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1.	COMMENTARY; ELECTRICITY DEREGULATION WAS DOOMED FROM START <i>Los Angeles Times</i> , December 21, 2000, Thursday,, Metro; Part B; Page 11; Op Ed Desk, (1087 words), PAUL RICHINS Jr., Paul Richins Jr., an economist and project manager with the, California Energy Commission, has worked on local and statewide energy, issues for the past 18 years. The opinions expressed here are his alone

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Los Angeles Times

December 21, 2000, Thursday, Home Edition

COMMENTARY; **ELECTRICITY DEREGULATION WAS DOOMED FROM START**

BYLINE: PAUL RICHINS Jr., Paul Richins Jr., an economist and project manager with the, California Energy Commission, has worked on local and statewide energy, issues for the past 18 years. The opinions expressed here are his alone

SECTION: Metro; Part B; Page 11; Op Ed Desk

LENGTH: 1087 words

With wildly optimistic promises of improved services, expanded products and lower rates, electricity deregulation in California was signed into law four years ago. Today, it is obvious that deregulation is not working as envisioned.

Concerns of rolling blackouts and the pleas from the California Independent System Operator--which controls the state's power grid--to conserve energy this holiday season are symptoms of fundamental flaws in the structure of California's electric markets. Natural gas--used to fuel many electricity power plants--that traded for \$ 2 to \$ 3 per million British Thermal Units last year has nearly doubled this year, at times spiking as high as \$ 25 to \$ 50. Electricity that sold for \$ 15 to \$ 50 per megawatt hour is nearing \$ 1,500 in today's energy markets.

Contrary to the rhetoric that there is an orchestrated effort by power plant owners to run up the price of electricity, there are no such villains in this sad saga. The power plant developers should not be blamed for the predicament, nor should the well-intentioned legislators.

Without fully understanding the principles of economics and the complexities of the electric system, the Legislature unknowingly designed a noncompetitive market in which savvy businessmen would be selling their wares. Rather than looking for a scapegoat, a more honest approach was offered by Richard A. Bilas, a member of the Public Utilities Commission and an outspoken advocate of deregulation. In a conversation with a colleague, he lamented, "I hate to admit this, but I don't know what's gone wrong. Where did we screw up?"

The benefit of 20-20 hindsight, along with a basic understanding of the electric system and economic principles, is instructional in explaining what went wrong.

* Electric generation competition is constrained by electric transmission. Over the past decades, the electric transmission system was designed and built by the monopoly utilities to move electricity from their power plants to the users. An obvious but important fact of physics is that the flow of electricity is constrained by the capacity of the existing electric transmission system. These physical operating limits are, in themselves, serious impediments to competition because the transmission lines cannot carry unlimited amounts of electricity to market. Supply-and-demand imbalances are particularly acute in transmission-constrained areas. Therefore, plants that interconnect to the existing electric transmission system at those strategic points will hold a decided advantage in the market.

* The electric generation industry has few competitors. For markets to be competitive there must be many buyers, many sellers and few barriers to enter the market. In the electric generation market there are many buyers of electricity but few sellers and considerable barriers. To be a serious player and provide some small component of competition, a corporation would have to commit more than \$ 1 billion in capital investment. The electric generation industry is one of the most highly capital-intensive and most specialized in the world. Consequently, few corporations are active in the electric generation industry. Because there are significant barriers and few corporations in the industry, prices can be artificially raised.

* The excess generation capacity necessary to ensure competitive markets will not materialize. When the electric generating plants were owned and operated by the monopoly utilities, they maintained a 15% reserve margin. This was regarded as a reasonable balance between supply and demand and sufficient to provide a reliable system with relatively stable prices. But under deregulation, unless there is even further excess capacity, markets tend not to be competitive. Additional supply above the 15% reserve margin is needed to ensure a robust market. For discussion purposes, let's assume that the excess capacity (that amount of supply above the 15% reserve margin) would need to increase to say 40%. In this example, 20 to 25 additional power plants, beyond that which were necessary under the old regulated monopoly paradigm, would be required for a competitive market. These plants would not be used to ensure reliability and to keep the lights on, but rather to promote and ensure competition. However, given the market power of the few participants, it is unlikely that plants would be built solely to provide excess capacity. What savvy businessman would embark on a \$ 400-million project knowing that the investment would be providing excess capacity to the system to drive prices lower? What financial institution would loan money to a power plant developer with the understanding that the plant would operate less than half the time? The capital investment would be too great and the risks too high. It is therefore unlikely that sufficient numbers of power plants will ever be constructed to ensure that the electric market is price competitive.

Even if the plants were built, the cleanest and greenest power plants create environmental impacts to our land, water, air and biological resources. Twenty to 25 additional plants would be a high environmental price to ensure a competitive market.

* Restructuring lacks accountability. The authors of the deregulation legislation significantly diluted the authority of existing governmental regulatory agencies and created new bureaucracies with little expertise, experience, authority or accountability to effectively oversee the bumpy transition from regulated monopolies to a deregulated market. In essence no one is in charge and there is little agency accountability and even less authority to attack the vast range of issues confronting the state.

Many knowledgeable experts believe the problems of the electric generation market can be fixed with Band-Aids and a few deep-wound stitches. Others believe that open-heart surgery is needed. The very nature of the electric system--the dependency of generation on electric transmission, the capital-intense nature of the industry, the limited number of competitors and the commodity itself--is not suitable for market competition.

Applying the principles of supply and demand to set the price of a commodity such as electricity is fundamentally flawed. It is doubtful that the market, regardless of the changes and fixes that are proposed, will ever achieve acceptable competitive market prices. Others may disagree but the debate is healthy and may lead to an eventual solution.

COUNTRY: NORTH AMERICA (91%);

STATE: CALIFORNIA, USA (91%);

SUBJECT: DEREGULATION (96%); ELECTRIC POWER INDUSTRY (95%); EDITORIALS & OPINIONS (93%); ENERGY REGULATION (92%); PUBLIC & PRIVATE UTILITIES (92%); POWER PLANTS (90%); LEGISLATORS (90%); ECONOMIC NEWS (90%); TRADE AGREEMENTS (90%); GAS & ELECTRIC UTILITIES (90%); ENERGY (90%); US STATE GOVERNMENT (78%); NATURAL GAS (78%); LEGISLATION (73%); POWER FAILURES (73%);

LOAD-DATE: December 21, 2000

LANGUAGE: English

GRAPHIC: GRAPHIC-DRAWING: How many power companies does it take to screw California?, MICHAEL RAMIREZ

TYPE: Opinion Piece

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