

Electricity deregulation threatens the nation's economy and security

by Marsha Freeman

On Feb. 10, Rep. Dan Schaefer (R-Colo.) introduced into the Congress, the "Electric Consumers Power to Choose Act of 1997," H.R. 665. Two days later, Schaefer and House Commerce Committee chairman Tom Bliley (R-Va.), led a "rally" in front of the Capitol to try to organize support for the bill. H.R. 665 would deregulate electricity production, mandating that by no later than Dec. 15, 2000, each customer will have the right to purchase retail electric energy services from any person offering to provide such services. This "freedom to choose" supposedly will lower the cost of electricity to all consumers—but, *caveat emptor* (let the buyer beware). The rally speeches were reminiscent of those of the proverbial snake oil salesman, peddling a cure-all product that entices his audience with fantastic promises; in the end, however, the salesman has their money, while the credulous buyers are left only with promises.

The claims of the deregulation proponents about the benefits that will come from "competition" in the electricity industry, are truly breathtaking. Representative Bliley told the rally that consumers would see their electric utility bills fall between 15 and 43%. Schools would be able to hire more teachers and buy more books and computers, Bliley said, if only their electric rates were reduced. Hospitals would be able to reduce the cost of health care, if only they could stop paying such exorbitant rates for electric power, and so on.

Nowhere do the deregulation proponents report that since 1982, U.S. electricity rates have actually *fallen* by 25%, as a result, largely, of the drop in fuel prices, thus giving lie to the assertions that wildly escalating costs for electric power are causing the economic ills of society.

In reality, the proposed anarchistic tearing down of the existing regulations—which have created the most reliable and the least expensive electricity system in the world over the past 60 years—is a potential threat to the economic health, and the national security, of the country, as has been pointed out by the President's Commission on Critical Infrastructure.

The road to deregulation

The road to deregulate the nation's electric utility industry, both publicly and privately owned, began in the Carter administration of the late 1970s, when, in order to promote the administration's anti-nuclear, environmentalist agenda,

utility companies were forced to buy electricity from "independent" producers who used renewable sources of fuel, such as solar, wind, and biomass, no matter how expensive the power produced was.¹

Deregulation was accelerated through further legislative initiative five years ago, when the Congress mandated that utility transmission systems be open to equal access by all producers. This allowed utilities to buy power from any other producer in the nation, and to use the transmission system to "wheel" that electricity through the interconnected grid system.

Already, these first steps—using the electricity system to encourage the use of "alternative energy" sources, and allowing the utilities to use the transmission system to "save money" by using other company's cheaper power—diminished the ability of the industry to ensure that there is universal access to adequate supplies of electricity, and decreased the reliability of the nationally integrated electric grid system.

Now, what is on the agenda of Wall Street and other financial interests, multinational natural resource-grabbing conglomerates, and the elected representatives who become, wittingly or unwittingly, spokesmen for these interests, is to put the more than \$250 billion per year in revenues from the sales of electricity at the disposal of speculators, who have already grabbed the resources of savings and loan banks, pension funds, and other assets of working Americans.

Proponents of electricity deregulation, who hope to get their hands on this pot of gold to keep their international speculative bubbles from bursting, try to sell deregulation to the public by claiming that electricity is just another "commodity," like pork bellies, or precious metals. They point to a drop in prices from the deregulation of trucking, the airlines, natural gas, and telecommunications as precedents, without mentioning: that many rural citizens now have little or no access to airline travel; that shortages of natural gas popped up last winter when it was cold, raising the price, and forcing utilities to burn more expensive oil; or that the deregulation

1. See *EIR*, Oct. 6, 1995, "Deregulating the U.S. Electric Utilities: The 'Kill Factor,'" by Marsha Freeman, for a comprehensive discussion of the history of the push for deregulation, and cause of the price differential in electricity in various regions of the country.



A parade in Tupelo, Mississippi, celebrating the town's signing of a contract (the first town to do so) with the Tennessee Valley Authority to get electric power, in 1934.

of the banking system led to the bailout of bankrupt savings and loans institutions, at a cost of \$250 billion to the American taxpayer.

The loudly touted benefits of deregulating the electric utility industry are a chimera. More important, turning an extremely sophisticated and highly integrated system—which requires the most intricate coordination on a minute-by-minute basis by trained experts—into a small group of competing, “diversified” self-interests, will destroy the quintessential requirement of electrical energy: *reliable, universal availability*.

Why electric utilities were regulated

In September 1932, during his election campaign, Franklin Delano Roosevelt made a speech in Portland, Oregon, before an audience of 8,000 people, in which he said: “Electricity is no longer a luxury. It is a definite necessity.” The private utility companies, FDR said, had been allowed “to get around the common law, capitalize themselves without regard to actual investment . . . and sell billions of dollars of securities which the public had been falsely led into believing were properly supervised by the government. . . . The public has paid and has paid dearly and is now beginning to understand the need for reform after having been fleeced out of millions of dollars.”

Once in the Oval Office, Roosevelt promulgated legislation to regulate the finances and service of the electric utilities, established the Tennessee Valley Authority and the Rural Electrification Administration, to bring electric power to customers who were considered “unprofitable” by the private utilities, and made the federal government responsible for the interstate trade in electric power.

To understand what brought an industry—which had been the great project of Thomas Edison and teams of scientists, inventors, and entrepreneurs—to bankruptcy and disgrace, it is useful to examine one man, Samuel Insull, who, although made the scapegoat of what had been widespread abuses throughout the industry, nonetheless exemplifies why a necessary public good, such as electricity, cannot be in the control of Wall Street financial interests.²

In 1890, Thomas Edison merged his company with the Thomson-Houston company. Thomson-Houston had recently “invented” the idea of the holding company, which would subsume individual corporate entities. Because the firms in this new electrical industry needed an extraordinary amount of capital to build generating plants and transmission

2. See “Leibniz, Gauss Shaped America’s Science Successes,” by Anton Chaitkin, in *EIR*, Feb. 9, 1996, for the history of the science which led to the development of electrical technology and the utility industry.

and distribution networks, the holding company was an attractive mechanism to allow them to acquire financial resources. In those early days of the industry, companies needed \$4 to \$6 of capital to produce \$1 of annual gross revenue. The holding company established by Thomson-Houston, United Electric Securities (later General Electric), accepted the utilities' "unattractive" bond securities as collateral for bond issues of a larger company, allowing the utilities to attract additional financing.

In 1892, financier J.P. Morgan pushed Thomas Edison out of the emerging electric generation and distribution business, and set up the General Electric Company.

A young fellow named Samuel Insull had come to the United States from England to serve as Edison's administrative secretary. In 1892, after Edison "merged" with J.P. Morgan, Insull left Edison's employ and became the president of the Chicago Edison utility. He adopted the holding company structure pioneered by Morgan, establishing Middle West Utilities in 1912.

