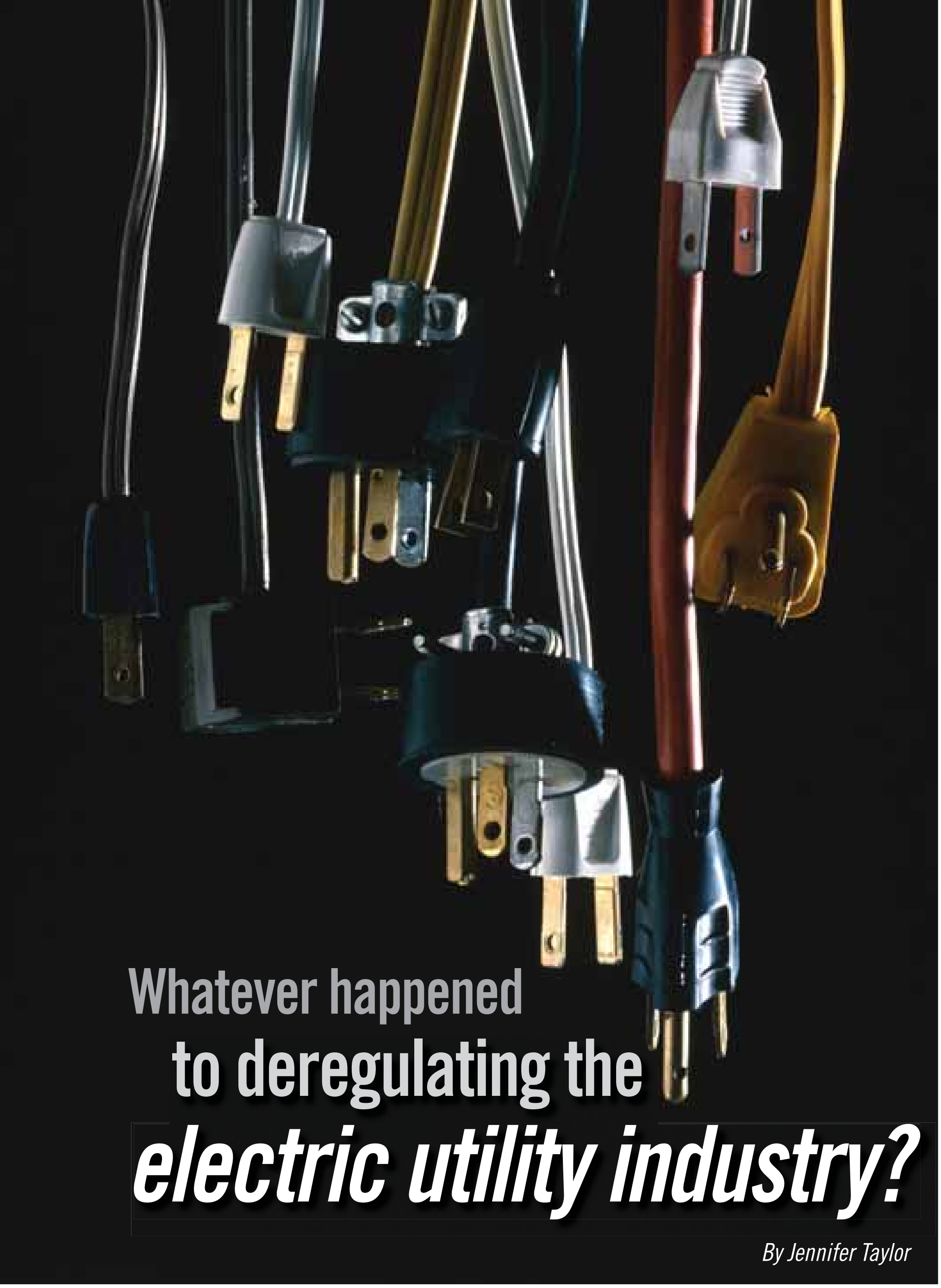

Whatever happened to deregulating the *electric utility industry?*

By Jennifer Taylor

10 years after the move to bring competition to the electricity business, all states that deregulated are feeling unwelcome ramifications, prompting some to reconsider the wisdom of retail restructuring altogether

Retail restructuring of the electric industry, commonly referred to as deregulation, has seen its share of ups and downs throughout the last decade. Beginning in the mid-1990s, industry leaders and legislators captured headlines as they debated whether or not to let retail electric consumers shop for power. Proponents promised competitive electric markets with lower rates, increased efficiency, new technologies and additional renewable resources. Opponents, though, questioned if effective competition would ever surface and what would happen to rates, no longer subject to review by state utility regulatory commissions.

In 1996, the Federal Energy Regulatory Commission (FERC) accelerated the process by issuing Order 888, which required publicly held utilities to provide open transmission access to support competitive electricity markets. Within a few years, New Hampshire, Rhode Island, Pennsylvania, Arizona, Illinois, New Jersey, Texas, Montana, and most notably California, among others, had enacted electric competition laws. Initially, some like Pennsylvania, experienced success with nearly 800,000 power company customers buying electricity from competitive electric generation suppliers. Others, like California, saw spectacular failures, suffering enormous price spikes and blackouts from a power grid drained dry.

Now, approximately 10 years later, all deregulated states are feeling unwelcome ramifications, prompting some to reconsider the wisdom of retail restructuring altogether.

