

Has Power Deregulation Shorted Out?

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MSNBC

Jan. 17 — Deregulation was supposed to do for electricity in the 1990s what it did for airline tickets and long-distance phone calls in the 1980s. But after five years and many false starts, power deregulation remains mired in a state-level effort to spur competition among producers while protecting consumers with adequate supplies at reasonable prices. Now, the collapse of power-trading giant Enron Corp. has regulators and the industry rethinking the goal of full-fledged, national competition among electricity producers.

IN THE BYGONE days of a fully regulated power industry, electric utilities were typically guaranteed a rate of return by each state they operated in. Consumers bore the cost of building and operating plants and transmission lines, plus a fixed profit — no matter how inefficiently the utility operated. While customers had no choice but to pay the rate set by the state, there were few surprises in their monthly bills.

But after a wave of deregulation brought competition to truckers, airlines and telephone companies, federal regulators in the 1990s turned to the power industry. On April 24, 1996, the Federal Energy Regulatory Commission ordered the power industry to open up its transmission lines to wholesale competition among power providers. The idea was to let customers buy their electricity from the most efficient provider. In theory, that would encourage efficiency among power producers, giving customers a shot at better prices. But nearly six years later, that hasn't happened.

“It certainly hasn't worked the way consumers were promised,” said Jannee Briesemeister, a senior policy analyst with Consumers Union. “I don't think you can point to any place where that has happened.”

Instead, the nation's electricity markets remain stalled halfway between full regulation and true competition. Only half of the states have decided to go ahead and change regulations to let customers choose where to buy power. Some of those efforts short-circuited — most spectacularly in California. As a result, some states that decided to take the plunge are having second thoughts: Of the 24 states that began down the road toward deregulating their power markets, seven have delayed or suspended those plans.

THE ENRON THUD

Now, with the collapse of Enron — one of the most powerful and effective advocates of energy deregulation — efforts to open the nation's electric markets to competition have taken another big hit.

The result is that many power producers and customers are now stuck with the worst of both worlds: Consumers aren't sure how much they'll have to pay for electricity, and producers in some parts of the country are leery of investing in new plants or

transmission lines for fear they won't get their money back, according to Ken Malloy, a former Federal Energy Regulatory Commission official who now heads the Center for the Advancement of Energy Markets.

"They don't know how to operate being stuck in the middle when nobody knows what the rules of the game are," he said. "When you can't have certainty, you get to be cautious about investing. That's not a good climate for an aging infrastructure that needs investment at a time when demand is growing."

After two summers of rolling blackouts and outages, the outlook for this summer's peak season for electricity demand remains unclear — much depends on the weather and the strength of the economy. Power shortages that spurred construction of new plants have created surpluses in many markets: More power plants will be added to the national grid in 2001 and 2002 than were added in all of the 1990s combined, according to Platts, an energy information unit of McGraw-Hill. But uncertainty in the financial markets following Enron's collapse, combined with falling electricity prices, has contributed to the cancellation of some 85,000 megawatts of new power in 2001 — more than triple the number of cancellations in 2000, according to Platts.

At the state level, early deregulation successes have turned to setbacks. At the time California's power market was melting down, for example, Pennsylvania was held up as the example of how to do things right. Initially, deregulation in the Keystone State got off to a great start: some 15 percent of the state's power customers threw the switch and abandoned their local utility to buy power from a flock of independent marketers who set up shop in the state. Prices for regulated customers were set high enough to give them an incentive to buy their power from the independents, who could still undercut the regulated price and make a profit. But when wholesale prices last year rose above that regulated rate, customers switched back in droves to their regulated utility.

"A lot of the marketers just disappeared," said Sonny Popowsky, the state's consumer advocate. "At one time there were 20 electricity marketers in Philadelphia serving residential customers. (When rates fell), most of them left and few of them have come back."

Wholesale rates have since fallen again below state's retail price caps. But as long as regulated retail prices are fixed, independent marketers are fearful that another price spike could wipe out their shot at beating the state's fixed retail price and still making a profit.