When he transferred his utility companies to the new parent holding company, Insull inflated the value of the stock tenfold, in order to release yet more stocks and bonds; at the same time, he raised prices to consumers. There being no constraints on this new industry, by 1916 Insull controlled 118 power systems operating in nine states.

Because of the capital-intensity of the electric industry, and the unbridled rates that could be charged through financial houses, the greatest cost to electricity consumers in this period was the financing charges on capital investment, which could be simply passed along to customers. One-third of all corporate financing during the 1920s was issued by private power companies. Nationally, there were 1.75 million utility stock- and bondholders.

By the 1920s, Insull and 15 other holding companies controlled 85% of the nation's electricity, of which they had gained control through a process of consolidations and mergers. Between 1922 and 1927, the holding companies swallowed more than 300 small private companies *each year*.

In the late 1920s, the House of Morgan tried twice to take over the *entire* electric power industry; by setting up the United Corporation in 1929, Morgan became the dominant force in the industry. Even through the collapse of the physical economy of the 1920s, which led to the stock market crash, there was a dramatic growth in demand for electricity. By 1928, two-thirds of American homes had access to this labor-saving technology.

According to the 1986 book by Richard Rudolph and Scott Ridley, *Power Struggle: The Hundred Year War Over Electricity*, the stock market crash of 1929 was in no small part fueled by speculation on huge volumes of utility stocks. For example, Insull's Commonwealth Edison stock went from \$202 in January 1929, to \$450 in August, and Insull's Middle West Utilities went from \$169 to \$529 in the same period. "In the 50 days ending Aug. 23, Insull's securities appreciated at

'round the clock' rates of \$7,000 a minute," they state.

Rudolph and Ridley report, "In another scheme, Howard C. Hopson, the head of AG&E and a rival of Insull's, exchanged ownership of a block of stock 37 times in 30 days among subsidiaries, in order to inflate the value several times over." But even after 1929, investors did not want to give up the cash-cow electric utilities. After the stock market crash, Insull's investment brokers continued to buy and sell power company stock in an effort to keep prices up.

By the late 1920s, sixteen holding companies, run by financiers who saw the opportunity for short-term speculative profits and building pyramids of assets, controlled 85% of all of the nation's power supply. They also held controlling interests in the nation's railroads and street cars; coal, ice, and water companies; banks and real estate firms; and operations in South America, Eastern Europe, and the Philippines.

But Samuel Insull and the Wall Street speculators' days were numbered. By April 1932, Insull faced the largest bankruptcy in history. The holding companies had gotten into debt to the banks, in an attempt to finance their money-losing operations after the stock market crash. They had put up an increasing amount of securities as collateral. On April 16, when Middle West Utilities was placed into receivership by its Wall Street creditors, it controlled 239 operating companies, 24 holding companies, and 13 other subsidiaries.

By 1934, the default on 19 Insull properties represented nearly \$200 million in obligations. The losses for investors holding stocks in the companies was estimated at between \$500 million and \$2 billion. Eight months later, Central Public Service went into bankruptcy. By 1935, more than 90 electric and gas companies had fallen into receivership. Industry-wide, there were between 3 and 5 million stockholders, who, as Franklin Roosevelt had explained it, had gotten "fleeced." Insull fled to Europe, but was caught in Turkey and came back to stand trial in Chicago for embezzlement and larceny; eventually he was able to get himself acquitted.

During his first hundred days in the office of the Presidency, Franklin Roosevelt signed the legislation creating the Tennessee Valley Authority, in order to bring water control, electric power, and transport infrastructure to a region the private companies had found largely "unprofitable." During his campaign, in his Portland speech, FDR had also taken a strong stand in the fight against the privatizing of water resources. "The water power of the states should belong to all the people. The title to this power must rest forever in the people," he said.

Not a luxury, but a necessity

After a fierce fight with the bankers and speculators who controlled the electric utility industry, FDR was finally able to get passage (by only one vote in the Senate) in 1935 of the Public Utility Holding Company Act, or PUHCA. The bill that passed was weaker than the one that Roosevelt wanted, because of a \$1 million public relations campaign by the util-

ies, but it broke Wall Street's grip on an industry that the President earlier had said was not a luxury, but a necessity.

PUHCA gave the federal government the power to eliminate holding companies that "served no demonstrable purpose," as determined by the Securities and Exchange Commission. And it required the strict federal regulation of the remaining ones. Holding companies were forced to divest, and conglomerates were broken down into single contiguous electricity systems. Most important, ownership of controlling shares by Wall Street firms was prohibited. As Rudolph and Ridley describe the intent, the bill was "aimed at reforming Wall Street, as much as the power companies." The act also gave the Federal Power Commission regulatory control over both the interstate shipments of electricity and the accounting procedures of the utilities.

Out of the chaos of the stock market crash and the Depression, many other nations, including Great Britain, took the electric utilities entirely out of private hands, and put this vital industry under the protection and direction of the state, making it a publicly owned resource. President Roosevelt would not have been able to garner congressional support for such a program, but the framework established under his guidance created the regulatory compact by which, in exchange for being granted an exclusive franchise to provide electric power for a certain geographic region, a utility had the legal obligation to provide reasonably priced, reliable electric power to every customer.

Today's rabid de-regulators are trying to rewrite this history of the Depression era, making it seem as if FDR's regulation of the utility industry was an unnecessary government interference into the private sector. For example, pretending that the abuses and bankruptcies of the utilities in the 1920s and 1930s never happened, the Heritage Foundation writes in its January 1997 report, "Energizing America: A Blueprint for Deregulating the Electricity Market," that PUHCA was enacted because "policymakers *feared* that these much larger concentrated entities *could* deceive their investors by shuffling finances among the many different branches, divisions, or affiliates they managed" (emphasis added).

One irony of the current drive for deregulating this industry in order to introduce "competition," is that the panic to become competitive, has launched a merger spree that is *reducing* the number of players on the field, as opposed to opening the market to an increasing number of new electricity providers. Some industry analysts predict that were deregulation to proceed, the 250 or so major privately owned electric companies may dwindle to 80 or so mega-utilities.

Of course, some people are making a bundle from the frenetic merger mania. According to Charles Bagli, writing in the Dec. 10, 1996 *New York Times*: "A small group of merger specialists see hundreds of millions of dollars in fees ahead as they help pull apart the wires, pipes, and power plants of the industry like some kind of Tinker Toy castle. The Duke-Panenergy merger will generate \$40 million in fees for more

than two dozen investment bankers. In 1996, there were 52 mergers or acquisitions valued at more than \$35.5 billion, translating into more than \$350 million in fees."

In testimony before the House Commerce Committee on May 15, 1996, the American Public Power Association, a lobbying group of locally owned, not-for-profit utilities, stated, "Today mergers threaten to reestablish, at least in terms of sheer magnitude and market power, the giant utilities that existed in the 1920s and were dismantled pursuant to PUHCA in the 1940s and 1950s. Last year, the sponsor of Senate legislation to repeal PUHCA [Sen. Alfonse D'Amato, S. 1317] argued that the Holding Company Act had achieved its purpose—it had broken up the mammoth holding company structures. Yet, in 1995 alone, there were eight merger announcements totalling \$75 billion in assets."

