



It's Greed Stupid! Debunking the Ten Myths of Utility Deregulation

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Introduction

If the purpose of deregulation is really to improve the quality of people's lives by lowering the cost of a critical commodity, it is obviously failing miserably—as demonstrated in California. To understand what has happened, we must begin with the past.

Prior to “deregulation,” electricity was supplied by regional monopolies that owned both the power plants and the transmission lines for the distribution of power. The California legislature set the rate of return of profit for the utilities, and the state Public Utilities Commission planned for future power needs and helped insure that rate increases were fair and based on the “cost of service.” While this system was often abused because of the enormous political power of the electric utilities and their ability to influence policymakers, it did keep in check the profiteering that we are now witnessing in California.

By the mid-1990s, large industrial consumers sought to escape the high costs of power in some parts of the country, like California, that came as a result of building expensive nuclear power plants. At the same time, independent power producers like Enron were actively lobbying to be able to sell power to these big consumers. Political pressure for deregulation mounted because the breakup of the \$300 billion dollar utility industry meant huge amounts of money could be made. Enron, an important campaign contributor to the Republican Party and to President Bush, lobbied for deregulation not only in California, but at state legislatures across the nation and in Congress.

Despite warnings from consumer groups, deregulation has been heartily embraced by both political parties, and under the Clinton administration, the U.S. Department of Energy wrote its own federal deregulation bill that it promoted unsuccessfully.

In California, the utilities, at first, were skeptical of deregulation, because of the high cost of power from their nuclear plants. However, they began to hunger for the profits that could be made in a speculative market. They lobbied heavily for deregulation because they knew that with their enormous political clout in the state legislature, they could shape the outcome of deregulation.

The legislation, written primarily by California's utilities, was extremely complex, a vast program for a vast state. It was wrangled over in a series of rapid-fire hearings, and rammed through the legislature at the last minute in a process that took only three weeks. It was unanimously passed and signed into law by Governor Pete Wilson in the fall of 1996.

The legislation, written and supported by utilities, privatized their profit and socialized their risks. The most glaring example of this was the \$28 billion dollar consumer-funded bailout

for their so-called “stranded costs.”¹ Stranded costs are essentially mortgage payments that the utilities make to cover their purchase of expensive boondoggle nuclear power plants. The utilities argued that the bailout was necessary because they would now be assuming marketplace risk, and the uncertainty of their future profits made the paying off of debts they incurred under regulation too burdensome. To accomplish this bailout, rates were artificially frozen for 4 years, at what was then 50% above the national average cost of electricity.² To date, ratepayers have bailed out the utilities for approximately \$20 billion dollars through added costs to their electric bills.³

In 1998, a coalition of consumer groups, Californians Against Utility Taxes, sponsored an initiative, Proposition 9, which would have invalidated portions of the 1996 deregulation bill, and prevented the utility bailout. The proposition would have required the utilities and their shareholders, not ratepayers, to bear the burden of the \$28 billion bailout.⁴ According to energy analysts at the California Energy Commission, if Proposition 9 had passed, residential power customers would have seen their energy costs “fall between 18 to 32 percent.”⁵ California’s utilities spent more than \$30 million defeating Proposition 9, compared to the \$1 million spent by consumer advocates.⁶

The legislation not only provided them with a bailout, but it enabled them to go on an international spending spree in which they purchased power plants. It also provided them with capital they used to invest in other industries that they had been prohibited from entering under the regulated monopoly system. California’s utilities have invested in telecommunications and other types of high-growth services that they plan to sell in conjunction with their sale of electricity. Between the bailout and their forays into new industries, Wall Street applauded their moves because of their increased earnings potential.

Also, the legislation provided incentives for California’s utilities to sell their power plants to unregulated companies.⁷ They sold most of their fossil fuel plants at above the book value, providing them with a significant profit. However, they retained their nuclear and hydro-power generation, along with a small amount of fossil-fuel plants.

¹ This figure was widely reported in the press after the California deregulation bill’s passage, for instance, in Financial Times, July 20, 1998. Public Citizen verified the amount for the bailout for the October 1998 report, *California Dreaming: The Bailout of California’s Nuclear Industry*. To do so, we used information provided by the NRC monthly Operating Reports: December 1997 and data from the California Public Utilities Commission (CPUC), including CPUC Decisions N. 97-05-088, N. 96-01-011, 96-04-059, and 96-12-083. The CPUC’s Office of Ratepayer Advocate also provided assistance.

² Herbert Chao Gunther and Joe Therrien, “An Overview of AB 1890, The California Utility Deregulation Bill,” Public Media Center, Summer 1998.

³ Conversation with Nettie Hoge, director of The Utility Reform Network (TURN) in California on January 29, 2000.

⁴ *The San Francisco Examiner*, Tuesday, July 21, 1998, “War of Words Escalates Over Prop. 9.”

⁵ Ben Arikawa, Ruben Tavares, “Preliminary Analysis of the Utility Rate Reduction and Reform Act,” California Energy Commission, Electricity Analysis Office, July 24, 1998.