CALIFORNIA, AND OTHER HEADACHES

In California, which pulled the plug on deregulation in September, officials are still trying to clean up a multi-billion dollar mess left behind by the state's deeply flawed effort to open up its power market. That plan, which forced utilities to buy all their power at spot-market prices while capping retail rates, sent wholesale prices soaring and landed the state's largest utility, Pacific Gas & Electric, in bankruptcy court. Then, after the state's water commission stepped in to buy long-term power contracts, market prices fell,

leaving the state committed to buying billions of dollars worth of power at above-market rates.

Now, the state is trying to renegotiate those power contracts, pass some of the \$10 billion of the cost to energy customers, and float a \$12.5 billion bond offer — the largest municipal bond issue ever — to cover unpaid power bills. But the finger-pointing continues. Last week, the state's attorney general sued PG&E, claiming it diverted billions of dollars in cash away from the utility to the parent holding company. PG&E called the suit “unwarranted, discriminatory and potentially harmful to the California economy.”

Even in states that have decided not to open their markets, some customers are feeling the downside of deregulation. In Iowa, which has not moved to deregulate, wholesale power costs are “substantially higher” since deregulation began to take hold around the country, according to Mel Nicholas, CEO of Eastern Iowa Light & Power Cooperative, which serves 22,000 mostly residential customers.

“It has nothing to do with cost of production,” he said. “A few years ago, before the transmission system was opened up, utilities took the production cost of excess capacity, marked it up 15 percent, and we'd share that capacity.”

Now, with the market determining the price of that excess capacity, Eastern Iowa Light & Power's costs for wholesale power have doubled, said Nicholas. As a result, the utility recently raised retail rates by 5.5 percent for the first time in 10 years.

“I really don't see how the residential customers are going to benefit from deregulation,” he said.

The most closely-watched market at the moment is Texas. For one thing, the state just threw the switch to begin deregulation at the beginning of the year. For another, it's the home state of both President Bush and Pat Woods, the former head of the state's Public Utility Commission who was recently appointed as FERC's chairman.

Texas officials are hoping to avoid several of California's biggest mistakes. For one thing, power providers are allowed to go back to the state twice a year to ask for higher retail rates to cover spikes in fuel costs. Texas is also letting power providers sign long-term wholesale contracts to help dampen the kind of spot price swings that sank California's deregulation plan.

But Texas also enjoys a level of self-sufficiency not seen in other electric markets. It has a large base of generating capacity within its borders, with more power plants under construction, and plentiful supplies of natural gas — the preferred fuel for new power plants.

Texas also has a transmission grid that remains largely unconnected to the rest of the country, so it imports little power from other states. California's heavy reliance on

power from outside the state, including hydroelectric power that dried up just when the state needed it most, was a major cause of the state's power meltdown.

ELECTRICITY'S INTERSTATE HURDLE

Moving power from one state to another has turned out to be one of deregulation's biggest stumbling blocks. Nationwide, it's not easy to move electricity to where it's needed most. Regulators, consumers groups and industry officials agree that market competition can't begin to work well until power can flow smoothly from one part of the country to another. Today, cross-border sales are hampered by numerous transmission bottlenecks in a system that was never designed to move bulk power coast to coast. As a result, transmission and distribution costs can eat up as much as 70 cents of every dollar paid for power. That means cheap, plentiful power is often unable to flow to areas of the country where surges in demand create price spikes, according to Malloy.

"Imagine driving from Florida to Boston, and every time the highway crossed a state line, you had to negotiate a separate price for using the highway," he said. "There are different rules and regulations, a different company owns it, and you have to have separate contracts. What you need is a single entity that can give you the right to send electricity from Florida to Boston in a single transaction."

The FERC began moving in that direction last year, when it announced that it would designate a handful of Regional Transmission Organizations — or RTOs — to replace the patchwork grid of regional and local transmission lines. Since then, the commission has designated one RTO for the Midwest, while negotiations continue over who will operate the regional grids elsewhere in the country.

But even if those negotiations are successful, skeptics say electricity markets may never reach the level of competition once envisioned for the industry. For one thing, the profit motive for power producers keeps running into lawmakers' desire to protect consumers from higher electric bills. Power producers have little financial incentive to build enough reserve capacity to prevent outages during limited peak periods of demand. And in the end, electricity just may be too vital a commodity to relinquish completely to the marketplace.

"In Texas, we see people die every summer out of fear of high electric bills," said Briesemeister. "There's too many public health and safety aspects to electricity to leave it to the public markets."