The current legislative initiatives propose to bring back the "good old days" of the "free market," with no reins on financial interests that, once before, put this industry, and its customers and investors, into chaos and bankruptcy. This time they will have the availability not only of the resources and chicanery of Wall Street, but of the entire bloated international financial system, with its instantaneous, worldwide computer-assisted suicide machines.

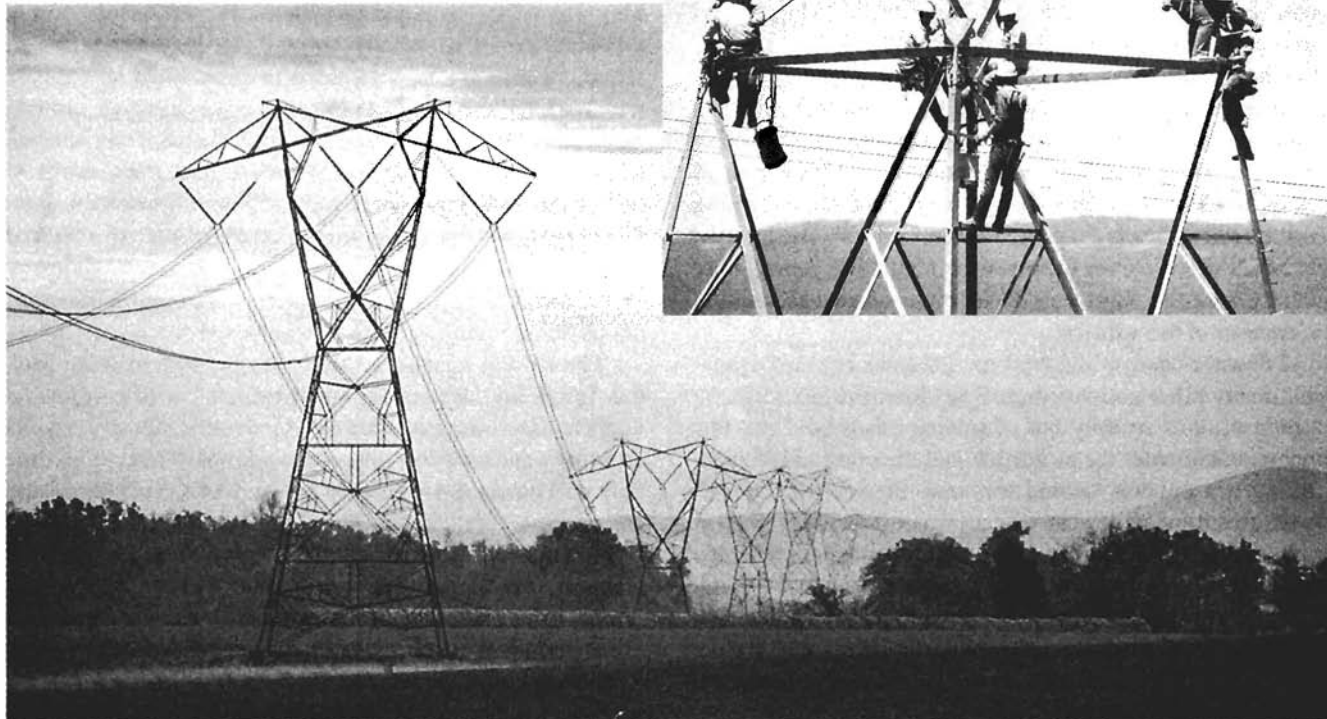
Spot market in electrons

As you read the statements below, which describe the various mechanisms that financiers plan to use to dip into the \$250-plus billion liquidity pot of annual sales of electricity, remember that they are not describing futures markets for pork bellies, or speculating on whether the price of oil will go up or down. They are discussing the energy that powers your heat and air conditioning, the nation's industries and hospitals, and is the prerequisite infrastructure for every aspect of our already deteriorating standard of living.

On May 15, 1996, James E. Rogers, chief executive officer of the Cinergy Corp., testified before the House Committee on Commerce regarding issues in electric industry deregulation. "The new marketplace will likely experience more frequent swings in price than can occur today," he said. This is because it will not require a rate case [before a regulatory commission] to change the price of electricity, only a fluctuation in the hourly (or perhaps even minute-by-minute) balance of supply and demand. Price volatility, of course, presents problems for sellers and buyers alike. Thus, such volatility will spawn a host of financial instruments including various forms of insurance. Suppliers and customers will purchase these instruments to provide themselves with price certainty; others will trade them to make money."

Jon Prendergast, chairman of the Electricity Consumers Resource Council, made up of industrial consumers of electricity, stated at the same hearing: "Short-term electricity spot markets are needed to assure long-run competition. These markets serve several purposes. First, the spot market makes the contract market operate efficiently by providing financial

For 60 years the United States has had universal access to reasonably priced, reliable electric power. If the electric utility industry is deregulated, this will change. Here, an electric power line in Virginia. (Inset) Tower construction on Bonneville Power Administration's McNary Alvery line in central Oregon.



mechanisms for reconciling differences in supply and demand in individual contracts. The spot market supplies and sets prices for replacement power of any generator that cannot fulfill its contractual obligations or for buyers with unexpected needs.

“Second, the spot market facilitates transactions that are not well suited to contractual arrangements for short-term supplies. . . . Third, the spot market provides market signals as to whether and when new capacity needs to be built. Finally, the spot market allows the creation of secondary markets, such as futures trading. Futures trading creates price stability by shifting the risk of uncertain prices from those who are least willing to bear risk to those who are least concerned about price uncertainty.”

Larry Ellis, senior vice president for energy services at Virginia Power, was quoted in the April 2 *Washington Post*, discussing the importance of a futures exchange for electricity. With a futures exchange, Ellis said, a utility can more easily plan for the future, protect against price swings, or try to make money off such swings by betting on them. “The biggest advantage is that it makes prices very transparent and develops a more workable market, just like the stock market,” Ellis said.

The *Post* article goes on to warn that “some industry experts” caution that future prices will not necessarily mean

stable prices. In the natural gas industry, for example, speculative trading in futures prices has contributed to unexpected price swings, particularly in cases where New York speculators were heavily involved.

And on May 10, 1996, the *Journal of Commerce* made it official, by reporting that on March 29, 1996, electrons had arrived as the world's newest futures commodity, “taking their place alongside pork bellies, orange juice, and gold as items that can be bought and sold at a set price months in advance.” The *Journal* lauds this development, smiling that it will transfer price risk from users to speculators.

Enron: A case study

According to the May 15, 1996 testimony of Kenneth Lay, chief executive officer of Enron, before the House Committee on Commerce, until 10 years ago, the Texas-based Enron was primarily a regulated company, with more than 80% of its net income coming from the then-regulated natural gas transmission business. As deregulation accelerated, five years ago, Enron embarked on new businesses, aided by its connections to the George Bush political apparatus in Texas, which now account for 40% of its \$520 million net income.

