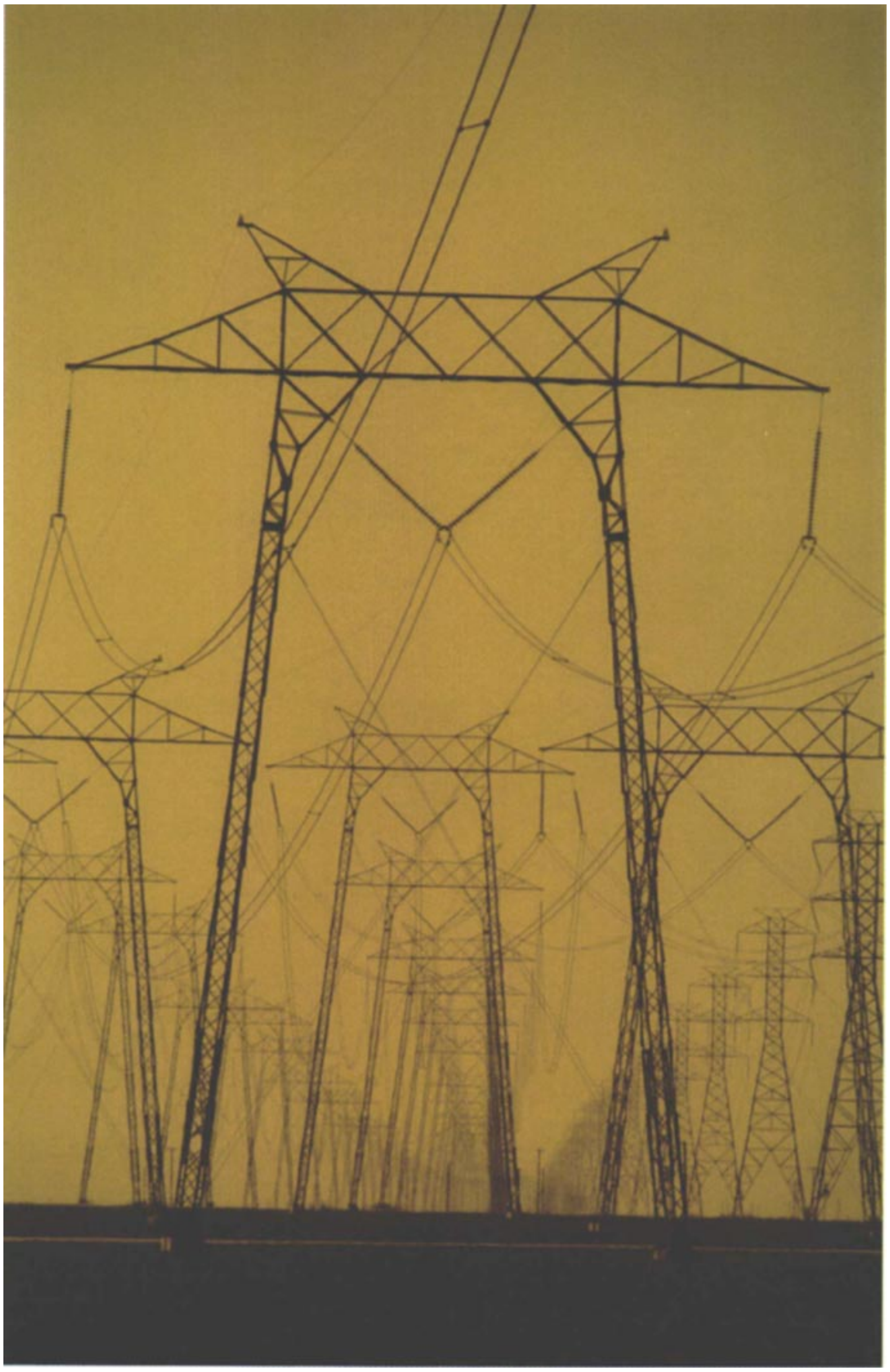
the Electric Economist

# Competition Comes to the Electron Superhighway

*by Jonathan Marshall*

***Scene I (1995):*** *"Wow, Marge, our electric bills this winter have been out of sight! We're going to go broke if it doesn't warm up soon so we can quit running the furnace."*

***Scene II (2000):*** *"Wow, Marge, look at all this junk mail! First it was the credit card companies, then the long distance carriers, and now the power brokers hitting us up with special deals. Seems like every day we get offered some new plan for buying electricity at a discount. How can we keep them all straight?"*



Within a few years, power suppliers will be marketing electricity to ordinary customers as vigorously as long-distance telephone companies do now. In England and Norway, competition in the electric power market is already a reality. In California—where rates are 40 percent above the national average—competition has been on the agenda since last year, when the state public utilities commission stunned the industry with a landmark proposal to let retail customers deal directly with the supplier of their choice.

