

# The False Promise of Electricity Deregulation

By Peter DeFazio, U.S. Representative, 4th District of Oregon

Not too long ago, Americans didn't have to wonder whether the lights would come on when they flipped the switch or worry that they might have to forgo other necessities to pay their electric bill.

What a difference a few years make!

## Regulation & Deregulation in the 20th Century

Deregulation proponents have either historical amnesia or nostalgia for a high-priced, volatile electricity supply. After all, our nation experimented with a deregulated electricity market until the early 1930s. That system was discarded after the spectacular Depression-era collapse of the energy empire of Samuel Insull, which threat-

ened to black out the entire industrial heartland of the Midwest.

Fortunately, Congress acted quickly and successfully to stabilize the volatile electricity markets. It created the Federal Public Works Administration in 1933 and passed five laws to correct the flaws of the deregulated system: the Tennessee Valley Act of 1933, the Public Utility Holding Company Act of 1935, the Federal Power Act of 1935, the Rural Electrification Act of 1936, and the Bonneville Project Act of 1937. These laws established a power generation and delivery system designed to stabilize power markets, ensure an

retail revenues, these funds by law will help customers of all classes reduce their usage and thus their bills, as well as mitigate the effects of the energy industry on the environment. Sixth, the law establishes a \$10 million annual fund that will assist low-income Oregonians who struggle to pay their utility bills.

Seventh and finally, the law does not mandate the sale of generating resources. Though some may say that SB1149 gives incentives to utilities to divest generating resources, this is a lazy and opportunistic analysis of the law and results in a serious misunderstanding. The law provides for a thoughtful process to assess the value, or costs, of retaining the utility's existing generating resources.

Oregonians did not "freeze in the headlights," but reacted with imagination and compassion when the electricity industry began to change. The state made sure large customers did not escape their obligations to utilities and strand smaller customers with additional costs. Oregon did not let its energy efficiency and renewables program disappear and refused to force Oregonians to choose between paying their energy bills and eating.

Oregon has designed an electricity-restructuring law that uniquely addresses major techno-

logical, policy, and economic changes in the industry without surrendering to the pressure to deregulate completely, as so many other states have done. States that have pulled back from more radical

deregulation schemes are now looking to Oregon as a model of restructuring, because SB 1149 acknowledges the major changes in the industry in a manner that protects and benefits all utility customers.

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## Restructuring in Oregon

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adequate power supply, electrify under-served areas of the country, and maintain reasonable rates for consumers. Public and private monopolies were created to generate and distribute power, and these were regulated by a mix of state and federal agencies.

This system achieved its major goals and now provides Americans with the most reliable, universally available, and affordable electricity service in the industrialized world. Unfortunately, free-market ideologues thought we could do better. They and other proponents of electricity deregulation reasoned that competition would result in better customer service, more efficient investments, and, most importantly, lower prices for consumers. Their work at the national level to “free” the power markets culminated in Congressional passage of the 1992 Energy Policy Act, which deregulated wholesale electricity prices and allowed states to deregulate their retail markets. Not surprisingly, proponents have been proven wrong on all counts.

### Free Markets: What Happens When We Deregulate?

Two important qualities of today’s regulated electricity markets will be lost if we deregulate:

reliability and affordability.

**Reliability.** To be reliable, an electric grid requires about 15 to 20 percent excess generation capacity to ensure sufficient supply during standard off-line time for maintenance, transmission line failures, and increased demands during severe weather. In a regulated market, the Public Utility

Commission (PUC) orders utilities to build backup generation capacity or to acquire reserves from other sources to ensure the excess capacity. The utilities are guaranteed repayment for these investments plus a reasonable profit, even if the reserves are never used. By contrast, in a deregulated environment, utilities have no incentive to build excess capacity since it tends to drive

down prices and profits. In fact, power marketers can get by quite comfortably with tight supplies since prices can be more easily manipulated by withholding a small amount of capacity, as happened recently in California. Similarly, conservation is less likely in a deregulated market, because utilities increase profits when customers use more, not less, electricity.

Under deregulation, generators are no longer bound by legal obligation to provide reliable,

affordable electricity. This duty to serve customers is replaced by a duty to serve stockholders.

**Affordability.** As the Boston-based Tellus Institute noted in a recent report, the deregulated market exhibits “inherently higher costs” than a regulated market. Shareholders demand an accelerated rate of depreciation and a higher average rate of return on equity, while lenders demand a higher cost of debt to compensate for the increased risks associated with an uncertain return.

