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Another Friday Outrage

By PAUL KRUGMAN

When the E.P.A. makes our air dirtier, or the Interior Department opens a wilderness to mining companies, or the Labor Department strips workers of some more rights, the announcement always comes late on Friday — when the news is most likely to be ignored on TV and nearly ignored by major newspapers.

Last Friday the Federal Energy Regulatory Commission, known as FERC, announced settlements with energy companies accused of manipulating markets during the California energy crisis. Why on Friday? Because the settlements were a joke: the companies got away with only token payments. It was yet another demonstration of how electricity deregulation has gone wrong.

Most independent experts now believe that during 2000-2001, price manipulation by energy companies, mainly taking the form of "economic withholding" — keeping capacity offline to drive up prices — added billions of dollars to California's electricity bills. A March FERC report concluded that there had been extensive manipulation of prices in both the natural gas and electricity markets.

Using methods widely accepted among economists, the California Independent System Operator — which operates the power grid — estimated that withholding by electricity companies had cost the state $8.9 billion. This estimate doesn't include the continuing cost of long-term contracts the state signed, at inflated prices, to keep the lights on during the crisis.

Yet the charges energy companies agreed to added up to only a bit more than $1 million. That is, the average Californian was bilked of more than $250, but the state will receive compensation of about 3 cents.

Was the fix in? Given the Bush administration's record of catering to energy companies, FERC isn't entitled to any presumption of innocence. Still, the main problem seems to be with the commission's approach: even in the aftermath of large-scale price manipulation, it demands givebacks of excess profits only when it can prove that those profits arose from a specific prohibited action.

This leads to very low settlements, for two reasons. First, while an industrywide pattern is easy to identify, intentional withholding by an individual producer is much harder to prove. Though investigators have found a few smoking guns — control room tapes, e-mail, memos — a power shutdown designed to increase prices is usually indistinguishable from a shutdown for genuine technical reasons.

Second, since withholding drove up prices across the board, each company profited from other companies' price manipulation. So even if FERC forced each company to give back the profits from its own bad behavior, it would leave most of the industry's excess profits untouched.

State officials wanted refunds based on estimates of the overall overcharging that resulted from price manipulation. But my expert contacts tell me that the antiquated language in the Federal Power Act, the basis of FERC's authority, probably doesn't give it the power to enforce such refunds.

On the other hand, FERC clearly does have the power to abrogate long-term contracts signed during the crisis. Indeed, the commission's March report contained a strong hint: "Staff recommends using the analysis in the report to inform ongoing long-term contract proceedings and other complaints that long-term contracts are not J & R [just and reasonable]." But in June, on a 2-to-1 vote (yes, two Republicans against one Democrat), the commission upheld those contracts. So California, the victim of one of the worst abuses of market power since the robber baron era, will get no redress.

So what does this say about electricity deregulation?

There is a theoretical case for a deregulated electricity market. But making such a market work, it's now clear, requires at least three preconditions. First, it requires a robust transmission system, yet the recent blackout made it clear that we have now created a system in which nobody has clear responsibility for the transmission network. Second, it needs a watchdog agency with adequate powers to prevent and punish price manipulation; FERC doesn't have those powers. Third, that watchdog must not be an agent of the very companies it's supposed to be policing. Enough said.

I admire the virtues of free markets as much as anyone. But given what we've seen so far, any state government that lets the federal government prod it into deregulation is just plain crazy.