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

The New Marketers

After three years of discussion and debate at the California Public Utilities Commission and the state Legislature, key regulators, lawmakers, utilities and dozens of "stakeholders" to the process have determined the basic outlines of how California's utility industry will be restructured beginning January 1, 1998.

But the full extent of change is really anybody's guess. Companies are changing names, shifting focus and creating new alliances. Once the new competitive market moves into operation, there will be unexpected events, unpredictable players and unforeseen developments that will be as important in determining the shape of the market as any regulatory decision or pronouncement by lawmakers.

We know what the components of the new market will be, but—at this point—we do not know precisely how they will work. California's investor-owned electric utilities will give up major aspects of their historic monopoly over the generation of electricity. They will transfer control over the buying and selling of power and energy resources to a new Power Exchange (PX), and they will hand over responsibility for the transmission of electricity to an independent system operator (ISO). Investor-owned utilities will maintain their role as distributor of electricity to end-users, but even some elements of that monopoly—metering and billing services—will be opened to competition.
When the new Power Exchange begins operation on January 1, 1998 [Ed. note: Later delayed until March 31], it will serve as a proxy competitive market for the electric power delivered to consumers who choose to remain with the local distribution companies.

But California end-users of all types will have the ability to choose power suppliers other than their territorial utility in the broadest application of Direct Access (also known as consumer choice or retail wheeling) yet attempted in the United States.

Who are these energy suppliers? What kinds of services will they be offering? And at what price? Who are the customers that will take immediate advantage of direct access? Will they realize any real savings on the cost of Direct Access power, compared to prices available through the Power Exchange?

These are questions that cannot yet be answered. The initial year of the new marketplace is bound to be one of trial and error. The Power Exchange price will fluctuate greatly—from season to season, from day to day, even from hour to hour. Many customers will choose to watch the market very carefully before committing to new power providers. Others will jump in head first, willing to accept the risk of the new market in order to achieve what they see as "early savings" opportunities.

How many marketers will set up shop in California? Again, that is anyone's guess. There are currently about 300 power marketers who have won certification from the Federal Energy Regulatory Commission to buy and sell electricity in wholesale power markets across the United States. Not all are active, but they all expect to be.

Many of them are considering ways to serve Direct Access retail markets in California and other states where competitive schemes are being attempted. Many firms that were previously consultants or utility analysts also see an opportunity to become power marketers. Some companies that formerly sold products and services only to utilities are now realizing that their potential market has been expanded to every single buyer and user of electricity.

How many of these marketers will earn a profit? Probably not very many at first. Some marketers will fail to make the grade in a highly competitive field. And, as occurred during the restructuring of the natural gas markets, some might go out of business, leaving their customers to fend for themselves. The rules of the field ensure that a stranded customer's lights will not go out—but the cost of replacement power provided by the LDC or the Power Exchange may be significantly higher than expected.

For this reason, it is especially important that customers learn how to minimize the risks inherent to an evolving marketplace. We believe that the best hedge against risk is accurate information about the market and about the market players.

In many cases, these companies are already in place, and we have drawn upon our reporting of their activities to provide a base of understanding about their expected strategies in the future. Several are major traders in regional bulk power markets or members of the Western Systems Power Pool. A few are spin-off affiliates from existing utilities. Others are brand new to the electric power industry but bring experience from telecommunications, finance or another competitive services industry.

Some marketers have been committed to the restructuring process for two or three years, participating in the many forums where restructuring rules have been developed. Others are already actively recruiting potential customers, or—in their capacity as buyers' agents, aggregators or brokers—they have been signing up other marketers to supply energy for their portfolios.

In every case, they are looking to California to be the field laboratory of the new competitive electric industry. And because they intend to be successful, they are pulling out all the stops. How they intend to implement their winning strategies is the major focus of these profiles.

• **The National Brands** are companies that expect to be active throughout the US. In fact, several—such as Enron, Southern Energy, LG&E and Duke Energy—have already made significant attempts to turn themselves into household names and have spent considerable sums on advertising to spread the message. These firms usually bring both a national presence and special expertise in ancillary services—natural gas marketing, finance, or both—to augment their electric marketing efforts.

In the fiercely competitive world of the future, in which some analysts see only a few "mega-marketers" remaining after a few years, these are the companies who intend to be among the survivors.

• **The Regional Power Houses** may have ambitions to match those of the national brand names, but they offer a particular kind of experience as developers and operators of independent power facilities of a wide variety of technology types—hydro, cogeneration, geothermal, biomass, wind, solar, and so on. In a very real sense, independent power developers were the pioneers of the competitive marketplace. For more than a decade, they tested the boundaries of the electric utility monopoly and helped establish the regulatory rules for open access to transmission services that are the platform upon which the competitive marketplace has been built.

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Because California and other Western states were traditionally the most active marketplaces for non-utility power—with more than 1,000 independent power facilities of every technology—this is also the region where many of the power houses got their start. As companies such as Calpine, US Generating, Tenaska and others turn to retail services, they will rely on Western credentials as an important calling card.

• **The Utility Affiliates** may derive their names and, in some cases, their financial support and key personnel from the monopoly utilities, but they purport to be something entirely new. California's IOUs have established energy marketing affiliates that are trying to redefine the nature of energy services in a post-regulated environment. So far, they have not been entirely successful or completely focused on what they want to be when they grow up. But each appears to have the resources and the full commitment of its parent corporation to become a major player regionally and/or nationally.

The California firms are also joined by affiliates of other regional utilities who see an unprecedented opportunity to capture new business outside of their traditional territories and beyond the boundaries of regulated returns on investment.

• **Irrigation Districts and Municipal Alliances** represent "wild cards" in California's new marketplace. Not strictly falling under the jurisdiction of the CPUC or restructuring law AB 1890, these entities nevertheless will exert a major competitive influence. Several irrigation districts are looking to expand beyond their traditional service territories to steal customers away from the IOUs. In a few instances, districts will be entering the retail electric service business for the first time—taking advantage of legal exemptions from having to pay for utility stranded costs that will be assessed via "competitive transition charges" (CTCs) on virtually all electricity consumers in the state for the next four years.

Municipal utilities are also being drawn into the competitive fray—some willingly, some not so willingly. Munis are responding in very different ways: The Sacramento Municipal Utility District is taking steps to implement Direct Access even before the IOUs do; the Los Angeles Department of Water & Power is considering a "strategic alliance" with national power marketer Duke Energy Trading & Marketing; and other munis are soliciting proposals for alliances or competitive services. In some cases, the munis will be customers of marketers, in others, they will be fully competitive partners.

• **The Niche Players** are already on the scene, developing what might be considered a brand new set of services for the electric utility industry. They might be aggregators who have established power buying pools for like-minded customers in the public sector or commercial fields. They might be consultants/marketers who will advise clients as they take their first steps in the new marketplace. They could be suppliers or packagers of "green power" who see the opportunity to create a stable commercial footing for renewable resources based on customer preference for clean power.

In any case, these players are pushing the envelope of available services and they will be in the forefront of the new market as it eventually expands beyond California **[Arthur O'Donnell].**

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