### Deregulation Failures at Home and Abroad

A thorough look at home and abroad reveals that there are no successful cases to use as a model. While California has clearly been the most spectacular failure, it is just one of many. U.S. deregulation is based on Britain’s model, which was introduced in 1990

under Prime Minister Thatcher. Under the British model, functionally separate companies carry out the generation and distribution of electricity. The generators bid into a power pool and designate the price at which they will deliver electricity. It did not take long for suppliers to learn how to manipulate the pool by withholding power from the market. According to British regulating agencies, market manipulation and collusion have become stan-

dard business practice since the country’s power markets were deregulated. Prices remain 70 percent higher in Britain than in America. Electricity rates in Alberta, Canada, skyrocketed after the province deregulated, rising from some of the lowest rates in North America to some of the highest. The large industries that originally pushed for deregulation clamored to be regulated again and even threatened to relocate to provinces that remained regulated. According to an article published in the April 24, 2001 *The Wall Street Journal*, “In order to placate angry citizens, the Alberta government has had to pledge billions of dollars in energy subsidies and tax rebates.”

When New Zealand deregulated in 1999, it attempted to reduce costs by cutting maintenance workers, and transmission

wires overloaded as a result, blacking out the capital city for more than a month. Since then retail rates paid by small- to medium-sized businesses have risen between 200 and 700 percent.

There are no success stories at home either. Like California, when Pennsylvania deregulated it capped consumer rates at artificially high levels to allow utilities to recover “stranded costs,” a term used to describe utilities’ prior investments that have proven unrecoverable. The

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number of “competitors” in Pennsylvania has plummeted from 25 to 6, some of which have requested a 30 percent rate increase in violation of the already artificially high cap.

Many other states have experienced consumer price increases and other problems in the wake of deregulation. For example, price volatility in New England increased 56 percent after deregulation and rates are almost three times the average price before “competition.” In addition, power-plant outages increased 47 percent after utilities cut maintenance expenses by 40 percent. In Rhode Island, the entrance of competitors—who have since left the market—brought price increases of up to 66 percent. And Massachusetts residents have experienced blackouts and seen prices increase as much as 70 percent. In each of these cases consumers have endured volatile rates, higher prices, and in some cases blackouts as power companies enter and exit the market to maximize their profits.

Montana’s experience may be the most important case for Oregonians to study, relevant to Oregon because of the availability of hydropower in both states. Prior to deregulation, Montana had a large surplus of power and its utilities had a duty to serve their customers. Like in Oregon, there was no problem to fix. After the state deregulated rates skyrocketed 1,000 percent, Montana industries laid off more than 1,000 workers, and power generators exported power out of the state to fetch higher prices.

Ironically, two federal agencies predicted such dismal outcomes in reports they issued in the late 1990s. In a January 1999 report, the U.S. Depart-

ment of Agriculture projected higher electric bills and slower economic growth following electricity deregulation for 19 states, including Oregon. And in September 1997 the U.S. Department of Energy found that deregulation would increase rates in the Northwest by about 29 percent, roughly increasing the average yearly residential utility bill by \$200.

#### Will Oregon be next?

Thanks to low-cost hydropower, Oregon has been blessed with some of the lowest electricity rates in the country. Apparently that’s not good enough for some—in 1999 the Oregon Legislature approved Senate Bill 1149 to deregulate electricity. I disagree with the four primary arguments that Oregon deregulation proponents make in defense of SB 1149:

1. It isn’t “deregulation,” it’s “restructuring.”

Deregulation as it is understood today essentially replaces one rulebook—designed to promote social, environmental, and reasonable profit goals—with another. I oppose this new rulebook because it is designed to create winners and losers; it pads the bottom lines of a few large corporations and does not include important social and conservation goals.

2. It will protect residential ratepayers and small businesses from market rates.

On the contrary, because the Oregon law sets the threshold for “large” businesses too low (those with demand greater than 30 kW during any two months within a prior 13-month period),

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26,000 unsuspecting small businesses could be thrown to the mercy of manipulated energy “markets.” As of this writing, the Oregon PUC is considering whether to raise this threshold.

Montana also claimed its residential ratepayers were “protected,” but instead, deregulation is leading to rate increases of 50 percent or more for residential consumers. Similarly, California consumers were “protected” by a rate cap which was quickly exceeded when the California PUC was forced to raise rates 20 to 40 percent.

