

## Halt Energy Speculation Before It Shuts Down the Nation

by John Hoefle

While the deregulation spin-doctors promised lower electric rates, what they delivered was just the opposite. Californians, for example, saw the price for electricity quadruple from 1999 to 2000, with the cost of electricity jumping from \$7.4 billion in 1999 to \$28 billion in 2000. In November and December 2000 alone, Californians spent \$9.5 billion on electricity—\$2 billion more in just two months, than they spent in all of 1999! Utilities absorbed most of the increase, and are facing bankruptcy as a result.

Deregulation proved to be a complete disaster. Not only did the state's electricity bill increase fourfold, but the reliability of the system has decreased to the point where blackouts and the threats of blackouts have become commonplace.

The effect of this goes far beyond the bankruptcy of Pacific Gas & Electric (PG&E) and Southern California Edison, the state's two biggest utilities. Businesses have been forced to close or scale back their operations, and many of the larger companies have either shelved expansion plans, or are considering relocating outside the state. Households, even those whose electric bills have not yet increased because of price caps, are also suffering, because the sharp rise in the price of energy raises the cost of just about every product on the shelves.

The very public catastrophe in California sent the deregulation spin-doctors into overtime, and they eventually came up with the line that California's problem was not that it deregulated, but that it didn't—that is, it did not *fully* deregulate. California's mistake, they claim, is that it deregulated the prices the utilities would have to pay, but left caps on what they could charge their customers. Had California fully deregulated in the first place, the spin-doctors insist, there

would be no problem now.

Oops! The cat's out of the bag. Were deregulation to have lowered prices as claimed, the price caps would not have been an issue. The new line is, somewhat indirectly, an admission that prices will rise under deregulation. Those who told you that deregulation would lower your electric bills were, in fact, just flat-out lying. Even in states where short-term price cuts were written into the deregulation laws, the manipulation of natural gas prices will end the honeymoon quickly.

### Bare Market

The essence of deregulation is the shift in the price structure from the traditional "cost of production plus a reasonable profit" model, to a "market-based" pricing system, with "market-based" being a more polite way to say "whatever the market will bear."

In the "old days," i.e., before Enron became a major player, and after FDR's New Deal initiatives, electricity was considered an essential component of the national infrastructure, regulated to keep the prices reasonable and the supplies stable. Utilities were required to provide universal service, even if providing electricity to a farm in the boondocks cost more than hooking up a new house in the city. It was understood that electricity, cheap and plentiful, was an important factor in the drive to improve the standard of living and the productive power of human labor. The increases in productivity more than offset the cost of providing the power.

But, my, how we've "progressed." We've seen the error of our ways in giving electricity away cheaply; if people want it, they're going to have to pay, and pay big. To do anything less, is just not "good business."

The California disaster is instructive. As part of deregulation, the utilities were required to divest themselves of about half of their fossil-fuel electricity generation capacity, meaning that they would not have nearly enough generation capacity to supply their customers and would have to buy power from outsiders. The state created the California Power Exchange (Cal PX) to hold auctions to facilitate such sales, and a California Independent System Operator (Cal ISO) to manage the transmission system.

Each day, the utilities would estimate the amount of electricity their customers would need the next day, then put out bids for that amount of power through Cal PX. The electricity generators would, in turn, offer to supply a given amount of power at a given price. The utilities would accept those bids, starting with the cheapest and working their way up, until they had the power they needed. However, the way the bidding worked, everyone whose bid was accepted got the highest accepted price.

Suppose, as a simplified example, companies A, B, and C each agreed to supply 30% of a utility's need for \$75 a megawatt-hour, company D agreed to supply an additional 9% for \$90, and company E agreed to supply the remaining 1% for \$100 a megawatt hour. In this case, all of the companies involved would be paid \$100 a megawatt-hour, regardless of their initial bids.

Under such a system, making sure that the last bid is a high one becomes a matter of much importance to the financial sharks. The process — “gaming,” in the parlance — of discreetly maneuvering to jack up the prices soon became a factor.

The effect of this process was to create sharp spikes in the price of electricity sold on the Cal PX (**Figure 1**). On Dec. 13, 2000, the day-ahead average Unconstrained Market Clearing Price (UMCP) of electricity on the Cal PX hit \$1,406.76 per megawatt-hour, more than 15 times California's 1998 average price of \$90.30 per megawatt-hour. During December 2000, the average UMCP was \$398.97 per megawatt-hour.