Enron's move into the marketing of wholesale electric power was enabled by the 1992 passage of the Energy Policy

Act. In 1994, Enron Capital & Trade Resources, “one of the new breed of entrepreneurial providers,” according to Lay, made its first wholesale power transaction. Today, Enron is the largest power marketer in the nation, having recently surpassed the TVA and Bonneville Power Administration in sales of electricity to utilities and municipalities, according to its headquarters office in Houston.

Enron has \$13.5 billion in assets, with existing or planned investments in 30 countries. The company is buying its second natural-gas-fired power plant in the deregulated British electricity industry, and after winning 24 lawsuits and reducing the charge to the people of India for its investment, Enron is building a liquefied natural gas plant in India. In January this year, it was announced that Enron Renewable Energy Corporation is in talks with Nepal to develop two hydroelectric power plants, some of which power will be exported to India and China, as part of Nepal’s invitation to foreign investors to tap into the potential of its “economic liberalization” program. Since the fall of the Soviet Union, Enron has also been in negotiations with the Russian giant Gazprom, and with governments of other former Soviet states.

After 1992, Enron turned Bush’s electoral defeat to its benefit by bringing into its orbit, and onto its board, former Bush administration officials, in order to help accelerate the company’s international grab for natural gas and electricity resources. These included former Secretary of State James Baker III, and former Bush/Quayle campaign chairman Robert Mosbacher, both tightly connected to Texas energy and banking. From 1991 to 1993, Lt. Gen. Thomas Kelly (ret.) was on the board of Enron. He had served as director of operations for the Joint Chiefs of Staff during George Bush’s Persian Gulf War.

These three Bush men, according to journalist Seymour Hersh, accompanied former President Bush on a trip to Kuwait in 1993, to “help” Enron secure a contract to rebuild energy plants that had been destroyed in the Gulf War. Not a bad “spoil of war,” as Hersh describes it.

Enron provides the capital to build and own basic infrastructural electric generating capacity in “emerging markets”—for a price—as a kind of corporate World Bank. This foreign control of a nation’s infrastructure goes hand-in-hand with today’s “conditionalities” by the International Monetary Fund. These conditionalities require that nations sell off the rights to develop their natural resources, which will no longer be seen as the patrimony of the entire nation, to be used for economic development. Enron has taken the same approach to infrastructure in its home country, and is a staunch promoter of the idea that what is needed in the electric utility industry is “universal competition.”

In his testimony, Lay stated that electric rates could be cut 30 to 40% through the introduction of competition. Mark Palmer, from Enron’s Houston office, explained that the 30 to 40% reduction figure comes from a comparison with deregulation in the natural gas, banking, trucking, and airlines in-

dustries. Historically, Palmer said, deregulation has brought reductions up to 60%.

According to Palmer, consolidations in the electric utility industry will lead to savings in areas such as billing, which could be centralized, and metering, which should use new technology “so someone does not have to come to your house.” Palmer made the fantastic claim that these services account for 15 to 20% of the cost of electricity. (The 1997 *Electric Industry Outlook*, however, published by the Washington International Energy Group, reports that “automated meter reading, whether wired or wireless, is too expensive if it will be used only to read meters once a month. Companies that see it as a way to cut costs, especially labor costs, should have already concluded that it doesn’t. What it does do, however, is allow utilities to communicate with their customers, send messages, and develop a customer intelligence system that monitors lifestyles.”)

Enron’s profitable Portland gambit

Last July, Enron proposed that it move from being simply a marketer of someone else’s electricity to utilities and public power wholesalers, to becoming an owner of electric-generating capacity. Here Enron saw its chance to prove how profit-making companies could “increase efficiency,” and substantially reduce the cost of electric power for consumers. Enron proposed to buy Portland General Electric company for \$3.2 billion, offering \$3 million in savings that would be passed on to customers. Because retail sales of electricity have not been deregulated—at least not until any of the pending federal legislation is passed—this merger must be approved by the Oregon Public Utilities Commission (PUC).

On Jan. 16, the staff of the PUC released its proposal for the merger, which included 23 “stringent” conditions. The staff recommended a \$47.4 million per year cut in electric rates for each of 4 years, not \$3 million; that Portland General Electric (PGE) customers *not* pay more for electricity, even if it ends up costing Enron/PGE more to produce it; that Enron’s financial books be open to inspection; that PGE maintain or improve the quality of service; and that Enron not use revenues from its PGE operations to subsidize any of its unregulated operations. The PUC staff rejected Enron’s idea that the merger should do “no harm.” Instead, it reminded the company that Oregon law requires that such mergers have to be *in the public interest*, or, one could say, promote the general welfare.

Commissioners and staff were aghast that while Enron proposed lowering rates by only \$3 million per year for its customers, its shareholders would stand to gain about \$675 million in stock price appreciation from the merger! The staff recommended cut in rates of \$47.4 million per year, which would be a reduction of 4.7% for consumers, compared with Enron’s offered \$3 million, which would be a reduction of an insignificant 0.3%—somewhat short of the grandiose claim of a 30 to 40% reduction made in testimony by Kenneth Lay

of Enron. The \$47.4 million figure was arrived at by the PUC, largely to cover the profits from Portland General Electric operations that Enron will not use to reduce rates or bring any benefits to customers, but will export to Enron's corporate headquarters in Houston, Texas.

Interestingly, the reaction of a spokesman for Portland General Electric to the cuts proposed by the PUC, gives lie to the claims by Enron of how much more efficient things will be once it is in control. "For the bulk of the rate cuts," the PGE spokesman said, "it's not clear at all to us where the savings are to come from that support that. We see the same costs to service our customers," as before the merger.

Less than a week later, Enron and Portland General Electric said that they object to the conditions regulators want to impose on their merger. Enron objected to the staff proposal to take into account Enron's earnings on *non-regulated* businesses when figuring PGE's rate of return, which the PUC will continue to regulate, while at the same time asking Enron to wall off its Portland General Electric regulated business from any risks incurred by its unregulated business. Unlike Enron, the PUC does not intend to play Russian roulette with the electric service of Oregonians.

On Jan. 24, the PUC staff told negotiators they were breaking off merger talks with Enron and PGE because, neither side was willing to compromise on the rate cut, so there was "no point" in continuing the discussions.

Chairman and CEO Kenneth Lay, told the Feb. 12, 1997 Paine Webber Energy Conference in New York: "We're committed to this merger. We want it to happen, but we won't be extorted. The merger isn't critical to our strategy."

Two days later, on Feb. 14, the daily *Oregonian* reported that rather than negotiate with the PUC over the merger, Enron and PGE were going to try an "end-run" around the regulators, and "plan to ask the Oregon Legislature to limit the PUC's authority."

