

Fight Mounts To Reverse Electricity Deregulation

by Marsha Freeman

During the first week in August, the electricity crisis in the state of California made front-page headlines in newspapers across the country. Residents of the southern California city of San Diego had received July bills from their utility that were more than double what they paid for electric power a year ago.

At a raucous meeting on Aug. 3, the state's Public Utilities Commission voted to authorize a \$100 million rebate to San Diego customers, to try to alleviate some of the impact of the rate hike. But many attendees characterized this action as "too little, too late." The delegation that had driven hundreds of miles from San Diego to the meeting in San Francisco, staged a silent walk-out, to demonstrate their displeasure.

Once the proud home of the aerospace and defense industry, and leading-edge research laboratories in nuclear and fusion research, San Diego's electric utility now is forced to ask businesses around the state to "help out": lower their electricity usage, stop work, and send employees home, in order to avoid rolling blackouts, which would be a threat to life and safety.

The crisis has reached the point where state legislators in California, who had "led the nation" by voting unanimously to deregulate the state's electric utility industry four years ago, now say that out-of-state conglomerates are exploiting the shortage of electric generating capacity in the state, charging customers rates that are unconscionable, and that may be illegal.

The California state legislature will be entertaining bills this summer to roll back electricity rates, as well as to prevent the full deregulation of the state's remaining partially regulated electric utilities. There are proposals that the state buy back the power-generating plants that deregulation forced all of the local utilities to sell, and buy up the generating facilities

that are for sale. The revolt against deregulation is on.

On Aug. 8, the Utility Consumers Action Network in California announced that it will be airing a series of advertisements on television, telling San Diego electricity customers to pay only what they paid last year, which is about 3¢ per kilowatt-hour, rather than the 17.6¢ rate on their current bill. The ad begins with an irate customer who says, "They lied to us about deregulation. They said our rates would go down, but they doubled." The ad includes advice to consumers from San Diego Board of Supervisors Chairman Dianne Jacob (a Republican, and hardly a rabblouser), to just "pay what you did last summer," when your electricity bill arrives. Her reply to threats of retribution was: "What are they going to do? There are 3 million of us."

For two dozen other states that are in the process of moving toward electric utility deregulation (see **Figure 1**), California gives a glimpse of the nightmare that full deregulation will bring. But even this summer, California is not the only state suffering shortages of power, and exorbitant prices for what is available (see box).

During a four-day heat wave in May, spot market prices for a megawatt-hour of electricity on sale to distributors went from the normal \$30, to \$3,900 in New York City. Consolidated Edison, the electricity distributor and formerly regulated generating utility for the city (before deregulation), reported in June that its costs were up 40% over last year (with no heat wave), because the wholesale price had skyrocketed in the whole region.

On Aug. 3, the New York Power Authority asked government and business offices to cut demand, offering them \$40 for each kilowatt of "saved" power. The only reason there have not been rolling blackouts in the New York region, is that it has been an unusually cool summer, with the temperature

FIGURE 1

States Where Steps Have Been Taken Toward Electricity Deregulation, as of July 2000



Source: Electric Power Supply Association.

during July never reaching 90°F.

In New England, the price for a megawatt-hour of power reached \$6,000 on May 8. On July 26, the Federal Energy Regulatory Commission decided to implement a \$1,000 cap for “competitive” wholesale power markets in New York and the Northeast, to try to prevent price gouging. This “cap” is far from a bargain, being *two orders of magnitude* higher than before deregulation began.

On June 29, a “code yellow” alert was issued in Nevada, with requests to reduce consumption, mainly as a result of supply problems in the entire west. On July 12, State Sen. Joe Neal (D-Las Vegas) asked the appropriate state legislative body to draw up a draft bill that he would submit, to halt the deregulation of Nevada’s electricity industry, slated to get under way before the end of this year.

Supply and Transmission Weak

Beside inadequate generating capacity, this summer has revealed that the electricity transmission system, which allows generating companies to buy and sell power as they need it, is a critical weak link in the chain of the power grid. When California reached a demand higher than its supply, the

‘Those Shocking Electric Bills’

“Many New Yorkers stared at their electric bills this month in confusion and disbelief. The cost of electricity distributed by Consolidated Edison in June went up about 40% over last year. July’s bills are expected to be 30% higher than a year ago—all despite a summer so temperate that even fans cooled lazily on their lowest speed.

“The reasons for this sudden spike in electric costs include not only higher fuel prices but also dramatic increases in the use of electricity because of the booming economy and no comparable increase in the amount of power being produced. But the main underlying cause is the deregulation of the power industry in New York and many other states over the last few years.”

—*New York Times* editorial, Aug. 8, 2000

TABLE 1

Net U.S. Summer Electric Capacity*

(Megawatts)

	Total***	Change	Utility**	Non-utility	Utility Additions	Non-Utility Additions	Total Additions
1995	769,517	—	706,611	63,406	5,752	—	—
1996	776,199	+6,682	709,942	66,257	4,786	1,800	6,586
						(est)	(est)
1997	778,513	+2,314	711,889	66,624	2,556	1,750	4,306
						(est)	(est)
1998	775,885	-2,628	677,800	98,085	458	3,002	3,460
1999	780,379	+4,494	639,143	141,236	3,182	1,312	4,494

*Net Summer Capacity is the expected hourly output expected to supply net summer capability.

