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

The Summer of Discontent

Even before the price spikes and system emergencies began in May, California businesses were beginning to sour on the competitive marketplace. Earlier in the spring, we'd had indications that direct-access programs in California were bogging down. New signups among commercial and industrial classes were slowing to a trickle and in some cases were offset by reversions to utility service.

As contracts signed the year before came up for negotiation, there was a distinct tension between buyers and sellers. No longer was a slight discount off the California Power Exchange price good enough--for either party. Sellers, who were likely to be losing money on the deal unless they had extremely good supply contracts in hand (or renewable power credits from the California Energy Commission), were looking to expand the services they were selling and to boost the price to a more sustainable, stable level.

Buyers, previously content with the 3 percent or 5 percent discount generally offered in contracts, began sniffing around to see if there might be better offers. A small but increasing number of customers moved from one ESP to another, according to the figures provided by utilities.

We didn't realize it then, but the few cases in which we were witnessing this dynamic--one example was the Commonwealth Energy deal with the San Diego Association of Governments (SANDAG)--would turn into an avalanche of direct-access defections once the summer spikes began in earnest.

Because of the difficulties that energy service providers were having finding power at reasonable prices, extending their credit to bankroll wholesale purchases or even figuring out what price they were competing against as utilities increasingly turned to nontransparent forward contracts, the reversions from competitive supplies to utility bundled services appear to be as much a case of ESPs turning back clients to avoid deep losses as of customers deciding to seek the shelter of utility tariffs.

The numbers are now telling us that the situation is more extensive than first thought. Revised June reports from Pacific Gas & Electric show that tens of thousands of direct-access customers have been returned to utility service in the past two months alone. We expected some of this, given that Commonwealth Energy had publicly admitted sending up to 18,000 customers home and NewEnergy dropped two-thirds of its commercial load.

But the loss of more than 35,000 "choice" accounts in June and July signals a serious setback to the competitive market. The level of direct-access participation has been turned back to that of last November--but then the motion was forward, inching toward a milestone of 200,000 accounts.

Now the momentum is arrested and possibly reversed. August has been no better for the market than June or July.

Even though there have been some 16,000 switchbacks of residential customers in recent months, the new signups among households have pretty much balanced out the ledger.

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Here, I'd like to consider the relatively large-scale defections of commercial and industrial customers from the power market, in part because these are the energy consumers who were thought to have the most to gain from entering direct-access relationships with ESPs. But with industrial direct-access participation dropping by about one-third since spring and larger commercial accounts falling by the thousands, there is obviously a disenchantment with retail choice that bears exploring. The problem may even go beyond spiking prices.

One indicator of the brewing discontent comes in the results of a survey of business accounts and other large energy users by RKS Research and Consulting. The firm, which counts utilities among its steady customers for intelligence about consumer preferences and sentiments, said that its latest National Business Customer Assessment and Key Accounts surveys conducted in May reveal that many commercial customers were disappointed with the savings and services offered by competitive electric service providers. The key accounts that stayed with their utility were far happier than those exercising retail choice.

RKS vice president Carmine Grastatero told CALIFORNIA ENERGY MARKETS that the issue is not just price. "Electric service is unlike any other product. Consumers generally associate higher prices with higher quality, but exactly the opposite is true of electricity," he explained. "As prices go higher, people perceive a lower quality. People complain not only about price but about everything else as well."

The business survey is national but divided into regional components. California businesses make up about 10 percent of the sample in the survey of 1,021 commercial enterprises and 37 out of the 402 key accounts. A key account is defined by RKS as a company with multiple sites that spends more than $2 million annually on electricity.

In the survey, it was found, only one-third of these largest users who switched energy supplies give their new providers high marks for service, and three-quarters of these customers are willing to let their utility meet or beat any competitive offers.

About the only customers who seem pleased with choice are those that take more comprehensive services from the supplier, not just commodity energy.

Customer service remains the key determinant of satisfaction, RKS found. "The only ones who are getting good marks are the traditional utilities," Grastatero concluded.

In follow-up contacts with energy managers, it became apparent that the discontent with direct access came down to the imbalance between risk and reward. "An energy manager is a 'cost center' for business," he observed. It takes a lot of effort to secure competitive power supplies, and if they cannot get something out of the effort, adding up all their time and the difficulties of getting higher-ups to sign off on any deals, "there may even be a negative return," he said.

Several managers said that they should have expected price volatility, but because the marketing focus was all on energy savings, they are only now beginning to realize that prices would go up as well.

Although utilities are almost always happy to welcome back lost business--despite any protestations that they are not really competing with ESPs--Grastatero said there is an increasing reluctance to sign long-term special contracts. Standard tariffs or one-year deals are the best a company can hope for. "And nobody negotiates during the summer because they don't want to get caught by surprise if prices turn out differently than expected," he said.

RKS contacted customers from one large ESP in California who were returned to their utility. Responses indicated that customers may be even more wary about entering competitive waters in the future. "They got a warning but no choice. They're in 'wait and see mode.' They won't switch to another provider immediately because it means more work, and they're not sure about the returns," Grastatero said. "Deregulation is not worth the effort as long as they perceive high prices" **[Arthur O'Donnell].**

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