Restructuring in the Rearview Mirror – a 10-Year Retrospective of California's Doomed Experiment with Electric Deregulation. By The Energy Overseer

Success and Failure in the New Energy Marketplace

Here we are, barely six months into California's new energy marketplace and already everybody wants to pronounce it either a terrific success or a dismal failure. I'm not ready to declare a final judgment either way. I believe that things are working out pretty much as expected--as long as you didn't have unrealistic expectations to begin with.

On the positive side, new market structures in the form of the Power Exchange and the California Independent System Operator are up and running and doing the job every day. Some days are more of a challenge than others, such as earlier this week when the ISO's administrative communications system temporarily went haywire and the PX's price-posting server malfunctioned. But during the historically stressful record-load days of August and September, the ISO successfully delivered nearly 45,000 MW through varying states of emergency without major problems. The customer load curtailment program inherited from the old utility contract system proved still viable and the addition of the PX's hour-ahead market appears to be lessening the pressures on the ISO's supplemental energy market.

During the past three months, the PX has had notable price volatility--as must be anticipated--and yet the average price is still pretty much what was forecast all along: $0.025/KWh. For the past two weeks of low loads, the average PX price has reverted to the predicted level.

The biggest ISO difficulty so far has been the late-July spike in ancillary service charges that led to imposition of an arbitrary and controversial price cap. The huge price swings are a transitional situation, unlikely to be repeated anytime soon. But they took system operators by surprise and have raised legitimate concerns--both for transmission controllers and for power generators. Working out the operational kinks is a priority. A longer-term need is to add more competitors into the currently "thin" market for reserves.

The billing settlements process represents the greatest current challenge for wholesale generators and scheduling coordinators. It is definitely problematic because it takes nearly three months for people to get the final tally for buying, selling and moving power. And, from most accounts, it seems that everyone involved is having to devote far more staff resources to the settlements process than anticipated.

From the general media's perspective, there is a lot of emphasis on the fact that residential direct access has not been a huge success--as measured by the fact that less than 1 percent of eligible customers have chosen alternate energy suppliers. Secondarily, the most recent spate of news headlines seems to be declaring "green marketing" a failure.

On these counts, I must disagree. Nobody who was paying any attention during the formulation of restructuring policies at the California Public Utilities Commission or in the Legislature believes that the system was set up to facilitate residential direct access. Stranded-cost recovery polices, the mandated 10 percent rate decrease and the high costs of customer acquisition and market entry are well-understood barriers to retail customer choice during the transition period. Some challenges--price volatility and billing settlement uncertainties--add mightily to the difficulties for energy service providers who are solely targeting residential customers.

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This week's lead story is about the economic troubles of three ESPs that have resulted in thousands of customer "reversions" to bundled utility service. Richard Rudden, an energy market-research consultant, this week told a meeting of the National Association of Business Economics that there is a difference between the failure of competition and the failure of some competitors. "The early disappointments and failures of companies that entered the competitive fray a little too aggressively or too early need to be recognized as the natural and inevitable costs of competition and structural change, not an invalidation of it," he said. Rudden may have been alluding to the numerous market-defections by wholesale energy sellers in the wake of the Midwest summer price spikes, but his observation holds true for the retail level of competition as well.

At the same time, certain ESPs are claiming substantial success. New Energy Ventures, for instance, boasts of capturing 40 percent of the current direct-access market in California.

Anybody could have predicted that industrial direct-access would be more successful than residential choice, and the numbers bear that out. Compared to the less-than 1 percent of residential switches, more than 14 percent of large industrial entities--representing over 21 percent of load--have chosen non-utility providers. The real news is that a company such as NEV has been able to carve out a substantial niche among small and medium commercial customers. The 10 percent rate savings that NEV claims for its customers will translate into millions of dollars and would not have been available without direct access.

As for green energy, whether you consider it a success or not depends entirely on what you expected to happen. A news story this week from the *Rocky Mountain News* sees "weak interest" for renewable resources in California. Only 20,000 or 30,000 residential customers have signed up for green power, laments Ryan Wiser of Lawrence Berkeley Labs, a "tiny fraction" of the state's 9 million residential customers.

Put it in context: That's 30 percent to 47 percent of the total numbers of residential direct access. To me, that's a pretty strong indication of success, not failure. Other indications are that the green marketers appear pretty happy with their results. Green Mountain Energy Resources is using its California program as a platform for national expansion. Even Keystone Energy, which unceremoniously dumped its "shared savings" customers because it couldn't make any money on them, says it is exceeding expectations for signing up customers under its EarthChoice all-renewables program.

Another indicator of success: Green power, which was always considered a residential-only product, is capturing some commercial customers--Toyota Motor Sales and Patagonia among them. Those are modest achievements, to be sure, but they show it can be done and there are commercial entities willing to express an environmental commitment with their energy dollars.

Six months into the transition to a new electric services market is far too early to declare success or failure. At present, we can only say for certain that much work remains to be done **[Arthur O'Donnell].**

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