**Includes investor-owned utilities, municipals, and Federal power marketers, such as Bonneville Power

***Capacity totals plus new additions may not add because of capacity retirements each year.

Source: Energy Information Administration, U.S. Department of Energy.

Washington State-based Federal Bonneville Power Authority offered to increase production at its hydroelectric dams, for export. The transmission capacity was not there for California to import it.

Insufficient transmission capacity, in a period of increased demand during the summer heat in Texas, has prevented the movement of power from one part of the state to another, requiring the state-wide transmission grid operator to issue a “level 2” transmission emergency alert on July 19, and another on Aug. 2.

Supply shortages are the ultimate cause of the electric power crisis. As **Table 1** illustrates, for the past five years, there has been a virtual national stand-still in total generating capacity. Between 1995 and 1999, a paltry 10,800 megawatts (MW) of net new capacity have been added to the power grid, on a total base of over 750,000 MW. This represents a less than 1.5% increase *over five years*. At the same time, average demand for electricity has been growing at more than 1% *per year*, and peak load demand, during hot summers and cold winters, has been growing at twice that rate, in some parts of the country.

In May, the North American Electric Reliability Council (NERC) published projections showing that under “normal” conditions, that is, a summer that was not too hot, and a 1.7% increase in peak demand, six of the ten NERC regional systems would have reserve margins below the 15% considered to be prudent by the industry. The crisis in electricity will not be solved until there is a recapitalization of the industry, primarily to build new generating and transmission capacity.

But shortages, caused by deregulation itself, as will be seen below, are not the only reason for price hikes, and certainly do not account for the extortion-level prices triggered by deregulation this year. As Richard Freeman’s article in this issue makes clear, the reason the electric utility industry was regulated in the 1930s under President Franklin Delano

Roosevelt, was that the President understood that providing electric power to every citizen, reliably and at a reasonable price, is a part of the government’s responsibility to provide for the “general welfare,” and is an underpinning of the economic growth of the nation.

Before FDR’s regulatory policies, the Wall Street bankers and financial interests who ran the power industry had no interest in serving the public; their interest was to pursue, using any manner of manipulation, their own gain. The relatively small amount of electricity supplied in the years before regulation, was unreliable, priced entirely by the financial conglomerates that owned the capacity, and non-existent in rural and poor regions where it was considered

“unprofitable” to provide it.

Return of the ‘Robber Barons’

As is spelled out in John Hoefle’s contribution to this report, the same financial interests that prevented the United States from having a universal and reliable power system before regulation, are now being given a free hand to repeat history. They are making a bundle doing it, and a company closely associated with the Bush family, Enron Corp., is taking the lead in the killing.

The fact that multithousand-dollar prices for megawatts of electricity has little to do with “competition,” has led to calls to investigate price fixing, “gaming” (the withholding of capacity to drive up prices), and other manipulations of the market by multi-state, multibillion-dollar holding companies.

Figures from the California state regulatory authorities reveal that while prices were tripling to San Diego customers, on many days the demand for power was no higher than last year! Where was the law of “supply and demand”?

By the beginning of July, California Gov. Gray Davis instructed the state’s Attorney General to investigate any illegal “market” activities, responsible for the spikes in spot market prices. After receiving letters from angry citizens and California elected officials, all the way up to the Senate level, the Federal Energy Regulatory Commission (FERC) announced on July 29 that it would investigate whether there is actually “competition” in the bulk power markets. Its report is due on Nov. 1.

In the middle of July, after more than a thousand workers in western mines, paper mills, and aluminum and copper plants had been thrown out of work, because these energy-intensive industries were losing money when electricity prices soared, Montana Sen. Max Baucus (D) asked the Federal Bureau of Investigation and the U.S. Department of Energy to investigate the West Coast price spikes, to determine

whether there was any illegal activity.

While local and state policymakers are now under the gun to make right a disastrous policy, national officials continue to peddle more poison as the cure for the patient. Energy Secretary Bill Richardson, who spent the spring holding energy conferences around the nation, warning of shortages this summer, repeats that the solution is more deregulation, but on a Federal level. President Clinton's response to the California crisis in early August was to ask government facilities to cut back on their use of electricity! Federal policy today is no different than that during the Jimmy Carter Administration of the 1970s: Conserve energy to avoid shortages, and turn the industry over to the "free market."

In 1995, *EIR* predicted that under deregulation, "electricity will become the latest commodity to be used as an object of financial speculation." The quickest way to turn the United States into a Third World country, we warned, "would be to destroy the highly reliable and affordable electricity provided by the public and private, regulated utility industry." Many states did not heed the warning.

But now there is a growing consensus that deregulation is not living up to its promise of cheaper electric power. Worse, it is threatening the reliability of the power grid, while lowering everyone's standard of living through inflationary price gouging, and the increasing possibility of supply interruptions.

For the elderly and other people on fixed incomes, this is not an inconvenience, but a threat to their very lives. San Diego Mayor Susan Golding has stated that pensioners in her city have turned off their refrigerators to avoid receiving massive electricity bills.

There is a well-placed fear that the energy crisis will get worse before it gets better. Even before next year's summer electricity crisis hits, this coming winter will present homeowners and businesses with the likelihood of not only more expensive, but short supplies, of natural gas. As detailed in an accompanying article, this artificially created crisis will threaten the health and welfare of the population in the winter, as well as continue to drive up the price of electricity.

