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ENRON BANKRUPTCY ROUSES DEBATE OVER NATIONAL ENERGY DEREGULATION

By Patrick Bryan

On December 1, 2001, Enron Corporation filed for Chapter 11 protection with the United States Bankruptcy Court in the Southern District of New York. The bankruptcy filing was only the latest chapter in the Enron saga that began in November 2001 with a sudden and unexpected restatement of the company's earnings. The earnings restatement caused intense scrutiny of Enron's accounting practices and a collapse of its share price. After a failed attempt to merge with its energy trading rival, Dynergy, Enron was left with mounting debts and numerous federal investigations into its practices, while Enron's investors were left with nearly worthless stock.

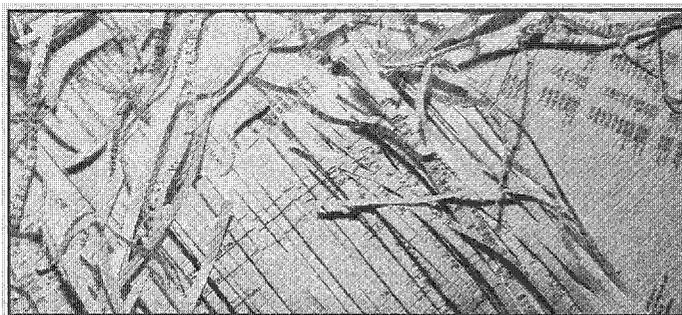
I. Enron and Energy Deregulation

From its meteoric rise to the seventh largest company in the United States (according to *Fortune Magazine*), to its precipitous financial collapse, Enron has long been at the center of the national debate over energy deregulation and an influential advocate of deregulation. The Enron collapse, however, has caused many public interest groups to question deregulation as a viable public policy.

The deregulation of the energy industry began with the passage of the Public Utilities Regulatory Policies Act of 1978. *P.L. 95-617; 92 Stat. 3117 (1978)*. This Act required regulated utility companies to connect their power grids to other non-regulated producers or sources of power. This allowed non-regulated entities to sell their power to the regulated power companies.

Deregulation took an important step forward in 1992 with the passage of the Energy Policy Act. *P.L. 102-486; 106 Stat. 2776 (1992)*. This Act deregulated the prices that utilities could charge each other for power they shipped across state lines. Although most states still regulated the prices utility companies could charge consumers, power utilities could profit from their excess generating capacity by selling their energy to those out-of-state utilities in need of more energy.

The passage of the Energy Policy Act led to considerable trading of power between utilities and thus created an expanded role for "power marketers" like Enron. Power marketers are companies that generally do not generate energy (although Enron was also a generator of electricity) but merely trade the energy produced by other utilities. These marketers make a profit if they can buy power from one utility and sell that power to another at a higher price. Power marketers thus enabled a utility company to sell its excess power not only to its neighboring utility company with which it shared transmission lines but inter-regionally and, in some cases, nationally.



Because consumer energy prices were still subject to state cost-based rate regulations, energy trading was constrained to the wholesaling of excess capacity. The rates paid by consumers of electricity were still determined by each state's regulatory authorities based on the cost to produce the energy plus a so-called "reasonable return" for the power company. Enron, and other power marketers, thus lobbied hard for states to deregulate their consumer or retail power markets, allowing consumer rates to be determined by market forces.

Until the California electricity crisis in the spring of 2001 cast a spotlight on these deregulation efforts, state deregulation of consumer power markets seemed inevitable. Almost half of the States had deregulated or had legislation pending to end the regulation of the rates consumers pay for electricity. Although California did not have a truly deregulated consumer rate market (California capped the rate consumers could pay), many states have viewed the California crisis as evidence that competition among power companies is

not necessarily good for consumers.

II. Criticism Mounts Against Energy Deregulation

The collapse of the biggest power marketer in the nation has given increased momentum to those who criticize the deregulation of electricity markets. Tyson Slocum, Research Director of Critical Mass Energy and Environment Program, argues that the deregulation of wholesale and consumer electricity markets has “removed accountability and transparency from the energy sector, allowing corporations like Enron to manipulate price and supply of electricity and natural gas through the exercise of significant market power.”

This sentiment is echoed by the Foundation for Taxpayer and Consumer Rights (FTCR). “Enron’s bankruptcy, after months of profiteering in California, shows that our energy system needs adult supervision,” said Doug Heller, a consumer advocate with the FTCR. “The power companies that promised consumer savings from deregulation acted like pigs at the trough and cannot be trusted to take care of energy service.”