⁶ Wall Street Journal, “California Backs Into the Future,” Editorial, November 3, 1998.

⁷ “California’s Electricity Options and Challenges Report to Governor Gray Davis,” August 2, 2001.

<http://www.cpuc.ca.gov>

Additionally, the deregulation bill transferred pricing of California's electricity generation to the Federal Energy Regulatory Commission by creating the Power Exchange, a private nonprofit organization that would operate the auction for wholesale power.

Most of the corporations that bought the California utilities' power plants are from out-of-state--such as Virginia-based AES, North Carolina-based Duke, and Houston-based Dynegy and Reliant. Eleven companies, not all of which own power plants in California, sell electricity into the Power Exchange, where electricity is bought and sold several times (in paper transactions) before it is actually delivered to consumers. Another new privately run entity, the Independent System Operator (CAISO), acts as a traffic cop, directing electricity to where it was needed.

Myth #1: Deregulation does not work because California did not deregulate enough.

Advocates for deregulation say that if the rate freeze was removed and consumers paid for the real cost of electricity through a free market, there would not be a problem. But they fail to mention that over the past few months, the cost of wholesale electricity has at times been almost 4,000 percent higher than before deregulation because of the speculative nature of the electricity market.⁸ **If all the costs were passed on to consumers, the average residential monthly consumer, who paid approximately \$55 a month before deregulation, would have been paid approximately \$600 a month when prices spiked in California this winter.**⁹

Second, the utilities agreed to assume a risk under deregulation, in return for the bailout and rate freeze. However, now that their plans have soured, they want to renege on the deal that they lobbied for in 1996. The retail rate "freeze" was designed by and for the state's electric utilities, as a way to subsidize them for their bad business decisions of the past, such as nuclear power plants.

Until the spring of 2000, the utilities greatly benefited from the artificially high rates that were "frozen" in 1996 at 50% above the national average for electricity. These outrageously high rates included: 1) reimbursement for their cost-of-service (all of the expenses associated with producing power); 2) approximately an 11.75% profit margin; and 3) the \$20 billion dollar bailout for utilities' bad investments of the past. The outrageous utility bailout is listed as a "Competitive Transition Charge" (CTC) on every Californians' electric bill.¹⁰

⁸ The peak cost for electricity in December 2000 was \$1500 per megawatt as compared to \$30 per megawatt hour as they were in April 1998, the first month the Power Exchange was in operation. California Energy Commission website: <http://www.energy.ca.gov/electricity/wepr/2000-12/index.html> January 29,2001.

⁹ This calculation is based on a price for electricity of \$1100 per megawatt, as compared to \$30 per megawatt, which electricity cost before deregulation.

¹⁰ Conversation with Nettie Hoge, director of The Utility Reform Network (TURN) in California on January 29, 2000. and the website: www.turn.org.

The Utility Reform Network (TURN), a consumer advocacy organization in California, explains the bailout and rate freeze:

This opportunity [the rate freeze], however, included the explicit risk that some costs might not be collected by the end of the rate freeze. With the advent of higher-than-expected power prices in recent months, these utilities now argue that they never took a risk for the costs of power under the rate freeze and therefore should be compensated for money spent to buy power for its customers.¹¹

To make matters even worse, the utilities overestimate the cost of electricity that they claim to have “under collected” from consumers in their frozen rates. As a result of the price spikes that began in 2000, the utilities are asserting that consumers have to pick up the exorbitant cost of wholesale electricity. The utilities claim to be “owed,” approximately \$12 billion dollars.¹²

In fact, this number is wildly exaggerated, because the utilities did not sell all of their power generation (they retained nuclear plants, hydra-electric facilities, and a small amount of fossil generation). Under deregulation, the electricity from all utility owned or contracted generation is resold into the Power Exchange. During periods of high energy prices, the net revenues associated with this generation can be substantial. But, instead of offsetting the costs of purchasing power for customers, under the current rules, these utility owned units provide no direct benefit to rate payers in the form of lower energy procurement prices.¹³

For example, if it costs PG&E approximately 1.4 cents per kilowatt hour to generate hydro-electricity and they sell this power at the Power Exchange for approximately .40 cents per kilowatt hour, they make an huge profit. This profit should be subtracted from the amount that the utilities estimate they have been overcharged for wholesale power. But, the utilities have not subtracted in their estimates of how they have been overcharged, their own substantial profits in wholesale market, which is roughly estimated at \$6 billion dollars. This means that the \$12 billion dollar figure that they claim to have over-paid in the wholesale market is wildly inflated by at least \$6 billion.¹⁴

Because of the profiteering on electricity trading at the Power Exchange, the city of San Francisco initiated a lawsuit on January 18, 2001, against a number of companies for unfair business practices. The companies being sued include Dynegy Power Marketing; Enron Power Marketing, Inc.; PG&E Energy Trading Holding Corporation; Reliant Energy Services; Sempra Energy Trading Corporation (owner of San Diego Gas and Electric), Southern Company Energy Marketing, Duke Energy Trading and Marketing, NRG Energy, Inc. and Morgan Stanley Capital

¹¹ “Cooking the Books: How PG&E and SCE Hide Assets, Artificially Inflate Their Power Purchase Costs, and Want Consumers to Pay for It,” TURN, October 18, 2000, pg. 1. 415-929-8876.