In response, PUC Commissioner Ron Eachus, who has been angered by Enron's behavior, as well as its proposals, stated that the question is not whether revenues come from regulated or unregulated businesses, "it's whether or not any benefits are being derived from the system that ratepayers are paying for." Mike Meyers, overseeing the PUC's staff review, said the bill Enron introduced into the state legislature would appear to disallow about \$144 million of the \$189.6 million rate cut, over four years, proposed by the staff. "They've got a long row to hoe with that," he said.

The PUC has made clear that unless the companies offer larger rate cuts, it will reject the deal. The commission is supposed to decide on the fate of this proposed merger by March 17, and the Federal Energy Regulatory Commission in Washington, D.C., will also have to approve it.

There are other potential problems with having out-of-state conglomerates control infrastructure, according to Bob Jenks, of the Citizen's Utility Board, which acts as a spokesman and lobbyist for consumer interests. Jenks reports that

the case of US West, which provides local telephone service in the West, is a preview of what electric utility deregulation and mergers of companies, will bring.

He explained that Denver-based US West, one of the seven "baby Bells" that was created by the 1984 breakup of AT&T, has cut staffing and frozen hiring in its "re-engineering" program. This had led to delays of up to a couple of months in getting new telephone service installed, and delays in getting repairs made to existing phone systems.

The reason for these cuts was the attempt by US West to make up losses it suffered in its unregulated business, through its regulated phone service. According to Jenks, US West had made some bad real estate deals and "lost their shirts." The conglomerate has tried to recover some of its loss by having its telecommunications company sign a 20-year lease, at above market rates, to rent office space from one of its own bleeding real estate companies. It then presents these artificially increased costs to state regulatory bodies, in order to get a consumer rate increase to cover this expensive real estate fee—which is being used to bail out the failed real estate investments. Jenks states that there are not adequate resources in state public utility commissions for them to police the multi-farious operations of unregulated service providers.

It is starting to become clear, at least to the people of Portland and some regional representatives, why companies like Enron are chomping at the bit to get their teeth into a deregulated electricity industry. As Rep. Peter DeFazio (D-Ore.) told the *Seattle Times* recently: "Why do we need to go through such a radical, risk-taking experiment? The answer is, there are people who are going to make millions or billions."

Will the lights stay on?

In the aftermath of the massive East Coast power blackout of 1965, electric utility companies around the country set up the National (now North American) Electric Reliability Council (NERC), to establish standards by which the increasingly integrated national electric power system would operate with a high degree of reliability, or, in short, "to make sure the lights stay on." NERC committees of technical experts, on loan from the individual utilities, work to ensure the reliability of the electric grid. These personnel are separated from the commercial and business operations of their respective companies.

Every year, NERC experts prepare an analysis of the outlook for reliability in the industry over the coming decade. The most recent report, released in October 1996, spans the years 1996-2005. Such a spread of years is necessary, because, although small-capacity, peak-load power plants can often be added in a few years, baseload power plants typically take a decade to build from start to finish. The Reliability Assessment states that "the focus of responsibility for electricity supply adequacy is shifting to the customer as the industry moves to a competitive market." In that situation,

NERC says, “the choices that customers make must not cause the operations of the interconnected bulk electric system to fall below the minimum reliability standards set by NERC. The potential consequences to the economy and public health and safety are too great.”

Two of the key elements in assuring there is a reliable supply of electricity, are adequate capacities to generate and to transmit the power. NERC experts are concerned that “market-driven capacity additions” may not provide resources on line in time to meet demand, in a way that is universally affordable. “If the market does not provide resources when and where needed, prices will rise and some customers will choose not to pay the price. . . . The customer that is willing to pay for electricity will receive service. At some point, price signals received by customers or service dissatisfaction of customers, will result in either construction of new resources or a reduction in demand.” A “reduction in demand” is a polite way of saying that there will be a segment of the population that will not be able to afford electric power.

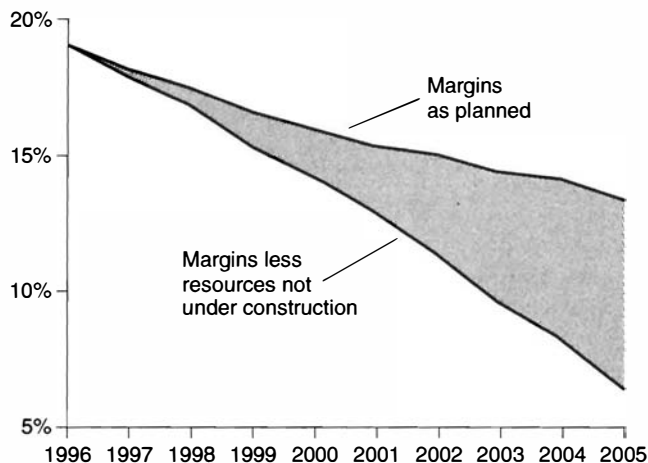
Will the “free market” invest the resources necessary to meet not only demand, but the extra requirements for reliability? Most likely not in advance. NERC reports that its reliability regions are no longer reporting generating capacity additions needed to satisfy regional criteria over the entire 10-year period, because almost all units planned are small peak load plants that can be built relatively quickly. “The result is a decline in reported capacity margins compared to the last several years” (Figure 1).

The capacity margin, which free-marketeers like to characterize as “surplus” capacity, or as demonstrations of the propensity of regulated utilities to “over-build,” is actually the margin of capacity that is on stand-by if there is an unscheduled outage at a power plant; unusual weather conditions, such as extreme heat or cold; problems or perturbations in one part of the system that forces capacity to shut down or a region to be isolated to prevent regional cascading failures; and many other contingencies that the public finds out about only when this intricate system fails, and there are outages.

Although NERC hopes that simply because utilities are not reporting plans to build capacity beyond the next couple of years, this does not mean that they will not build such new capacity, it warns that this “does signal an increased reliance on short lead-time resources that allow commitments to be delayed until clearly required, and reflects a shift toward a market-driven supply where customers choose the quantity and level of supply adequacy appropriate for their purposes.” In other words, if a shortage has otherwise driven the cost out of their reach, customers will be able to “choose” having limited access and lower reliability, in order to bring down the cost of electricity so that they can afford to pay for it.

Another likely threat to reliability, besides the inadequate number of plants scheduled to be built, is that the overwhelming majority of the plants that are planned are natural-gas-fired, gas-turbine units, which can be placed in service in

FIGURE 1
Capacity margins
(percent of total capacity)



Source: North American Electric Reliability Council, “Reliability Assessment 1996-2005.”

