after all, PPL enjoyed tremendous profits in the state's deregulated market—two state Representatives spearheaded a successful grassroots ballot initiative to overturn this bailout. Reps. Michelle Lee and Chris Harris have qualified their referendum to repeal Montana's deregulation bailout for the November 2002 election.³¹

While other states' experiences are not nearly as dramatic as California's and Montana's, serious problems lurk just around the corner if the states continue pursuing deregulation. Sharing a border and high wholesale prices with California, Nevada repealed its deregulation law in April 2001, forbidding the completion of the sale of the state utilities' generation assets in the process. Arkansas pushed back their deregulation state

date by a year in response to the California crisis. In Arizona, a judge ruled that deregulation violated the state's constitution, placing that state's restructuring on hold. In April 2001, New Hampshire's state government delayed the start of deregulation for several years. New Mexico, bowing to the fears that they could end up like California, delayed the start of their deregulation for five years. In May 2001, Oklahoma placed their deregulation laws on hold indefinitely. Oregon voted in June 2001 to delay deregulation for five months. In West Virginia, the legislature has so far failed to implement the necessary bills to enable the state's Public Service Commission to proceed with deregulating the state's electricity market.³²

Of those states that are left, there are no deregulation successes. Of the states that passed deregulation legislation, only a handful (like Connecticut) actually changed their energy supply systems. And since these few are participants in a broader power pool with both wholesale and retail price controls, their system does not resemble a deregulated marketplace.

Some places, such as Washington, DC, negotiated low-priced long-term contracts as a condition of the sale of the utility's power plants. But when the contract expires in 2004, DC will have no leverage to negotiate another favorable contract.

Other "success" stories like Pennsylvania, retain strict retail price caps. In addition, all but one of the state's utilities still retain their generation assets, meaning the state continues to have a regulated monopoly. But the retail price caps are set to be removed beginning in 2004, at which point the state's consumers will be subject to an unregulated monopoly (it is significant to note that the one Pennsylvania utility which divested its generation assets has petition state regulators for a rate increase, as it can no longer afford to purchase overpriced electricity in the wholesale market).

Britain's deregulated electricity market, often touted in America as a successful attempt, has been rife with similar problems. The Office of Electricity and Gas Markets found last year that collusion and price manipulation of Britain's power pool was the norm. This uncompetitive behavior has translated into British consumers paying, on average, 70% more for their electricity than their American counterparts.

Should we be so surprised? Deregulation's failures are strikingly similar to other recently-deregulated industries with features comparable to the electricity industry. The Telecommunications Act of 1996 was supposed to usher in an era of competition and choice. Instead, the American economy is saddled with a dozen telecom multi-billion dollar bankruptcies, not to mention contracting revenues, highlighted by the \$50.6 billion fiscal year loss reported by JDS Uniphase in July 2001. Meanwhile, 91.5% of phone lines continue to be controlled by the old monopolies.³³

Since Congress relaxed regulations for the cable TV industry in 1996, consumers are paying 35 percent more for the price of basic cable, and consolidations have resulted in six corporations presiding over 80% of the market.³⁴

In a series of incremental deregulation orders, residential natural gas customers are reeling under high

prices. The federal government once enforced tight price controls on interstate natural gas pipelines. But with market pricing now firmly in control, the handful of pipeline and wholesale market traders dictate the price to residential consumers. Since the Wellhead Decontrol Act, natural gas wholesale prices have actually fallen. But the price at which natural gas is sold to residential consumers has skyrocketed, while prices sold to industrial and commercial consumers has fallen substantially.³⁵ For most economists, such overt price discrimination clearly indicates the existence of a noncompetitive market.

Just like these capital-intensive and transmission-constrained phone, cable and natural gas industries, true competition in deregulated electricity markets has not materialized.

Solutions To Protect Consumers

The flaws in the cost-based rate system pale in comparison to the damage wrought by price gouging and unreliability under market-based rates. Most states with looming deregulation deadlines have made the prudent move to re-regulate. But for millions of American household and business consumers in states exposed to deregulation, the damage has been done. For those states, re-establishing regulatory authority over deregulated wholesale markets will be an expensive, but crucial step. It is important to note that those states that have experienced severe market power abuses in their wholesale deregulated markets—California, New York and Montana—have established State Power Authorities which have the ability to buy or build power plants. This solution—leveraging public control over generation—is crucial in order to return accountability to electricity markets. Encouraging municipally owned and controlled power is the key. Across America, the 2,000 communities with publicly owned power pay far less than those customers served by corporations. Los Angeles and the 29 other California public power communities were completely immune from the state's energy crisis because the city power companies had no incentive to price gouge their owners, who also happen to be their customers.

A federal role also exists. Increased transparency and swift enforcement of market rules, not less as is the trend under deregulation, is the only guarantee of producing markets accountable to consumers. Lawmakers, rushing to correct deregulation's failures, must exercise diligence not to make matters worse. A prime example is illustrated in the calls for a "federalization" of America's transmission grid. The failure to expand transmission capacity from a system designed to handle small loads between regional regulated monopolies to one capable of handling deregulation's frenzied pace of trading is one valid explanation for supply constraints. But, prescribing both broad regulatory (through RTOs) and eminent domain authority for the federal government without addressing the utilities' monopoly control over transmission is a misdiagnosis. Nondiscriminatory, reliable access to the transmission grid at affordable prices can only be provided by consumer-owned, non-profit transcos.

¹ Can Electric Utility Restructuring Meet the Challenges it has Created?, by Richard A. Rosen. The Tellus Institute, November 2000, Page 10-11.

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- ² Rosen, page 13-14.
- ³ Rosen, page 14.
- ⁴ U.S. Department of Energy, Energy Information Administration
- ⁵ This figure was widely reported in the press after the California deregulation bill's passage, for instance, in *Financial Times*, July 20, 1998. Public Citizen verified the amount for the bailout for the October 1998 report, California Dreaming: The Bailout of California's Nuclear Industry. To do so, we used information provided by the Nuclear Regulatory Commission monthly Operating Reports: December 1997 and data from the California Public Utilities Commission (CPUC), including CPUC Decisions N. 97-05-088, N. 96-01-011, 96-04-059, and 96-12-083. The CPUC's Office of Ratepayer Advocate also provided assistance.
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- ⁷ *The San Francisco Examiner*, Tuesday, July 21, 1998, "War of Words Escalates Over Prop. 9".
- ⁸ Ben Arikawa, Ruben Tavares, "Preliminary Analysis of the Utility Rate Reduction & Reform Act," California Energy Commission, Electricity Analysis Office, July 24, 1998.
- ⁹ *Wall Street Journal*, "California Backs Into the Future," Editorial, November 3, 1998.
- ¹⁰ Public Citizen analysis of data from Edison International filings with the Securities and Exchange Commission.
- ¹¹ Public Citizen analysis of data from PG&E filings with the Securities and Exchange Commission.
- ¹² U.S. Department of Energy, Energy Information Administration, *Electric Power Annual*.
- ¹³ U.S. Department of Energy, Energy Information Administration, *Annual Electric Utility Report*.
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- ¹⁵ Exhibit 99.4, *Financial Statements of West Coast Power*, to NRG Energy's 10-K filed with the U.S. Securities & Exchange Commission on March 29, 2001.
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