



Ideas in Action

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Utilities Deregulation -- A Different View

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First, the debate that is currently taking place is not about deregulation, but about re-regulation and restructuring the electric utility industry. The debate on re-regulation and restructuring is based on the correct assumption that the generation of electricity is not a natural monopoly, however most observers continue to recognize that the transmission and distribution of electricity remains a natural monopoly.

Why has this debate suddenly become a national issue? In my opinion it's simply the result of technological change in the production of electricity. Today, new natural gas-fired, combined cycle plants can be constructed and operated at less total cost than some of the plants used to provide electrical customers their needs. However, the incremental cost of these plants is less than the total cost of a new plant.

Fifteen years ago, when I was serving on the Florida Public Service Commission, new generation plants cost substantially more than the embedded cost of old plants. Large industrial consumers were satisfied to pay regulated embedded costs because that was less expensive than new plant costs. Currently, due to actions by the Federal Energy Regulatory Commission (FERC), competition at the wholesale level has been implemented. This action could bring benefits to all electricity consumers. It is too early to determine the value of those benefits, but it is clear that the benefits will be shared by all consumers, not just the large consumers of electrical power.

The real issue is whether retail wheeling would be more beneficial to all consumers than a competitive wholesale market. There are several issues that should be addressed in answering this question.

1. Recognizing that the cost per KWH of new plant, may be less than the embedded cost of some existing plant, would retail wheeling bring benefits to all consumers, or to less than all? Certainly one should determine the additional costs of retail wheeling in making such determination. If a competitive wholesale market is in place and new generation is acquired in a competitive manner, how and from whom would the added cost of transmission companies and distribution companies be recovered?

2. Under the current system, and under a competitive wholesale market, the company providing electricity is responsible for reliable service. If a utility provides unsatisfactory

reliability it can affect "the bottom line" and there is no question who is responsible. Under a retail wheeling scenario, fixing responsibility for reliability is more difficult and may well be impossible.

3. For a competitive retail market to work, someone must have the capacity they are willing to sell, at the same time no additional capacity is needed. This raises the question of how much new capacity is needed to create an effectively competitive market. In Florida we have about 40,000 MW of generation capacity. Even if we had 5,000 MW of new capacity we would still rely on 35,000 MW of the existing capacity to meet our needs. Are we going to pay existing utilities their cost of their entire generation or are we going to allow them to charge "market rates." If either alternative is allowed, does that mean the customers using the 35,000 MW will pay more under retail wheeling, less, or the same?

4. If the existing utilities were permitted to serve their existing customers who had an alternative, at rates that cover their incremental costs, but not their fully allocated costs, would there be pressure from large industrial customers for retail wheeling? Obviously, large industrials, like all other consumers, want the lowest price electricity possible, but if the total cost of new generation exceeds the incremental costs of existing generation, both the large consumer and all consumers would be better off, if the large consumers' needs were met by the existing utility.

5. What is the fair way to deal with existing utility assets, built prudently under the regulated model, if they are not fully recoverable in the competitive market? Most legislation suggests that these are "stranded costs" and would be recoverable from all or selected consumers. If this is true, then how will the cost of excess generation, which is necessary to create a competitive market, lower the price to all consumers.

6. Currently the nation's tax laws provide preferential treatment to selected providers of electricity. This preferential treatment is provided in federal income tax laws, state sales and use tax laws, ad valorem tax laws and subsidized loans. If we are going to have effective competition in the generation of electricity, or in the retail sale of electricity, shouldn't we level the taxation playing field? In a competitive market no provider should have a tax advantage over other providers. This issue should be of concern to TaxWatch.

I'm sure that there are other issues that should be considered, but the above issues should also be addressed in this debate. It is interesting that the states with the highest retail rates are the ones leading the push for retail wheeling experiments. Fortunately, Florida's rates are at about the national average, notwithstanding our lack of native boiler fuels.

Since the 1973 oil embargo Florida has taken several steps to ensure reliable electric service at a reasonable price for all consumers.