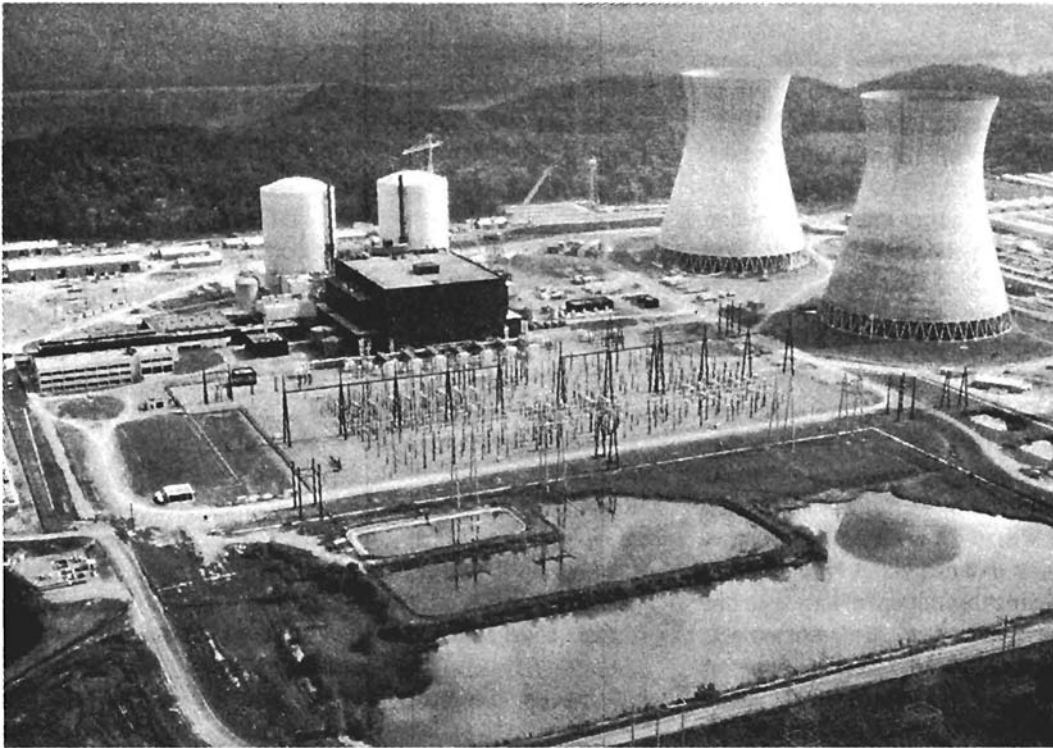
The electric utility industry has historically considered a reserve margin of at least 15% as adequate, to ensure the reliable delivery of power. If all of the generating capacity that is planned were built, by the year 2002, reserve margins would fall below the safe level. But most of that planned capacity is not even under construction, and if it is not built, reserve margins would be unacceptable before the turn of the century.

two to three years. But NERC warns that there is a threat to reliability in “over-reliance of any particular fuel technology.” Shortages in the now-deregulated natural gas industry during last winter, for example, forced power plants to use back-up oil systems, and such shortages could become a serious threat to reliability in the future.

As writer John Dillon aptly queries in the May-June 1996 issue of the Massachusetts Institute of Technology *Technology Review*, “The elaborate electricity grid must first operate under the laws of physics, not just according to the invisible hand of Adam Smith. . . . Will the lights stay on during this economic free-for-all?”

Dereg will bring on more regulation

In order for the lights to stay on, some things that used to be voluntary may have to become mandatory. Membership in NERC is open to all segments of the industry, both public and private, and adherence to NERC’s reliability standards and “rules of the road” has always been voluntary. Until so-called “competition” started to rear its ugly head, each company recognized that the integrity and security of the *entire* system is a prerequisite for any individual company’s ability to meet its legal obligations to provide reasonably priced, universally available, reliable electric power—and, also, to



The Bellefonte nuclear plant, built and operated by the TVA, could be one of the power plants found to be "uneconomical" were the free market to determine the price of electric power.

pay dividends.

There is no other economic activity that compares to the electric grid, in terms of the necessity to be a "team player." There are times when a utility might have to produce reactive power to keep the transmission system stable, or take costly measures that are required to ensure the integrity of the whole. Electricity must be produced "ondemand"; it cannot be stored. Therefore, it must be constantly coordinated by experts, with command authority, to oversee the interconnections of the generation and transmission networks across the country.

One year ago, to zero in on the most important aspect of changes in the electrical industry, the chairman of the NERC established a reliability compliance team, comprised of senior people in the electric industry, to make recommendations for reliability management, so that it does not "degrade" under a new, market structure. The team's report, completed on Oct. 12, 1996, offers an evaluation in the first paragraph of where we are headed:

"In the new competitive structure, it is not clear who has responsibility for reliable operation of the Interconnections, who should pay for reliability, who enforces reliability protocols, and what obligations market participants have to ensure system reliability is not compromised." Worse still, the NERC team observed, "in the move toward a competitive industry, there has been little or no recognition of potential negative impacts to reliability; it appears to have been taken for granted."

After examining the nuclear, health care, and securities and exchange industries, the team concluded that "the tradi-

tional voluntary compliance approach taken by NERC and its member regions will not serve the needs of the new industry. . . . Competitors do not cooperate, and the existing cooperative and voluntary system for reliability management cannot survive the transition to a competitive market."

The NERC team further states: "It will be essential that all regulatory jurisdictions approve such [reliability] agreements and support the terms and conditions, including sanctions. Legislation will be necessary if non-jurisdictional entities do not voluntarily submit themselves to contractual agreements for reliability."

The report recommends the establishment of Security Coordinators and control-area operators who are "charged with responsibilities associated with reliability, up to and including requiring the reduction or disconnection of load or generation to protect overall network security." Further, in order to maintain the integrity with which the NERC has functioned, the report recommends that "the industry should endorse functional separation of reliability management and commercial functions." The NERC team proposes that enforcement can be performed by FERC, the Federal Energy Regulatory Commission, with the support of federal legislation if necessary.

Lest this seem to be a particularly harsh set of recommendations, the NERC team points out, "there is no such thing as a fully self-regulating industry in America. Some aspect of virtually every business in America is governed by some federally mandated regulations, especially when health or safety is concerned." In the electricity business, however, unlike any other, "universal participation is critical to insuring reliabil-

ity,” so “100% compliance should be achieved through regulatory pressure.”

So much for the free market being in charge of a functioning electric utility industry.

Why the push for deregulation?

The headlong rush into deregulating the electric utilities has been led by the state of California. In a frank article published in the May 1996 issue of *Nuclear News*, Daniel W. Fessler, former president of the California state Public Utilities Commission, explained that the cutbacks in the aerospace and defense industries in the late 1980s, led to a “collapse greater than the Great Depression” in his state. This “forced Californians to reassess what they were paying for everything.”

One reason that the electric industry became a prime target in California’s panic to find a way to lower operating costs and thus lure industry back to the state, Fessler said, was that “the public mood has shifted and is now dominated by distrust of the abilities of government at any level to improve the commonwealth. . . . Private solutions and market institutions are in vogue, while governmental planning and regulation stand in broad disrepute. In these circumstances the faith in the genius of the market has, for some, taken on the overtone of a secular religion.”

During the same period, California stopped building its own electric generating plants (largely due to stringent environmental requirements), and became dependent upon the import of cheap hydroelectric power from the Pacific Northwest (it was these large, bulk transfers of power that contributed to the cascade of outages last summer).