More and more people are realizing that they have been taken for a ride, in turning over this critical infrastructure to the greed of financiers and "stakeholders," leaving citizens unprepared for the vagaries of the weather, and the unpredictable, but lawful, operating problems in this vastly complex system.

The fight is spreading to stop deregulation. It can not be won too soon.

California: A Case Study in Deregulation

In 1996, when the California state legislature passed the bill to deregulate the electric utility industry, the Federal gov-

ernment had already taken the first steps. The FERC had, four years earlier, mandated that utility companies, which had paid for and built transmission wires and towers, would have to open them up for power transmission by other producers.

As early as the 1970s, President Carter had signed into law the Public Utility Regulatory Policies Act, which mandated that his favorite small-scale "renewable" sources, such as wind and solar energy, be allowed to "compete" with fossil- and nuclear-fueled power plants. These inefficient, and uneconomical energy sources were actually designed to help

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reduce consumption, by raising prices (even though they were subsidized), and forcing people to conserve, in order to reduce demand, and the need for new capacity. The regulated utilities were forced to purchase this more expensive power, to promote the anti-growth political agenda of the Administration, and of the Club of Rome, one of the principal oligarchical propaganda outlets for Malthusianism.

In 1993, the Resource Data Institute estimated that the forced purchase of power from these "independent power producers," was costing Southern California Edison customers alone, an extra \$800 million per year, because the utility had to buy solar energy-produced power at 15¢ per kilowatt-hour, which was five times what it would have to pay for wholesale power otherwise.

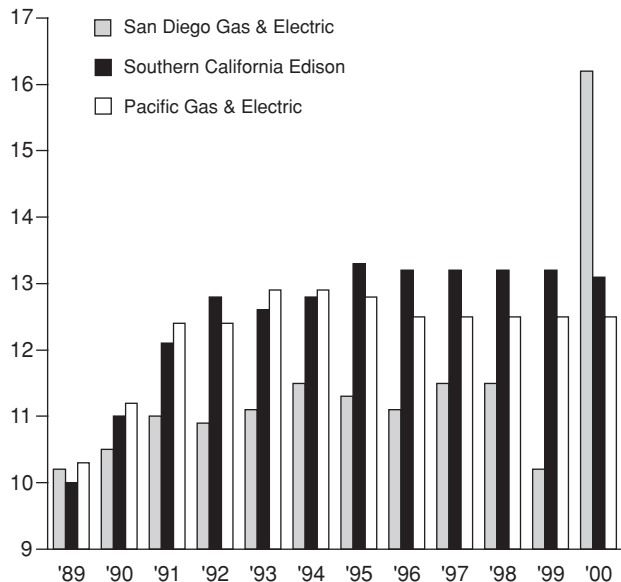
The 1996 California state law mandated that the vertically integrated industry, in which a power company produced the electricity, distributed it to homes and businesses, and billed and serviced the customer, be broken into pieces. On March 31, 1998, the state legislature ordered the regulated utilities to divest themselves of most of their power plants, to open up the production of electricity to "competition."

Middleman power marketers, such as Houston-based, and George Bush-connected Enron, spent millions of dollars to pressure California officials, promising them that lower electricity prices would be the result of deregulation. Harvey Rosenfield, an activist with the Foundation for Taxpayer and Consumer Rights in Santa Monica, stated during the

FIGURE 2

California Residential Electricity Rates, July 2000

(cents/kWh)



Source: California Electricity Options and Challenges, Report to the Governor, August 2000.

early August 2000 crisis, that the deregulation law “was ramrodded through the Legislature in two weeks, by utility companies who donated more than \$3 million to lawmakers that year.”

For more than 50 years, the compact between the utilities and the states had allowed the investor-owned utility companies to have a monopoly in their service area to deliver electricity. In return, they were to provide reliable power, by building and maintaining the capacity needed. Utilities were guaranteed a fair return on their investments in new plant and equipment, which typically required up to a decade to start to generate income from the sale of power. But California allowed itself to be lured by the promises that wrecking the compact with the regulated utilities, and opening up electricity to “competition” from other suppliers, would lower prices for everyone.

On Aug. 2, the president of the California Public Utilities Commission and the chairman of the Electricity Oversight Board delivered a report to Governor Davis titled, “California’s Electricity Options and Challenges.” Governor Davis had requested the report on June 15, in response to blackouts in northern California the day before, the price increases in San Diego, and the state-wide wholesale price surges.

The report points out the results of the past ten years’ policies in the state, summarized in **Figure 2**. Since the late 1980s, the residential rates for electricity have increased for

all three of California’s formerly regulated utilities. The reasons for this increase are not particular to California, and will be elucidated below.

But what is clear, is that this year, when the rates charged by San Diego Gas & Electric were totally deregulated—a fate planned for the state’s other two utilities by March 2002—the rates nearly doubled from July 1999 to July 2000. The report warns: “The rise in bills experienced in San Diego prefigures rises that will eventually come to other California customers.”

Over a matter of weeks, from mid-June this year to the end of July, wholesale prices of electricity in the state increased an average of 270%. This translated into over \$1 billion in excess payments by customers for electricity. Moreover, these billions do not fund new investments in power plants or increase reliability: “They may flow solely to power producer profit margins.”

‘Choice’ of Poisons

How did this situation come about?

