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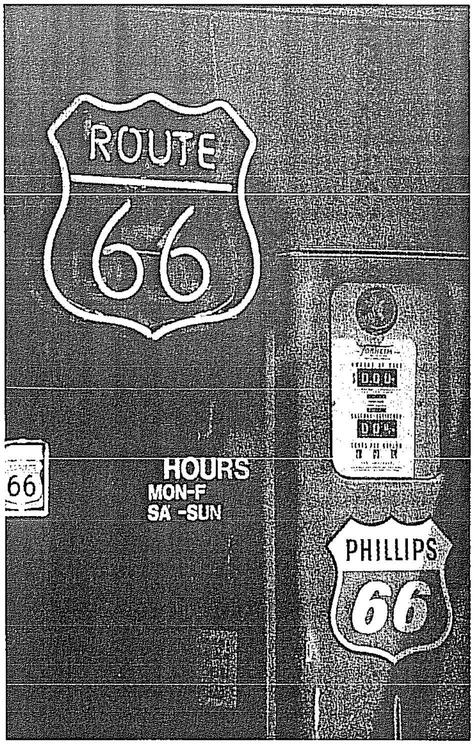
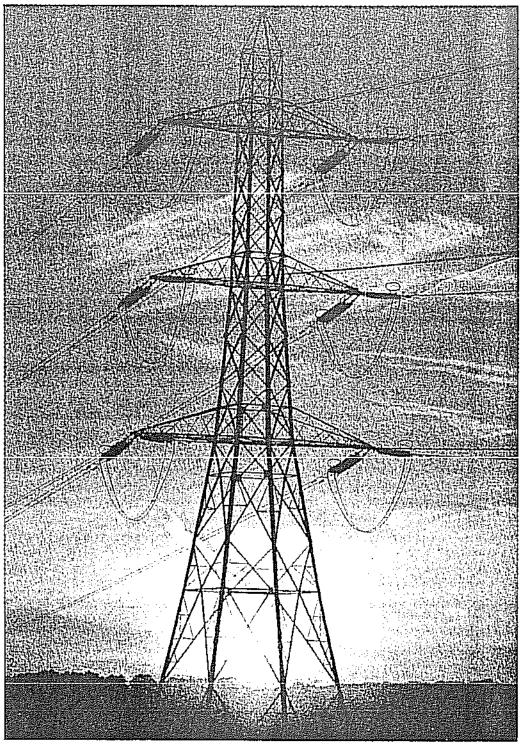
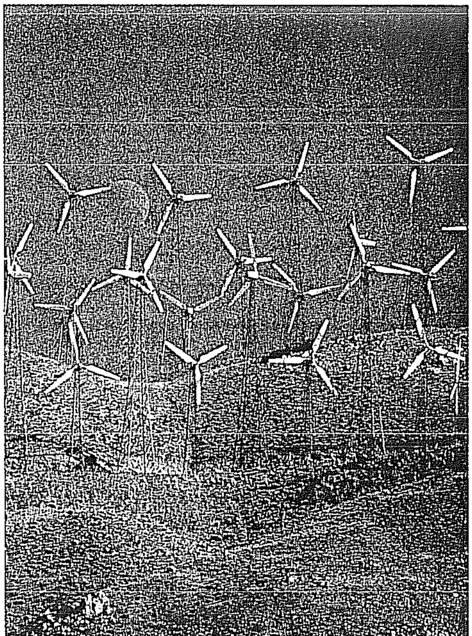
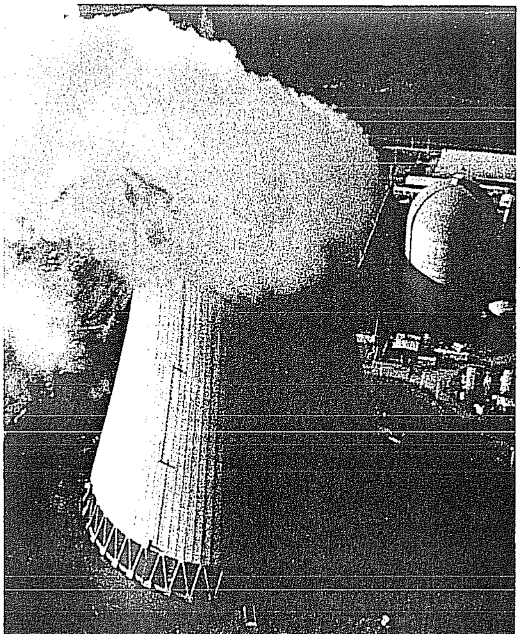
ENERGY IN CALIFORNIA









