Steffy: Worst of both worlds likely for Texas power consumers

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Power Lines near Clear Lake. (Photo: BFS Man)

Texas purports to have a free market for electricity, but to solve the problems with electric deregulation, regulators are turning more and more to a controlled market.

While we're unlikely to return to the days of monopoly utilities, regulators seem to be encouraging an oligopoly in which market power is concentrated among a few big companies.

Deregulation has been a flop for consumers, but this could actually make it worse. "Deregulation," of course, was never an accurate term. It was a sales pitch, a way to convince the public of benefits that never materialized.

By the end of the summer, any lingering pretense of a free market is likely to have melted away. As concerns about reliability mount, the Public Utility Commission is acting much as it would have in the old days of regulation — enacting policies to direct a specific market outcome.

If the PUC succeeds with its plan, improved reliability will come with higher prices and fewer choices for consumers — the exact opposite of the benefits promised when deregulation was introduced more than a decade ago.

"At every stage, they go further and further from competitive markets," Robert McCullough, a Portland, Ore.-based energy analyst who follows deregulation issues, told me recently.

Last week, I wrote about "voluntary mitigation plans," one of which has already been approved, under which the PUC will pre-emptively rule on potential market manipulation by big generating companies.

Those plans, combined with the PUC's earlier vote to raise the price limits on the wholesale market by 50 percent, will give big generators greater potential to control the market.

Meanwhile, the higher prices that are supposed to encourage companies to build additional generation haven't attracted any new capital.

In fact, NRG, the state's biggest power producer, just agreed to spend $1.7 billion for Houston-based GenOn, another generating company. NRG President David Crane hailed it as "a new era of scale, scope, and market and fuel diversification in the competitive power industry," but it's unlikely to bring many of those benefits to Texas.

Crane, in a conference call with reporters, said the merger won't result in new generation here. "We stand ready at our sites to build more as soon as pricing tells us it's time to build," he said. "The pricing point hasn't been there yet."

Don't expect it to get there anytime soon.

The PUC already has indicated it intends to double the cap on wholesale rates again next year. If you were NRG, would you be in a rush to build generation when you know you have the potential to sell power at double the current price limits next year?

As I've written before, the higher price caps mean more volatility in the wholesale market, which will make it more expensive for retailers — companies that sell you your electricity — to hedge against price swings. Already, one retailer, Epcot Electric, has gone under since the higher caps took effect. (YEP Energy acquired its customers and assumed their contracts.) More may follow.

In a free market, of course, weak competitors get driven out, but in this case, the PUC is adding volatility to the market and causing a shakeout of smaller retail competitors.

Companies with deep pockets — primarily retailers backed by generators such as NRG and TXU — are better able to weather the volatile market.

We've seen this happen before. In early 2009, NRG bought retailer Reliant for a song after Reliant got upside down on its hedges. It was the classic offer that couldn't be refused. NRG topped that deal by buying two other retailers: Green Mountain Energy and Energy Plus.

Even if the PUC succeeds in driving prices high enough to encourage more generation demand in a few years, the market by then will be more concentrated, less competitive and dominated by a few large players that share pricing power in both the wholesale and retail sides.

That may not be re-regulation, but it isn't deregulation, either. It's the worst of both.

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