To give citizens a “choice,” the state mandated, in its 1996 law, that generation of electric power would be run by for-profit plant owners, who would compete for business by lowering prices, and that the state’s regulated utilities’ generating capacity would have to be sold, if the companies wanted to stay in the distribution business. This is described as “unbundling” their systems. The electricity produced would be sold at auction.

Up until deregulation, 55% of the generating capacity in the state was owned by regulated utilities, 23% was owned by municipal and other public agencies, and 22% was built by independent power producers. **Figure 3** presents the picture today. Regulated utilities now own 15% of the state’s capacity, and the new non-utility generators own 40%.

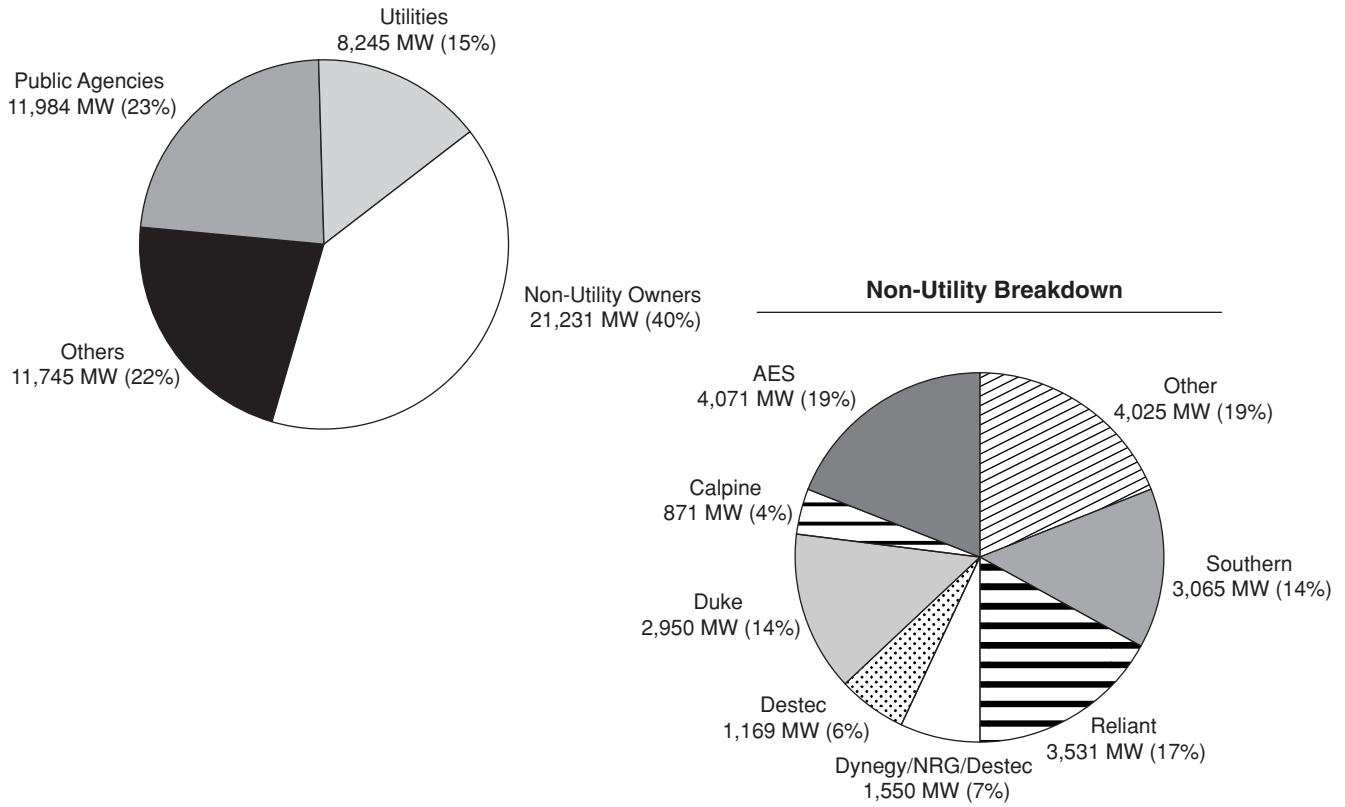
Who are these unregulated non-utility generators?

They are not local companies that decided to apply their business acumen to electricity generation. They are out-of-state mega-conglomerates, which have been buying up power plants out of their own, regulated service areas, to make a higher profit in unregulated markets, like California’s. They invest in holdings outside the United States, particularly in developing countries, or in the former Soviet Union, where they can prey upon the economies suffering from desperate underinvestment in power industries, and reap a higher profit than they can at home.

To operate this non-regulated system, the 1996 deregulation law created two non-public supervisory organizations which “have no duty to protect the public or consider the retail customers,” according to the report. One is the Independent System Operator (ISO), which operates the state’s transmission system, and the second is the Power Exchange (PX), which controls wholesale pricing policies. It has become increasingly clear that these two self-perpetuating organizations (they appoint their own members), are an integral part of the scam to fleece California’s consumers.

FIGURE 3

Who Owns Electricity Generation Capacity in California?



Source: Based upon data from the California Energy Commission Database of California Power Plants.

The Fox Guarding the Chicken Coop

The report describes this new system of buying and selling power as “extraordinarily complex.” One day in advance, participating generators bid power into the wholesale market auction, which is conducted by the Power Exchange. The PX estimates the amount of power needed to meet demand the next day. It then sets the price to be paid to all sellers, and it is set at the *highest* price of that hour, even if some sellers would have offered the power at a lower price.