¹² *Financial Post*: News, “California Ups Power Rates to Aid Utilities: 10% Not Enough,” pg. 3, January 5, 2001.

¹³ “Cooking the Books,” pgs. 11-12.

¹⁴ *ibid.*

Group, Inc.¹⁵

The California Public Utilities Commission comments that the pricing patterns in the Power Exchange's "day ahead" and "day of" markets raise questions about the bidding behavior of market participants that cannot be coincidental.¹⁶

California is suffering today because of no regulation – not because of over-regulation.

Myth #2: Deregulation will lower costs for consumers.

Deregulation has been sold to the public as a way to lower prices. Unfortunately, the inverse is often true, with deregulation resulting in higher prices over time. When deregulation legislation sailed through the California legislature with unanimous bipartisan support in 1996, proponents claimed that consumers would see *at least* a 20 percent reduction in their electric rates eventually.¹⁷ Now, as wholesale prices have skyrocketed since last year, proponents argue that consumer rates will have to *increase* to encourage more competition. Long-term contracts are being promoted as the anecdote for the crisis. But, the price being quoted for electricity under these contracts is at least three times more expensive than under regulation. What happened to lower rates under deregulation?

The answer is that California's power producers have no restrictions on the prices they can charge for electricity, and regulators no longer set minimum energy reserve requirements to prevent power shortages. Advocates of deregulation said that prices and reserves would be set at optimum levels by the free market. But the opposite has been true. Power marketers restrict supplies by reducing the amount of electricity that is produced, creating shortages and price spikes (see Myth 4). Predictably, gaming the system has meant skyrocketing profits for power marketers in California.

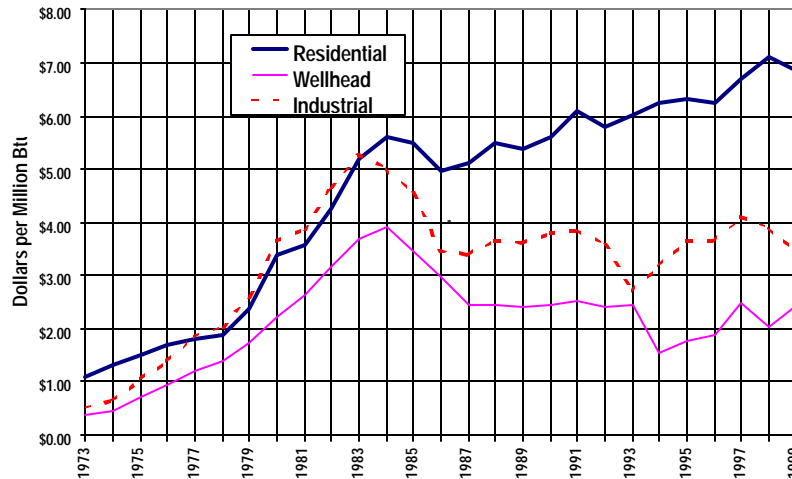
An analysis of the effects on consumer prices in another deregulated energy industry—natural gas—is a good indication of what will happen to consumer's electric bills if they are left to the vagaries of a deregulated market. Since the natural gas industry was deregulated a decade

¹⁵ *People of the State of California, by and through San Francisco City Attorney Louise H. Renne vs. Dynergy Power Marketing, et al. Superior Court of the State of California, Complaint For Unfair, Unlawful, and Deceptive Trade Practices in Violation of Business and Professions Code 1720, et seq. Filed January 18, 2001. (no case number available. City Attorney 415-554-3800.*

¹⁶ "California's Electricity Options and Challenges Report to Governor Gray Davis," August 2, 2001, pg. 19. <http://www.cpuc.ca.gov>

¹⁷ *The New York Times*, AP Byline, "Utilities Plan In California," Business Section, September 2, 1996.

Natural Gas, CALIFORNIA Energy Prices



ago, wellhead, or wholesale, costs have actually fallen. But the price at which natural gas is sold to residential consumers has skyrocketed. In 1984, just prior to complete deregulation, residential prices for natural gas were 44 percent above the wellhead price. By 1987, it was 110 percent above. By 1999, it was 181 percent above. At the same time, prices to larger, industrial consumers rose, but not as much as for residential consumers. In 1984, industrial prices were 28 percent above the wholesale price of electricity. In 1987, they were 39 percent of the wellhead price. By 1999, it was 42 percent of the wholesale price. This price discrimination indicates a noncompetitive market.

Even with high natural gas prices—which according to economic theory causes sellers to increase supplies—reserves are low and there are indications that some type of market manipulation may be occurring. It seems that we have our own natural gas cartel operating in the U.S., which behaves like OPEC. With government regulators no longer protecting consumers and defining the rules of the road, control has been ceded to a handful of energy companies that in many cases are also the business of selling electricity in places like California.