Prompted in part by California's lead, utilities and regulators all around the nation are starting to listen to consumer demands for competitive rates and service. As the manager of one public power agency in northern California put it, "not since the introduction of the Beach Boys and the California surfing lifestyle has the state had such a huge opportunity to influence the rest of the country."

Although many environmentalists, union leaders, and even a few consumer groups are skeptical of competition, some utilities are rushing to meet the future. Last October, for example, Spokane-based Washington Water Power and

Reno-based Sierra Pacific Resources announced plans to merge, citing growing competition in the utility industry and their plans to invade the California market as reasons to cut costs and boost their marketing clout.

In December, UtiliCorp United of Kansas City, Missouri said it aimed to become the first utility to operate in 50 states. It will market electricity and gas nationally under the brand name EnergyOne to take advantage of markets as they open up. "We decided [customers] will be taken away from us unless we get on the offensive," said the utility's chairman, Rick Green.

And Wisconsin Electric Power is urging its state's regulators to throw the market open to competition even before California. "As a low-cost producer, we see regulatory change as an opportunity to grow market share," said David Porter, senior vice president.

"Retail competition in electricity can be delayed but it cannot be denied," says Vinod Dar, chairman of Jefferson Electric, an electricity broker based in Washington, D.C. "Increasing competition in the distribution of goods and services is a systemic national and global trend that the regulated, entrenched distributors of electricity can as little resist as a man on a beach can stay a tidal wave. Competition in distribution has come to industry after industry.... It is accelerating in natural gas and local telephone calls and inexorably and inevitably coming to the electromagnetic spectrum and electricity."

Dar predicts that prices will tumble "far and fast" when competition hits the retail electric market, a prediction borne out by Norway's experience, where customer bills dropped 20 percent or more after the country threw its market open to competition in 1991. "Tens of billions of dollars per year will be liberated, greatly augmenting the competitiveness of the U.S. economy and the well-being of homeowners and small businesses," said Dar.

Beyond reducing prices, shifting control of the power market from producers to consumers will prompt a spurt of technical and financial innovation to satisfy specialized customer demands. Instead of one-shoe-fits-all service, power entrepreneurs will offer a host of customized options based on time of use, quality of frequency and voltage control, type of fuel, credit terms, and service plans. In addition, they'll market complete energy solutions, installing highly efficient appliances or construction technology to satisfy customer needs.

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Doug Bechtel, general manager of Orcas Power and Light in the Pacific Northwest, said customers can expect an explosion of services similar to that in the telephone industry. "I now have touch tone, call waiting, an FCC charge, a hearing impaired surcharge, an enhanced 911 charge and the telephone company is now offering me personal voice mail and differentiated ringing so I can tell who the telephone call is for.... This same scenario will be played out in the electric business."

These heady visions are hard for a slow-moving industry to absorb. "There's a lot of chaos and confusion in thinking about the future," said Pacific Gas and Electric vice president Bob Haywood. "This has come at us very quickly. It's really a sea change, a watershed event."

One force driving the push to competition is the failure of traditional monopoly regulation, which has saddled customers in many states with high rates, long delays in reacting to market changes and costly bureaucratic battles. In its proposal for industry competition last year, the California Public Utilities Commission cited dissatisfaction with its own "fragmented, outdated, arcane and unjustifiably complex set of regulatory policies."

What makes competition possible, in turn, is proliferation over the past 15 years of independent power producers—who currently sell electricity wholesale to utilities, but could sell directly to consumers if regulators open transmission and distribution lines to all comers. The independent producers' market has become highly competitive, driving down the cost of new power. In 1992, for the first time, independents built more new generating capacity than utilities did.

Wholesale markets for electricity are already flourishing as utilities buy and sell surplus power to each other on an hourly basis to avoid having to build new plants. A broker in PG&E's energy control center in San Francisco may purchase power from New Mexico one morning and sell to a utility in Washington that afternoon. High-voltage transmission lines, veritable electron superhighways, carry power thousands of miles with low losses, expanding the scope of regional markets. With more computer power and intelligent metering, nothing stands in the way of extending retail competition down to the household level.

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The political breakthrough for retail competition came in April 1994, when the California Public Utilities Commission proposed giving customers "direct access" to the power company of their choice. Its timetable envisions opening the door first to large industrial

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customers in 1996 and finally to all consumers by January 1, 2002. The commission has been taking public comment and expert testimony, and consulting with state and federal officials, to refine its recommendations.