The Independent System Operator then directs the flow of electricity throughout the state’s transmission system, to meet the demand. When the supply of power purchased by the PX is lower than the demand, the ISO is responsible for making up the difference.

To meet any gap in demand, and maintain operating reserves, which is a buffer needed at all times to maintain reliability, the ISO issues an Alert if the forecasted reserves for the next day fall below 7%, and asks generators to increase their power bids. If forecast reserves fall below 7% on the current day, the ISO issues a “Warning,” and begins buying

power supplies directly. But if the *actual* reserves fall below 7%, then 5%, and then 1.5%, the ISO issues a Stage 1 (then 2, and then 3) Emergency, which begins with public appeals for conservation, and ends with rolling blackouts, where electricity is cut off to parts of the service area in rotation, for designated periods of time. So far this summer, the ISO has issued nine Stage 2 Emergencies.

The ISO supposedly limits the top price that wholesale purchasers will be charged for electricity with price caps, which must be approved by the FERC in Washington. But in times of emergency, the ISO, which is responsible for keeping the grid functioning, is faced with the choice of purchasing the power at whatever outrageous hour-by-hour real-time spot market price the sellers are offering, or issuing emergency alerts, and cutting off power.

Currently, the law requires that California utilities purchase almost all of their power through the ISO and the Power Exchange. Some longer-term bilateral contracts, with stable prices between generators and distributors, are allowed for individual, large customers and marketers. While other states

have established supervised ISOs to regulate the flow of electricity through the transmission system, only California has an ISO comprised of stakeholders (who benefit from higher electricity prices), rather than an ISO that is a public agency.

This inherent conflict of interest has now become an issue in the state. The Public Utilities Commission, in its report to the Governor, examined carefully why California's prices are now so high. The increase in the state's wholesale electricity prices over the past year, the PUC report reveals, is not explainable simply by increased costs to the producers, extremes of weather, higher volumes of power produced, or a higher price cap. Comparing June 29, 1999 to June 29, 2000, the report states that the peak loads were comparable, as were sales volumes on the Power Exchange, yet the price was sevenfold higher this year.

The report's researchers found that during the peak demand hours this June, 3,000 fewer megawatts of power were supplied in the day-ahead market. "This suggests sellers may have been withholding power from this market in order to drive up prices in other parallel markets," meaning the real-time spot market. The report poses the question of whether suppliers could have colluded "to drive the prices higher," gouging consumers.

This year, nearly 10% of the demand load in California was supplied through real-time markets, at prices that were 50% higher than the already astronomical price on the day-ahead Power Exchange, which had risen from \$49.56 last June to \$522 this year. Last June, the price cap was \$250 per megawatt-hour. This June, the cap, thanks to the ISO, was three times that. An official with San Diego Gas & Electric remarked on Aug. 1, that if a \$250 cap had been in effect in June and July this year, the company would have saved 37% on its purchases of electricity, and customers would have saved \$99 million.

Why wouldn't the ISO and Power Exchange be implementing policies to make sure power was available to consumers at the lowest possible price?

The report reveals how dangerous the decoupling of accountability from control has been, analyzing where the allegiances lie among the ISO and PX board members. On the ISO board, only 2 of the 27 members represent the interests of residential consumers. On the PX board, the figure is 2 out of 25. On the ISO board, there are at least seven members who directly represent non-utility and private marketing interests, including Enron. On the PX, the number is comparable.

ISO Board Chairman Jan Smutney-Jones, for example, is the executive director for a group of energy wholesalers who produce about 40% of the state's electricity! These non-regulated generators and power marketers have made out like bandits, in their extortion racket against Californians this summer.

Sempra Energy, the parent company of San Diego Gas & Electric, announced on July 27 that its second-quarter income rose 34%, to \$110 million. Income at SDG&E actually fell

15% during the quarter, because higher billings to customers had not yet caught up with the outrageous price the distributor was paying for power. But Sempra's energy-trading unit was making a killing, as the number of trades skyrocketed due to shortages. The trading division's net income jumped 1,233% from April through June. In fact, the company's generation unit showed a rise in net income of 200%, because it owns part of a Nevada power plant which sells (exorbitantly priced) electricity in California.

Similarly, Enron Corp., the nation's largest distributor of energy, announced a 26% increase in earnings on July 24. This increase was not due to investments in new power plants, but mainly "investments" in entertainment. As a matter of fact, during the second quarter, Enron sold \$55 million worth of interests in power plant projects, getting out of some markets where it became obvious that it could not make sufficient profits, because, unlike California, many states had taken precautions to protect their consumers.

The report states that the group of conglomerates that sell power on the California market "benefitted substantially from the summer's unprecedented wholesale electricity price run-up in California." But it is unclear whether there are grounds to prosecute companies for their behavior. According to an executive from Pacific Gas & Electric, which must buy its power on the Power Exchange, "If you've got the only Beanie Babies in town, you can charge whatever you want. . . Is that [price] gouging? I don't know."

All Utilities at Risk

In addition to the suffering the free-roaming producers and marketers have brought to the people of California, as the price for wholesale power rises, the two large remaining semi-regulated utilities in the state—Pacific Gas & Electric and Southern California Edison—are put at risk, because they could be liable for billions of dollars in excess generation costs this summer, which they cannot recover.