At the very least, if the market is not being manipulated, years of experience show that the natural gas market is failing for consumers. After 15 years of higher prices, it is time to reexamine natural gas deregulation.

Meanwhile, we have a very different example set by publicly owned electric power systems. While energy companies defend their high prices, California’s 30 communities with municipally owned and controlled power offer the same electricity at lower prices. The City of Los Angeles’ Department of Water and Power charges 20 to 25 percent less than comparable privately run utilities elsewhere in the state.¹⁸

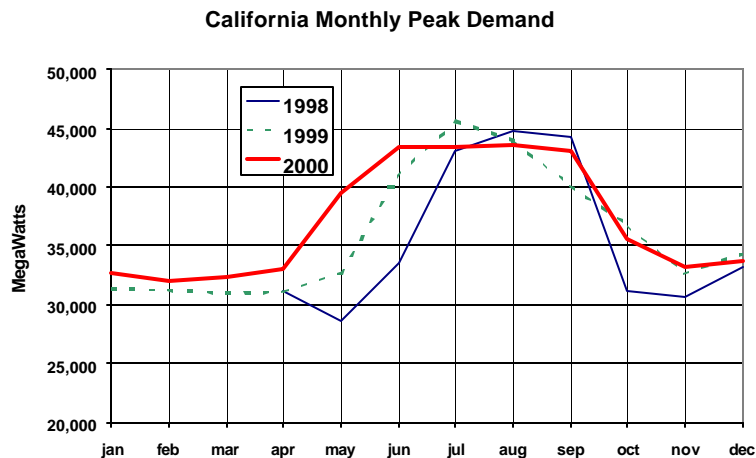
Myth #3: Prices for electricity are being driven up because the demand for electricity is increasing.

¹⁸ New York Times, December 22, 2000.

Planning for new power plants is based on the need for electricity at the time of year that maximum usage of power occurs—the time of peak demand. Indeed, California’s Independent System Operator (CAISO), the traffic cop for the transmission of electricity under the deregulated market, has records showing that the state’s peak demand for electricity in 2000 occurred on July 12 and was approximately 45,600 megawatts. (For comparison, a large nuclear power plant is approximately 2000 megawatts.) California uses the most electricity in the summer, when air conditioners run.

CAISO uses this information about demand to find out how much energy must be produced by various plants to meet California’s energy needs. The agency records the highest amounts of demand by hour within the state of California. The data shows that while demand did soar in May, in four out of the past six months--July, August, October and December--California saw a lower peak demand in 2000 than during the same months in 1999.¹⁹

Overall, according to the California Energy Commission and confirmed by California



Public Utilities Commission President, Loretta Lynch, the average amount of electricity used throughout the day, grows at about 2% a year.²⁰ This does not mean that peak demand is growing; it does mean that consumers use more power at midnight because they are using their computers.

In fact, recently, there have been blackouts when demand was less than 30,000 megawatts, approximately 15,600 megawatts less demand than the peak amount of electricity needed in California in the summer. Obviously, it is supplies of electricity being held back, not demand that is causing the problems with deregulation

¹⁹ California Independent System Operator website: www.caiso.org

²⁰ California Energy Commission website: http://38.144.192.166/electricity/commission_demand_forecast.html
January 29, 2001.

Myth #4: The problems are being caused because there is not enough power to supply California.

So, why are suppliers short? **Because under deregulation, power producers have no incentive to run plants at full capacity.** As noted above, California has 55,500 megawatts of power generating capacity and 4,500 megawatts of power on contract. Following is a breakdown of plant ownership:

- unregulated power suppliers: 21,231 megawatts (40%)
- public agencies: 11,934 megawatts (23%)
- qualifying facilities, large industrial consumers and others:²¹ 11,745 megawatts (22%)
- utilities: 8,245 megawatts (15%)

Of this power, the Independent System Operator has access to approximately 45,000 megawatts to provide electricity for the state.²² But large numbers of power plants are not running at full capacity or are down for unscheduled maintenance, keeping supplies short.

The tighter the supply, the more prices rise. As much as 13,000 MW of capacity was off-line in January for undisclosed reasons.²³ According to *The Wall Street Journal*, on August 2000, 461% percent more capacity was off-line than a year earlier.²⁴

Because details about why these plants are off-line is confidential, the public is literally left in the dark. According to CAISO, many suppliers are not even complying with the requirement to turn in an annual plan for when they will have plants off-line for maintenance, and there are no penalties for this lack of cooperation. Regardless of whether one suspects that power producers are intentionally taking capacity off-line to hike prices, these statistics illustrate that under deregulation, the public has little control over pricing and reliability.

The fact is that today, the state of California has access to more capacity than the 45,000 MW of summertime peak demand—the maximum amount used during the highest usage time of year.

