History of Utility Industry - Dave Sabo

The following information was part of Dave's presentation but due to the length of the meeting minutes, it was decided to excerpt and include as an attachment to the minutes.

Back in the late 1970's Congress had passed some tax laws that gave incentives to utilities to develop more generation. A lot of utilities built up quite a bit of generation and they were looking at others. They were putting on coal fired, nuclear fired plants as fast as they could until Three-Mile Island and then they scaled back to just going to coal fired plants. Gas generation wasn't a real big item because there has always been a concern that there was a limited amount of gas out there for generation plus it didn't make financial sense at the time. They could put in large scale coal fired plants and the cost of production and the cost of installing was fairly cheap. They built a lot of generation in the 1970's and there was a lot of surpluses. There were a number of utilities that were talking with the Federal Energy Regulatory Commission (FERC) at the time about the idea of competition, that competition could somehow control and help levelize the regulation that was going on in the electric market place at the time.

They did a series of experiments. The first one was called the Southwest Bulk Power Marketing Experiment. It was rather small and only had four utilities involved. It lasted two years and proved to be modestly successful so FERC allowed a bigger experiment. WAPA wrote an agreement called the Western Systems Power Pool Agreement in the mid 1980's. It took 20 facilities to begin with that gradually expanded into many more and basically said they would commit their transmission for a set price, would commit certain amounts of generation for set prices, and then they would let competition operate it. The reason FERC liked this is because it diminished the amount of regulatory oversight they had because it set limits on both the pricing for the transmission and the pricing for the generation. It worked fairly well. Actually Western Systems Power Pool went beyond an experiment and it is still in place today. Almost all the western utilities belong to the WSPP but it wasn't enough. It wasn't really and truly an experiment in competition. It proved that mechanisms could be put in place that allowed generation to be sold without a lot of regulatory oversight.

In 1992, Congress passed the National Energy Policy Act which gave FERC additional authority to order transmission usage. It basically leveled the playing field in terms of transmission. It also gave FERC the incentive to move towards true competition. If FERC could diminish the market power that utilities had over their transmission, they could set their own prices but FERC still required everybody to file any type of transmission or generation agreements with them. There was an awful lot of the industry owned utilities and this new group of energy brokers called non-utility generators (nugs) and they really saw an opportunity that if they could move beyond into a true competition, they might be able to exercise new opportunities into new market conditions. Also happening at the time, were still big surpluses of generation. Competition is the greatest thing in the world if you're in surplus situation. It's the worse of all possible worlds when there is not a surplus of generation because then people can really play the market and exercise market control and get inordinately high prices for generation.

By the time deregulation was unfolding, California decided that it would jump out ahead of everybody

else. In fact, there was an opportunity here for the way they viewed it that the competition could drive down the prices. California had extremely high prices even then. The California legislature and others passed their deregulation laws. Those laws required that the utilities separate and either sell or create some other separate company that would take over their generation. It would separate the generation completely off and most of them actually ended up selling a lot of their generation to the non-utility generators. The law also then allowed the utilities to be held harmless to a certain extent because they would then compete with one another and the sellers would compete in selling to them and they could pass the cost back through directly to the customers. There were some other provisions in the law that allowed them to recover stranded investments, that is investments which hadn't been put in rate base or weren't completely paid off. What finally happened was the market was able to exercise control over the other side. We were in a true lack of surplus situation or a deficit situation.

There was an ever increasing demand than there was the supply, particularly in California. For years California had been hamstrung in the ability to build new generation. Environmental laws passed in the 1970's limited the utilities from constructing any type of thermal generation that wasn't natural gas and even the natural gas was limited because of the air quality standards within certain areas of California. The utilities were not allowed even to participate in nuclear plants. They could get long-term contracts for coal but they were scrutinized fairly heavily and coal was still a pretty good resource because it was relatively cheap and the utilities in the west that did control coal generation weren't really willing to sell off too much of that for too long a period of time. California has been in an ever decreasing spiral of the amount of generation and meeting an ever increasing amount of load. Along came total deregulation and there isn't enough generation or there is such a demand for the generation, both within California and coming into California, that the non-utility generators and other generators just drive the prices right up. If California were the only problem, we could solve the problem.