There's A Silver Lining Around the Cloud of California's Power Crisis

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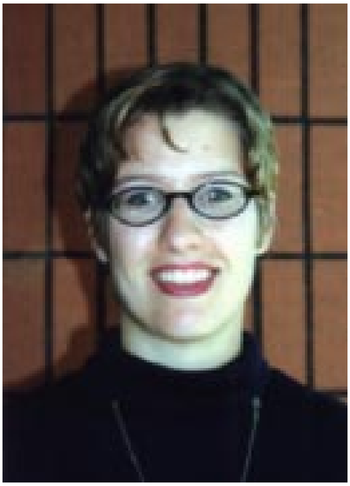

Editor's Note: Once again, California has lead most other states—and the Federal government—in tackling a very tricky process: deregulating an electricity system. California is also a leader in working to solve the complex, unforeseen problems that deregulation has created. Readers in every state can learn from this report on the "California Experience."

"Broken" and "dysfunctional" are two of many unflattering descriptions used to describe the state of California's deregulated electricity system. Wholesale power caps have been cut from $1000/MW to $250/MW. San Diego residents are urged to ignore their current bill and only pay as much as they paid for energy last year. A recent report created for Governor Davis is critical of the current system and, while not calling for reregulation outright, concludes that restructuring was a bad idea.

With rolling blackouts and soaring prices, California has become the poster child for what not to do in deregulation. However, deregulation is not the sole cause for the current electricity crisis. Perhaps the biggest problem in California today is the supply shortage. Simply put, supply has not matched demand. For the past three years, with the current backlog in generating plant construction, utilities have felt the power crunch in the summer months in California and lost tens of millions of dollars in the volatile wholesale market.

San Diego Gas & Electric, the first utility in the state to recover its stranded costs, has passed on the price crunch to its customers and the public outcry has been sharp. In a quick fix attempt, price caps were lowered to $250/MW.

This move, however, is one frequently denounced by economists since it creates an artificial demand price. The growing pains felt in the restructured California electricity market are quite evident, but manipulation of the demand price is unlikely to result in market relief. Supply and demand in a free market cannot hope to balance if the market is manipulated.

THE GOOD IS OFT OVERLOOKED

Out of all that has gone wrong in California's pioneering effort in deregulation, what has gone right is oft overlooked. The success of green power in California was an unexpected benefit to restructuring and the accomplishments are related, in large part, to deregulation. Green power includes such renewable energy technologies as wind power, solar, geothermal, biomass, and small hydropower (less than 30 MW). The definitions of what is green and what is renewable vary by state.

California's market, since its opening at the end of March in 1998, has always shown a fairly slow and steady rate of customer switching. Currently, about 2.2 percent of eligible customers have switched suppliers. What is significant, however, is that nearly all of the approximately 160,000 customers have switched to green power suppliers.

When the market first opened, the residential market was all but ignored and most marketers focused on the larger commercial and industrial accounts. At its peak, more than 200 energy service providers had registered with the California Public Utilities Commission (PUC) for participation in the direct access market. The majority of these did not have green power offerings.

In February of 1999, only six energy service providers remained active in the California market and all marketed green power. As of June of this year, there were 23 green power marketers registered with the California PUC providing service to residential and commercial customers. Of these 23 providers, 7 are certified to use the *Green-e* logo, which means the products that they offer meet the program's minimum requirement of 50 percent renewable content.

The success of green power has been indicated by consumer groups in other ways as well. The Los Angeles Department of Water and Power (LADWP) currently has the most successful green pricing program in the country. The *Green Power for a Green L.A.* program, launched in May of last year, has 31,000 customers as of April 2000. The LADWP program purchases four to five million kWh of renewable energy each month through the Automated Power Exchange (APX). Additionally, it purchases 1.2 MW from a landfill-gas project.

SMUD'S GREENERGY PROGRAM

The Sacramento Municipal Utility District (SMUD) also has a successful green pricing program. The *Greenergy* program supports 6,100 customers (as of April 2000). While it has less participants than the LADWP program, *Greenergy* is the fifth most successful pricing program in the nation (in terms of number of customers participating). The utility has also installed more than 450 residential and 30 commercial PV systems through its *PV Pioneers I* program (launched in 1993). Under the program, participants pay a small fee to have a grid-connected PV system installed on their roof. The electricity produced is fed back into the grid. *PV Pioneers II* was launched late in 1998 and is expected to result in 400 system installations a year. Under this program, customers may purchase a PV system under a net-metering agreement with SMUD "buying down" more than half the system cost.

IS RE-REGULATION THE ANSWER?

While it is clear that California's electricity system is experiencing severe problems, it is not so clear that re-regulation is the answer. Pennsylvania is one example in which restructuring has been for the most part, a positive experience. From the initial opening of the market at the beginning of 1999 through the end of July of this year, almost 530,000 customers have switched suppliers.

An interesting contrast, however, is that while Pennsylvania has had a more successful overall deregulation experience, it has not had the success in green power that California has had. Less than 100, 000 of the total customers that have switched suppliers have chosen a green power supplier.

An alternative lesson to draw in reviewing various successes and failures in deregulated states may be the great need for federal legislation regarding restructuring. Every state that has passed restructuring legislation has done so differently. Some of those that are contemplating competition have put plans on hold pending the eventual resolution in the California market.

New Mexico, which had approved a start date of 2001, has now delayed until 2002. State-by-state planning can have severe consequences from a regional standpoint. A coalition of 23 states has petitioned Congress to make them exempt from deregulation. The movement, the Low-Cost Electricity States Initiative (LCESI), has actually been in existence for over a year but is using the problems in California to gain momentum. What the LCESI brings to light is the complexities involved in 50 different approaches to deregulation. How is power transported over distances if states that remain regulated deny access to transmission lines?

DO... GOOF... LEARN

The problems in California are largely a result of mistakes in the restructuring legislation combined with a burgeoning demand that has not been met. There were no new power plants built in the last several years due to the uncertainty that surrounded restructuring legislation. Instead of a call for re-regulation, California's example should be used to help states develop better restructuring plans and, ultimately, serve as a catalyst for federal legislation to help guide the process. Every new market experiences glitches and electricity is no different. When markets have been deregulated in the past, the consumer has ultimately benefited. To return to the monopoly system would not only create more harm than good. It would effectively end the fledgling green power market by taking away the competitive forum that allowed its development in the first place.

ABOUT THE AUTHOR

Heidi Anderson is a research analyst, energy markets, with Frost &. Sullivan's San Jose, California, office. She has authored, or assisted in preparing, custom projects analyzing selective world power generation facility markets, and in a study of the marketing of bundled energy management solutions. The focus of her research is on renewable energy markets in North America, including renewable energy technologies and manufacturers, green pricing and marketing, and emerging markets and technologies. Articles, and quotes, by her have appeared in a number of technical press and trade journals.

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