California's Deregulation Disaster – A Consumer Advocate's View

By Harvey Rosenfield and Douglas Heller

When state lawmakers voted unanimously to deregulate California's electricity supply in 1996, consumers were promised a 20% rate reduction, lower taxes, competition and consumer choice. Those were the buzz words, perfected by focus groups, by which a radical departure from a nearly 100-year-old system was marketed to the press and the public. Indeed, when California became the first state in the nation to lift government oversight of electricity prices and production, it was the culmination of a carefully orchestrated, two decade-long campaign by the energy industry that began in the early 1980s and included the elimination of federal controls over natural gas.

Today, California is on the precipice of economic disaster. Electricity prices have risen 1,000% since last year. Rates have been increased by an average of 49% since January of this year. The State's largest utility, PG&E, is in bankruptcy, with Edison not far behind. Both are begging lawmakers to order an additional $12 billion in rate increases to bail them out, the cost of which would mean still another 40% increase in our monthly bills. Over $8 billion of taxpayers' money has been used by the State since January to purchase electricity from the handful of energy companies – mostly from out-of-state – that have seized control of our power plants and are manipulating the supply of electricity in order to maximize profits. This summer, when supplies are traditionally tighter, these companies may double or triple their prices yet again, forcing the average monthly residential utility bill to reach $600 or more, while the energy industry is warning us to expect rolling blackouts on a near-daily basis. The wholesale price of natural gas – used by many homes and businesses – is 170% higher in California than on the East Coast. It, too, is controlled by the energy cartel. As the *coup de grace* to California's car-driven culture, oil companies have used their control of the refinery spigot to push gasoline prices at the pump to astronomical levels.

Welcome to the world of deregulation, the single greatest public policy mistake in California history, rivaled perhaps only by the State's pioneering deregulation of bank savings and loans in 1983. Just as that ingenious idea spread throughout the nation, ultimately costing American taxpayers hundreds of billions of dollars, numerous other states followed California's lead on electricity deregulation and are already beginning to pay the price. New York has seen 43% price increases and faces summer blackouts. Pennsylvanians paid $12 billion in excess charges under deregulation, with more rate hikes coming. In Massachusetts, PG&E is being accused of the very price-gouging that brought its utility company to ruin in California.

The Deregulation Ideology vs. Reality

The collapse of deregulation in California has driven the energy industry propaganda machine into desperate overdrive, faced as it is by the threat that greed will have killed the goose that laid the golden egg before all 50 states are deregulated. According to the industry, California's problem is not deregulation, but not enough deregulation. "California deregulated the wholesale market, but kept a regulated price freeze in the retail market," the pro-deregulation forces say. They are correct on the facts, but the conclusion they draw – that "full" deregulation would work – is plainly wrong.

The freeze on retail rates was imposed by the utility companies themselves in the 1996 law. Set at a price level 40% above the then-market price, its purpose was to allow the utilities to surcharge ratepayers to pay off the utilities' bad debts – principally cost overruns in the construction of nuclear plants in previous decades. Between 1997 and the summer of 2000, the deregulation law handed PG&E, Edison and SDG&E their first bailout — $20 billion worth. The utilities' holding companies got this cash and, with the proceeds from the sale of some of their power plants, went on a spending spree: buying power plants throughout the world, buying back stock, increasing dividends and executive pay. But last summer, the companies that purchased the California power plants decided they wanted to cash in on the gravy train too. They boosted wholesale prices beyond the frozen price. Suddenly, the rate freeze that the utilities wrote to enrich themselves at the expense of ratepayers was now protecting ratepayers by preventing utilities from passing through the higher cost of power.