California has 55,000 megawatts of in-state electricity generating capacity through about 1,000 power plants. In addition, the state is able to import about 4,500 megawatts of electricity,

²¹ Under federal law, which predates deregulation, qualifying facilities (QF) were allowed to sell their electric output to the local utility at avoided cost of building new power capacity. To become a QF, the independent power supplier had to produce electricity with a specified fuel type (cogeneration or renewables), and meet certain ownership, size, and efficiency criteria established by the Federal Energy Regulatory Commission. This category also covers self-generation by large industrial customers (or contracts they may directly enter into.) From the California Energy Commission website: http://38.144.192.166/restructuring/restructure_glossary.html. January 30, 2001

²² California Independent System Operator website: www.caiso.com/aboutus/infokit/FAQ.html January 26, 2001.

²³ Interview with Rich Glick, assistant to former Secretary of Energy, Bill Richardson, on National Public Radio's syndicated program, "The Diane Rehm Show," on January 23, 2000.

²⁴ *The Wall Street Journal*, "Overload: For Power Suppliers, the California Market Loses Its Golden Glow," January 25, 2001, pg. 12.

which is under existing long term contracts.²⁵ These thousands of megawatts of capacity could easily meet demand if wholesaler suppliers were not manipulating the system. The situation would be even better if energy efficiency strategies were maximized. New plants are not needed; instead, stricter scrutiny of existing plant operations is needed. Even so, many new plants are already under construction, which will even further increase the amount of electricity that is available.

Myth # 5: California’s environmental laws are preventing new power plants from being built in the state.

It is untrue that California’s environmental laws have prevented new plants from being built and are responsible for the current crisis. As noted earlier, there is enough existing capacity tied into the state’s grid to meet even summertime peak demand. And while the state’s sensible environmental laws get the blame for the lack of new construction, it is important to note that California’s utilities did not want to make investments in new power plants. The state’s utilities blocked decisions by the CPUC to build new capacity because under deregulation, the utilities realized they would have assumed the economic risk for bad decisions—rather than consumers—who paid for past mistakes as part of rates.²⁶

Southern California Edison (SCE) even went so far as stopping the development of 1,500 MW of new renewable energy and cogeneration (the heat from industrial processes is used to generate electricity) projects. This more environmentally friendly electricity would have been available to help meet the current crisis, and would have cost of under 5.5 cents per kilowatt-hour. But, SCE’s Chief Executive Officer, John Bryson, in the mid-1990s petitioned the Federal Energy Regulatory Commission (FERC) to stop the construction of these projects.²⁷

Before deregulation, California had a planning process for building the infrastructure for the energy sources to meet demand. In 1993, this Biennial Resource Planning Update (BRPU) process set a price that was below 5.5 cents per kilowatt (a much lower price than the cost of power from long-term contracts today), and a bidding process was initiated. The cost of environmental damage was taken into consideration in the bidding process. The Public Utilities Commission accepted bids and planned to build 1,500 MW of new wind, geothermal and cogeneration plants. Bryson then started a petitioning process at FERC, which resulted in none of the generation being built because he did not want to risk investments in new capacity. FERC voted to not allow the California Utilities Commission to require the new projects. Today,

²⁵ “California’s Electricity Options and Challenges Report to Governor Gray Davis,” pg. 6. August 2, 2001. <http://www.cpuc.ca.gov>

²⁶ Ibid, pg. 23.

²⁷ Conversation on January 26, 2001, with former Sacramento Municipal Utility District (SMUD) director, Ed Smeloff, who was with SMUD for more than 10 years. He is now Director of the PACE Energy Project, (914) 422-4221 website:www.law.pace.edu/env/energy

California is suffering from the FERC's bad decision and Bryson's efforts to stop new renewable energy capacity from being build.²⁸

Even so some power plants were built, according to the agency that permits new power plants:

In the 1990s before the state's electricity generation industry was restructured, the California Energy Commission certified 12 new power plants. Of these, three were never built. Nine plants are now in operation producing 952 megawatts of generation...Since April 1999, the Energy Commission has approved nine major power plant projects with a combined generation capacity of 6,278 megawatts. Six power plants, with a generation capacity of 4,308 megawatts are now under construction, with 2,368 megawatts expected to be on-line by the end of the year 2001.

In addition, another 14 electricity generating projects, totaling 6,734 megawatts of generation and an estimated capital investment of more than \$4.3 billion, are currently being considered for licensing by the Commission.²⁹

Although new power plants are under construction and in the planning process, the best way to address California's energy needs is through energy efficiency measures and renewable energy projects. Building more centralized plants may be a way to obtaining higher profits for power producers, but it is a poor investment in light of the new technologies that are rapidly becoming available. For instance, the expanded use of distributed generation, where small amounts of generation (roof top solar power is an example) is located on a utility's distribution system for to help meet energy demand.

Energy efficiency is always the cheapest and best method of lowering the demand for electricity. It cuts energy use, saves consumers money, offers predictable financial requirements, and benefits the environment by reducing energy use. Examples include: the use of compact florescent bulbs--which last ten times longer than conventional ones and use one quarter of the energy; double-paned windows; and more efficient appliances and industrial production lines.