Deregulation—An overview of the issue

Deregulation is the process of governments removing or reducing restrictions on private industries, such as the electric industry, to encourage competition, higher productivity, more efficiency and lower prices. Beginning in the 1970s, deregulation of the transportation, telecommunications, and natural gas industries illustrated that deregulation was feasible. Thus, supporters of restructuring felt they could do the same with the electricity market.

As envisioned, retail restructuring would give customers a choice of power suppliers. If a company could offer power for less, or offer better or more innovative services than what customers were receiving from their local utility, they would have the ability to change providers and buy electricity from the alternative source. In particular, customers would be able to purchase power from renewable energy sources, to help promote development of "green power." In any event, customers would still pay a monthly bill to their local utility to deliver the power over its system.

To establish competition, public utility commissions or legislatures in deregulated states capped electricity rates for a period of time (usually five to 12 years, including extensions). This way, regardless of the price of the power, costs to consumers taking service from their traditional supplier would not increase. The capped rates also helped set the local price for power that competitive suppliers needed to beat. So what happened?

Deregulation—today's concerns

Beginning in 2001, increases in wholesale power prices drove many retail suppliers out of business; they simply could not acquire power at a price that allowed them to beat capped rates charged by local utilities. Then, as rate caps expired in a number of states, utilities began passing on the real cost of power. Needless to say, electricity prices skyrocketed. One investor-owned utility in Delaware adopted a 59 percent increase in residential power rates; in Maryland, residential customers served by Baltimore Gas & Electric experienced a 72 percent increase. States with rates caps scheduled to expire in the next few years, such as Virginia, began reconsidering their restructuring initiatives and looking for ways to avoid steep rate increases. Virginia likely will be the first state to enact a form of "re-regulation" legislation. With residential customers shocked and angered over their electric bills, industry experts and legislators wonder what happened to the benefits promised by deregulation.

Simply stated, deregulated electricity prices result from the basic laws of supply and demand. The population across the country has continued to grow since deregulation was implemented. The growth in population increases the need for more electricity. The demand for electricity, however, has not been sufficiently met by increases in baseload generation capacity, driving up the cost to purchase power. To meet demand, new power plants have to be built, along with transmission and distribution systems to deliver the additional load. Although some new power plants have been constructed, it has not been enough to keep up with growth and create a competitive market for retail electricity.

Also, rate caps were set when fuel costs and demand for electricity were lower. Since then, fuel costs have increased substantially, especially for natural gas, which is used to generate approximately 18 percent of the country's power. Moreover, as wholesale markets have been restructured, natural gas has increasingly set the price for all power plants, including less expensive coal and natural gas generators. The dramatic increase in natural gas prices, therefore, has had a much larger influence on wholesale, and conversely, retail power prices. With an ever-increasing need for more electricity, coupled with higher wholesale power costs, utilities in restructured environments have had to significantly increase rates because rate caps did not allow them to meet operational costs.

Additionally, it is not economically viable for competitive electric generation suppliers to sell to small businesses and residential customers in rural areas when they could compete for large, industrial customers. Based on an analysis by Kenneth Rose, a researcher and energy consultant for state utility commissions, retail access remains technically available in many jurisdictions. However, retail competition has yet to develop for smaller customers.

Overall, rate increases have been higher in deregulated states than in states that maintained regulated systems. Rose remarks, "The national result continues to question the ability of retail competition to provide lower prices for electric service than would have prevailed under traditional regulation of the industry."

Deregulation and electric cooperatives

Each state's restructuring legislation affected electric cooperatives differently. In some, co-ops were given the option to opt into or out of deregulation; in others, co-ops competed fully.

"Electric cooperatives do not need to fear deregulation," says Perry Stambaugh, editor of RE Magazine. Stambaugh worked for electric co-ops in Pennsylvania and New Jersey when those states implemented customer choice laws. "The co-op focus on doing what is best for consumers gives rural electric systems a leg up on potential competitors. In addition, the same reason power companies did not want to serve rural areas 70 years ago—because they couldn't make a profit supplying power to predominately residential consumers in sparsely populated areas—still exists for competitive suppliers today."

Jay Morrison, senior regulatory counsel for the National Rural Electric Cooperative Association, said, "In Pennsylvania, where electric cooperatives were the first utilities to open their doors to competition, no one showed."

Electric cooperatives work to ensure and protect the interests of their member-owners. Cooperatives are dedicated to providing safe, reliable electricity at the lowest possible cost. Electric cooperatives are concerned at state and national levels about the impacts of restructuring, but maintain their commitment to protect and advance the interests of their consumers.

Sources: National Rural Electric Cooperative Association, Federal Energy Regulatory Committee and the Energy Information Administration.

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North Carolina & Electric Utility Restructuring

The North Carolina General Assembly in April 1997 formed the Study Commission on the Future of Electric Service in North Carolina to consider issues surrounding retail competition in the electric utility industry. The commission met several times and heard comments from industry and consumer groups. In April 2000, the panel recommended full competitive retail electric service in the state by 2006, with a phase-in beginning in 2005. Issues that remained unresolved—debt held by municipal power providers, consumer protection, environmental and alternative energy effects, taxes, transmission and distribution service—were to be addressed as the process unfolded.

As deregulation in California stumbled in 2000, North Carolina like other states put the process on hold. The state's municipal power providers, who had been proponents of retail competition, reversed their position and joined the call for caution.

To date, no legislation has been introduced to implement the recommendations of the commission, but policymakers and industry officials have addressed related issues that arose during the study.