More evidence of price-gouging in California energy market

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9 June 2001

Over the past several weeks, additional evidence has surfaced regarding price-gouging by energy suppliers that sell electricity to utility companies in California as part of the state's deregulation scheme. More than $4 billion has already been drained from the state treasury to subsidize energy purchases. Unless the situation changes by the end of this year, experts predict the state will spend approximately $50 billion to cover soaring energy costs.

Earlier this month it was disclosed that Duke Energy Corporation charged $3,880 per megawatt-hour of power over an eight-day stretch from late January into early February. This price is more than double the highest previously reported price of $1,900 per megawatt-hour charged by Reliant Energy earlier this year. According to Duke, the company is charging a credit premium because state utilities had previously failed to pay their bills.

Duke maintains that if they are paid for the power, which amounts to $19.4 million for 5,000 megawatts, they will reduce the price by 80 percent. This would bring the bill down to $776 per megawatt-hour, or a total of $3.8 million. This price would still be double the average cost for the same month. According to the *Los Angeles Times*, if Duke's “premium” charge were passed on to consumers, the average household consuming 500 kilowatt-hours per month would see their monthly electrical bill rise to $1,940.

While California Governor Gray Davis publicly attacked Reliant Energy earlier—calling the company's practices “obstructionist”—the governor has said nothing regarding Duke. Earlier in the year Davis held closed door discussions with Duke Energy representatives who offered the governor political support if he toned down his criticisms of Duke and the deregulated energy market.

The revelations about Duke's price-gouging come on the heels of a May 25 filing by the California Independent Systems Operator (Cal-ISO), the institution that oversees the flow of power along the state's transmission grid, with the Federal Energy Regulatory Commission (FERC). Cal-ISO is demanding a $5.5 billion refund to the state.

Energy suppliers have used two principal methods to drive up wholesale prices in California, where power is sold by bidding on a spot-market. The first is called “economic withholding.” Energy corporations enter bids that are substantially higher than the actual cost of the power, with the intention of raising the market clearing price. The second method is “physical withholding,” which refers to the intentional restriction of the energy supply placed on the market, in order to increase the price of the remaining supplies of energy under the company's control.

Cal-ISO's May 25 filing cites reports by researchers who analyzed market conditions over the last year:

“Dr. Eric Hildebrandt found that 30 percent of the wholesale energy prices over the last year can be attributed to the exercise of market power and determined that, on an annualized basis, wholesale prices since January 2000 exceed the cost necessary for new investment by approximately 400 percent and would allow recovery of an investment in new supply in a period of just over one year. Dr. Sheffrin found withholding, especially economic withholding, plagued the market for most hours from May to November 2000. Of the 25,000 hourly bidding profiles studied, fewer than 2 percent displayed no clear pattern of withholding. The study provides direct evidence that many large suppliers actively have engaged in strategic bidding efforts, consistent with oligopoly pricing behavior, with a direct and substantial impact on market prices."

The energy suppliers have reaped vast profits from the deregulation of the energy market. In 2000, Reliant Energy's adjusted earnings rose 164 percent to $838 million. The company more than doubled its 2001 first-quarter profits over last year, earning $274 million. Close behind was AES Corporation, which saw net income in 2000 jump 189 percent to $658 million. Dynegy, which earned $452 million in 2000, increased profits by 210 percent over the previous year.

The Williams Corp. reported $873 million in income for 2000, and more than a 200 percent rise in first-quarter earnings. In a press release, the company boasts to current and prospective big investors: "The increase primarily was due to substantially higher profits from the energy market and trading business, reflecting successful proprietary natural gas and electric power trading during a year of nationwide volatility across these energy portfolios."

In addition to the Cal-ISO filings with the FERC, an administrative law judge with the commission heard testimony at the end of May by the California Public Utilities Commission (PUC) and Southern California Edison, one of the state's major utility companies, charging energy suppliers with price-gouging. The suit charges that the El Paso energy merchant group purchased pipeline capacity from El Paso Natural Gas and then withheld the fuel in order to restrict supply and drive up prices. Once prices had risen significantly, the natural gas was set flowing again. The head of El Paso Corporation, the parent company, admitted he approved the collusion between the two branches.

In the face of rising public anger against the energy conglomerates, the Davis administration, with the support of several Democratic state legislators and the City of Oakland, filed a largely ceremonial lawsuit against FERC for failing to ensure that wholesale energy prices are "just and reasonable." A federal judge threw it out.

The governor's base of support has been eroded by the continued threat of rolling blackouts this summer, his endorsement of steep rate hikes on consumers and his general prostration before the demands of the energy giants. A recent Field Poll found an 18 percent drop in Davis's approval rating since January, leaving the governor with well under half of the state population's support.

Davis has said he was considering suing FERC for a third time, despite the previous failures. He has also demanded that municipal utilities in Los Angeles and elsewhere—which were not deregulated under the state's 1998 plan and retained control of their generating facilities—sell all their surplus power to the state this summer at prices well below the market rate. The utilities rejected Davis's demand, confident that suggestions he might exercise his power to seize plants are a bluff.

While Davis is desperately searching for ways to appear pro-active, he is hemmed in on all sides by the Democrats' support for deregulation and his political ties to the energy industry. At the same time, as the governor's recent meeting with President Bush underscores, the Republican administration in Washington opposes even the slightest restrictions on the profits of the energy monopolies, such as temporary price caps.

A recent article in the *New York Times* disclosed the fact that Kenneth Lay, head of the energy corporation Enron, offered political support to Curtis Hebert, then chairman of the FERC, in exchange for support for deregulation policies that would provide windfall profits to Enron. In particular, Enron, which poured large sums of money into Bush's presidential campaign, is keen to get the federal government to push for opening up energy transmission lines owned by private utility companies—currently under the jurisdiction of state governments—to outside private control.