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*-- Doug Heller, consumer advocate,
Foundation for Taxpayer and
Consumer Rights (FTCR)*

But has this distrust of deregulation caused by the California crisis and Enron’s bankruptcy translated into an end of state electricity deregulation? The answer may depend on whom you ask. Since March 2001, Nevada legislators repealed a law to deregulate consumer electricity markets less than two years after its passage. The so-called “customer choice” law allowed businesses and consumers to choose the source of their electricity. Likewise, Oklahoma legislators voted down a deregulation plan that once had looked certain to

pass. Moreover, states like North Carolina, Alabama, Colorado, Indiana and West Virginia, where deregulation once seemed certain to become reality, have since delayed such deregulation proposals in favor of further study. Illinois, however, is continuing its implementation of a limited deregulation plan passed in 1998. In Illinois, residential customers will be eligible in May 2002 to choose their electricity supplier but, like California, consumer electricity rates will not be subject to market competition until 2005.

Some consumer interest groups have attempted to capitalize on these state legislative successes. Many are now using Enron as an example of why deregulation cannot work. Consumer groups are now arguing that companies like Enron were able to use its position as a power marketer, a middleman between production and distribution of energy, to create false power shortages in California to drive up prices. Heller argues that power marketers overcharge for electricity by controlling supply in times of high demand.

Consumer advocates are concerned that if deregulation moves forward, Enron’s competitors, such as, Dynergy, Duke, Williams and others, will fill in the void left by the collapse of Enron. These companies “have been equally culpable in the price gouging that devastated California,” according to the FTCR. Groups such as FTCR and Public Citizen thus advocate that states not only halt plans to deregulate energy markets, but also to re-regulate those regions which have ended traditional energy rate regulation.

III. Supporters of Energy Deregulation Persist

Yet, others view the California energy crisis and the collapse of Enron as examples of other failures and not the failure of deregulation. Proponents of deregulation argue that California was not a failure of deregulation but a failure of the state legislature to truly deregulate. California’s plan to deregulate its energy market was a compromise between consumer advocates and power company interests. The result was that rates paid by consumers for electricity were capped while power companies were free to trade energy on the wholesale market and enter into binding contracts to sell their excess power.

Feature: Energy Deregulation

Therefore, when demand rose in the region, California power companies had already agreed and were obligated to sell some of their power capacity to other regions. California power companies were unable to purchase electricity at rates below the rate paid by consumer per kilowatt-hour to meet the higher demand and were unable to pass on the higher cost of energy to consumers. Thus consumers had no incentive to conserve energy through higher rates when capacity in the region was restricted by wholesale contracts. Proponents of deregulation argue that if consumer power rates were deregulated and free to fluctuate, consumer demand would have decreased and the crisis avoided.

“In my mind, it is a classic case of a company growing very fast and not putting in place the financial controls and management depth that was needed...The market has worked pretty efficiently.”

-- Nora Mead Brownell, Federal Energy Regulatory Commission (FERC) member

Enron is similarly viewed as a failure of business management and not a failure of deregulation. “In my mind, it is a classic case of a company growing very fast and not putting in place the financial controls and management depth that was needed,” said Federal Energy Regulatory Commission (FERC) member Nora Mead Brownell. Brownell contends that “the market has worked pretty efficiently.”

Some commentators have compared Enron to a “sophisticated dot-com” engaged in a risky trading strategy and argue that the collapse of Enron should not impede efforts to deregulate energy markets. In fact, deregulation at the federal level appears to be advancing despite the hysteria surrounding Enron.

Congressional leaders and federal regulators are moving forward on what had been a primary lobbying goal of Enron: reducing the local control of electricity transmission lines so that energy merchants can trans-

port and sell power more easily. Brownell argues that this legislation will open regional electricity markets and better serve consumers. Brownell recognizes that there are lessons to be learned from Enron’s collapse, but insisted that “we should not leap to the conclusion that competitive markets do not work.”

IV. The Future of Deregulation

Chairman of the Senate Energy and Natural Resources Committee, Senator Jeff Bingaman (D-NM) agrees with Brownell. “We have to look carefully at the causes [and] consequences of Enron’s collapse,” Senator Bingaman said. “But I don’t see anything in this that would keep us from moving ahead with open transmission access [of electricity lines] and these types of things.”

The Enron bankruptcy clearly has officials in Washington, D.C. and several states rethinking the future of the \$200 billion power industry. Although federal legislative efforts to deregulate transmission and power distribution at the wholesale level appear to enjoy solid support, consumer rate deregulation efforts have lost momentum in light of the California energy crisis and Enron’s failure. Although there does not appear to be consensus on erasing the legacy of consumer rate deregulation encouraged by Enron and other power marketers, the absence of Enron’s lobbying efforts and campaign largess will likely slow future state legislative efforts. Therefore, it is likely that the trend of exposing state-regulated consumer energy markets to direct competition will slow, despite the continued deregulation of the wholesale energy markets.

“...I don’t see anything in [Enron’s collapse] that would keep us from moving ahead with open transmission access [of electricity lines]...”

***-- Senator Jeff Bingaman (D-NM),
Chairman of the Senate Energy and Natural
Resources Committee***