3. Oregon’s experience will be different from California’s.

Defenders of Oregon’s deregulation law claim that they learned lessons from California’s botched attempt and won’t make the same

mistakes. What they fail to mention is that Oregon’s law was approved in 1999, before the serious problems with California’s plan were apparent. Opponents of deregulation in Oregon had to fight tooth and nail last year to change just one egregious section of Oregon’s deregulation law that would have required the same type of divestiture that precipitated the energy crisis in California.

4. The public purposes tax is critical for funding renewables, low-income heating assistance, and similar programs.

A number of environmental and consumer groups supported SB 1149 because it included a three-percent tax on electricity bills to fund programs for conservation, renewables, and low-income heating assistance. The bill is written, however, to allow large customers to avoid the charge. The burden should not be borne entirely by residential consumers. Regulators could easily require a renewable portfolio standard, which means that a certain percentage of a utility’s power would have to be environmentally friendly.

It is also a mistake to move forward with deregulation if power supplies are tight and the transmission system is congested. In a deregulated market, tight power supplies mean the potential to exercise market power is enormous. Even a relatively small player can successfully withhold some of its capacity in order to drive up prices. In addition, there are currently about 50 identified congestion points in the Northwest transmission grid. Deregulation will increase the number of transactions taking place on the grid, which will



## Restructuring in Oregon

... continued ...

only exacerbate congestion and contribute to higher prices.

I agree there are a lot of things markets do very well. Competition tends to allocate social and economic resources more efficiently than a command and control economy. However, the fact that free markets are good does not mean that

freer markets are always better. That is certainly true for the

generation, transmission, and distribution of electricity.

Congressman Peter DeFazio (no photo available) is senior member of the Resources Committee where he serves on the Water and Power Subcommittee which has jurisdiction over the Bonneville Power Administration (BPA). Earlier this year, DeFazio introduced legislation to re-regulate the energy industry. In 2000, DeFazio was instrumental in enacting legislation to give Bonneville Power Administration the authority to sell power to Joint Operating Entities (JOEs). JOEs will allow smaller, customer-owned utilities to more effectively purchase their power from BPA and achieve more efficiency in their operations.

by Jeff Bissonnette, Organizing Director of FCEC

**W**hen Congress passed the Federal Energy Policy Act in 1992, serious questions confronted the public interest community in Oregon, and answers were not readily apparent.

During a long history of rate-case battles, advocates for residential consumers and commercial representatives each struggled to avoid shouldering an inordinate share of the electric system's costs. Consumer groups, environmental organizations, and human-service agencies often worked, if not at cross-purposes, then certainly with little unity. Public interest advocacy models in other states offered little guidance.

In Illinois, consumer groups and agencies representing low-income citizens had secured fairly strong protections and substantial funding for rate-payment assistance at the expense of legitimate concerns raised by the environ-

mental community. In California, the environmental community had ensured significant funding for new energy conservation and renewable energy investments, but consumer groups had been unable to protect their constituents from the manipulations of marketers and suppliers.

### Deregulation in the Northwest

In Oregon and throughout the Northwest, the issues around retail deregulation reached the public agenda in late 1996. A joint effort by parties throughout the region had just completed a year-long Comprehensive Review of the Northwest Energy System at the request of the four Northwest

governors. The review looked at how the restructuring put in motion by the Federal Energy Policy Act of 1992 might affect our region. While the Review provided a basic roadmap for restructuring in the Northwest, it carried no legal weight. Each state would establish its own plans, policies, and programs, particularly regarding transactions at the retail level.

Oregon's public interest community began to grapple with the issues of conservation and the need for investment in renewable energy, as well as the social component of free markets. Both Oregon's world class conservation program and renewables had been cut back drastically.

The federal government had cut low-income rate-payment assistance programs to half of what they had been a few years before. Finally, industrial and commercial interests were pressuring Oregon state legislators to deregulate the electricity industry.

### The Formation of the Fair and Clean Energy Coalition

To address these concerns, several consumer groups, environmental organizations, and human-service agencies—including the Citizens' Utility Board, Renewable Northwest Project, Oregon State Public Interest Research Group, the Northwest Energy Coalition, AARP, and several others—came together and quickly reached consensus on a few key issues. First, because many groups felt that the status quo was not desirable, they recognized that