According to the Center for Renewable Energy and Sustainable Technology, higher energy efficiency standards for central air conditioners (over the course of its lifetime) would save as much electricity as more than 1.2 million Californians would use. And more efficient clothes washers would save the electricity consumed by more than 700,000 Californians.³⁰

Renewable energy projects should be built to replace old, dirty generation. Renewable energy projects can now be built at the same cost as conventional facilities. Today wind turbines

²⁸ *ibid.* Also, more information about the BRUP process can be found on the California Energy Commission's website.

²⁹ California Energy Commission website: <http://www.energy.ca.gov/sitingcases/background.html> January 25, 2001.

³⁰ Center for Renewable Energy and Sustainable Technology website: <http://solstice.crest.org/efficiency/index.shtml> January 26, 2000.

show great promise, tomorrow, fuel cells are likely to change the face of energy production. Renewable energy offers dependable, even fixed-cost power that is particularly important in a state that is facing blackouts and price roller coasters. Renewable energy offers dependable, even fixed-cost power that is particularly important in a state that is facing blackouts and price roller coasters.

Myth #6: Deregulation is good for the environment.

While deregulation creates short-term incentives to gouge consumers by artificially ensuring low supplies of electricity, in the long run deregulation creates economic incentives for power suppliers to sell more electricity. As prices rise, suppliers push to build new plants in an attempt to maximize profit. At the same time, deregulation provides an incentive to keep cheap, dirty coal power plants running longer. The market forces driving deregulation will not shut down old plants and replace them with cleaner ones. Instead, the old plants will run, and new plants will be built as well, because deregulation encourages more energy use.

This situation means that nationally the likely environmental effects of deregulation will be sharply increasing emissions, particularly if existing coal-fueled power plants remain exempt from air pollution standards.

In addition, because a speculative electricity market is inherently volatile, and because some suppliers have an alarming amount of market power, a larger reserve margin of power is necessary. The independent power producers are using the uncertainty of the market to push for relaxing environmental regulations, to drill for natural gas in sensitive areas and to build more power plants and more transmission lines.

If utility deregulation continues on its current course, not only will air pollution increase and ecologically sensitive areas be degraded, but our global climate will be further threatened by more greenhouse gases.

Myth #7: California's energy crisis is best resolved through state, not federal, actions (as stated by President Bush).

Unfortunately, the Clinton Administration promoted electricity deregulation relentlessly, and now the new Republican Administration is supporting the same reckless deregulation scheme that we are seeing unfold in California today.

The Bush administration argues that blame for the current crisis lies with the state: allow the utilities to pass their costs on to consumers and ease the state's environmental standards to quickly build new power plants to increase supply.

The cause of California's deregulation crisis is the result of the removal of any government oversight on producing and selling electricity. With government regulators no longer present to protect the public interest, power producers and marketers are charging outrageous

prices for electricity, and the utilities then attempting to pass on the cost to consumers (see Myth 3).

While the Bush administration seems content to blame the state for the problems with deregulation and to claim that raising rates and building new power plants would solve everything, the federal government is sitting on the one action that will directly address today's high prices. Under the authority of the Federal Energy Regulatory Commission (FERC), which is now chaired by Bush-appointee Curt L. Hebert, Jr., the federal government is the sole entity that can impose cost-based rates on these power producers. If the administration was willing to order power plant owners to sell their product at the cost-of-service (the cost of generating power) and a reasonable profit, California's utilities could buy the electricity needed and the pressure to raise consumer's electric rates would be removed. Meanwhile, the state could investigate the price-gouging and act thoughtfully in solving the problems caused by deregulation.

But, Enron, Reliant, and the other power producers and power marketers operating in California heavily financed the Bush administration. Bush and his new energy secretary, Spencer Abraham, who lost his recent run for the Senate and who once advocated the abolition of DOE, received more than \$2.5 million from energy interests during the campaign and for the inauguration events. The new power suppliers for California are making so much money from their profiteering that they will maintain pressure on the Bush Administration to keep the current system in place.

To date, the only federal action Bush has called for is to drill in the unique and pristine coastal area of Alaska's National Arctic Wildlife Refuge to tap into a supply of oil that would amount to only a sixth month supply of oil and would take 10 years to bring to market. Furthermore, oil is rarely used for electric power generation today.

Myth #8: California's three big utilities were forced, against their will, to sell their power plants.

As described in the introduction, California's three big utilities lobbied intensely to pass the 1996 deregulation bill, which provided incentives for them to sell their power plants. Some nuclear and hydropower facilities were retained by the utilities. The California utilities believed that they would thrive from electric utility deregulation and become international energy companies.

