



## Overseer's Undercurrent

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Last week, California Public Utilities Commission president Mike Peevey challenged industrial power users to tell him why the suspension of direct access should be reconsidered. "There would be more of a drive to look at direct access if there was more of a clamor for it," Peevey said in his talk to the California Manufacturers & Technology Association energy conference at Lake Tahoe. He hinted that people wanting to end the nearly five-year-old suspension of customer choice should speak up.

I'm not promoting a pro or con position but believe there is a real need to debate whether direct access should be revived as a retail services option.

The commission should certainly take another look at the suspension, but not as part of the resource-adequacy case, where it is currently lodged. The issues deserve to be considered in a comprehensive, coordinated fashion and not parsed over a half-dozen proceedings as they have been in recent years. Perhaps that means waiting until the election campaigns and peak energy-use periods are past us. Something tells me that this summer would be made even less bearable by overheated rhetoric from either side of the issue.

As readers will no doubt recall, direct access ("customer choice," as it is called everywhere else) was among the first victims of the 2000-01 energy crisis.

Supposedly a linchpin of market restructuring, choice never advanced much beyond a modest foothold in retail electricity sales. At most, about 225,000 households and another 30,000 or so commercial and industrial end users elected to purchase power from nonutility electric service providers, what we call ESPs. Just before the crisis hit, about 16 percent of total regulated utility load had been transferred to ESPs, but most of that was attributable to bigger power users. Residential consumers never really saw much savings from the program, though there was at one time a healthy market for "green power" products sold at a slight premium over the frozen utility retail rates.

In the first wave of market quakes during the summer of 2000, many ESPs found themselves unable or unwilling to stand by their commitments and returned customers to utility service. There was no real penalty for doing so, even though it made an unstable market even shakier. Other retailers tried to hold out and, in fact, are active in the market despite emergency changes to state law and the CPUC's September 2001 directive freezing direct-access sign-ups.

Currently, there remain about 45,420 accounts taking direct-access service: 23,900 residential customers, about 20,000 commercials, 1,056 industrials, and 313 farms. After holding steady for a few years and even regaining some ground after the suspension, those numbers have been eroding gradually, dropping 15 percent since a year ago. Residential erosion over the past year has been about 25 percent.

Most of the active ESPs were on hand at the CMTA meeting - APS Energy Services, Commerce

Energy, Constellation NewEnergy, Sempra Energy Solutions, and Shell/Coral among them. It seems they do a lot of trading of customers as well as electrons.

Larger customers remain the stronghold, with almost 1 in 5 industrials consuming 28.5 percent of load for that class, and 1 in 20 of the larger commercial clients buying about 14 percent of the sector's energy demand from ESPs. More than 20 million KWh of energy is sold under direct access, roughly 10.8 percent of the utilities' load, which has grown to about 190 million KWh annually.

There have been fitful attempts to revisit choice, in proposed legislation and especially in Governor Arnold Schwarzenegger's early interest in a "core-noncore" market structure that would restore choice for larger customers, as long as they paid for the privilege.

Those ideas never went far, because of a lingering taint on all aspects of restructuring. Former regulators Loretta Lynch and Carl Wood frequently expressed the sentiment: "Direct access is a hidden tax on residential and small business customers to subsidize the electricity bills of the big users."

If that was ever true, which I doubt, it certainly isn't now. Industrial customers had their rates hiked most during the crisis, while residential customers had a cap put on their increases. If there was a subsidy, it was within the same class. But I don't buy the notion that direct-access customers unfairly escaped any costs.

Arguably, all of the conditions imposed by lawmakers for resumption of direct access have been met, notably the restoration of utilities as the procurement agents. The Department of Water Resources was relieved of its emergency backstop role back in 2003. Many financial protections have been put into place since; surcharges of several flavors are inescapable; and ESPs and other load-serving entities must meet the same utility-grade standards for resource adequacy, reliability of service, and renewable energy purchases.

There are still issues to be worked out, because ESPs are simply not the same as regulated utilities - although they must operate under the authority of the CPUC in most regards except the rates they can charge.

Restoring direct access does not solve all of the market concerns that linger, but neither does it threaten system reliability or the financial health of the utilities. There might even be benefits that accrue by providing an alternative wholesale market for needed generation that is still unable to secure utility power sales contracts, such as for Calpine.

As I review retail markets around the country, I see mixed results from the choice experience. But the biggest failures stemmed from unreal expectations and regulatory constraints preventing true competition - including the common mistake of freezing retail rates, which is now coming back to haunt regulators in several states.

I don't know that household direct access will ever be a big success, but that shouldn't foreclose a debate over reopening choice.

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