(a) In the early 1970's, to avoid having excess capacity the state required a certification of need for new electric generating plant and this has helped avoid having excess capacity, a problem faced by some states.

(b) About 18 years ago Florida instituted a broker system that provides incentives to all utilities to utilize the least cost generation available in the state. Since inception the broker system has produced savings to consumers in excess of \$800,000,000.

(c) In 1980 Florida implemented cost effective conservation programs. Florida did not implement conservation programs unless they met state adopted, cost-effectiveness tests.

(d) In the early 1980's Florida implemented incentives for the efficient generation of electricity and for plant availability.

(e) Florida's dependence on oil was reduced by an incentive program to construct additional import capacity of electricity from Georgia (we call it coal by wire).

(f) Florida did not require payments for cogeneration in excess of estimated avoided cost as some states did. However, because of the changes in circumstances, some of those cogeneration contracts are no longer cost effective.

(g) The Florida PSC is required to certify not only that new capacity is needed, but that the plant certified is the least cost alternative available and the result is that the benefits of competition in generation of electricity is shared by all consumers.

Florida's Public Service Commission currently is monitoring the activities of other states as they begin their programs of retail wheeling. Many states are experimenting with restructuring their electric utility industry. They should be viewed as appropriate laboratories for these changes. It's too early to determine the outcome of these experiments and it's too early to determine if competition at the wholesale level would be more or less beneficial than retail wheeling. If retail wheeling experiments prove more successful than competition at the wholesale level, states will take action to benefit their consumers, however it is too early to tell how these experiments will work out. One thing, however, is certain: no one is advocating deregulation as suggested in the article "Keep America Competitive."

About the Author

Joseph P. Cresse has been a non-lawyer Special Consultant in the areas of utilities regulation, legislation and economic and business analysis since 1986 with the Tallahassee law firm of Messer, Caparello & Self, P.A. He is an accountant by education, receiving his B.S.B.A. degree from the University of Florida. In his 31-year Florida State government career, Mr. Cresse has served in numerous positions, including as a member (1979-85) and Chairman (1981-1983) of the Florida Public Service Commission, State Budget Director for Governor Rubin Askew (1975-1978) and Assistant Secretary for the State of Florida Department of Administration (now the Department of Management Services). Mr. Cresse has participated in numerous state and national forums and committees in the areas of regulated utilities, budgeting, finance and taxation.

About Florida TaxWatch

Florida TaxWatch is the only statewide organization entirely devoted to protecting and promoting the political and economic freedoms of Floridians as well as the economic prosperity of our state. Since its inception in 1979, Florida TaxWatch has become widely recognized as the watchdog of citizens' hard-earned tax dollars. Without lobbying, Florida TaxWatch has worked diligently and effectively to build government efficiency and promote responsible, cost-effective improvements that add value and benefit taxpayers. This diligence has yielded impressive results: through the years, three-fourths of TaxWatch's cost-saving recommendations have been implemented, saving taxpayers over \$5 billion. That translates to approximately \$875 in added value for every Florida family.

The nationally distributed *City and State* magazine (purchased by *Governing* magazine) in 1989 published a poll of the nation's statewide taxpayer research centers. Based on this poll, the publication cited Florida TaxWatch as one of the six most influential and respected government watchdogs and taxpayer research institutes in the nation. In recent years, news stories about Florida TaxWatch have run in all Florida newspapers, *The Wall Street Journal*, *The New York Times* and *The Washington Post*. In addition, Florida TaxWatch has been featured on the prestigious *MacNeil/Lehrer Newshour* and several times in *The Wall Street Journal*.

Florida TaxWatch is a private, non-profit, non-partisan research institute supported entirely by voluntary, tax-deductible membership contributions and philanthropic foundation grants. Membership is open to any organization or individual interested in helping to make Florida competitive, healthy and economically prosperous by supporting a credible research effort that promotes constructive taxpayer improvements. Members, through their loyal support, help Florida TaxWatch to bring about a more effective, responsive government that is accountable to the citizens it serves.

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