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

After the Freeze in San Diego

As California works through the legendary "transition period" to a new competitive marketplace, one of the ideas that sustain new retail marketers is "Everything will change once the CTC goes away." With utility stranded costs off the books, rates will no longer be frozen and will better reflect actual market conditions. Competitors hope this will introduce actual price competition between utility and non-utility sellers. This has had one effect so far: an increase in direct-access sign-ups. Less clear, however, is any effect on rates.

The competition transition charge is an elusive figure in that it is different for every class of utility customer and changes with each billing period. In fact, the CTC varies on an hourly basis for those equipped with real-time metering. CTC is best measured by taking the difference, or headroom, between the posted utility tariff (frozen at mid-1996 levels) and the sum of all fixed costs of utility service (transmission, distribution, public benefits, nuclear decommissioning and rate-reduction bond payback) plus the variable Power Exchange price. During the four-year transition period, utilities are able to collect that headroom, book it into a balancing account and then put it into their bank accounts.

Although I've seen projections that CTC will account for as much as 38 percent of a household's electric bill, my own case so far has proved different. As a customer of Pacific Gas & Electric, I find that my average CTC since April 1998 works out to 9 percent of all my power bills--almost exactly one penny per kilowatt-hour. This average, of course, masks huge fluctuations inherent in the design of the charge as the monthly PX average varies. At its highest (not surprisingly, when the PX charge was at its lowest), my personal CTC reached 32 percent of the monthly bill. At the other extreme, there was one month when the CTC was a negative figure because the sum of the PX and other rate components exceeded my frozen rate.

Now, as everyone knows, San Diego Gas & Electric's four-year transition was truncated into an 18-month period. The utility declared that, thanks to above-book sales of its power plants, it had already collected enough money and was ready to terminate the rate freeze and transition period on July 1.

Concerned that ending the freeze just before summer peak periods might expose residential customers to Power Exchange price volatility, SDG&E and state regulators agreed to put a cap on price swings, such that household power rates would not move higher than 112 percent of the previously frozen rate through September.

Now that summer has passed, so has the interim rate cap period, and San Diego electricity users will from now on see their energy costs rise and fall with the general power market. For some marketers, that could prove to be an opportunity, if they can offer customers a better price than the PX average or even a deal that smoothes out worrisome price volatility.

One of the panel discussions during the well-attended and well-received conference "Restructuring in California: Surviving the Transition" that CALIFORNIA ENERGY MARKETS co-sponsored this week with Law Seminars International and Wilk & Associates was devoted to the San Diego situation. Speakers were Bill Reed, vice president of regulatory affairs for SDG&E and Sempra Energy, Michael Shames, the executive director of the Utility Consumers' Action Network (UCAN), and Nancy Day, vice president of customer marketing for NewEnergy.

Although there was quite a difference in the perspectives offered by utility, consumer advocate and energy service provider (to say the least), the discussion brought out some indications of what San Diego has experienced in the initial post-transition period. Whether the exact experience will be repeated in other service territories cannot be predicted, but many people are watching for any sign that anything will in fact change once each utility ends its freeze period.

For the record, it is important to note that CTC will not completely disappear for quite some time. As per restructuring law AB 1890 and California Public Utilities Commission policy, certain costs of transition will linger, contract payments to independent power producers and employee costs among them. Nuclear incentive payments may follow different timelines than the general CTC period specified in AB 1890, and the rate-reduction bond payback period lasts a full decade, even though the discounts end within four years.

As a result, for instance, Southern California Edison ratepayers may see a continuing CTC of approximately $0.014/KWh--higher than I've been paying PG&E on average--based largely on continuing nuclear and QF costs. Bond payback diminishes over time but will add at least another $0.01/KWh to the monthly household bills.

But SDG&E has a much lower tab for independent power, and while it owns 20 percent of the San Onofre nuclear units, it intends to sell them and the associated liability to some other party. If so, continuing CTC may be minimal and power rates for San Diegans will track the market.

According to Reed, one of the apparent effects of ending the freeze was a boost to direct-access sign-ups by customers. While the utility was conducting an extensive media campaign to inform customers about the change and to alert them to the issue of PX volatility, a few marketers capitalized on the promotion by promising discounts off the PX price or a more stable rate structure.

This had the result of increasing direct-access sign-ups in SDG&E territory. Reed showed that total direct-access service requests increased from 1,800 in May to an average of 5,000 in June and July – a change he calculated as a 180 percent increase. Much of that was in the residential sector, particularly reflecting actions by green power marketers to capture more customers. Even in the large commercial and industrial sector, though, SDG&E noted a 150 percent increase in DASR figures once the freeze was declared over.

These are, of course, preliminary figures and do not include August or September (or the unknown future), but they may be compared to the statewide change in direct-access figures, which have increased about 30 percent since June. That's a healthy increase, but nowhere near the 180 percent rise for SDG&E.

So, at least by this single measure, ending the freeze in San Diego has resulted in a documented market change.

What about rates? This is a more complicated matter and must be viewed in the context of summer prices.

Several speakers at the "Restructuring in California" conference noted that summer 1999 was cooler than average; one even termed it "the coolest summer in 32 years," although that could have been a joke about 1967, the "Summer of Love" in San Francisco. The state's system was beset by fewer system emergencies and less severe emergencies than during 1998, although PX price volatility appeared to be equivalent. Overall energy scheduled through the Power Exchange day-ahead market was about the same as last year, but the California ISO recorded a new system peak in July that was 1,000 MW higher than the peak of August 1998 for transmission use.

Still, according to figures provided by John Yurkanin of the CalPX, this year's average market clearing prices on the PX day-ahead auction proved far lower than those of 1998.

On the surface, this suggests that San Diego customer rates ought to be lower simply because the PX price was lower by about 20 percent on average. This was borne out by figures from SDG&E's Reed, comparing current rates for various customer classes with the previously frozen rates

We see a generally positive change emanating from the end of the freeze, at least compared to prior rates. But these figures beg a question: If the PX rate was 20 percent lower and the CTC is gone, why is it that San Diego's customers are not seeing a much lower level of discount? Where is the total 20 percent discount that AB 1890 projected once the rate freeze and transition period end?

For this I don't have an answer, but UCAN's Shames has one: The end of the freeze has had no impact on customers at all, he said, and all of SDG&E's numbers are suspect. In fact, Shames offered a countering estimate that suggests residential rates are now actually slightly higher than they were before the freeze went into effect. NewEnergy's Day joined in with an allegation that Sempra (and the other utilities) are "breaking the deal" made in AB 1890 by inhibiting customer choice in scores of ways.

This is a dispute I cannot arbitrate, only report. But I will offer some observations about the future, whether the other utilities end their rate freezes early or carry them out through the full statutory transition period.

Continued price reductions are by no means a certainty. They depend on future conditions in the market and price trends on the PX (modified by transmission congestion costs for particular areas and settlements incorporating ancillary service costs from the ISO). They also depend on how successful utilities are in boosting distribution charges to make up for lost revenues from their now-gone generation facilities.

But whether residential customers see any price benefits at all will depend on how regulators decide to allocate those benefits across customer segments. The initial proposals by utilities tend to favor larger customers at the expense of smaller ones (no surprise there), and the initial results from SDG&E bear this out. If that's the case, then nothing really changes **[Arthur O'Donnell].**

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