Under the state's deregulation law, their rates are frozen until March 2002, or until they pay off their debts. This freeze was enacted to prevent them from raising rates in this transition period, while they have to pay off, or write off, debt and other costs that will make them uneconomical, or "uncompetitive," under full deregulation. The report points out that the losses they are incurring are only being balanced against the profits the utilities are receiving, mainly from the *nuclear* generating units that they still own.

One of the recommendations by the report to the Governor, is that the boards of the ISO and PX "should be comprised of members who are appointed by the Governor or other lawmakers, rather than comprised of 'stakeholders.' No member should have a conflict of interest. Moreover, the law should be modified to provide that the duty of the boards is to provide [for] the interests of the State of California, its consumers, and economy." Sounds more like a return to the "general welfare," than deregulation.

IMF and WTO Force Worldwide Deregulation

The many nations that are being bludgeoned by the International Monetary Fund and the World Trade Organization, to relinquish their sovereignty and privatize their electricity infrastructure, should carefully study the case of California, before they agree to do so.

As part of its package of austerity-driven “conditionalities” for developing nations, and those formerly part of the Soviet Union, the IMF includes the selling-off of electric capacity to private interests, and its deregulation from government oversight, to control by “market forces.” The practical result of this policy is to turn the national patrimony of these nations over to foreign-controlled conglomerates, which have no interest in the future economic development of their new “clients.”

Two examples suffice.

At the end of July, an IMF mission concluded a two-week visit to one of the poorest countries in the Americas—Honduras. The delegation insisted that the partial privatization of Honduras’s electrical services, which the government had already begun, must be total. At the present time, more than half of the nation’s 6.4 million citizens, especially those in rural areas, do not have any electrical service at all. Now it will be left to the “free market” to extend service to Honduras’s poorest, which did not happen in the United States, and will not be “profitable” anywhere else.

Using its muscle as the largest creditor to Bulgaria, the IMF has insisted that the government in Sofia restructure its energy sector to “curb state subsidies, and inefficient production, and attract key investors,” Reuters reported on July 13. Several officials from the state-run National Electricity Company resigned before the start of the reform. Local media warned that privatization would lead to

power shortages, but the government has forged ahead.

So far, the Bulgarian government has broken up the “monopoly” of the NEC and created seven state power firms for distribution. The next step is to sell them, and the generating assets, to private interests, including the Kozlduny nuclear power plant, which produces half of Bulgaria’s power.

At a hearing held by the International Trade Commission in Washington, D.C. on June 6, representatives from the National Electrical Manufacturers Association (NEMA), called on all 136 member-countries in the World Trade Organization (WTO) to deregulate their energy sectors. “The proper government enforcement role,” NEMA president Malcolm O’Hagan told the Commission, is not planning for resources, or being responsible for the growth of the energy sector, but “enforcing existing efficiency standards for products.”

O’Hagan proudly pointed to the privatization of electricity sectors in Brazil, Canada, the European Union (which will complete full retail competition by 2003), Australia, and Japan as models for the rest of the world.

Sitting next to O’Hagan as he pronounced these “models,” was Richard Kean, vice-president and CEO of Enron Corp., the Bush-dominated company which is spearheading electricity deregulation in many of those countries, and in many states of the United States.

But electricity deregulation *did not* start in the United States; rather, it was Great Britain, in the late 1980s, that began this “experiment.” The result? It was reported on Aug. 5, that according to the British government, the poor have seen no benefit from the deregulation and sell-off to private interests of Britain’s electricity sector. About 5 million households in Britain, out of a total of 20 million, are classified as suffering from “fuel poverty.” This is defined as having to spend 10% or more of the household income just to heat a home. In this formerly industrialized nation, an estimated 30,000 people die of the cold each year.—*Marsha Freeman*

What Can Be Done?

There are two basic problems in California that require solution, before the state can return to an electricity delivery system that serves the needs of the people.

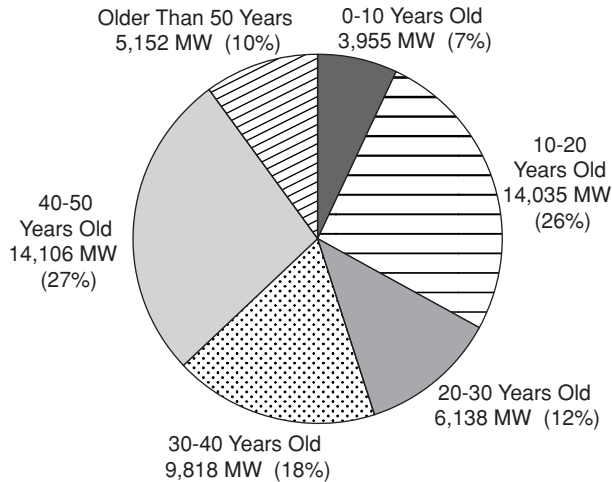
One is to begin the rapid construction of new power plants. Since the 1996 vote for deregulation, peak load demand in the state has grown by an accumulated 5,522 MW. The net capacity additions, to meet that demand increase, were 672 MW, over the same period of time. As a result, California imports about 25% of its electricity from neighboring states. If those states cannot spare the power, or the transmission lines cannot accommodate the transport, there are shortages.