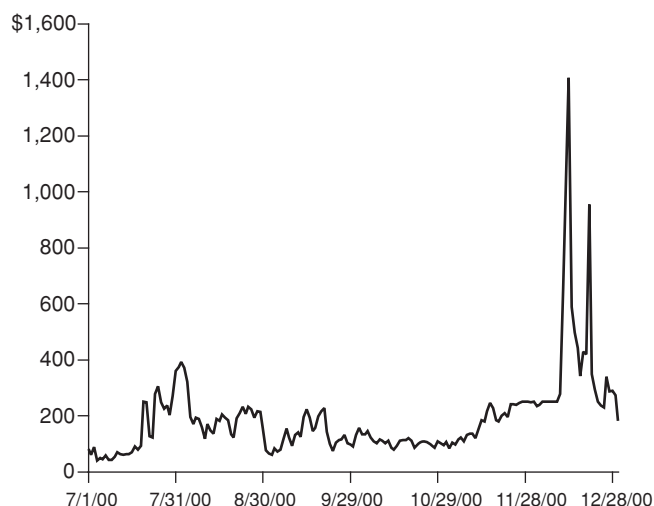
On top of that, on days when the Cal ISO needed more power than contracted for through the Cal PX, the ISO had to buy the extra power on the open market, where it was often even more expensive. Naturally, the “gamers” soon learned to hold some of their electricity out of the Cal PX auction, and save it for the ISO.

In such circumstances, it is hardly surprising that the non-utility power producers, such as Reliant, Southern, Duke, and Dynegy, made record profits in the fourth quarter of 2000, and that PG&E and Southern California Edison, operating with caps on what they could charge their customers, were bankrupted.

## Enron Leads the Pack

The ringleader of this crop of energy pirates is Enron, a natural gas company which has transformed itself into the

FIGURE 1  
**Deregulation Sends California Electricity Prices Soaring** (Day Ahead Average Unconstrained Market Price)  
 (\$ per Megawatt-hour)



Source: California Power Exchange.

world's leading energy speculator. Enron's Houston headquarters contains a trading floor comparable to the trading floors of the Wall Street investment banks, which are also turning increasingly to energy speculation. Its activities have been highly profitable, with revenues soaring to more than \$100 million in 2000, thanks to the sharp rises in electricity and natural gas prices (**Figure 2**).

In its 1999 annual report, Enron defines itself as a “New Economy” company “driven by a quest to restructure inefficient markets,” a polite way of saying that it intends to do to the energy market what Wall Street has done to the financial markets—namely, turn it into a giant casino. For several years, Enron has held a seat on the board of the International Swaps and Derivatives Association, the major derivatives trade group, and its board includes Wendy Gramm, who, as chairman of the Commodity Futures Trading Commission in 1993, issued an illegal regulatory decree which opened the door to a new wave of derivatives speculation.

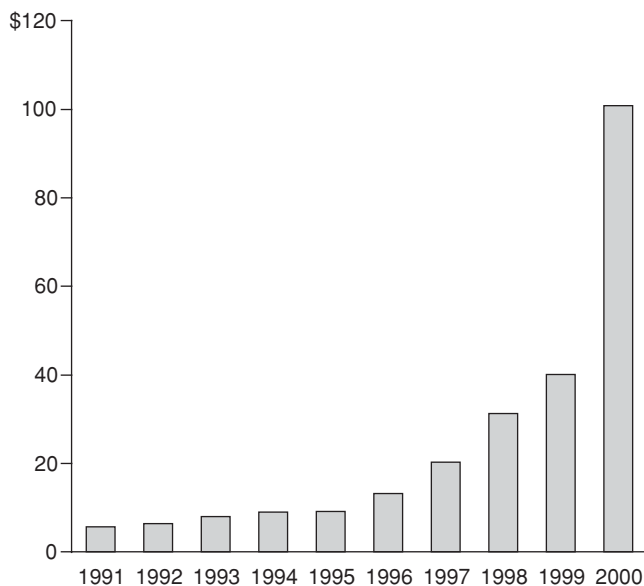
Enron's rise to international infamy began in 1989, when it was selected to play a role in the deregulation of Britain's electricity and natural gas markets. Britain, under Prime Minister Margaret Thatcher, was the staging ground for pushing deregulation in the United States, Europe, Ibero-America, and Asia; Lord John Wakeham, Thatcher's deregulation czar, currently sits on the Enron board.