In order to freely replace allegedly “expensive” nuclear generation with the cheaper power it could import, California had to change its own rules and regulations, and promote deregulation on the federal level. Enticed by the promise of lower electric rates, at least for industries that are threatening to move their manufacturing plants to cheaper pastures, nearly all the other states in the union are now considering loosening regulatory constraints on the electric utilities.

Where is this “cheap” electricity supposed to come from? The theory holds that if customers are allowed to haggle to get the best price from any producer who has any electricity to sell (through a power marketer like Enron), the most expensive capacity will become “uneconomical,” and will be beaten out by the competition, lowering rates for everyone. Of course, this assumes that there are significant surplus gigawatts of electric-generating capacity, which is not the case now, if reserve margin is recognized to be necessary at all times for the protection of the grid—and will certainly not be the case within the next five years.

Thanks to well-financed interference by anti-nuclear environmentalists, many of the nuclear power plants that came on line in the 1980s were delayed so long their cost doubled, tripled, or even quadrupled. Unfinished nuclear plants, including the half-dozen or so that are more than 50% complete,

have left nuclear-operating utilities billions of dollars in debt for assets that produce no revenue. Fearing that they will be left with no customers if retail “choice” is introduced, some nuclear utilities have tried to match the competition, by lowering costs through staff cutbacks. But as William Council, former managing director of the Washington Public Power Supply System, stated at the annual meeting of the American Nuclear Society last June, “competition among nuclear utilities is a death wish.”

As far as the propaganda claiming that the regulated utility industry has “overspent by about \$200 billion,” mainly for nuclear capacity, according to Enron CEO Lay, this winter, because of unusually cold weather, the Bonneville Power Administration hydroelectric system would have run short of electricity, even though it had had a record snow and rainfall year for its dams, had it not had access to output from a nearby nuclear power plant.

What will happen if dozens of nuclear power plants are forced to close? Aside from the impact on reliability, which would be devastating, considering nuclear energy’s more than 20% contribution to the nation’s generation, dozens of utilities could be thrown into bankruptcy.

More than the nation’s nuclear utilities face bankruptcy, however, if so-called stranded costs are not recovered. These stranded costs are the result of the mandated purchase of uneconomical “renewable” power, which was legislated during the Carter administration; demand-side management and other conservation programs; social programs to reduce rates for the elderly and indigent; and environmental costs, which escalated with the 1992 amendments to Clean Air Act.

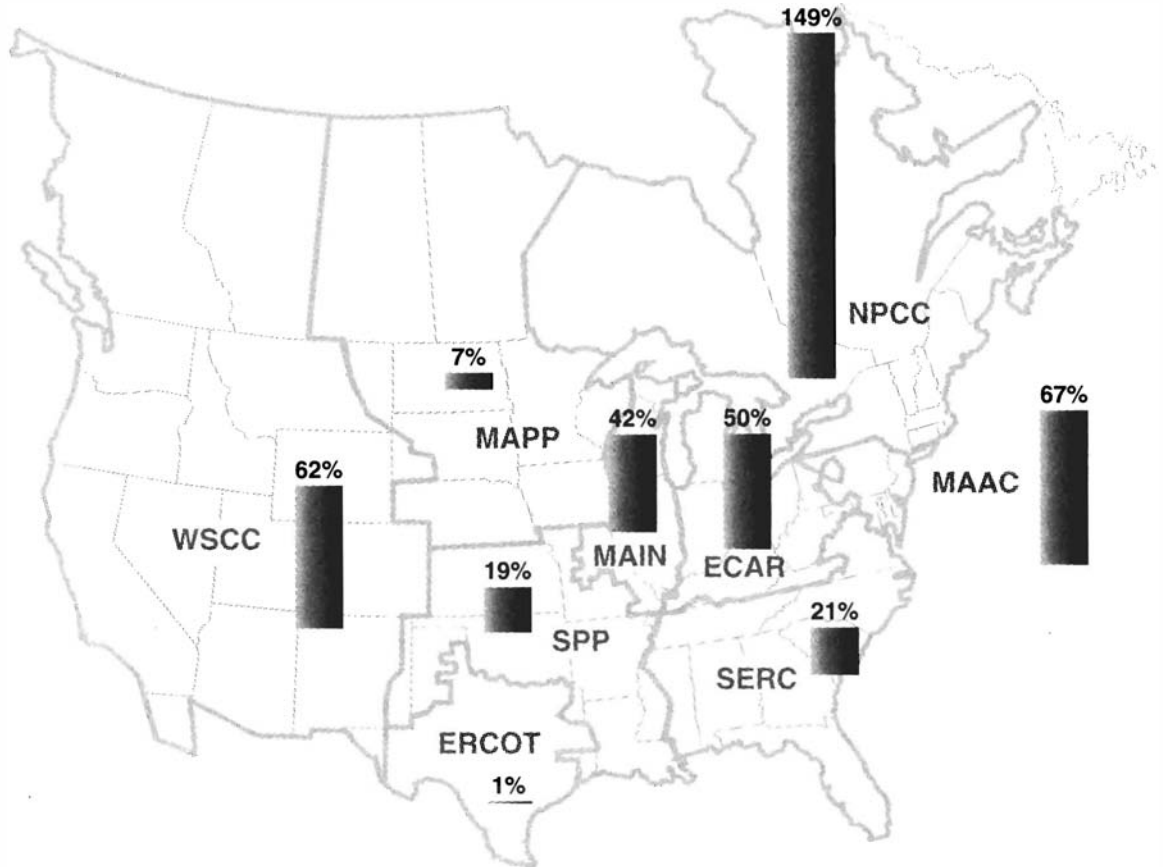
A series of studies done by specialists at the Oak Ridge National Laboratory reveals that there are 16 states where stranded costs might exceed 50% of the equity value of the franchised utilities. Nationally, 25 to 30 utilities have stranded costs exceeding their equity value (**Figure 2**). According to the Edison Electric Institute, investments in power plants, mostly nuclear, account for 40% of the total stranded costs, another 40% are taxes and other regulated subsidy programs, and 20% are from uneconomical purchases of power from independent producers.

The case of New York is instructive, because at about 14¢ per kilowatt hour, its rates are the highest in the nation, and are often cited as a good reason why rates must be lowered through “competition.” According to Consolidated Edison, 22% of its total revenues goes to taxes other than federal income taxes. This is more than its cost of fuel, or purchased power, or payroll and pensions, or materials and services! Con Edison’s customers bear the single largest tax burden of any energy supplier in the United States, amounting to 3.2¢ per kilowatt hour in taxes. It’s hard to make the case that its high rates are the result of “overbuilding” by the utility.