Instead of fighting the utility commission's plan, California's three investor-owned utilities have embraced the general thrust. In February, for example, Pacific Gas and Electric proposed that, starting next year, its large commercial and industrial customers should have the right to buy power from any producer. A senior executive said the utility wanted to "break the logjam" of the restructuring debate with this experiment.

PG&E has been preparing for the inevitable with a wrenching program of cost cutting, including a 25 percent staff reduction that has prompted Electrical Workers Union members and other rank-and-file workers to resist the California restructuring proposal. Workers have rallied on the steps of the utilities commission and barraged the media with complaints that PG&E is risking service quality and safety by cutting payrolls. The utility has also frozen its electric rates to get them more in line with neighboring states.

But while utilities and their major customers are embracing competition, other interest groups demand that state regulators go slow or reverse course. Major legal and policy questions must be resolved before competition sweeps the industry:

- Who has authority to deregulate? In addition to the utilities commission, the state legislature, other states and the Federal Energy Regulatory Commission have some overlapping jurisdiction. Hundreds of state and federal laws may need to be changed to permit interstate sales of electricity to end users. This could leave the reform stranded in court for years.

- Who will bear the transition costs? Competition entails losers as well as winners. Among the biggest potential losers could be owners of expensive nuclear power plants whose value would plummet if regulators no longer guaranteed their rate of return. Resources Data International, a consulting firm in Boulder, Colorado, estimates that a competitive market would leave $163 billion in utility assets uneconomic or obsolete. Utilities say they should be compensated for this "stranded investment," built when the rules of the game were different—possibly by imposing a surcharge on all customers for the first several years of competition.

- Who should enjoy the benefits of competition first: ordinary ratepayers or big industrial and commercial users? The latter are the easiest and most practical to serve first, but consumer groups denounce deregulation that starts with big business and lowers household bills only later.

MOVEMENTS TO DEREGULATE OTHER INDUSTRIES, FROM TRUCKING TO TELEPHONES, FACED THE SAME OBSTACLES AS THE ENERGY LIBERATORS MUST NOW BATTLE: LEGAL TANGLES, OPPOSITION FROM ORGANIZED LABOR, AND DEEP AMBIVALENCE WITHIN THE INDUSTRY ITSELF. ALL CAN BE OVERCOME.

- What will be the fate of current state programs that subsidize rates for low-income customers, promote energy efficiency, and mandate the use of "renewable" energy? Greens and poverty activists fear that these costs will be harder to pass on to the public when they are no longer hidden in utility bills. Shifting low-income assistance programs to the California State General Fund "would surely lead to these programs' demise," argues a coalition of liberal groups including Chinese for Affirmative Action and the Latino Issues Forum. Similarly, Ralph Cavanagh, an attorney with the Natural Resources Defense Council, insists electricity competition "threatens to unleash significant and irreversible damage to both California's economy and its environment" by putting low energy prices ahead of lower energy use and the promotion of renewables.

But competition advocates say that if energy efficiency and fuel diversity are sound investments, consumers and producers will make them in a free market—as many already are. Competition will force electricity suppliers to price according to true marginal cost, rather than average cost, and this will encourage customers to control their energy demand more precisely. Competition will also give power companies an incentive to sell more than just electrons, including energy services like efficient lighting, innovative building design and heating, more informative metering, and energy controls that respond to changing prices.

Competition may not kill the existing renewable energy industry, either. Jerry Alderson, the CEO of Kenetech, a San Francisco-based leader in windpower, says he's a "wild fan of competition." In his view, power marketers will hedge against the risk of rising fossil fuel prices by diversifying their generation resources to include some wind power. "But we're the only company saying that," he conceded. "The problem is that most supporters of renewables don't trust markets. They tend to have backgrounds in government."

Alderson also cites surveys suggesting that 10 percent of customers would be willing to pay more for "green" power from environmentally "benign" sources, such as wind, solar, or geothermal energy. Just as some mutual funds now market to "socially responsible" investors, so could power companies if they were liberated from regulation. But "right now I can't give you frequent flyer miles for green electrons," Alderson complained.

Movements to deregulate other industries, from trucking to telephones, faced the same obstacles as the energy liberators must now battle: legal tangles, opposition from organized labor, and deep ambivalence within the industry itself. All can be overcome. The big questions in electricity deregulation are not of the "if and why" variety, but rather center around "when and how." Whether this inspires dread or euphoria, the power industry is headed for its most radical period of change since the days of Thomas Edison.