The company made its move into the Big Time in February 1993, when the Administration of Sir George Bush re-

FIGURE 2

## Enron Revenues Surge as Energy Prices Climb

(\$ Billions)



Source: Enron.

turned to private life and began cashing in their chips. Secretary of State James A. Baker III and Commerce Secretary Robert Mosbacher both joined Enron as consultants, and former President Bush accepted a number of lucrative speaking assignments for the company. Enron chairman Kenneth Lay stated at the time that the presence of former Bush Administration officials would “greatly enhance Enron’s goal of becoming the world’s first natural gas major.”

Within weeks, Enron announced a \$1 billion expansion into Ibero-American power markets, and by August announced a natural gas development deal with Russia. Earlier, in 1992, Enron had announced a deal to build a power plant in Dabhol, India, a plan which by 1995 had proved so controversial that some in India have described Enron as the modern incarnation of the British East India Company. Thanks to heavy political pressure—some called it thuggery—Enron then moved in on natural gas fields in Mozambique, Qatar, and Jordan.

In July 1996, the Bush-connected Enron made a bid to buy Portland General Electric, an Oregon electric utility, for \$3.2 billion, as a way to jumpstart its electricity generation business. Enron, helped by the Federal Energy Regulatory Commission, managed to overcome the objections of the Oregon Public Utility Commission and complete the deal. It was the first purchase of a regulated utility by a non-utility power producer, and opened the floodgates for the disaster to follow.

By 1998, Enron was making a killing on the Summer heat waves in the Midwest and on the East Coast, selling electricity to utilities whose own generating capabilities proved inadequate to meet demand.

Enron also became a major player in the weather derivatives business, selling “hedgies” against unprofitable weather to theme parks, breweries, fertilizer companies, sports-drink companies, film studios, golf resorts, snow removal companies, and others. (About the only thing for which Enron had no hedgies to sell, was stupidity.)

In 1999, Enron launched a major media campaign to scare people into supporting electricity deregulation, suggesting that without deregulation, the country would be hit with brownouts and blackouts. Typical of such propaganda campaigns, Enron acted through a front group, Americans for Affordable Electricity (AAE). According to Electric USA, a coalition of rural electric cooperatives and others, the AAE was Enron’s “puppet coalition,” with Enron paying 75% of the group’s expenses.

Enron has also been active in the water privatization business. In April 1998, Enron formed a company named Azurix to buy water companies around the world. In July, Azurix paid \$2.4 billion to buy Wessex Water, a British water utility. Fortunately, Azurix proved something of a failure, as the concept of water privatization has thus far seen limited support.

Deepening its ties to the Mother Country, in 1999 Enron contributed £300,000 to Prince Charles’s Prince of Wales Trust, bringing its total contributions to the Trust to nearly £1 million.

Enron’s Lay, a longtime friend of the Bush family, is currently an adviser to both President George W. Bush and Energy Secretary Spencer Abraham, and is said to be in the running to be appointed U.S. Ambassador to Britain, a prized position among U.S. Anglophiles.

### Shut Down Enron

In recent comments to *EIR*’s staff, Lyndon LaRouche called for Enron to be shut down, both as a threat to the nation, and as an example of the corruption of the Bush Administration. LaRouche noted that to even begin to solve the California breakdown, President Bush would have to do something he has shown no inclination to do, namely, immediately re-regulate the electricity and natural gas industries. Such re-regulation would bankrupt Enron and wipe out a huge chunk of the speculators who financed young Bush’s political career. (Enron was *the* leading contributor to George W. Bush’s gubernatorial and Presidential campaigns.)

As long as deregulation remains U.S. policy, the situation in California will only get worse, and spread. The danger is not restricted to California, or the Western United States. Unless this speculation-induced breakdown is contained, the “California crisis” could be the trigger which detonates a global financial crash, turning lights out all over the world and sending mankind down a path to a New Dark Age.