Over the past decade, there has been no power plant built in California larger than a small 50 MW one. During that time, the population grew by more than a half million.

Policies in the state over the past 20 years have discouraged new plant construction. These have included environmental regulations—the strictest in the nation—and “public participation” (read: disruption) in the power plant siting and permitting process, which makes the construction of new capacity almost impossible. In the 1990s, the report to the Governor points out, regulators abandoned Integrated Resource Planning, which was used to plan for needed new capacity. Now, no one has any responsibility for planning ahead for the

FIGURE 4

California's Power Plants Are Aging



Source: California Energy Commission.

state's ability to provide power.

The need for building new capacity is urgent, as seen in **Figure 4**. More than half (55%) of California's existing capacity is over 30 years old. Ten percent is more than 50 years old. The impact of the aging is that more plants will be out of service for longer periods of time, more often, for unscheduled maintenance. Many of these plants will be retired over the next few years, shrinking the capacity further.

Deregulation has aggravated the problem. For-profit unregulated companies find it more "profitable" to run power plants into the ground, than to make the investments necessary to ensure their long, productive life. Even in states where full deregulation has not yet been implemented, like New York, necessary maintenance has been deferred, due to the uncertainty of making a return on the investments when the price of power that can be sold in the future is unknown. Last year, Con Edison in New York deferred the replacement of a steam generator at one of its Indian Point nuclear reactors, for that reason. When the generator sprung a leak in a water pipe in February, the plant had to be taken off line for repairs, and is still out of service. Con Ed is paying tens of thousands of dollars per day to replace the lost electricity, during the summer peak demand.

Deregulated companies also find it more "profitable" to take older, more costly, facilities out of service for baseload, year-round operation, and only have them available when summer peaking periods allow them to charge higher prices. (Under the regulated system, the cost of running these more expensive plants was folded into the overall rate the power company was allowed to charge.) This has led to a decrease in the on-line capacity available throughout the nation, as more than 110,000 MW of utility capacity has been sold to

non-regulated companies since 1997. More than 100,000 additional MW is currently up for sale, as more states get ready for deregulation.

In response to this supply crisis in California, it has been proposed by State Sen. Steve Peace (D-El Cajon), and recommended by the Public Utilities Commission, that the Governor use his authority to expedite the construction of the ten or so power plants that are in the process of being licensed in the state. Onerous environmental restrictions can double the time it takes to bring a new plant on line. While such an action will help, it is important to examine who is proposing to build this new capacity.

Regulated electric utilities in the state are not allowed to own generating capacity. Therefore, as they are in the process of selling off the remainder of what they built, non-utility, unregulated conglomerates are "offering" to build power plants, seeing the supply shortage in California as a potential goldmine. Since, as has been shown above, the supply does not really determine the price, more power to sell means higher profits.

However, the track record of non-utility suppliers should make the buyer beware. The Electric Power Supply Association, based in Washington, D.C., which promotes deregulation, states that as of June 2000, "competitive" power suppliers have announced the potential development of more than 178,000 MW of merchant power to be completed by 2007. But according to Richard Schwartz from Platts/UDI, which tracks the industry, the "non-completion rate is 50-80%" for the non-utility generating companies. Others have described the announcements from these companies as "release-a-watts," rather than megawatts, because the electricity only exists in their press releases. "It costs you about \$5 to put a press release together and send it out," stated Harvey Campbell, from West Coast Energy. "These plants can disappear as soon as they appear."

Until new generating capacity comes on line in California, which will not be, at best estimate, for another two or three years, the state can try to cap the price of energy that can sold by the ISO, in order to control prices to consumers. But as soon as the ISO hinted that the cap of \$500 per megawatt-hour of power might be lowered to \$250, the non-regulated power companies (40% of the state's supply) threatened that they would go elsewhere to sell their power, because they could "get a better price."

Return to Regulation

While it would not be an easy task to un-do the deregulation that the state has implemented, there must be a return to regulation by government to control the price charged to consumers, to prevent suppliers from manipulating the market for their own gain, and to establish mandatory "rules of the road," which have been called for nationally, to maintain the reliability of electricity delivery, regardless of any detrimental impact on individual suppliers.

The report to the Governor takes some steps in this direc-

tion, recommending that the ISO and PX function in the interest of consumers (which will require a change in the deregulation statutes); that Federal regulators, who must approve state market changes, take steps to protect consumers, such as interstate wholesale market price caps; that federal regulators declare that the state's power markets are *not* competitive; that the governor create a California Energy Council, modelled on the National Security Council, to unify state action to resolve problems; that he enhance the state's enforcement for power plant maintenance, and against price manipulation and power gaming; and so forth.

(On Aug. 7, FERC Chairman James Hacker indicated that the Federal regulatory body will likely reject Governor Davis's proposal to cap the California Power Exchange's one-day-ahead rate at \$250, as has been done for the ISO's day-of-market price.)

In short, the report finds California's deregulation experiment to be a failure. All of the above recommendations require the state government to re-institute regulations, and bring back control over a system that used to provide its citizens with reliable electric power and critical infrastructure, which deregulation has destroyed.

Why the Utilities Were Deregulated

Why were otherwise sane state legislators and public utility commissioners in more than half of the states of the Union stampeded into tearing apart their electricity utility systems?