In testimony before the New York State Assembly on Nov. 16, 1995, Kevin Burke, Con Edison’s vice president for corporate planning, reported that the company had cut its workforce by 20% through attrition, to try to reduce costs. He

FIGURE 2

Potential stranded costs, as percentage of equity, by region



ECAR	East Central Area Reliability Coordination Agreement	NPCC	Northeast Power Coordinating Council
ERCOT	Electric Reliability Council of Texas	SERC	Southeastern Electric Reliability Council
MAAC	Mid-Atlantic Area Council	SPP	Southwest Power Pool
MAIN	Mid-America Interconnected Network	WSCC	Western Systems Coordinating Council
MAPP	Mid-Continent Area Power Pool		

Source: Baxter, L. and Hirst, E., "Estimating Potential Stranded Commitments for U.S. Investor-Owned Electric Utilities," Oak Ridge National Laboratory, December 1994.

Were there to be a radical deregulation of the electric utility industry, there would be billions of dollars in costs that would become uneconomical, or "stranded." In some parts of the country, these stranded costs amount to more than 50% of what the utilities have in equity. Among 25 or 30 utilities, stranded costs exceed the equity value of the company.

said that because of state legislation which had set a price of 6¢ per kilowatt-hour for contracts, Con Ed was forced to buy electricity from more expensive "independents," thus incurring more than \$400 million per year in charges to customers than would be necessary if it did not have to purchase this more expensive power.

Radical free-marketeers claim that this shake-out of the industry is necessary. On Sept. 28, 1996, Rep. Tom Delay (R-Tex.) introduced the Consumers Electric Power Act of 1996. The bill includes a ban on any exit fee or other levy imposed in connection with any purchaser who terminates a purchasing

relationship with any seller, which fee is one of the proposed ways for utilities to recover their stranded costs. It would repeal PUHCA, so there would be no protection against abuses by the financial interests that could now own your source of electricity. No federal, state, or local government authority would be allowed to regulate the pricing, terms, or conditions of service offerings of electric service providers.

Conservative revolutionaries turned populist snake-oil salesmen, have proposed that rather than having the beleaguered ratepayer shoulder the burden of paying for utilities to recover and retire their stranded costs and assets, the so-

called greedy investors should pay for the alleged transgressions of the utilities that pay them a dividend. This might be a just solution, were utility investors the Michael Milkens of Wall Street.

In reality, however, the majority of the utility industry's 6.3 million shareholders are over 65 or approaching retirement age. These investors have opted for the lower return on utility stocks in return for a lower risk on their investment. On Feb. 2, 1997, the *Seattle Times*, commented: "Some critics worry that deregulation will bring on a financial crisis on par with the savings-and-loan bailout of the 1980s. . . . People who could benefit most from a lower electricity bill—retirees, for example—might be shocked to find that their low-risk mutual funds and retirement plans invest heavily in vulnerable utility stocks." Graham Painter, spokesman for Houston Industries, Inc., which serves the Houston area, is quoted, "You yourself may be a major utility investor and not know it."

Rally the opposition!

Increasing segments of the U.S. population are becoming wary of the congressional and statewide initiatives to deregulate the electric utility industry. The multi-state cascading blackouts on the West Coast this summer shocked some, even in Washington, D.C., into questioning whether tearing apart the nation's grid system was a good idea. Deputy Secretary of Energy Charles Curtis, currently acting secretary of the Department of Energy, pointed out last year, "This is not an industry in crisis, at least not unless we make it so."

Curtis has stated over the past year that the Clinton administration believes that the federal government should not rush into mandating changes in the industry, but that states should have the authority and responsibility for making decisions on stranded cost recovery, and issues on the benefit to the general welfare, and so on.

According to Energy Department spokesman Bill Wicker, the administration has decided not to respond to the Republican-sponsored bills, but will draft its own legislation, which is now undergoing an interagency review. It will be reviewed by the Department of Defense, which is the nation's largest consumer of electricity; the Environmental Protection Agency; the Department of Agriculture, which underwrites more than \$30 billion in rural cooperative loans; and other agencies. Wicker expects that the bill is not likely to be introduced before March.

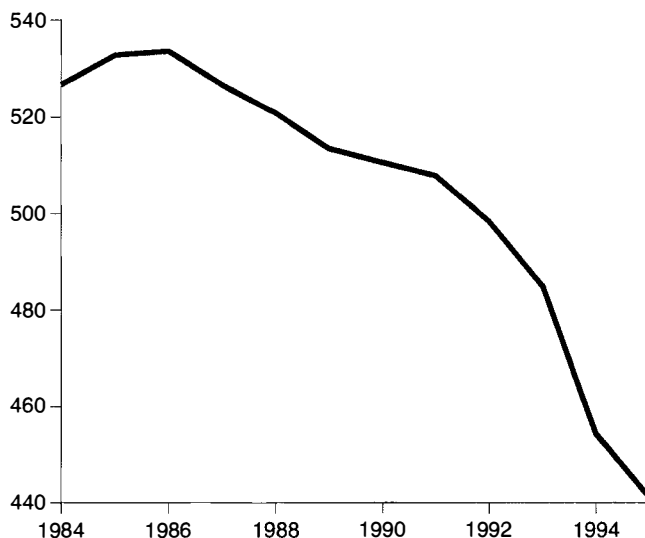
The National Association of Regulatory Utility Commissioners (NARUC) has also raised warnings about deregulation. In testimony on May 15, 1996, before the House Committee on Commerce, Robert Gee, from the Texas PUC, speaking on behalf of NARUC, stated, "While I would not discount the fact that there are cost-related problems in some regions of the country, in most states rates are very competitive, supply is abundant, service is reliable, and as a result, consumers are generally satisfied with the quality and cost of their electric service."

Commenting on the rash of mergers and acquisitions hit-

FIGURE 3

Number of employees in investor-owned electric utilities

(thousands)



Source: Edison Electric Institute

While deregulation promoters have claimed that utilities will become more competitive by introducing new technology and shutting down "uneconomical" capacity, in reality the loss of over 90,000 jobs in the past decade demonstrates where utility cost-cutting has taken place.

ting the industry, and the potential for financial abuses as the slide toward deregulation continues, Gee stated, "I would anticipate that the FERC will perform an increasingly anti-trust-like role as it is called upon to deal with complaints of anti-competitive behavior, unfair dealing, and abusive cross subsidies."

The International Brotherhood Electric Workers (IBEW), whose members are the backbone of this technology-intensive industry, has been very outspoken on this issue. The union is certainly not crying "wolf" in its warning that "competition" will mean mostly large-scale layoffs. **Figure 3** demonstrates where most of the "cost-savings" have come from, particularly since the 1992 federal law to open up the wholesale side of the industry for competition.

Consumer groups, like the Citizens Utility Board in Oregon, are increasingly holding the deregulation promoters' feet to the fire, forcing them to explain specifically where benefits and rate reductions are supposed to come from, and keeping a watchful eye on abuses.

But it is in the interest of every citizen to vote "no" on this issue. The nation must have the capability to mobilize the resources necessary to meet any and all demands that may be placed on our electricity generation and distribution system. Reliable, abundant electric power is a prerequisite for economic health and national security.