The sale of the power plants, along with the infusion of consumer-funded subsidies, gave the two utilities accelerated depreciation, enabling them to build up cash on their parent companies' balance sheets to finance the stock buyback plans and pour investments into Mission Energy, the National Energy Group and other unregulated divisions. According to a report released by TURN in October 2000, the generation owned or contracted by Pacific Gas and Electric (PG&E) and Southern California Edison (SCE) produced large profits between May and August of 2000, amounting to \$2.7 billion. Because the power is credited to stranded costs, the

average monthly collection of stranded costs was accelerated by 79% for PG&E and 56% for SCE. Accelerated depreciation has provided large amounts of cash for the utilities.³¹

However, now that they have been beat at their own game by bigger and meaner companies like Enron, and they are crawling back to the legislature and begging for another consumer bailout.

Myth #9: California's utilities are close to bankruptcy and need to be bailed out.

California's two major utilities, Southern California Edison (SCE) and Pacific Gas & Electric, claim to have racked up such significant losses under deregulation that they are threatening to file for bankruptcy. In 1996, when the promise of huge profits loomed large they agreed to assume some risk, now that the market has failed they are demanding that the state provide direct assistance. or else they will no longer be able to afford to supply their customers with electricity.

But their parent companies, using the money they made from selling their power plants and from the bailout have spent more than \$22 billion on power plants, stock buybacks and other purchases that far exceed their alleged \$12 billion debt from California operations. Edison International and PG&E have done this both through those two companies and through affiliated companies, Mission Energy (a subsidiary of Edison International) and National Energy Group (a PG&E subsidiary).³²

Created in 1990, Mission Energy's revenues and profits didn't take off until 1999, when expensive investments began to pay off. A recent Public Citizen analysis showed that Mission Energy, along with a few other smaller Edison International subsidiaries, spent more than \$10 billion on non-California investments since December 1998--more than double the SCE's stated debt of \$5 billion. In addition, Edison International has spent \$2.35 billion on stock buyback programs since deregulation began.³³

³¹ "Cooking the Books," pg 1.

³² Company financial disclosures at the Securities and Exchange Commission, and company websites.

³³ Ibid.

Edison International Shopping Spree: December 1998 to Present

Subsidiary Making Purchase	What did they Buy?	Cost, in BILLIONS	Date of Purchase?
Citizens Power	P&L Coal Holdings in Boston, MA	\$0.05	Sep-00
Edison Capital	Swisscom, a telecommunications network	\$0.3	Sep-00
Mission Energy	Italian Vento Power Corp.	\$0.04	Mar-00
Mission Energy	Commonwealth Edison's 12 plants in IL	\$5.0	Dec-99
Mission Energy	Ferrybridge & Fiddler's Ferry power plants in England	\$2.0	Jul-99
Mission Energy	40% stake in New Zealand's Contact Energy	\$0.7	May-99
Mission Energy	Homer City power plant in PA	\$1.8	Mar-99
EME del Caribe	EcoElectrica co-gen facility in Puerto Rico	\$0.2	Dec-98

TOTAL, in BILLIONS **\$10.08**

SOURCE: Edison International SEC filings.

PG&E Corp. Purchases or Commitments, 1999 to Present

Subsidiary Making Purchase	What did they Buy/build?	Cost, in BILLIONS	Date of Purchase?
Nat'l Energy Group	810 MW Southhaven power plant in Mississippi	undisclosed	Nov-00
Nat'l Energy Group	Purchase of 44 turbines & 15 other projects from Societe General	\$7.8	Oct-00
PG&E Generating	Power plant in Okeechobee County, FL, to be completed 2003	\$0.2	Sep-00
Nat'l Energy Group	Constructed Madison Windpower in New York	\$0.02	Sep-00
Nat'l Energy Group	Attala 500 MW power plant in Mississippi	undisclosed	Sep-00
Energy Trading	Tolling rights to peaking plant in suburban Indianapolis	undisclosed	Sep-00
Nat'l Energy Group	Tolling rights to Liberty power plant in suburban Philadelphia	undisclosed	Jun-00
PG&E	Stake in True Quote trading software	undisclosed	Apr-00
PG&E	Aerie broadband pipeline project	undisclosed	Apr-00
PG&E Generating	Power plant in Pleasant Prairie, WI	\$0.5	1999
Nat'l Energy Group	Lake Road power plant in Killingly, CT	\$0.5	1999

TOTAL **at least \$9.0 billion**

SOURCE: PG&E SEC filings, news wire reports.

PG&E's high-growth subsidiary, National Energy Group, hasn't been as forthcoming, electing not to disclose the purchase price of many of its recent acquisitions. Information gleaned from several news reports reveals that since 1999, PG&E's purchases outside California and the Pacific Northwest have totaled at least \$9 billion. This far eclipses PG&E's alleged \$6.6 billion deficit from its California operations. PG&E spent more than \$1 billion on its own stock buyback plans since the onset of deregulation.

Myth #10: Electricity deregulation is working in other states.