Electricity deregulation, as the map in Figure 1 shows, has been very popular among the coastal states, such as New York, New England, and California. The delivered cost of electricity had been steadily declining through the 1960s, thanks to economies of scale, technology improvements, and the coming of age of commercial nuclear power, during a time when real economic growth created a 7% per year increase in demand. But prices started an upward climb when the oil price shock of the mid-1970s quadrupled the cost of oil, sending electricity rates in coastal states that import petroleum, through the roof. Other fossil fuels followed the upward trend.

As utilities planned prudently to increase their reliance on cheaper nuclear energy, and reduce their dependence on fossil fuels, a series of shocks at the end of the decade forced nuclear power costs to increase, as well. **Table 2** indicates why electricity prices started to increase for consumers using nuclear power. The actual cost of completed nuclear plants increased, in some cases, by an order of magnitude, due to two factors.

First, Federal Reserve Chairman Paul Volcker's Columbus Day 1979 hike in interest rates, into the double-digits, suddenly shot the cost of utility borrowing to build new capacity from the tens to the hundreds of millions of dollars. The electric utility industry is the most capital-intensive industry in the country, requiring billions of dollars of investment an-

TABLE 2

Projected and Actual Cost of Nuclear Power Units

(billions \$)

Unit	Megawatts	Initial Cost Estimate	Actual Cost
Millstone III (Massachusetts and Connecticut)	1,150	.400	3.82
Limerick I (Pennsylvania)	1,055	.344	3.8
Wolf Creek (Kansas)	1,055	1.03	2.93
Susquehanna I (Pennsylvania)	1,050	.665	2.05
Susquehanna II (Pennsylvania)	1,050	.720	2.05

Source: Public utility commissions in the respective states.

nally, just to maintain capacity that is in line with demand growth.

Second, the gear-up of the anti-nuclear movement in the late 1970s, partly paid for by the oil multinationals that had raked in a fortune from the oil price hike, created a class of people known as "intervenors," who disrupted the process of completing plants, to the point where utilities spent 8-10 years building the plant, and then a decade in court trying to get the go-ahead to operate it.

Even with the price shocks to the fossil fuel and nuclear suppliers, electricity rates hit their peak in 1983, and then started to decline. But the effect of the Reagan free-market economic "revolution," the FERC transmission deregulation of 1992, the break-up of the Soviet Union and the attendant cutbacks in the leading-edge U.S. aerospace/defense sector, and the turn from real industrial expansion and economic growth to the "new economy," based on speculation and financial thievery, fueled an upward climb in electricity prices, and a collapse in investment in the industry.

Large companies fighting to stay in business in the declining economy, threatened states such as California and New York that if they did not offer them bargain-basement electricity prices, they would relocate to the sunny, unregulated, and non-union south, or to other states with low rates from hydroelectric power. Suddenly, industrial states found themselves in a bidding war to offer their large customers the lowest power rates. So they let in the Enron salesmen, who were promising bargain-basement prices.

The clinching point made by the power marketers and free marketers to elected officials, was that the reason rates in California and New York were the highest in the nation, was that the greedy utilities had "overbuilt," putting on line too many power plants, accumulating too much debt, and passing the cost of those unneeded plants on to the consumer. Why, there is so much excess capacity, they claimed, if you open up the market, these expensive nuclear, oil-fired, and older generating facilities will not be competitive, but will

be replaced by cheaper, newer natural-gas-fired plants, and everyone's bill will go down.

The primary assertion itself is a lie. Utilities did not "over-build." Capacity was growing in the 1960s because demand was growing at a healthy 6-7% per year. To be responsible, the utilities, and the state regulatory agencies that oversaw them, make plans ten years ahead of time, to make sure that there would be enough capacity in the pipeline for the future demand growth. No one could foresee that prices would soar, and demand would slow down, through the 1970s, thanks to the political manipulation of fossil fuel prices.

No one could predict that the combination of financial interest-rate penalties, the anti-nuclear movement, and the slowdown in the economy in the 1980s, would lead to utilities abandoning half-built nuclear plants, which would never produce an income, but had debt payments due that still had to be honored.

To blame the utilities for "overspending" to build enough capacity, to meet demand and provide a proper margin of reserve in the future, is like saying that it is a waste of money to build dams for flood control this year, because it may not rain a lot for the next decade. Where are all of those "extra" and "unnecessary" power plants now?

Deregulation is a failed policy. California Public Utilities Commissioner Carl Wood has called it a "mistake," and this

summer's crisis "the predictable consequence of an ideologically driven . . . policy." The outcome was predictable, because deregulation was never intended to lower electric power rates, much less enhance reliability, for the vast majority of the nation's consumers.

Through deregulation, electricity has been turned into a "commodity" ("like pork bellies," commented one executive), open to the same abuse and financial manipulation as the oil industry, the cartel-controlled food industry, the futures market, and all forms of speculation. The difference is that electricity, unlike any other form of "commodity," cannot be stored during good times, to be used in times of need. When there is not enough, there is an immediate, life-threatening crisis. This critical infrastructure must be in place, and function properly and efficiently, *every minute of the day and night*, or this country cannot function at all.

It is ironic that newspaper accounts and foolish "economists," blame increased electricity demand from the booming "new economy" of computers, mobile phones, and the Internet for the electricity shortages California has faced this summer. If companies in California had been building power plants, rather than mobile phones, there would not be a power crisis, but instead the basis to rebuild the high-technology and R&D capabilities of one of the nation's most economically important states.

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