If the retail rate freeze was not now in effect, California ratepayers would be paying the full deregulated price of electricity – estimated at about $600 per household per month. Last summer, San Diego residents and businesses experienced full retail deregulation and were subject to the wholesale cost pass-through because SDG&E had

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recovered all of its prior debts a year earlier than expected. "Real deregulation" happened in San Diego and it led to 300% rate increases, business closures, and hospitals and school districts cutting programs to cover energy costs. It brought the county to the precipice of economic collapse. "Real deregulation" inspired a bipartisan and ongoing movement in San Diego County to shelve the market system and create a publicly-owned county-wide utility company.

"Electricity is too important a commodity to be left to the vicissitudes of imperfect markets... The State must focus on regaining control of wholesale energy prices in the very short term, and control of the electricity system in the long term."

State legislators should have known better than to trust the legions of economists, academics and policy experts unleashed by the utility and energy companies to lobby for deregulation under the thin veneer of scholastic inquiry. While the "free market" can work superbly if there is adequate competition, policed by enforcement of the antitrust laws, it simply makes no sense for some services (police, fire, national defense are other examples). Indeed, as California has witnessed first-hand, electricity suppliers have more to gain by keeping supplies tight than by building the extra power plants that would keep prices down and assure a steady supply of electricity. (Guaranteed reliability requires a 20% reserve of electricity, so when the weather changes or a plant goes down we are capable of maintaining affordable service). The utility companies have consistently lobbied state and federal agencies to disapprove construction of new plants.

Electricity is too important a commodity to be left to the vicissitudes of imperfect markets. Which is why, nearly 100 years ago, California chose to treat utility companies as heavily-regulated monopolies—and why cities with publicly owned power companies are experiencing none of the blackouts and skyrocketing prices that have befallen the rest of California.

Solutions to the Crisis

The push for deregulation was driven by the energy industry's ideology. Solving the crisis caused by deregulation requires practical solutions. Given what deregulation has done to our economy and our electric bills and knowing how expensive it will be for Californians to fill up their tanks this summer and pay gas heating bills next winter, the State cannot afford the luxury of allowing ideology or political concerns to dictate the response of policymakers.

Neither a bailout (as proposed by the utilities), the issuance of $13.4 billion in State bonds to cover power purchases (as enacted by the Legislature at the request of Gov. Davis), nor the laissez-faire policy of the Bush-Cheney administration will do anything to resolve the immediate problem: eight energy companies that control a third of the State's power supply have become a cartel in whose hands deregulation has become a license to steal. The State must focus on regaining control of wholesale energy prices in the very short term and control of the electricity system in the long term.

The only way to protect the Golden State from an imminent economic and public safety disaster is to force the energy wholesalers to cease their manipulation of electricity supply and reduce their prices. The Federal Energy Regulatory Commission (FERC) has the responsibility to order cost controls and rate reductions, but FERC and the Bush-Cheney administration are too entwined with the energy industry and enamored of deregulation to do so. The State's options are harsh, to be sure, but warranted in light of the gravity of the threat. One is to impose a windfall profits tax on the generators; such legislation has passed both houses of the Legislature. If this fails, the State will have to exercise its power of eminent domain to seize the plants, at least temporarily. Paying the fair value for these facilities would be a bargain: In the last six months, California has already spent twice as much on power as the $3.2 billion price the cartel paid to buy the plants from the utilities. Perhaps the energy cartel would choose to lower its prices to fair profit levels rather than pay a windfall profits tax or lose their plants altogether.

A long-term plan to restore a reliable and affordable electricity system is already underway. Governor Davis has signed into law the Consumer Power and Conservation Financing Authority, a public power system that is designed to become the principal long-term energy provider for California. The 2,000 public power systems in this country provide a reliable supply of power at a price that averages 15-20% lower than that charged by regulated private utilities. L.A.'s DWP electricity prices are ten times lower than the current extortionary price under deregulation, and DWP's customers are not threatened with blackouts. Finally, the Legislature should encourage California's substantial native business and entrepreneurial talent to develop 21st century alternative energy and conservation technologies. ❖

Harvey Rosenfield and Douglas Heller are consumer advocates with the Foundation for Taxpayer and Consumer Rights. An extensive analysis of deregulation, the energy crisis and necessary solutions can be found on its Web site, www.consumerwatchdog.org.