Flashback

To know nothing of what happened before you were born is to remain ever a child—*Cicero*

# The Strange Populism of the Anti-Masonic Party

"'Twas a night as dark and drear, as e'er o'er-spread the Earth"—or at least that's how partisans imagined the evening in September 1826 when William Morgan was drowned in the Niagara River and up bobbed the oddest political party of our history.

Morgan, a 52-year-old itinerant toper, had fought under Andy Jackson at the Battle of New Orleans and he kept battling for the rest of his tumultuous life. He settled in Western New York, where he joined the Masons, the centuries-old secretive fraternal order. The voluble boozer was bounced from chapter to chapter, until, resentful, he exacted revenge by revealing Masonic oaths and pledges and other arcana in his book *Illustrations of Freemasonry*. For his perfidy Morgan was "plunged into the dark and angry torrent of the Niagara...at the black hour of midnight." (His body never washed ashore, and to this day a few loyal Masons insist that Morgan was spirited north to Canada, where he swore—and kept—another oath, this one of silence.)

Rumor and speculation ran rampant. A cover-up was alleged: Morgan's disappearance was desultorily investigated by a legal-political structure rife with Masons, from Governor DeWitt Clinton on down. The region was already on the cusp of a great and fiery religious revival: Morgan's murder lit the match, and the tinderbox blew.

Anti-Masons held raucous caucuses that resembled revival meetings. Claiming to be animated by "the blessed spirit," they sang not of William Morgan, drunkard, but of Captain Morgan, the people's hero:

A Martyr has yielded his life to the cause
Of freedom and truth, and respect for the laws;
'Tis *Morgan* whose blood still proclaims from the ground
That life is in peril, where masonry's found

How absolutely baffling it must've been for a typical Mason—a well-to-do merchant, prosperous and respected—to wake one morning and find himself vituperated as a homicidal cabalist!

In 1873, two generations after the backlash, one elderly New York Mason recalled the sting: "Masons were excluded from a participation in the Holy Communion; their names were thrown out of the jury box; and at the social gatherings of the grave matrons of the neighborhood resolutions were...passed forbidding their daughters from keeping company with a Mason."

The fury concretized into the Anti-Masonic Party, which in its newborn purity rested on a single plank: to bar Masons from political office, juries, indeed all of public life.

In 1827 Anti-Masons won 15 seats in the New York Assembly; over the next quadrennium the party became preeminent in much of New York and Vermont and parts of Pennsylvania, electing congressmen, legislative blocs, and even capturing Vermont's governorship. In 1830 the Anti-Masons barely lost the gubernatorial race in New York, 128,000–120,000.

Damning secret societies became the rage: John Quincy Adams, trawling for Anti-Masonic votes in 1828, offered to expose the treacheries of Phi Beta Kappa.

Then came the locusts. A host of cunning men who would later found the Republican and Whig parties—William Seward, Thurlow Weed, Millard Fillmore, Horace Greeley—cut their eyeteeth on Anti-Masonry. They'd found a regular lode of votes, but still, they winced at a rabble given to such overheated utterances as "Let the friends of good order and civil law rise in their strength, and drive back to the dark regions from which it sprang this Beast with Seven Heads and Ten Horns." ("Anti-Masons tended not to believe in venial sins," historian Lee Benson noted with understatement.)

The coup was bloodless. Master strategist Weed ousted the leader of the red-hots, publisher Solomon Southwick (poor Solomon's habit of basing major decisions on a coin flip proved lethal to his reputation), and the party fell to a cadre of well-groomed young lawyers on the make. The new Anti-Masons committed the party to Henry Clay's program of high tariffs, a national bank, internal improvements, and other matters unrelated to the Beast with Seven Heads.

The deposed Southwick saw "the cloven foot of Clay...in the movements of some folks who pretend to be Anti-Masons," but the hijacking was successful. Lost in the shuffle was the party's reason for being: the Anti-Masons were now indifferent on the subject of Masonry! In 1832 Weed engineered the nomination of an unrepentant ex-Mason, William Wirt, for the presidency; Wirt carried only Vermont. The party was finished; the smooth alchemists Weed and Seward admixed its tailings with Henry Clay's National Republicans to create the Whigs, while the firebrands were left in the lurch, betrayed and sputtering.

And what of Masonry? The order was decimated in the Northeast. In 1825 the Masons counted 480 lodges and 20,000 members in New York; a decade later they numbered fewer than 50 lodges with 3,000 adherents. Today the Masons are no more clandestine than the Rotary Club; lodges are likelier to sponsor Little League teams than governors.

Oh, and by the way, 14 presidents have been Masons. Which raises the question: what if the conspiracy theorists were right?

—Bill Kauffman