Electricity deregulation has passed (or been adopted by a regulatory process) in 23 states plus the District of Columbia. However, because of the situation in California, Utah has repealed its deregulation bill and New Mexico has delayed its the implementation of its deregulation legislation. Of the states that passed bills, only a handful of them have begun changing their energy supply systems. Some places, like Washington, D.C., negotiated long-term contracts at reasonable rates, which will put off by several years the disasters of a truly deregulated market. And in almost all states,

deregulation is to be phased in over a period of years. To make the legislation politically viable, price caps, mandated rate reductions and other benefits that will be sunset were included.

Also, electric utilities across the country were given huge bailouts for their bad investments in nuclear power and other items as part of the deregulation deals in their states. These so-called "stranded-costs" were passed on to consumers. According to a report by the Safe Energy Communications Council, utilities in 11 of the states that have deregulated (California, Illinois, Massachusetts, Michigan, Montana, New Hampshire, New Jersey, New York, Pennsylvania, Ohio and Texas) are demanding or have already received more than \$112 billion to bail out their failed investments.³⁴

States such as Massachusetts, where utilities were bailed out, have had no electricity suppliers willing to serve residential suppliers. The idea that there is competition in the market has become a joke. Power suppliers that sprang up to serve customers in New England, Pennsylvania and New Jersey are now "dumping" their customers back to the old utilities. The new suppliers simply cannot compete in the region's electricity markets.

Pennsylvania, which has been touted as a deregulation success, does not really have a deregulated market. The state's utilities went through a regulatory process to determine how much their bailout should be. The cost of the bailout was included in the price of electricity that each utility can charge. Each investor-owned utility has a regulated price of electricity; depending on how large a settlement it received for its "stranded cost" recovery. This is basically a regulated price for electricity, which depending on the utility, will be in place for as many as nine years.

This regulated price of electricity is keeping prices in check in Pennsylvania. It means that suppliers must keep their prices lower than the regulated price to be competitive. For instance, PECO Energy has a winter price of 5.57 cents per kilowatt-hour. But many of the utilities in the region retained ownership of their plants, so suppliers must buy electricity from the utilities that are still regulated. This has meant that many suppliers have gone out of business.

No matter where deregulation has occurred, problems are already arising. For the past two summers, blackouts have plagued residents and businesses in other deregulated markets where prices on the wholesale market have spiked, most notably in Chicago, New York City and northern New Jersey.

New York City is an instance in which consumers were subject to the vagaries of the market and prices skyrocketed because of the volatile, speculative market for electricity. New York used a regulatory process to deregulate. Consolidated Edison, which serves New York City, **was** allowed to pass all of its costs on to consumers. So when price spikes occurred, bills skyrocketed, raising rates 43% for residential

³⁴ "The Great Ratepayer Robbery: How Electric Utilities Are Making Out Like Bandits At the Dawn of Deregulation, the Safe Energy Communication Council, Washington, DC. Fall 1998 pg. 3.

consumers and 49% for commercial users.³⁵ Obviously, passing on the cost of a speculative market for electricity will not make deregulation a success.

Additionally, deregulation is encouraging dozens of mergers and acquisitions in the electric industry. We have seen this type of consolidation in other industries, and it has meant higher prices and poorer service in most cases for consumers.

We've seen what mergers do to consumers when we look at the airline industry. The largest airlines have engaged in numerous mergers, reducing competitors at every turn. They are masters at price discrimination, forcing business travelers to pay fares several times higher than vacation travelers, who can plan for travel weeks or months in advance. They also use their ticketing computers to send price signals to each other in a game of collusion that keeps profits up. Major airlines maintain "fortress hubs" where they have a monopoly on air service, allowing them to set prices due to lack of competing airlines. Deregulation in the airline industry has also led to terrible service, which is now legendary.

Consolidation does not lead to competition, lower prices or better service. On the contrary, it allows a handful of companies to exert market power and prevent consumers from receiving good service at reasonable prices. But, unfortunately, utility analysts predict that only a handful of companies will survive deregulation, if it continues to be embraced, and that these same companies will sell any number of services. This concept, called convergence, will mean that consumers will be forced to use a single company to provide necessary services such as power, water, telecommunications and Internet access. Prices for all of these services will be "bundled" (included in a single price), which will leave little room for price comparison.

Policymakers should think seriously, and there should be a public debate, before deregulation reaches this level. The bottom line is that if deregulation doesn't help real Americans, we shouldn't continue to pursue it.

Conclusion

Electricity is an absolute necessity that should not be a speculated product. Consumers have a right to affordable energy, produced in the most environmentally sustainable fashion possible. But, when treated as a speculative commodity, the cost and supply of electricity becomes uncertain. This situation invites price-gouging and profiteering, as we are witnessing today in California.

We must critically analyze the intentionally perpetuated myths by the proponents of deregulation, because it is clear that what many pro-deregulation politicians are saying just is not true. We need to carefully look at their assertions, or we will not only continue to bailout utilities, we will have higher prices, less reliability, and a threatened environment. It is time to hold policymakers accountable for the mess they have created, and roll back dangerous electric utility deregulation schemes.

³⁵ *Daily News*, "No Relief from Rate Hikes," August 3, 2000, pg. 17.